LOMBARD

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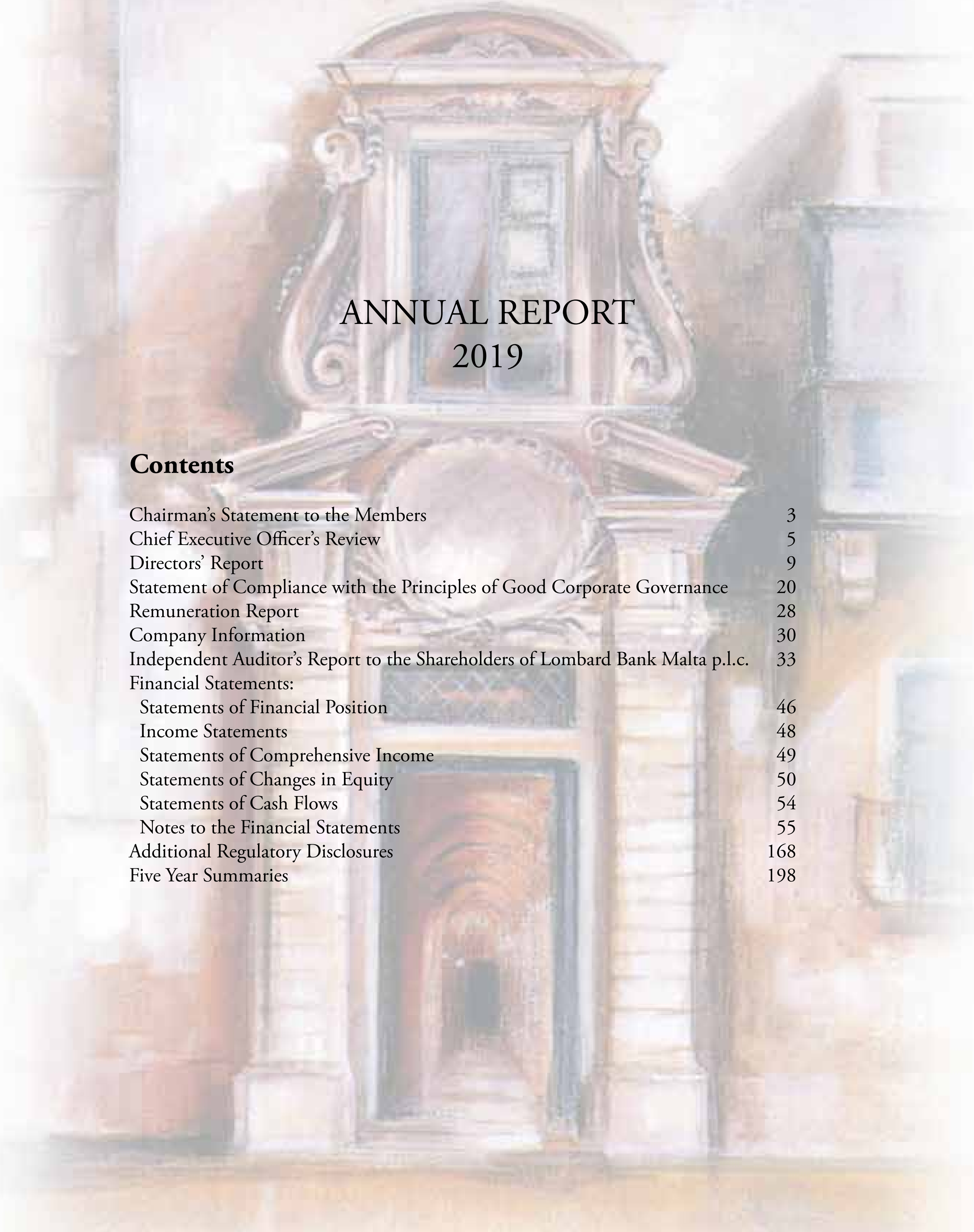


ANNUAL REPORT
2019

Contents

Chairman's Statement to the Members

I am pleased to report that during 2019 the Lombard Bank Group achieved a satisfactory performance notwithstanding a challenging operating environment characterised by unrelenting pressure on income streams. This result is reflected in an 11.1% increase in pre-tax profits to €15.3 million, to which both members of the Group, Lombard Bank Malta p.l.c. (the Bank) and MaltaPost p.l.c., contributed albeit in varying degrees.

The increase in the Bank's profits consolidated the excellent progress registered the previous year. Moreover, it occurred in the context of a generalised de-risking stance in the domestic banking industry occasioned by the reputational damage done to our financial jurisdiction by sanctionable practices in some credit institutions as well as by more stringent prudential regulations. The Board believes that the year's results thus confirm the validity of the Bank's low-risk business model. We therefore reaffirm our commitment to a selective approach to onboarding depositors and borrowers, to prioritizing capital protection over short-term financial gain in all our operations and to avoiding exposure to economic sectors which experience has shown to be inherently risky. The consistent application of such prudent guidelines in previous years is also reflected in the relatively small impairment charge that was necessary in 2019, so that the benefit of the Bank's income-generating activities was almost entirely transmitted to the bottom line.

The main driver behind the increase in operating revenue was again net interest income, up by 12.7%, mainly a reflection of the sustained growth in the Bank's lending activity despite loan interest rates falling further to a historically low level in the face of stiff competition. The growth by over three-fourths in total lending over the past four years, which was accompanied by a simultaneous halving of the amount of so-called 'Non-Performing Exposures', testifies to the effectiveness of the Bank's management of risk in its intermediation between savers and borrowers in support of the creation of sustainable economic activity and employment. Interest earned on placements with banks, mainly on higher-earning dollar and sterling balances, also rose and this, combined with the declining cost of customer deposits, helped to boost net interest income as well as the interest margin.

The contribution of the Bank's core deposit-taking and lending activities to revenue generation was supplemented by increased inflows of fee and commission-based income. This was partly attributable to the growing volume of stockbroking, wealth management and international banking business. The imminent completion of the restructuring project in this area, which will include the use of a tailor-made software system and the recruitment of more qualified personnel, will expand the range of investment services we provide and thus become a more substantial source of revenue.

The Bank's operating expenses kept pace with income in 2019 such that the cost-to-income ratio was unchanged and remained below the industry average. Employee compensation and benefits, the major cost item, increased faster this past year, reflecting additions to the staff complement but also the need to employ more specialized expertise and to retain staff in a tight labour market characterised by wage inflation. During the year the Bank participated successfully in the MCAST apprenticeship scheme and also experienced a lower staff attrition rate. At the same time, the programme of both internal and external training courses was extended to cover new topical areas. Apart from the higher human resource costs, new investments in information technology and related support services also entailed considerable expenditures.

The Bank's operations during 2019 produced a 10.8% increase in profit before tax to €14.0 million. This result reflected a return on equity of 8.2% and boosted shareholders' funds further to €114.6 million. The total capital ratio consequently also rose, reaching 16.0%, as did the liquidity coverage ratio, to 301.5%, both well above the statutory thresholds. The leverage ratio, meanwhile, at 10.5%, was more than three times the required level. These solid financial buffers testify to the Bank's soundness and, equally important, the potential to maintain its growth momentum while remaining within the bounds of our prudent risk appetite. Against this reassuring background, the Board has decided to recommend an increased gross dividend of seven cent per share.

Chairman's Statement to the Members

Another noteworthy outcome of the Board's strategy of pursuing steady, sustainable growth was the attainment in 2019 of the €1 billion mark in balance sheet size. This milestone largely reflected the Bank's continuing success in channelling retail deposits into loans, both of which grew in tandem such that the relevant ratio remained unchanged at a safe level of 63.8%. The strong inflow of deposits, mainly into long-term accounts despite historically low interest rates testified to continued customer confidence, while the expanded lending volume was significant in that it was partly driven by another increase in household and personal lending, in particular home loans. In this regard, the imminent roll-out of a structured plan centred on an automated loan management system, specially trained home loan officers and a marketing campaign is expected to further grow the Bank's share of this credit sector in line with our income diversification strategy.

The Bank's subsidiary, MaltaPost p.l.c., also had a successful year in 2019 recording a pre-tax profit of €3.0 million. This result benefited from a partial upward revision of postal tariffs which, however, remain the lowest in Europe, and was achieved in spite of a continued downward trend in Letter Mail volumes and an increasingly competitive environment in the area of e-commerce, as well as higher costs mainly due to significant staff turnover in a tight labour market. During the year the company continued to actively implement its diversification plan centred on new postal products, document management and financial services. A major initiative was the creation of a life insurance company jointly with three other partners. The take-up of these diverse services should benefit from the planned strengthening of the company's market presence through its branch network and thus lead to further revenue generation.

Going forward, while the Bank's existing time-tested policies promise to deliver sound fundamentals and continuing profitability, the Board is mindful of threats to the sustainability of traditional bank intermediation models. These include interest rates that are set to remain at their current low levels, the ever-increasing cost of regulation and compliance and growing competition from fintech institutions and digital services providers, compounded by the recent marked deterioration in the global economic outlook. Domestically, delays in conforming to international standards of financial risk management and compliance could become an additional factor.

In the period ahead the Bank will seek to mitigate such market risks and also to modernise the delivery of banking services while adapting them to changing customer preferences. Priority will be given to strengthening our governance, risk and compliance functions through the further refinement of management structures and processes and the acquisition of appropriate expertise and technological support. At the same time, we will endeavour to further grow our new business activities while building on the Bank's established brand to expand our customer base, including through an increased geographical presence jointly with MaltaPost p.l.c. A paramount consideration in all our operations will remain the preservation of the Bank's assets and the creation of shareholder value.

In conclusion, I would like to express my gratitude and that of the Board to the Bank's staff and management team, ably led by the Chief Executive Officer, Joseph Said, without whose professional competence and commitment the past year's results would not have been possible. I would also like to thank you the Bank's shareholders for your steadfast support and all our customers for their continued loyalty.

Michael C. Bonello
Chairman

Chief Executive Officer's Review

The results of the Lombard Bank Group for the financial year ended 31 December 2019 combine the financial performance of Lombard Bank Malta p.l.c. and Redbox Limited, which is the company holding the Bank's shares in MaltaPost p.l.c.

Summary Overview

In the concluding remarks of the Chief Executive Officer's Review of last year we stressed *"…focus on what we know and do best – namely, the building of long-term customer relationships and serving responsibly the Maltese community at large."* Our core approach to business has not changed and remaining committed to that business philosophy, we are pleased to report a growing number of relationships and a sound financial performance, following on the positive trends of recent years. This relatively simple formula continues to work for us in that it allows the Group to grow while also further strengthening its financial fundamentals.

During the year the Maltese banking sector faced a persistent challenging environment by way of continued low interest rates, competitive pressures, an intense regulatory environment and a subdued euro area economy. Malta's robust economy was, however, a generally positive influence supporting a strong demand for credit.

Against this backdrop, our commercial and home loan books registered satisfactory growth and though the average interest rates on the respective loan books decreased, the growth in volume more than made up for this and, as a consequence, resultant interest income grew. The lower average interest rates were generally a reflection of the stiff competition for credit and the prudent collateral we continued applying so as to achieve healthy Loan-to-Value ratios. Growth was not achieved at the expense of quality, and overall, we also sought to maintain quality even in the case of those exposures termed as non-performing, by containing these within the set parameters.

Interest revenue from deposits with banks rose, mainly due to interest-earning USD and GBP balances. During the last quarter of 2019 the ECB adopted a system which exempts from negative interest part of banks' excess liquidity holdings with the ECB. This measure, together with pro-active and judicious Treasury management, helped improve our net interest income.

Investment in our relatively new business lines of cards, home loans and investment services continued through the adoption of additional technology and the recruitment of experienced staff members. Similar investment was made in the area of Regulation and Compliance, where besides projects undertaken to fulfil regulatory obligations, we also sought to strengthen related oversight capability and capacity. Our transaction banking business continued to develop, though always in a controlled manner, particularly in light of market developments in this respect.

Our subsidiary MaltaPost p.l.c. realised a pre-tax profit of €2.98 million for its financial year ended 30 September 2019, – an increase of 12.9% over the previous year. The decline in Letter Mail volumes, coupled with postal tariffs that remain among the lowest in Europe render segments of the postal service unsustainably onerous. Therefore, besides engaging with the Regulator on certain tariff matters, MaltaPost continues with its diversification efforts leveraging on its brand, reach and resources to broaden income streams and strengthen profitability in the long term. In this respect the initiatives in the area of life insurance progressed significantly and increased volumes continue to develop the Document Management Services operations.

Review of Financial Performance

For 2019, the Group registered a Profit before Tax of €15.29 million, an increase of 11.1%. Net interest income reached €19.68 million, 12.4% above the previous year.

Fee and commission income rose, by 11.3%, as a result of a higher volume of new credit facilities as well as growth in our transaction banking business.

The overdue review of certain postal tariffs which was authorised by the Malta Communications Authority helped MaltaPost partly offset the additional costs incurred as a result of the year-on-year shrinkage in Letter Mail volumes. Notwithstanding this, growth was registered in other lines of activity, including international parcels.

Group Employee Compensation and Benefits rose by 11.0% to reach €23.04 million, mainly a reflection of the current competitive labour market. The Cost Efficiency Ratio of the Group stood at 73.5% (FYE 2018: 77.8%) while that of the Bank was 47.1% (FYE 2018: 47.4%), the former reflecting the high-volume, low-margin and labour-intensive postal services business. These ratios compare well with those of other companies in the respective industry segments.

The Bank remained vigilant in its resolve to discourage situations where repayments by borrowing customers risked falling in arrears. Impairment Allowances for exposures arising from financial assets, including customer credit, were always applied using prudent criteria, taking into account the high quality of collateral held. Since 2018 Impairment Allowances are known as 'Expected Credit Losses' and are based on statistical calculations imposed by accounting standard IFRS 9. The resultant level of provisioning reflects the high quality of the Bank's financial assets as well as the collateral cover held. The charge in the Income Statement for Credit Impairment Losses rose to €0.55 million in 2019, compared to €0.23 million in 2018 - this within the context of a higher level of credit facilities.

Loans and Advances to Customers rose by 8.0% to €552.04 million. Advances to Deposits Ratio stood at 63.8% compared to 64.9% at the start of the year. Total Assets exceeded the €1 billion mark.

Liquidity and Own Funds

With global uncertainty dominating the financial markets also during 2019, we continued to manage our liquidity judiciously. Customer deposits increased by €76.95 million (9.8%) to €864.99 million.

Total Assets at the end of 2019 stood at €1,042.30 million (2018: €950.07 million), while Equity Attributable to the Shareholders of the Bank increased by a further 10.0% to €119.13 million. Net Asset Value (NAV) per share stood at €2.70 (2018: €2.45). Group Earnings per Share (EPS) increased to 21.1 cents. Return on Assets (ROA) stood at 0.9% (2018: 0.9%) while post tax Return on Equity (ROE) was 8.2% (2018: 8.3%).

Treasury Management

Our policy of primarily investing in the local economy continued, with the main objective being that of protecting assets and minimising the impact of negative interest rates affecting euro balances, which make up the bulk of our portfolio.

Holdings in Government of Malta Treasury Bills as at FYE 2019 were €100.14 million (FYE 2018: €93.63 million) and in Malta Government Stocks €83.98 million (FYE 2018: €73.86 million). A small portfolio was held in local equities. All investments were bought to hold and not to trade.

International money market placements with authorised counterparties remained selective. Maturities with such counterparties were on tenors of between overnight and one month.

Risk Management

The overall management of risk is governed by various overarching policies and detailed procedures. Policies are subject to annual review and procedures reviewed in line with business needs.

Understandably the Bank is exposed to various risks and hence operates a risk management strategy by identifying, assessing, managing, monitoring and reporting with the objective of mitigating their impact on its financial position. A bank-wide risk register is in place which serves as a repository of the various risks that are identified and, where applicable, includes actions to manage them.

Regular detailed risk reports were submitted to the Board and the Audit & Risk Committee to ensure appropriate monitoring and continuous management of key risks. The reports provided detailed insight recording the current position and degree of compliance with set limits. Stress testing and sensitivity analyses of key risk indicators as set out in the Risk Appetite statement were also carried out.

The Bank's Total Capital Ratio at the end of 2019 stood at 16.01%. As a result, the 'Pillar I' requirements of the CRR/ CRD IV and any additional regulatory buffers were fully met. Additionally, 'Pillar II' risks that have been established within our Internal Capital Adequacy Assessment Process (ICAAP) were also fully covered.

Through an Internal Liquidity Adequacy Assessment Process (ILAAP), the Bank confirmed that it remained amply liquid, as evidenced by its Liquidity Coverage and Net Stable Funding ratios, which ended the year at 301.5% and 140.2%, respectively, both well above the minimum regulatory requirement of 100%.

Human Resources

In an environment where the Maltese economy remained robust and as a consequence employment opportunity abundant, recruiting and retaining suitably skilled and experienced staff was a continuous challenge. Despite these difficult circumstances, we managed to increase the staff complement in various roles and this in line with our growing business activity and higher regulatory requirements. The number of persons employed with the Group stood at 972: Bank - 183, MaltaPost - 789.

In recruitment we remained steadfast in our resolve to offer employment opportunities to those who besides being qualified for the respective roles, demonstrated readiness to embrace our culture and values. We firmly believe that unless there is shared culture and values, we will fall short of delivering services to the level expected by our customers. We also promote and practice an equal opportunities policy which ensures that there is no discrimination of whatever type or form in relation to staff members.

Investment in the skills and development of our staff by way of internal and external training and development opportunities coupled with on-the-job training was ongoing throughout the year. Such investment is a prerequisite for the achievement of results and the success of the Group. In this regard we remain committed to offer a work environment that meets with the priorities and aspirations of our staff, whether these be career progression or work-life balance goals.

Projects

Projects mainly addressed needs in the area of delivery channels and adoption of systems and technology. Both the Bank and MaltaPost continued with investment in their respective networks. Where possible, outlets are designed to cater for 24/7 areas which allow access to self-service products of both the Bank and MaltaPost.

We regularly review our presence in the various locations and allocate our resources accordingly. We are well aware that physical presence remains an important aspect of our service offering and, in this regard, continue to be on the lookout for establishing a presence in locations that lend themselves to supporting our business goals.

We continued with the deployment of ATMs at suitable locations. The security features of our internet banking services were enhanced while a project to allow users the possibility to opt for OTP tokens on smart mobile telephones is in progress. Other IT investment concerned regulatory and compliance related developments.

For the second year running the Bank together with the Central Bank of Malta issued the Melita gold €100 bullion coin. The 2019 coin was struck only in one ounce weight, while the 2018 issue sold out in all three weights.

Corporate Social Responsibility

As in past years the Group supported several organisations engaged in charitable and philanthropic work.

The Group is also aware of its role in minimising potential adverse impact on the environment which may result from its operations. To this end it took initiatives such as increasing its fleet of electrically-driven vehicles. The Bank launched a scheme to encourage staff members to use public transport, effectively providing for free public transport to coincide with office hours.

Outlook

This positive set of results instils in us the necessary confidence to realise our strategic priorities, namely:

1. Further strengthening the Bank's Governance, Risk and Compliance functions, always aligned to regulatory expectations.
2. Maintaining sound asset quality in line with our prudent risk appetite.
3. Developing our new business lines, for these to become relevant revenue contributors.
4. Widening physical representation for growing our relationship base.
5. While acknowledging the vital role of digital solutions, we equally understand that customers value our personalised service which remains a hallmark of Lombard Bank.
6. Continue providing the right work environment and the necessary conditions for our staff so as to ensure job satisfaction and retention.

Going forward we expect to be well positioned to successfully pursue these priorities, which should result in the further enhancement of stakeholder value.

Joseph Said
Chief Executive Officer

Directors' Report

The Group

The Lombard Bank Group (the Group) consists of Lombard Bank Malta p.l.c. (the Bank), Redbox Limited and MaltaPost p.l.c., a subsidiary of Redbox Limited. Tanseana Limited is a subsidiary of MaltaPost p.l.c.

Principal Activities

The Bank was registered in Malta in 1969 and listed on the Malta Stock Exchange (MSE) in 1994. It is licensed as a credit institution under the Banking Act, 1994 and is an authorised currency dealer and financial intermediary. It also holds a Category 2 Investment Services licence issued by the Malta Financial Services Authority (MFSA) in terms of the Investment Services Act, 1994. It is a member of the Depositor Compensation Scheme and the Investor Compensation Scheme set up under the laws of Malta. The Bank is also a member of the MSE for the purpose of the carrying out of stockbroking on the MSE. The Bank has a network of branches in Malta and Gozo providing an extensive range of banking and financial services. A list of branches, outlets and departments is found on page 32 of this Annual Report.

Redbox Limited, a company virtually wholly owned by the Bank, was registered in 2006. During the year under review, Redbox Limited continued to serve as the special purpose vehicle holding, as at 31 December 2019, the Bank's 71.5% shareholding in MaltaPost p.l.c., with the remaining 28.5% of the ordinary share capital of MaltaPost p.l.c. being held by the general public. MaltaPost p.l.c. was listed on the Malta Stock Exchange on 24 January 2008. MaltaPost p.l.c. is Malta's leading postal services company, being the sole licensed Universal Service Provider of postal services in Malta.

Tanseana Limited was established in 2016 to carry out document management services and other related services being offered by MaltaPost p.l.c.

Review of Performance

An overview of the development in the Bank's business and that of its subsidiaries during the year under review together with an indication of likely future developments may be found in the 'Chief Executive Officer's Review of Operations' of this Annual Report.

Results for 2019

Profits after taxation of €9.9 million and €9.0 million for the Group and the Bank, respectively were registered for the twelve months ended 31 December 2019.

A gross dividend of 7 cent per nominal 25 cent share (net 4.55 cent) for the twelve months ended 31 December 2019 is being proposed for approval by the shareholders. A resolution to this effect will be proposed to the Annual General Meeting.

Board of Directors and Senior Management

The composition of the Bank's Board of Directors and Senior Management is shown in the section on 'Company Information' on page 31 of this Annual Report and further information is given in the 'Statement of Compliance with the Principles of Good Corporate Governance'.

Risk Management

The Financial Risk Management note to the Financial Statements (note 2), illustrates the process of how the Group identifies and manages its risks and uncertainties. The main categories of risk described in this note are credit risk, market risk, liquidity risk and operational risk. The same note includes extensive detail of the processes undertaken by the Bank to manage these risks.

Directors' Report

Statement of Directors' Responsibilities for the Financial Statements

The Directors are required by the Companies Act, 1995 to prepare financial statements which give a true and fair view of the state of affairs of the Group and the parent company as at the end of each reporting period and of the profit or loss for that period.

In preparing the financial statements, the Directors are responsible for:

- ensuring that the financial statements have been drawn up in accordance with International Financial Reporting Standards as adopted by the EU;
- selecting and applying appropriate accounting policies;
- making accounting estimates that are reasonable in the circumstances; and
- ensuring that the financial statements are prepared on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business as a going concern.

The Directors are also responsible for designing, implementing and maintaining such internal controls as they deem necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and that comply with the Companies Act, 1995 and the Banking Act, 1994. They are also responsible for safeguarding the assets of the Group and the parent company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The financial statements of the Bank for the year ended 31 December 2019 are included in this Annual Report, which is being published in printed form and made available on the Bank's website. The Directors are responsible for the maintenance and integrity of the Annual Report on the website in view of their responsibility for the controls over, and the security of, the website. Access to information published on the Bank's website is available in other countries and jurisdictions where legislation governing the preparation and dissemination of financial statements may differ from requirements or practice in Malta.

Statement of the Directors pursuant to Listing Rule 5.68

The Directors confirm that, to the best of their knowledge:

- the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2019, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU; and
- the Annual Report includes a fair review of the development and performance of the business and the position of the Bank, together with a description of the principal risks and uncertainties that they faced.

Investment Services Rules for Investment Service Providers

In accordance with Rule R4-5.3.5 of the Investment Services Rules for Investment Service Providers regulated by the MFSA, licence holders are required to disclose any regulatory breaches of the Rules or other regulatory requirements in this Annual Report. Accordingly, the Directors confirm that no breaches of the Rules and no other breach of regulatory requirements, which were subject to an administrative penalty or other regulatory sanction, were reported.

Information Provided in Accordance with Listing Rule 5.70.1

There were no material contracts to which the Bank, or any of its subsidiaries were a party, and in which any one of the Bank's Directors was directly or indirectly interested, except for transactions disclosed in the notes to the financial statements.

Going Concern

In compliance with Listing Rule 5.62 and after having duly considered the Bank's performance, the Directors declare that they expect the Bank will continue to operate as a going concern for the foreseeable future.

Listing Rules – Disclosures

In terms of Listing Rule 5.64, the Directors are required to disclose the following information.

As at the Annual General Meeting held on the 11 April 2019, the authorised share capital of the Bank was €20,000,000 made up of 80,000,000 ordinary shares of a nominal value of 25 cent each. As at that date the issued and fully paid up share capital of the Bank was €11,044,479 divided into 44,177,914 ordinary shares of a nominal value of 25 cent each, all of one class. As at 31 December 2019 the authorised and issued share capital remained the same.

Equity attributable to shareholders of the Bank as at 31 December 2019 stood at €119.1 million.

Amendments to the Memorandum and Articles of Association of the Bank are effected in conformity with the provisions in the Companies Act, 1995. Furthermore, in terms of the Articles of Association:

- Directors may be authorised by the Bank to issue shares subject to the provisions of the Memorandum and Articles of Association and the Companies Act;
- Directors may decline to register the transfer of a share (not being a fully paid share) to a person of whom they do not approve;
- Directors may decline to recognise any instrument of transfer, unless accompanied by the necessary evidence;
- no registration of transfers of shares shall be made and no new particulars shall be entered in the register of members when the register is closed for inspection; and
- the Bank may, from time to time, by extraordinary resolution reduce the share capital, any Capital Reserve Fund, or any Share Premium Account in any manner.

Currently there are no matters that require disclosures in relation to:

- holders of any securities with special rights;
- employee share schemes;
- restrictions on voting rights or relevant agreements thereto; or
- significant agreements to which the Bank is a party and which take effect, alter or terminate upon a change of control of the Bank.

The Remuneration report on page 28 refers to the financial contributions towards Retirement Gratuities that the Board of Directors approves from time to time. The same Board had previously resolved that a retirement gratuity be eventually paid on an *ex gratia* basis to the Chief Executive Officer on his retirement.

The rules governing the changes in Board membership are contained in the 'Statement of Compliance with the Principles of Good Corporate Governance'.

Shareholders holding five per cent (5%) or more of the share capital of the Bank:

	Shares in Lombard Bank Malta p.l.c. at 31 December 2019*
National Development & Social Fund (NDSF)	49.01%
Virtu Holdings Ltd	9.86%
Global Capital Life Insurance Ltd	5.55%
First Gemini p.l.c.	5.31%

*Other than an increase to 5.60% in the shareholding of Global Capital Life Insurance Ltd, there were no further changes from 31 December 2019 to 29 February 2020.

Directors' Interest in Group Companies

Joseph Said, who is a Director of the Bank, is also a Director of the following companies that have a shareholding in the Group as follows:

	Shares in Lombard Bank Malta p.l.c. at 31 December 2019*
Safaco Ltd	42,188
First Gemini p.l.c.	2,344,134

	Shares in MaltaPost p.l.c. at 31 December 2019*
Safaco Ltd	44,745
First Gemini p.l.c.	36,341

*There were no changes from 31 December 2019 to 29 February 2020.

In addition Joseph Said holds preference shares in Safaco Ltd.

Audit & Risk Committee

The Audit & Risk Committee is composed of non-executive Directors and is intended to ensure effective internal controls, compliance and accountability. The Committee also acts to ensure that high ethical standards are maintained, as explained in the 'Statement of Compliance with the Principles of Good Corporate Governance' in another section of this Annual Report.

Auditors

In view of PricewaterhouseCoopers being the Bank's external auditors since 2010, the Bank was required to comply with its statutory obligation to organise a tendering process for external auditors. A number of firms, including PricewaterhouseCoopers, were invited to submit their proposals for the external audit. Following an assessment of the proposals received by a working group set up specifically for this purpose as well as the Audit & Risk Committee & Board of Directors, it was decided that PricewaterhouseCoopers be recommended to the Annual General Meeting for reappointment by the Bank.

Non-Financial Statement

The Companies Act requires that a non-financial statement be included in this report containing information on the Group's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters and this in the form of particular disclosures on certain aspects.

1. Business Model

The Bank is a Malta-based bank and for financial stability purposes is considered by the Central Bank of Malta as a core domestic bank, catering mostly for the local economy, and therefore actively supporting economic actors in their activities. The Bank's loan book is largely characterised by lending selectively to the commercial sector, although with the Bank's continued execution of its strategic priorities in respect of broadening of its product and services portfolio, growth in the mortgage lending book continues gaining momentum.

Lending is funded by a diversified deposit base and underpinned by solid capital and liquidity ratios. The Bank has never relied, and does not intend to rely, on the interbank market for its funding requirements, and retains ample liquidity from its retail operations. This approach to business underpins the Bank's image and facilitates pricing decisions. In this respect the Bank seeks to progress slowly, prudently yet surely, as evidenced by the quality of its assets and relationships. The Bank follows risk review processes to ensure that business is in line with risk appetite frameworks, which themselves are also reviewed periodically in light of developments and emerging risks.

The Bank's plans to broaden its product and services portfolio in a manner which complements rather than crowds out its traditional business focus remain in implementation.

As a result the Bank continues to invest in the development of business along three main lines, viz commercial lending, retail and transaction banking and investment services. The Bank's business model is based on building stakeholder value by delivering financial services and solutions in a prudent, yet innovative and cost effective way and by setting the highest standards in professional behaviour. The Bank's competitive strengths are in its unique business operating model, its conservative outlook towards risk and its robust fundamentals. The characteristics of its business model give the Bank a competitive advantage, enabling it to continue to deliver value to all its stakeholders in a challenging environment which remains highly competitive and increasingly regulated. The Bank's brand, which stands for the provision of personalised and tailored financial services, remains strong.

The Bank's subsidiary, MaltaPost p.l.c. (MaltaPost) was registered in 1998 and listed on the Malta Stock Exchange (MSE) in 2008. MaltaPost is Malta's leading postal services company, being the sole licensed Universal Service Provider of postal services on the Maltese Islands in terms of the Postal Services Act (Chapter 254 Laws of Malta) and under the terms of the Universal Postal Union Convention and Constitution on behalf of the Government of Malta. It is regulated by the Malta Communications Authority and has a network of 40 Post Offices and 32 Sub Post Offices around Malta and Gozo providing an extensive range of postal and financial services.

Postal services remain characterised by a decline in Letter Mail volumes and in the relative income. This business line however still requires the company to maintain a labour intensive and extensive delivery and retail network in order to meet its Universal Service Obligation. MaltaPost therefore continues to pursue its diversification into logistics, document management and financial services. In respect of logistics, MaltaPost's strategy will necessitate closer concentration on this area of business and the related eCommerce market so as to keep up with demand and higher expectations. MaltaPost therefore remains committed to be the trusted postal and logistics operator offering a comprehensive product portfolio.

Tanseana Limited, a company wholly owned by MaltaPost, was established to enter into any agreement or make any arrangement relating to the company's business to provide document management services and to carry on such services which include, but are not restricted to, scanning, printing, shredding, storage and retrieval of digital and/or physical documents.

The Bank's acquisition of the majority shareholding of MaltaPost facilitates the induction of the latter to financial services, intended to target a market segment different from that of the Bank and this within the diversification strategy adopted by MaltaPost. The Bank has itself successfully executed a focused market strategy targeting specific retail and corporate financial services market segments, with a reputation for delivering personalised services. MaltaPost similarly intends to follow a focused market strategy as a 'low cost financial services' provider. MaltaPost is well placed to execute this strategy in view of its widespread network of outlets, many in core community locations which benefit from high footfall and walk-in custom.

The Group Boards of Directors pursue policies and practices designed to meet all regulatory and legal requirements and also to assist in the discharge of responsibilities and in the execution of business models and strategy. The Boards' functions are fully described in respective charters, which are reviewed periodically.

The purpose of the charters is to promote high standards of corporate governance and clarify the role and responsibilities of the Boards and their committees, which enable the Boards to provide strategic guidance for the companies and provide effective management oversight. The oversight function concerns the review of management decisions, including approval of major decisions, the adequacy of systems and controls and the implementation of policies.

The effectiveness of the adopted policies is evidenced by, among other things:

- the Group's strong ethical culture based on trust, integrity and professional behaviour;
- the rigorous custodianship of property entrusted to the companies by customers in the normal course of business and shareholder capital;
- the pursuit of long-term corporate and financial objectives as against short-term gains;
- assurance of ongoing compliance with all applicable laws and regulations;
- risk awareness and oversight in the determination of risk appetite and risk profile;
- adoption of the four eyes principle in a manner which pervades all operations; and
- accountability through suitable reporting frameworks.

The Boards are confident that the companies benefit from satisfactory diversity of views and expertise allowing for proper discharge of responsibilities.

2. Risk Reporting

A Group enterprise-wide risk management framework provides the foundation for the risk management reporting processes. This framework is subject to constant evaluation to ensure it meets the challenges and requirements of the markets in which the Group operates, as also regulatory standards and industry best practices.

The Group's strong governance framework is supplemented by clear organisation structures and reporting lines, and well defined procedures embedded in processes throughout the Group and is subject to ongoing review.

The organisation structure ensures that responsibilities and duties are well-defined and known. Within the functions defined, processes are in place to identify, monitor, manage and report risks. The processes also include internal control mechanisms, together with appropriate administrative and accounting procedures.

The Bank has a formal Risk Management Policy which provides the foundation for achieving a balance between sound practices and profitability by applying strict internal controls and discretionary limits, and optimising the returns thereof, in line with the Bank's risk appetite.

The risk appetite determines the maximum risk assumed to meet business objectives. From time-to-time the risk appetite is updated for the purposes of strategic direction after a thorough analysis of the current risk profile. The risk appetite is reviewed by the Board at least once a year.

The main categories of risk to which the Group is exposed to are:

Capital Risk Management – Is the ability to hold sufficient capital to comply with regulatory requirements, safeguard the Group's ability to continue as a going concern and provide adequate returns for shareholders and to maintain a strong capital base to support the development of the business. [Notes to the Financial Statements note 2.7; Additional Regulatory Disclosures notes 6 and 7]

Credit Risk – Is the risk of suffering loss should any of the Group's customers, clients or market counterparties fail to fulfil their contractual obligations to the Group. Credit risk mainly arises from customer loans and advances, but also from exposures arising from investment activities. It constitutes the Bank's largest risk in view of its significant lending and securities portfolio. To minimise credit risk, facilities are generally adequately secured by tangible security that are reviewed periodically to ensure that the collateral still covers the facility.
[Notes to the Financial Statements note 2.3; Additional Regulatory Disclosures note 2]

Market Risk – Is associated with fluctuations in the fair value or future cash flows because of changes in market prices. The Bank does not operate a Trading Book and hence this is limited to Interest Rate Risk, Currency Risk and Equity Price Risk. The Bank is accordingly in a position to manage the interest rate

terms of its financial assets and simultaneously to effect changes to interest terms of liabilities reflecting the Bank's strategy together with market developments.
[Notes to the Financial Statements note 2.4; Additional Regulatory Disclosures note 3]

Non-Financial Risks – Are the risk of losses resulting from the lack of skilful management or good governance within the Bank and the inadequacy of proper control which may involve internal operations, staff, systems or external occurrences, compliance related matters that would in turn affect the income and capital funds of financial institutions. Every staff member is responsible for the risks inherent in day-to-day duties. This also incorporates the 'four eyes' principle.
[Notes to the Financial Statements note 2.6; Additional Regulatory Disclosures note 5]

Compliance Risk – Is the risk of legal sanctions, material financial loss, or loss to reputation the Bank may suffer as a result of failure to comply with laws, its own regulations, code of conduct, and standards of best/good practice. The Compliance function identifies, assesses, advises, monitors and reports on the Bank's compliance risks. The function is also the central point through which all interaction with regulatory and enforcement bodies are routed.

Financial Crime Risk – Is the risk related to offences such as money laundering, terrorist financing, fraud, bribery and corruption, market abuse and insider trading. The Bank through its various policies and procedures, is committed to combating financial crime and ensuring that its products and services are not misused for the purpose of money laundering, terrorism financing and fraud events.

Information Security Risk – Is the risk of loss caused by deliberate or accidental loss, alteration, falsification or leakage of information or by destruction, disruption, errors or misuse of information systems. An Information & Cyber Security Policy is in place which ensures adequate measures are taken and controls are in place to mitigate threats from such risks.

Liquidity Risk – Is the risk arising when the Bank is unable to meet current and future payment obligations as they fall due. Liquidity management includes the constant monitoring of liquidity ratios against internal limits as set in the Risk Appetite Statement and regulatory requirements.
[Notes to the Financial Statements note 2.5; Additional Regulatory Disclosures note 4]

3. Anti-Corruption and Bribery Matters

The Group has a zero tolerance policy to bribery and corruption and breaches of the relative laws and regulations. Bribery and corruption are serious criminal acts and the Group strives to act with integrity, care and diligence in all its undertakings. In this respect the Group developed and maintains robust policies designed to prevent and detect potential bribery and corruption in the form of an Anti-Bribery and Corruption (ABC) Policy and Whistleblowing Policy. These policies are reviewed by the Audit & Risk Committee and Board of Directors following recommendations made by the relative business and internal control functions.

The Risk Management and Compliance functions exercise oversight over the implementation of respective Policies, the former by including ABC in risk assessments and the latter by ensuring constant standards of compliance. The Risk, Internal Audit and Compliance functions also work together to ensure the proper functioning of these policies. Any deficiencies are brought to the attention of the Audit & Risk Committee and Board of Directors. During the year under review, there were no reported cases on the basis of the above-mentioned policies and therefore no necessary investigations.

The implementation of these policies is by means of procedures and respective controls, which are embedded in the Group's structures in order to ensure that staff members act responsibly within the work place and outside. Guidelines and instructions regarding ABC and Whistleblowing are applicable and available to all staff members. Staff members have access to the guidelines and instructions and each is responsible for complying with them. The Group supports a 'speak-up attitude' to encourage reporting of concerns relating to what might appear to be suspected illegal, unethical or otherwise improper acts or their concealment.

The same standards are expected from any third parties providing services for or on behalf of the Group. Staff members who fail to comply with the Group's policies and standards may face disciplinary action, up to and including dismissal or termination of employment. Training sessions keep staff members abreast of their obligations at all times.

4. Social and Employee-Related Matters

Social and employee matters are given full attention by the Group. The Group's human capital is a key resource for the carrying out of business. The ability to attract and retain human resources of the right skill, mix and experience condition to a large extent the Group's performance. The risk of not attracting or retaining the appropriate quality staff in line with the Group's business needs is mitigated generally by the approach to managing this resource and specifically through a number of measures. Information on employees is found in note 31 to the Financial Statements.

Collective Agreements are in place at the Bank and MaltaPost, setting the conditions of work and generally regulating the employer/employee relationship. The prevailing Agreements contain a number of measures of assistance to staff including days of special paid leave additional to those stipulated at law.

The Bank also extends a number of products and services to Group staff on favourable terms. The Group keeps an active line of communication with staff members and is committed to maintaining a working environment where staff is valued, respected and supported to fulfil potential. A number of staff social events are organised and Group staff associations are supported through funding and other initiatives.

The Group is committed to ensuring the highest levels of health and safety and physical security of staff in accordance with the Occupational Health and Safety Authority Act, 2000. Occupational health awareness training is also provided. The Group carries out health and safety risk assessments to ensure that situations that may pose risks to the health and safety of staff and others on Group premises are identified and mitigated. Some Group staff benefit from personal accident insurance cover and others benefit from private health care insurance, as well as death in service.

Investing in learning and development equips staff members with the knowledge and expertise to work in line with applicable internal policies and handbooks. Fully fledged training facilities are in place with a training manager responsible for keeping staff members well trained. As in previous years, during 2019 Group staff members attended classroom training and followed on-the-job training programmes.

All staff is treated on equal terms with regard to training, career development and appointments and the Group supports and practices gender equality and diversity. Remuneration levels are regularly reviewed to ensure that they are in line with the Group's Remuneration Policy.

Positive conduct is reinforced and Group culture promoted. The Group abides by all applicable laws, rules and regulations relating to employment. While conscious of the fact that the legal obligations are the minimum acceptable standard, the Group strives to surpass standards in this area and continues to increase awareness among staff. The Group, for example, with 6.2%, well exceeds the obligation to have 2% of the total staff complement composed of persons with disabilities. This reaffirms the Group's social outlook and its commitment to create a positive impact in society.

The Group holds and processes confidential data and for this purpose has the necessary data protection policies, procedures and safeguards to prevent the unlawful use of data, whether this might be as a consequence of data protection and/or human rights considerations. Regulatory data protection is given high importance, and similar to other aspects governed by regulatory frameworks, developments are monitored, analysed and resulting changes adopted as necessary.

The Group is satisfied with its non-financial performance in respect of staff related matters in areas such as work flexibility and well-being. Group staff members make use of family friendly measures which the Group commits to developing further. Performance in the area of adoption by staff of the Group's culture and values is considered satisfactory and is manifested in the interaction with customers, among colleagues and in the general manner in which staff members conduct themselves.

5. Respect for Human Rights

The Group is aware of the importance of ensuring that human rights are upheld across its operations. In this respect the Group carries out its business without discrimination, respecting the standards set by national law or higher standards as applicable, such as effective information and consultation processes, particularly where these affect the place and conditions of work. Policies are in place to support this stance, which extend also to counterparties. For example, economic sectors that may be linked to violation of human rights or to social vices are avoided and services that promote financial inclusion have been introduced. Financial inclusion is considered to improve people's overall welfare and social development.

The PostaPay&Save accounts were introduced by the Group as a basic bank account for the unbanked, well before this was required by regulation. This enabled a number of persons who were previously unable to open bank accounts to enjoy the facilities of basic payment accounts with relative services.

The Bank participated in an industry wide initiative to support the introduction of a code of ethics for the prevention of financial abuse of elderly persons. During the year under review, the Group did not encounter any issues, claims or reports on any human rights related issues. A grievance procedure is in place to provide effective remedy as and when needed. The Group is committed to investigate any reports of human rights violations.

6. Environmental Matters

The Group is mindful of its obligations to safeguard the environment as much as possible and aims to minimise the environmental impact of its business. Besides assisting in the reduction of costs, being environmentally friendly and taking measures to reduce its carbon footprint fits within the overall corporate social responsibility objectives of the Group. Measures are in place to reduce and recycle waste, procure energy efficient equipment, and periodically update the Group's motor vehicle fleet with reduced fuel emissions and electrically powered models. Installation of PVA panels and other energy efficient installations such as air conditioning systems and light fittings is carried out where practical. In addition, the Bank launched a scheme to encourage the main categories of its staff members to use public transport. The scheme effectively provides for free public transport during office hours.

The Group continues with its efforts to preserve buildings of architectural importance now serving as modern and functional branches/offices. 'Restoration with respect' continues to be the Group's motto when acquiring and renovating buildings of architectural heritage value, delivering them back to society in their original splendour.

In past years, awards were received for outstanding and significant contributions to Maltese cultural and architectural heritage. The Group is committed to continuing its work in this regard. MaltaPost runs a postal museum in a restored building in Valletta housing an extensive collection of artefacts related to Malta's history as depicted in postal material from the 15th century. The museum is now firmly established as part of Malta's heritage. Premises, including self service areas and ATMs, meet all accessibility regulations, apart from where physical restrictions make this impossible, in which case discussions with the relevant regulatory bodies are held.

The Group's business is mostly carried out in Malta. The Malta climate-related risks are not expected to have a consequence on the impairment or fair value of assets, give rise to credit losses and/or potential provisions or contingent liabilities. Therefore the impact of climate change on the financial performance is not expected to be material. That said, like any other business the Group is however not shielded from the economic risks of climate change, which in turn can have an impact on the financial performance.

The Board of Directors does not monitor specific non-financial key performance indicators but is sensitive to all matters considered in this statement, also bearing them in mind during discussions and reviews of relevant policies and other documents. The Board may consider introducing targets and adopting suitable metric criteria and key performance indicators for such matters where appropriate and practical which would allow for further oversight and monitoring.

The Group remains committed to dedicating further resources and efforts to the matters outlined in this statement as they are considered important aspects of its varied and extensive business activities.

7. Other Information

COVID-19 Pandemic

The COVID-19 virus was first detected in Malta in early March 2020.

The Bank has been closely monitoring developments as these unfolded and assessing the effects which this pandemic could have on the Bank. (Refer to Company Announcement LBM 239 issued on 17 March 2020). A Bank-wide contingency plan is in place and various measures are being implemented as circumstances evolve and demand. The plan is constantly updated and relevant risk assessments are undertaken to take account of ongoing developments, including the measures introduced by the Maltese Authorities and regulators from time to time.

As at the date of publishing of this Annual Report, the Bank is not aware of any significant information concerning the impact that the COVID-19 pandemic may have on the Bank's fundamentals, prospects, financial situation, operations or performance.

With respect to actual impacts, other than the measures taken by the Bank in line with its contingency plan, to date no adverse material impact on the Bank has been registered.

Furthermore, while it is likely that this pandemic shall have some form of bearing, it is considered far too premature to forecast what lies ahead in terms of potential impacts on the Bank's business activities, financial situation and economic performance, since developments continue to unfold on a daily basis and therefore identifying the nature and extent of such impacts is impossible at this stage. Nevertheless, the Bank is confident that it has in place robust financial fundamentals, proper technical resources and a competent staff complement which together will enable it to meet the challenges that the pandemic may present.

The Bank shall continue closely monitoring developments and shall seek to identify any actual and potential impacts based on qualitative and quantitative assessments, when possible and will take all necessary action to counter any such impacts. In the meantime, the Bank shall endeavour to ensure the continuity of its business operations with least disruption possible and to support its customer base during these extraordinary times. Keeping a full branch service open, continuation of all services and the allotment by the Bank of €12.5 million to provide temporary working capital requirements to business customers facing temporary liquidity shortages testify to this disposition.

The best interests of the Bank's stakeholders remain a priority and will be safeguarded at all times. Cognisant of the fact that the Bank provides an essential service, staff members have shown dedication and commitment during this period of uncertainty while measures are in hand to ensure the safety of their health and wellbeing at all times.

The Bank shall keep the market updated on any material developments through Company Announcements and any forthcoming interim financial reporting disclosures.

Approved by the Board of Directors on 23 March 2020 and signed on its behalf by:

Michael C. Bonello
Chairman

Joseph Said
Director and Chief Executive Officer

Statement of Compliance
with the Principles of Good Corporate Governance

A. Introduction

In terms of the Listing Rules of the Listing Authority (Listing Rule 5.94), Lombard Bank Malta p.l.c. (the Bank), as a company having its securities admitted to trading on a regulated market, is obliged to report on the extent to which it has adopted the 'Code of Principles of Good Corporate Governance' (the Principles) embodied in Appendix 5.1 to Chapter 5 of the same Listing Rules, as well as the measures which have been taken by the Bank to ensure compliance with these Principles.

While the Principles are not mandatory, the Board of Directors of the Bank has endeavoured to ensure that they are upheld to the fullest extent possible, and this while acknowledging that good corporate governance is indeed beneficial to all the Bank's stakeholders. The instances in which the Bank has departed from the Principles are explained below under Section C - 'Non-Compliance with the Code'.

After having carried out a review of the extent to which the Bank has been compliant with the Principles throughout the financial year ended 31 December 2019, the Board of Directors, in terms of Listing Rule 5.97, presents its report as follows:

B. Compliance with the Code

Principle 1: The Board

The Board of Directors of the Bank consists of five (5) Directors, four (4) of whom are non-executive Directors together with the Chief Executive Officer of the Bank who is also a Director. The Directors, individually and collectively, are considered fit and proper to direct the business of the Bank, having the necessary skills and experience to be able to do so.

In order to assist it in the execution of its duties and responsibilities, the Board of Directors has set up a number of committees and these include the Audit & Risk Committee, the Assets & Liabilities Committee, the Credit Committee and the Suitabilities & Evaluations Committee, all of which are regulated by their own Terms of Reference as approved and periodically reviewed by the Board.

Principle 2: Chairman and Chief Executive Officer

Different individuals occupy the positions of Chairman and Chief Executive Officer. A clear division of responsibilities exists between the Chairman's responsibility for the running of the Board of Directors and the Chief Executive Officer's responsibility for the running and managing of the Bank's business. This separation of roles of the Chairman and Chief Executive Officer avoids concentration of power, authority and unfettered discretion in one individual alone and differentiates leadership of the Board from the running of the Bank's business.

The Chairman's responsibilities, inter alia, include: (i) leading the Board and helping it reach its full potential, particularly by facilitating the effective contribution of Directors and encouraging discussion; (ii) setting of the Agenda for Board meetings; (iii) ensuring that the Directors receive precise, timely and objective information so that they can take sound decisions and effectively monitor the performance of the Bank; (iv) ensuring that all strategic and policy issues are appropriately discussed and formally approved; and (v) maintaining effective communication with the Bank's shareholders at all times.

As stated below, the Chairman meets the independence criteria set out in the Principles. On the other hand, the Chief Executive Officer is responsible for managing the day-to-day business of the Bank in conformity with the agreed plans, policies and strategies approved by the Board.

Statement of Compliance
with the Principles of Good Corporate Governance

Principle 3: Composition of the Board

The following Directors served on the Board during the period under review:

Michael C. Bonello
Graham A. Fairclough
Kimon Palamidis
Joseph Said
Michael Zammit

All Board members are non-executive Directors who are not engaged in the daily management of the Bank, with the exception of Joseph Said who is also Chief Executive Officer of the Bank. Furthermore, the Board considers Michael C. Bonello, Michael Zammit, and Kimon Palamidis as independent Directors. Mr. Zammit is still considered to be independent despite the fact that he has served on the Board for more than twelve consecutive years. In determining the independence of its members, the Board has taken into consideration the relevant criteria and Principles as well as what are generally considered sound, acceptable standards. All non-executive Directors have declared in writing to the Board that they undertake:

- to maintain in all circumstances their independence of analysis, decision and action;
- not to seek or accept any unreasonable advantages that could be considered as compromising their independence; and
- to clearly express their opposition in the event that they find that a decision of the Board may harm the Bank.

It is considered that, in the circumstances, the size of the Board is sufficient for the requirements of the business and that the balance of skills and experience therein is appropriate to enable the Board to carry out its duties and responsibilities. The composition and election of the Board of Directors is determined by the Bank's Articles of Association wherein it is established that it is the shareholders who must appoint Directors to serve on the Board. In addition, however, the Bank, by virtue of the Board-appointed Suitabilities & Evaluations Committee, carries out suitability assessments of its existing Directors and any new nominated Directors and the MFSA undertakes due diligence exercises in order to ensure that the suitability, fit and proper criteria are observed, pursuant to all applicable laws, rules, regulations, guidelines etc.

The Suitabilities & Evaluations Committee when carrying out suitability assessments of existing or nominated Directors takes into account a number of attributes in terms of applicable laws, rules, regulations, guidelines etc. The overall composition of the Board and the collective knowledge and expertise required are evaluated during each individual suitability assessment so as to ensure that the Board is effectively discharging all its duties and obligations at all times.

Taking into account the Bank's size, complexity and business model, the Board considers that as a policy and as reflected in its Board of Directors' Charter, it endeavours to have a varied board, particularly in terms of diverse educational and professional backgrounds and extensive and specialised experience of its members. The Board is confident that for this reason, and in light of the current circumstances in which it is operating, it benefits from a satisfactory diversity of views and expertise which allows for a good understanding of current affairs, the environment in which the Bank operates and longer-term risks and opportunities related to the Bank's business. It also benefits from international expertise.

The Board continues to remain committed to achieving further diversity among its members particularly in terms of number, age, gender, experience, educational and professional backgrounds. However, since the appointment of Directors to the Board is a matter that is reserved entirely to the Bank's shareholders in terms of the Memorandum and Articles of Association, this depends on the profiles of nominees proposed and their suitability in terms of applicable laws, rules, regulations, guidelines etc. The Board of Directors will consider formalising its diversity policy in this regard.

Statement of Compliance
with the Principles of Good Corporate Governance

Principle 4: The Responsibility of the Board

In pursuing the execution of the four basic roles of corporate governance, namely, accountability, monitoring, strategy formulation and policy development, the Board of Directors, having the first level of responsibility for such execution:

- regularly reviews and evaluates corporate strategy, major operational and financial plans, risk policy, performance objectives and monitors implementation and corporate performance within the parameters of all relevant laws, regulations and codes of best business practice;
- applies high ethical standards and takes into account the interests of stakeholders and acts responsibly and with integrity and on a fully informed basis, in good faith, with due diligence and in the best interests of the Bank and its shareholders;
- recognises that the Bank's success depends upon its relationship with all groups of its stakeholders, including employees, suppliers, customers and the wider community in which the Bank operates;
- monitors effectively the application and implementation by Management of its policies and strategy;
- recognises and supports enterprise and innovation within Management and examines how best to motivate the Bank's Management;
- seeks to establish an effective decision-making process in order to develop the Bank's business efficiently; and
- ensures that a balance is struck between enterprise and control in the Bank.

Furthermore, the Board of Directors:

- defines in clear and concise terms the Bank's strategy, policies, management performance criteria and business policies and effectively monitors the implementation of such by Management;
- establishes a clear internal and external reporting system so that the Board has continuous access to accurate, relevant and timely information;
- has appointed Committees, including the Audit & Risk Committee, Credit Committee, Assets & Liabilities Committee and Suitabilities & Evaluations Committee;
- continuously assesses and monitors the present and future operations' opportunities, threats and risks;
- evaluates the Management's implementation of corporate strategy and financial objectives;
- ensures that the Bank has appropriate policies and procedures in place to assure that the Bank and its employees maintain the highest standards of corporate conduct, including compliance with applicable laws, regulations, business and ethical standards;
- ensures that the financial statements of the Bank and the annual audit thereof are completed within the stipulated time periods; and
- requires Management to constantly monitor performance and report fully and accurately to the Board.

Furthermore, Directors are informed on an ongoing basis of their statutory and fiduciary duties, the Bank's operations and prospects, the general business environment and skills and competences of Senior Management. The expectations of the Board are also discussed regularly.

Principle 5: Board Meetings

The Board convened eight (8) times during the period under review with attendance as follows:

Michael C. Bonello	8
Graham A. Fairclough	8
Kimon Palamidis	7[1]
Joseph Said	8
Michael Zammit	8

[1] K. Palamidis appointed an Alternate Director when he was unable to attend.

The dates when the Board meetings are scheduled to be held are determined prior to the beginning of the year in question. When required, further meetings are scheduled. Board members, at times, participate in meetings by appointing an Alternate Director or attend via teleconference.

Ahead of Board meetings an agenda and supporting documentation is sent to all Directors. Other than in the case of meetings specially convened to discuss particular matters, generally the agendas of regular Board meetings balance items of a long-term strategic nature, as well as performance-related issues together with credit applications which fall within the discretionary limits of the Board and also compliance. During meetings, Directors are encouraged to present their views pertinent to the subject matter and are given every opportunity to contribute to the relevant issues on the agenda. Following each meeting, minutes which record attendance as well as all decisions taken are circulated to all Board members.

Principle 6: Information and Professional Development

The Board of Directors appoints the Chief Executive Officer. Each newly appointed Member of the Board is briefed by the Chief Executive Officer and Senior Management officials on all aspects of the Bank's business, while the Company Secretary provides each newly appointed Director with a dossier containing reference to the more important relevant Legislation, Rules, Guidelines, the Bank Statute as well as policy documents.

Board members are reminded that the Company Secretary is at their disposal to provide any advice or service that may be required in the discharge of their duties and responsibilities. The Company Secretary is responsible for advising the Board, through the Chairman, on all governance matters. The Secretary is responsible for ensuring that Board procedures are complied with as well as that effective information flows within the Board, its committees and with Senior Management. The Secretary also facilitates induction and assists with professional development, as required.

Directors are given the opportunity to update and develop their skills and knowledge, particularly through detailed presentations, briefings and training by senior executives and other relevant Bank officials. They are invited to attend training sessions organised specifically for the Board and are also informed of and encouraged to attend externally run seminars throughout their directorship. In addition, all Board members may obtain independent professional advice at the Bank's expense.

Furthermore, Directors have access to the advice and services of the external auditors who are invited to attend all Audit & Risk Committee meetings as well as Board meetings when required, including the meetings at which the Bank's financial statements are approved.

The Board continues to be mindful of the crucial importance of recruiting, retaining and motivating quality management. The ongoing training and development of staff at all levels is considered of the utmost importance and this also in the light of the need for orderly succession.

Principle 7: Evaluation of the Board's Performance

An assessment exercise of the Board's performance was carried out through a 'self-evaluation' questionnaire in which Board members participated. Furthermore, assessment exercises of performance of the committees were also carried out by virtue of 'self-evaluation' questionnaires completed by the members and some regular attendees of the Audit & Risk Committee, the Assets & Liabilities Committee and the Credit Committee. These exercises also included an evaluation of the Chairman of each respective Committee. These 'self-evaluation' questionnaires were then set to be analysed by the Suitabilities & Evaluations Committee established by the Board to report to the Board accordingly. This exercise did not reveal the need for any material changes in the Bank's governance structures and organisation.

Principle 8: Committees

The Board has appointed the following committees:

Audit & Risk Committee

The primary purpose of the Audit & Risk Committee is to protect the interests of the Bank's shareholders and to 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 assists the Board in fulfilling its supervisory and monitoring responsibility for effective financial reporting, risk management, control and governance and this by, inter alia, reviewing any financial information, statements and disclosures to be issued, systems of governance, systems of internal control established by Management and the Board, the risk management processes, the external and internal audit processes as well as the compliance processes. The Audit & Risk Committee met eight (8) times during the period under review.

With respect to Risk Management, the Committee, inter alia, reviews reports from Management which enable the Committee (and the Board) to consider the process of risk identification and management, to assess the risks involved in the Bank's business and to understand how they are controlled and monitored by Management. The Committee also advises the Board on the Bank's overall current and future risk appetite and strategy and assists the Board in overseeing the implementation of that strategy by Management.

The Audit & Risk Committee is currently composed of the following four (4) non-executive Board members three (3) of whom are independent: Michael C. Bonello (Chairman), Graham A. Fairclough, Kimon Palamidis and Michael Zammit in accordance with the Audit & Risk Committee's Terms of Reference.

Michael C. Bonello is considered by the Board to be independent and competent in accounting and/or auditing in terms of the Listing Rules, having previously served in various senior positions within other institutions, including as Governor of the Central Bank of Malta for a number of years. The Bank's Head of Internal Audit and Head of Risk attend meetings of the Audit & Risk Committee. The Bank's External Auditors and members of Senior Management and others, including, inter alia, the Chief Executive Officer, Chief Financial Officer and the Compliance Officer, are also invited to attend meetings as is deemed necessary by the Committee. The Company Secretary acts as Secretary to the Audit & Risk Committee.

Assets & Liabilities Committee (ALCO)

Membership of this Committee is made up of a number of Chief Officers and senior officers, including from the Finance and Treasury departments. The Chief Executive Officer chairs the ALCO whose main objective is to manage risks within approved limits at the same time as maximising returns by efficient and judicious management of the Bank's assets and liabilities. Risk Management officials are also invited to attend meetings. A Secretary is appointed by the Committee.

Credit Committee

The Credit Committee is responsible for considering and approving credit applications within delegated limits of authority and is composed of a number of Chief Officers and senior officers. The Chief Executive Officer chairs this Committee and a Secretary is appointed by the Committee.

Suitabilities & Evaluations Committee

This Committee is responsible for carrying out suitability assessments of nominated and existing Directors, Key Function holders or any other persons as may be required and also assesses the Board's annual performance and that of its committees following the completion of the self-evaluations by the Board and committee members. The chairman of the Committee is selected by the Board of Directors (currently the non-executive Director and Committee member, Graham A. Fairclough) and the Company Secretary acts as Secretary.

Remuneration Committee

The functions of the Remuneration Committee are carried out by the Board of Directors in view of the fact that the remuneration of Directors for the holding of their office on the Board is not performance-related.

A separate 'Remuneration Report' features on page 28 of this Annual Report in compliance with the Principles.

Principle 9 And 10: Relations with Shareholders and Markets and Institutional Shareholders

The Bank fully appreciates the importance of maintaining open lines of communication with shareholders, the markets and institutional shareholders. The Board, in this regard, considers that throughout the period under review the Bank has continued to communicate appropriately by means of regular company announcements.

Specifically, the Bank communicates with its shareholders during the Annual General Meetings when Directors and senior officers are also present in order to answer any questions that may arise. The Annual Report and Financial Statements are sent to all shareholders at least twenty-one (21) days prior to the holding of the Annual General Meeting.

The Bank's website (www.lombardmalta.com), contains information about the Bank and its business and is updated regularly.

It is therefore the Bank's policy:

- to publish information that can have a significant effect on the Bank's share price through the MSE and immediately after on the Bank's website;
- to make other published information available to the public on the Bank's website;
- to strive for open, transparent communications;
- to ensure continuity and high quality in the information disclosed to be accessible to all stakeholders. Minority shareholders are entitled to call special meetings should a minimum threshold of share ownership be established in accordance with the Bank's Memorandum and Articles of Association; and
- Minority shareholders may formally present an issue to the Board if they own the predefined minimum threshold of shares.

Principle 11: Conflicts of Interest

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

Strict policies are in place, particularly in the Board of Directors' Charter, to enable the management of conflict of interest, both actual as well as potential, should the occasion arise.

In addition, the '*Policy on the Prevention of Market Abuse*' was adopted and implemented in conformity with Market Abuse laws and regulations. Directors and staff members are also regularly reminded of their obligations when dealing in securities of the Bank and other scheduled financial instruments.

Joseph Said, who is a Director of the Bank, holds a directorship in two companies that have a shareholding in the Group, as disclosed in the Directors' Report.

Principle 12: Corporate Social Responsibility

Directors are fully aware of the need to adhere to accepted principles of corporate social responsibility. The Bank remains fully committed to behaving ethically at all times and to contributing to economic development while at the same time improving the quality of life of the work force and their families, as well as of the local community and society at large. The Bank puts into practice the principles of corporate social responsibility through its extensive contributions and initiatives and direct community involvement as well as the support it gives to a number of causes.

C. Non-Compliance with the Code

Principle 4: (Code Provision 4.2.7)

The above Code Provision states, *'The Board should develop a succession policy for the future composition of the Board of Directors and particularly of the executive component thereof, for which the Chairman should hold key responsibility'.*

The appointment of Directors to serve on the Board is a matter which is entirely reserved to the shareholders of the Bank in terms of its Memorandum and Articles of Association (except where the need arises to fill a casual vacancy). Therefore, the Board does not at this stage consider it necessary to develop a succession policy for the future composition of the Board.

Principle 8A: (Remuneration Commttee)

The Board did not establish a Remuneration Committee as specified in Code Provision 8.A.1. In terms of Code Provision 8.A.2 of the Principles, given that the remuneration of Directors for the holding of their office on the Board is not performance-related, the functions of the Remuneration Committee are carried out by the Board of Directors.

Principle 8B (Nomination Committee)

A Nomination Committee has not been set up since the appointment of Directors to the Board is a matter that is reserved entirely to the Bank's shareholders in terms of the Memorandum and Articles of Association.

In this connection every member of the Bank holding in the aggregate at least fifteen percent (15%) of the ordinary issued share capital of the Bank shall be entitled to appoint one (1) Director for each and every fifteen percent (15%) of the ordinary issued share capital owned by that member.

Any fractional shareholding in excess of fifteen percent (15%) not applied in appointing such a Director or Directors, and only that fraction, shall be entitled to vote in the election of the remaining Directors together with the remaining body of shareholders. These are entitled to appoint the remaining Board members in accordance with the provisions of the Bank's statute.

This notwithstanding, in light of regulatory requirements, the Suitabilities & Evaluations Committee referred to above was set up specifically to carry out suitability assessments of nominated and existing Directors, Key Function holders or any other persons as may be required and also to assess the Board's annual performance and that of its committees.

Principle 9: (Code Provision 9.3)

There are no procedures disclosed in the Bank's Memorandum or Articles as recommended in Code Provision 9.3 to resolve conflicts between minority shareholders and controlling shareholders.

D. Internal Control (Listing Rule 5.97.4)

The Board is ultimately responsible for the Bank's internal controls as well as their effectiveness, while authority to operate the Bank is delegated to the Chief Executive Officer. The Bank's system of internal controls is designed to manage all the risks in the most appropriate manner. Such controls, however, cannot completely eliminate the possibility of material error or fraud. The Board, therefore, assumes

responsibility for executing the four basic roles of corporate governance, i.e. accountability, monitoring, strategy formulation and policy development.
In summary, the Board is therefore responsible for:

- reviewing the Bank's strategy on an ongoing basis as well as setting the appropriate business objectives in order to enhance value for all stakeholders;
- appointing and monitoring the Chief Executive Officer whose function it is to manage the operations of the Bank; and
- identifying and ensuring that significant risks are managed satisfactorily.

Given the fiduciary responsibility involved, the Board of Directors also sets high business and ethical standards for adoption right across the organisation.

The Board upholds a policy of clear demarcation between its role and responsibilities and those of Management. It has defined the level of authority that it retains over strategy formulation and policy determination together with delegated authority and has vested accountability for the Bank's day-to-day business in the Assets & Liabilities Committee, Credit Committee and in the management team comprising of the:

- Chief Executive Officer; and
- Chief Officers and other senior officers.

The Board frequently participates in asset allocation decisions as well as credit proposals above a certain threshold, after the appropriate recommendations have been made.

E. General Meetings (Listing Rule 5.97.6)

General meetings are called by giving at least twenty-one (21) days' notice and conducted in accordance with the provisions contained in the Bank's Articles of Association.

The 'Ordinary Business' which is dealt with at the Annual General Meeting consists of the adoption of the annual financial statements, declaration of a dividend, appointment of Board members, appointment of auditors and the fixing of their remuneration together with the voting of remuneration to the Directors for the holding of their office. All other business shall be deemed 'Special Business'.

All shareholders registered in the shareholders' register on record date as defined in the Listing Rules have the right to attend, participate and vote in the general meeting.

A shareholder or shareholders holding not less than five per cent (5%) of the voting issued share capital of the Bank may: (i) request the Bank to include items on the agenda and; (ii) table draft resolutions for items included in the agenda of a general meeting. Such requests shall be submitted to the Bank at least forty-six (46) days before the date set for the general meeting.

Every shareholder shall be entitled to appoint only one (1) person to act as proxy holder to attend and vote at a general meeting instead of him. The proxy holder shall enjoy the same rights to speak and ask questions in the general meeting as those to which the member thus represented would be entitled.

Approved by the Board of Directors on 23 March 2020 and signed on its behalf by:

Michael C. Bonello
Chairman

Joseph Said
Director and Chief Executive Officer

Remuneration Report

As indicated in the 'Statement of Compliance with the Code of Principles of Good Corporate Governance', in terms of the 'Code of Principles of Good Corporate Governance' within the Listing Rules issued by the Listing Authority, the Board of Directors performs the functions of a Remuneration Committee on the basis that the remuneration of the Bank's Directors for the holding of their office on the Board, is not performance-related and does not include share options, pension benefits, profit-sharing arrangements or any emolument related to the performance of the Bank. Amongst the obligations established in the Listing Rules, the Board, where applicable, carries out the main duties established in the Supporting Principles enshrined in Principle 8A of the 'Code of Principles of Good Corporate Governance'. This Remuneration Report was approved by the Board of Directors at the Board Meeting held on 23 March 2020.

Remuneration Policy

Directors

While there were no changes effected to the Bank's policy on remuneration of its Directors during the financial year under review, in terms of the Listing Authority Listing Rule 12.26A et seq. the Bank has further formalised its Remuneration Policy for Directors which is set to be approved by shareholders during the forthcoming Annual General Meeting.

In terms of the Bank's Memorandum and Articles of Association, the Bank's shareholders determine the maximum annual aggregate remuneration of the Directors. The maximum amount is established by resolution at each Annual General Meeting of the Bank. The aggregate amount fixed for this purpose during the last 2019 Annual General Meeting was seventy thousand euro (€70,000).

No Board committee fees were payable to any of the Directors during the year under review.

It is confirmed that none of the Directors in their capacity as Directors of the Bank are entitled to profit sharing, share options, pension benefits, variable remuneration or any other remuneration or related payments from the Bank. Only one of the Directors has a service contract with the Bank.

The fees paid to Directors for the holding of their office during 2019 amounted to €48,900. This amount is within the limit of €70,000 approved by the Annual General Meeting of 11 April 2019.

Directors' fees attributable to the current financial year are disclosed in note 33 to the financial statements. During the year, Directors received fees as follows:

	€
Michael C. Bonello (Chairman)	20,960
Graham A. Fairclough	6,985
Joseph Said	6,985
Michael Zammit	6,985
Kimon Palamidis	6,985
Total	**48,900**

Remuneration (other than directors' fees) paid to the executive member of the Board of Directors is included with the emoluments to Senior Management detailed below.

Senior Management

There were no changes effected in the Remuneration Policy for the Bank's Senior Management during the financial year under review which warrant reporting. The Board of Directors is satisfied that the packages offered to senior management continue to ensure that the Bank attracts and retains management staff with the necessary qualities and skills. The Bank's policy remains that of engaging its senior management staff on the basis of indefinite contracts of employment, and this after a period of probation. The terms and conditions of employment of senior management are established in the relative employment contracts. The applicable notice periods, after probation, are those provided for in the relevant legislation.

Share options, share incentive schemes and profit sharing do not feature in the Bank's Remuneration Policy, and the individual contracts of employment of senior management do not contain provisions for termination payments and/or other payments linked to early termination other than as determined by the Law.

From time to time the Board of Directors of the Bank approves the allocation of a financial contribution towards Retirement Gratuities that it may decide to grant and/or a Staff Pension fund that may be formally established in the future. Gratuities that it may make, on an ex gratia basis, to its employees, including its Chief Executive Officer, are made upon retirement. Amounts contributed for this purpose in 2019 amounted to €100,000 (2018: €100,000). Once contributed, these amounts are held in a separate bank account which is not controlled by the Bank and is therefore not included in the Bank's financial statements. The Board of Directors has resolved that a retirement gratuity be eventually paid on an ex gratia basis, to the Chief Executive Officer on his retirement. Amounts intended as a contribution to an eventual pension fund will be regulated by rules yet to be determined in light of relevant legislation. No other pension benefits are currently payable by the Bank.

Senior management staff are eligible for annual salary increases, which are not directly performance-related. Annual bonuses are paid to senior management staff members according to individual overall performance during the previous financial year. Bonus payments do not exceed 100% of the fixed component of the total remuneration for each individual.

Non-cash benefits include private health care insurance as well as death-in-service benefits and personal accident insurance cover. The Chief Executive Officer is entitled to the use of a company car.

Total emoluments received by senior management during the period under review are as detailed below, in terms of Code Provision 8.A.5.

Fixed Remuneration	Variable Remuneration	Share Options	Others
€804,000	€121,000	None	Non-Cash benefits referred to above

Other

For other employees, fixed pay is determined by a Collective Agreement and annual bonuses are differentiated by individual performance and grade.

The Bank does not plan to effect any changes in its Remuneration Policy in the upcoming financial year, unless required to do so in terms of any regulatory obligations or otherwise.

Company Information

Number of shareholders at 31 December 2019 analysed by range:

Range	Shareholders	Shares
1 – 500	160	26,007
501 – 1000	89	63,332
1001 – 5000	493	1,267,125
5001 and over	679	42,821,450
Total	**1,421**	**44,177,914**

Number of shareholders at 29 February 2020 analysed by range:

Range	Shareholders	Shares
1 – 500	161	26,303
501 – 1000	90	64,234
1001 – 5000	490	1,257,287
5001 and over	680	42,830,090
Total	**1,421**	**44,177,914**

The Bank has one class of shares and each share is entitled to one vote.

Company Information

Board of Directors

Michael C. Bonello (Chairman)
Graham A. Fairclough
Kimon Palamidis
Joseph Said
Michael Zammit

Company Secretary

Helena Said

Senior Management

Joseph Said	Chief Executive Officer
David Attard	Chief Officer - Group Corporate Services
Anthony Bezzina	Chief Officer - Credit
Paul Debono	Chief Officer - Legal
Eugenio Farrugia	Chief Operations Officer
Aurelio Theuma	Chief Financial Officer
Anthony Zahra	Chief Information Officer

Company Information

Registered Office
67 Republic Street Valletta VLT 1117
Tel: 25581 117

Branches
67 Republic Street Valletta VLT 1117
Tel: 25581 100

225A Tower Road Sliema SLM 1601
Tel: 25581 260

Ninu Cremona Street Victoria VCT 2561
Tel: 25581 600

Balzan Valley Road Balzan BZN 1409
Tel: 25581 500

44 Tigné Street Sliema SLM 3174
Tel: 25581 251

24/7 Outlet
Paceville Avenue St. Julian's STJ 3103

Credit
9A St. Frederick Street Valletta VLT 1470
Tel: 25581 115

Home Loans
4 Main Street Qormi QRM 1100
Tel: 25581 370

International Business Banking
Graham Street Sliema SLM 1711
Tel: 25581 223

Legal Office
59 Republic Street Valletta VLT 1117
Tel: 25581 116

Trade Services
4 Main Street Qormi QRM 1100
Tel: 25581 366

Wealth Management
67 Republic Street Valletta VLT 1117
Tel: 25581 112

Independent Auditor's Report
To the Shareholders of Lombard Bank Malta p.l.c.

Report on the Audit of the Financial Statements

Our opinion

In our opinion:

- Lombard Bank Malta p.l.c.'s consolidated and parent company financial statements (the "financial statements") give a true and fair view of the Group and Bank's financial position as at 31 December 2019, and of the Group and Bank's financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU; and
- The financial statements have been prepared in accordance with the requirements of the Maltese Banking Act (Cap. 371) and the Maltese Companies Act (Cap. 386).

Our opinion is consistent with our additional report to the Audit & Risk Committee.

What we have audited

Lombard Bank Malta p.l.c.'s financial statements, set out on pages 46 to 167, comprise:

- the consolidated and parent company statements of financial position as at 31 December 2019;
- the consolidated and parent company income statements and statements of comprehensive income for the year then ended;
- the consolidated and parent company statements of changes in equity for the year then ended;
- the consolidated and parent company statements of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

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 *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report.

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

Independence

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

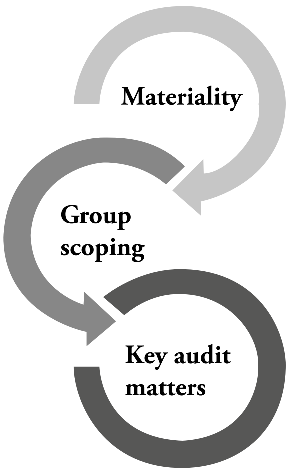
Independent Auditor's Report *(continued)*
To the Shareholders of Lombard Bank Malta p.l.c.

To the best of our knowledge and belief, we declare that non-audit services that we have provided to the parent company and its subsidiaries are in accordance with the applicable law and regulations in Malta and that we have not provided non-audit services that are prohibited under Article 18A of the Accountancy Profession Act (Cap. 281).

The non-audit services that we have provided to the Group and its subsidiaries, in the period from 1 January 2019 to 31 December 2019, are disclosed in Note 33 to the financial statements.

Our audit approach

Overview



Overall Group materiality: €765,000, which represents 5% of profit before tax.

The audit procedures carried out covered all the components within the Group namely Lombard Bank Malta p.l.c., Redbox Limited, MaltaPost p.l.c. and Tanseana Limited which are all based in Malta.

Credit loss allowances in respect of loans and advances to customers of Lombard Bank Malta p.l.c.

Revenue recognition of MaltaPost p.l.c.

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the consolidated financial statements. In particular, we considered where the directors made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall group materiality for the consolidated financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Independent Auditor's Report *(continued)*
To the Shareholders of Lombard Bank Malta p.l.c.

Overall Group materiality	€765,000
How we determined it	5% of profit before tax
Rationale for the materiality benchmark applied	We chose profit before tax as the benchmark because, in our view, it is the benchmark against which the performance of the Group is most commonly measured by users, and is a generally accepted benchmark. We chose 5% which is within the range of quantitative materiality thresholds that we consider acceptable.

We agreed with the Audit & Risk Committee that we would report to them misstatements identified during our audit above €61,000 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

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. 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.

Key audit matter	How our audit addressed the Key audit matter
Credit loss allowances in respect of loans and advances to customers of Lombard Bank Malta p.l.c. Credit loss allowances in respect of loans and advances to customers represent management's best estimate of expected credit losses ('ECLs') within the loan portfolios at the balance sheet date. In the previous financial year, the Bank transitioned to IFRS 9, which is a complex accounting standard triggering a conceptual shift in the measurement of impairment allowances from an incurred loss model under IAS 39 to an expected loss model. A considerable level of judgement is required in the development of models designed to estimate ECLs on loans measured at amortised cost in accordance with the requirements of IFRS 9. In general, the Bank calculates ECL by using the following	Subsequent to the first year of adoption of IFRS 9, we continued to focus on the key drivers of the estimation of ECL. Apart from assessing the continued appropriateness of management assumptions, updates to key parameters, new assumptions and enhancements were evaluated and tested. Discussions with the Audit & Risk Committee and management were held on: - inputs, assumptions and adjustments to ECL, in particular changes to risk factors and other inputs within the Bank's models, in respect of which we provided updates on the results of our testing procedures; - the application of forward economic scenarios, including the severity and magnitude of modelled downside scenarios; and - individually significant loan impairments.

Key audit matter	How our audit addressed the Key audit matter
key inputs: probability of default (PD), loss given default (LGD) and exposure at default (EAD). The maximum period considered when measuring ECL is the maximum period over which the Bank is exposed to credit risk. Credit loss allowances relating to all loans and advances are determined at an instrument level. For non-defaulted (Stage 1 and 2), the Bank's ECL model relies on risk parameters, specifically PDs determined on the basis of internally developed statistical models and historical development data derived from the Bank's own experience as available at the reporting date. The LGD used for the Bank's credit portfolios is driven by the collateral held securing the individual facilities and takes into account other assumptions, including market value haircut (which includes costs to sell), time to sell and the impact of discounting the collateral from the date of realisation back to the date of default. For defaulted (Stage 3) exposures, discounted cash flow models are utilised in order to estimate ECLs. Judgement is required to determine when a default has occurred and then to estimate the expected future cash flows related to the loan, which are dependant on parameters or assumptions such as the valuation of collateral (including forced sale discounts and assumed realisation period) or forecasted operating cash flows. The Bank is required to assess multiple scenarios in this respect, which scenarios will have probabilities attached. Under IFRS 9, the Bank is required to formulate and incorporate multiple forward-looking economic conditions, reflecting management's view of potential future economic developments, into the ECL estimates. A number of macro-economic scenarios based on the selected macro-economic variables are considered to capture non-linearity across credit portfolios. The complexity attributable to this factor requires management to develop multiple macro-economic scenarios involving the use of significant judgements. The Bank utilises	With respect to the ECL models utilised by the Bank, the continued appropriateness of the modelling policies and methodologies used was independently assessed by reference to the requirements of IFRS 9. *ECL calculation for non-defaulted loan exposures* We understood and critically assessed the models used for ECL estimation for the Bank's loan portfolio. Since modelling assumptions and parameters are based on historic data, we assessed whether historic experience was representative of current circumstances and of the recent losses incurred within the portfolios. The appropriateness of management's judgements was also independently considered in respect of calculation methodologies, calibration of PDs and LGDs, segmentation and selection of macro-economic variables. Model calculations were also tested independently. Substantive procedures were performed as follows: Performed an overall assessment of the ECL provision levels by stage to determine if they were reasonable considering the Bank's portfolio, risk profile, credit risk management practices and the macro-economic environment. - Tested a sample of loans to independently review the borrower's financial performance and ability to meet loan repayments and assess the appropriateness of the credit rating assigned by management. - Challenged the criteria used to allocate an asset to Stage 1, 2 or 3 in accordance with IFRS 9 and tested a sample of assets in Stage 1, 2 and 3 to verify that they were allocated to the appropriate stage. - Tested the completeness and accuracy of the critical data, extracted from the underlying systems, that is utilised within the models for the purposes of the year end ECL calculation. - Risk based testing of models, including independent

Key audit matter	How our audit addressed the Key audit matter

a statistical methodology to generate the economic inputs applied within the ECL models.

Data used in the impairment calculation is sourced from a number of systems, including systems that are not necessarily used for the preparation of accounting records.

This increases risk around completeness and accuracy of certain data used to create assumptions and operate the models. In some cases, data is unavailable and reasonable alternatives have been applied to allow calculations to be performed.

Since the estimation of ECLs is subjective in nature and inherently judgemental, the Bank's application of the IFRS 9 impairment requirements is deemed to be an area of focus.

We focused on credit loss allowance due to the subjective nature of specific data inputs into the calculation and the subjective judgements involved in both timing of recognition of impairment and the estimation of the size of any such impairment.

Accordingly, summarising the key areas relevant to the Bank's measurement of Expected Credit Losses (ECLs) would include:

- Allocation of assets to Stage 1, 2, or 3 using criteria in accordance with IFRS 9;
- Accounting interpretations and modelling assumptions used to build the models that calculate the ECL;
- Completeness and accuracy of data used to calculate the ECL;
- Inputs and assumptions used to estimate the impact of multiple macro-economic scenarios; and
- Measurements of individually assessed provisions including the assessment of multiple scenarios.

re-build of certain assumptions. We tested the assumptions, inputs and formulas used in ECL models on a sample basis. This included assessing the appropriateness of model design and formulas used, and recalculating PDs, LGDs and EADs on a sample basis.

- Independent testing of model calculations.
- Reviewing and challenging the valuation of collateral applied by the Bank in the ECL calculations, including the application of certain parameters considered by the Bank in the LGD calculation such as the time to realise the collateral and costs associated with such process.
- Tested the multiple macro-economic scenarios and variables using our experts to assess their reasonableness. We assessed the base case and alternative economic scenarios, including challenging probability weights. We assessed whether forecasted macro-economic variables were appropriate and we challenged the correlation and impact of the macro-economic factors on the ECL.

Our testing of models and model assumptions did not highlight material differences.

Based on the evidence obtained, we found that the model assumptions, calculations and data used within the model to be reasonable.

ECL calculation for defaulted loan exposures

For defaulted exposures within the loan portfolio, the appropriateness of the methodology and policy used to calculate ECLs was independently assessed. We understood and evaluated the processes for identifying default events within loan portfolios, as well as the impairment assessment process.

Substantive procedures were performed in respect of identification of defaults as follows:

- Assessed critically the criteria used for determining whether a default event had occurred by testing

Key audit matter	How our audit addressed the Key audit matter
Relevant references in the Annual Report: - Accounting policy: Note 1.7; - Credit risk management: Note 2.3; - Note on credit impairment losses: Note 32; - Note on loans and advances to customers: Note 8; and - Critical accounting estimates and judgements: Note 3.2.	a sample of loans with characteristics that might imply a default event had occurred (for example a customer experiencing financial difficulty) to challenge whether default events had actually occurred and to assess whether default events had been identified by management in a timely manner. - Selected a sample of performing loans, which had not been identified by management as potentially defaulted, to form our own judgement as to whether that was appropriate and to further challenge whether all relevant events had been identified by management. Substantive procedures were performed on defaulted exposures in respect of the estimation of the amounts of the respective ECL provisions, as follows: - Reviewed the credit files of a selected sample of loans to understand the latest developments at the level of the borrower and the basis of measuring the ECL provisions and considered whether key judgements were appropriate given the borrowers' circumstances. - Challenged the severity of scenarios being applied for these exposures, together with their respective probability weights by forming an independent view of the recoverability of the selected loan exposures under different scenarios, assigning probabilities independently and comparing the outcomes to that of the Bank. - Tested key inputs to and reperformed the impairment calculation used to derive expected cash flows under different scenarios. - Assessed the appropriateness of a sample of property valuations securing impaired loans through the use of experts. In the case of some impairment provisions, we formed a different view from that of management, but in our view the differences were within a reasonable range of outcomes.

Independent Auditor's Report *(continued)*
To the Shareholders of Lombard Bank Malta p.l.c.

Key audit matter	How our audit addressed the Key audit matter
Revenue recognition of MaltaPost p.l.c. ISA 240 presumes that there is a risk of material misstatement due to fraud related to revenue recognition and requires the auditor to treat this assessed risk of material misstatement due to fraud as a significant risk, thus requiring special audit consideration. This comprises the risk that sales revenue is misstated due to fraud as individuals may have incentive to manipulate revenue, and hence results. The risk of fraud in revenue recognition entails the risk that sales revenue is not recognised in accordance with IFRS 15 requirements, and that revenue is not completely or accurately reflected or that fictitious sales revenue is recorded or that the cut-off point at which risks and rewards are transferred is not correctly reflected in the financial statements. The subsidiary's revenue consists of revenue from retail sales, comprising sale of stamps, philatelic sales, sale of non-postal stationery and provision of non-postal services, and sales revenue comprises terminal dues, consisting of remuneration for processing and delivering post items received from other territories. Terminal dues are invoiced on a quarterly basis in arrears on the basis of volume data accumulated throughout the respective quarter. Accordingly the risk of fraud in revenue recognition in respect of terminal dues is principally attributable to the unbilled revenue at year end in respect of the last quarter of the financial year. Revenue from retail sales is attributable to a large volume of low value transactions handled through an operational retail system in an automated manner, whereby inventory items are updated with sales taking into account standing data in respect of unit prices. In this respect, the risk of fraud in revenue recognition is mainly in respect of the output of the operational retail system not being properly reflected within the accounting system.	We confirmed our understanding and evaluation of the subsidiary's control processes and procedures in respect of revenue recognition, including IT and system controls. Specifically in respect of revenue from retail sales, we evaluated the relevant systems and the design of controls, and tested the operating effectiveness of automated and non-automated controls over the: - capture and recording of revenue transactions comprising products or services supplied to customers; - authorisation of price changes and updating this information within the operational retail system; and - calculation of amounts invoiced to customers. Accordingly we validated key controls including automated control procedures in respect of the operational retail system. We tailored our final audit plan based on the results of our assessment of the control environment and operating effectiveness of such controls. We utilised computer assisted audit techniques to recalculate aggregate revenue recognised by extracting independently volume data from the operational retail system and taking into account independently sourced or verified sales prices to address accuracy and existence. We also tested reconciliations between the operational retail and accounting systems to address completeness and cut-off. We have also carried out audit procedures, comprising validation of controls and tests of detail, in respect of cash counts and stock counts covering the retail sales business. In respect of terminal dues, we have carried out tests of detail by recalculating revenue recognised during the year on the basis of volume data accumulated over time. We have validated volume data to third party documentation or documentation duly approved by third parties. We have also validated volume data by carrying out tests as sequence checks and other data validation tests. We have validated terminal dues rates to contractual arrangements or other supporting documentation. We have also tested revenue recognised in

Key audit matter	How our audit addressed the Key audit matter
Relevant references in the Annual Report: - Accounting policy: Note 1.27; and - Note on postal sales and other revenues: Note 28.	respect of terminal dues within the accounting system to amounts invoiced and the subsequent receipt of payment. We found no significant exceptions in our controls testing and no material misstatements were identified in our substantive testing.

How we tailored our group audit scope

The Group is composed of four components: Lombard Bank Malta p.l.c. (the parent company), and its subsidiaries Redbox Limited, MaltaPost p.l.c. and Tanseana Limited. MaltaPost p.l.c. has been determined to be a financially significant entity. We tailored the scope of our audit in order to perform sufficient work on all components to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates, and local statutory requirements.

The Group audit team performed all of this work by applying the Group overall materiality, together with additional procedures performed on the consolidation. This gave us sufficient appropriate audit evidence for our opinion on the Group financial statements as a whole.

Other information

The directors are responsible for the other information. The other information comprises the Chairman's Statement to the Members, the Chief Executive Officer's Review, the Directors' Report, the Remuneration Report, the Company Information, the Additional Regulatory Disclosures, and the Five Year Summary.

The other information does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information, including the Directors' Report.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above 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.

With respect to the Directors' Report, we also considered whether the Directors' Report includes the disclosures required by Article 177 of the Maltese Companies Act (Cap. 386).

Independent Auditor's Report *(continued)*
To the Shareholders of Lombard Bank Malta p.l.c.

Based on the work we have performed, in our opinion:

- The information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- The Directors' Report has been prepared in accordance with the Maltese Companies Act (Cap. 386).

In addition, in light of the knowledge and understanding of the Group and the Bank and its environment obtained in the course of the audit, we are required to report if we have identified material misstatements in the Directors' Report and other information that we obtained prior to the date of this auditor's report. We have nothing to report in this regard.

Responsibilities of the directors and those charged with governance for the financial statements

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with IFRSs as adopted by the EU and the requirements of the Maltese Banking Act (Cap. 371) and the Maltese Companies Act (Cap. 386), 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 Group's and the Bank'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 Group or the Bank or to cease operations, or have no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's and the Bank's financial reporting process.

Auditor's 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 auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- 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 Group's and the Bank'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 Group's or the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's 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 auditor's report. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and the Bank's ability to continue as a going concern. In particular, it is difficult to evaluate all of the potential implications that COVID-19 will have on the Group's and the Bank's assets and liabilities and the disruption to the respective operations and the overall economy.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance 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 those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to 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 those charged with governance, 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 auditor's 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.

Report on other legal and regulatory requirements

Report on the statement of compliance with the Principles of Good Corporate Governance

The Listing Rules issued by the Malta Listing Authority require the directors to prepare and include in their Annual Report a Statement of Compliance providing an explanation of the extent to which they have adopted the Code of Principles of Good Corporate Governance and the effective measures that they have taken to ensure compliance throughout the accounting period with those Principles.

Independent Auditor's Report *(continued)*
To the Shareholders of Lombard Bank Malta p.l.c.

The Listing Rules also require the auditor to include a report on the Statement of Compliance prepared by the directors.

We read the Statement of Compliance and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements included in the Annual Report. Our responsibilities do not extend to considering whether this statement is consistent with any other information included in the Annual Report.

We are not required to, and we do not, consider whether the Board's statements on internal control included in the Statement of Compliance cover all risks and controls, or form an opinion on the effectiveness of the Company's corporate governance procedures or its risk and control procedures.

In our opinion, the Statement of Compliance set out on pages 20 to 27 has been properly prepared in accordance with the requirements of the Listing Rules issued by the Malta Listing Authority.

Opinion on other matters prescribed by the Maltese Banking Act (Cap. 371)

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 of those books;
- the Bank's financial statements are in agreement with the books of account; and
- to the best of our knowledge and according to the explanations given to us, the financial statements give the information required by any law in force in the manner so required.

Other matters on which we are required to report by exception

We also have responsibilities under:

- The Maltese Companies Act (Cap. 386) to report to you if, in our opinion:
  - returns adequate for our audit have not been received from branches not visited by us; and
  - certain disclosures of Directors' remuneration specified by law are not made in the financial statements, giving the required particulars in our report.
- The Listing Rules to review the statement made by the Directors that the business is a going concern together with supporting assumptions or qualifications as necessary.

We have nothing to report to you in respect of these responsibilities.

Independent Auditor's Report *(continued)*
To the Shareholders of Lombard Bank Malta p.l.c.

Appointment

We were first appointed as auditors of the Bank on 10 April 2010. Our appointment has been renewed annually by shareholder resolution representing a total period of uninterrupted engagement appointment of 10 years.

PricewaterhouseCoopers
78, Mill Street
Qormi
Malta

Simon Flynn
Partner

23 March 2020

FINANCIAL STATEMENTS

For the Year Ended 31 December 2019

2019

Statements of Financial Position

As at 31 December 2019

	Notes	Group 2019 € 000	Group 2018 € 000	Bank 2019 € 000	Bank 2018 € 000
Assets					
Balances with Central Bank of Malta, treasury bills and cash	5	**182,348**	128,726	**181,701**	128,143
Cheques in course of collection		**1,214**	1,422	**1,214**	1,422
Investments	6	**111,731**	100,070	**107,806**	96,245
Loans and advances to banks	7	**121,060**	140,581	**115,678**	125,819
Loans and advances to customers	8	**552,043**	511,124	**552,055**	511,124
Investment in subsidiaries	9	**-**	-	**15,732**	15,732
Investment in associate	10	**1,684**	1,684	**1,645**	1,645
Intangible assets	11	**2,000**	1,701	**399**	375
Property, plant and equipment	12	**43,348**	38,554	**23,536**	21,449
Assets classified as held for sale	8	**134**	778	**134**	778
Current tax assets		**193**	865	**-**	681
Deferred tax assets	14	**9,801**	9,221	**9,258**	8,639
Inventories	15	**1,468**	1,360	**804**	754
Trade and other receivables	16	**5,625**	5,010	**1,817**	1,812
Accrued income and other assets	17	**9,648**	8,973	**4,380**	4,618
Total assets		**1,042,297**	950,069	**1,016,159**	919,236

LOMBARD

Statements of Financial Position *(continued)*

As at 31 December 2019

	Notes	Group		Bank	
		2019	2018	**2019**	2018
		€ 000	€ 000	**€ 000**	€ 000
Equity and Liabilities					
Equity					
Share capital	18	**11,044**	11,044	**11,044**	11,044
Share premium	19	**18,530**	18,530	**18,530**	18,530
Revaluation and other reserves	19	**19,832**	17,356	**17,901**	15,490
Retained earnings		**69,722**	61,380	**67,137**	59,097
Equity attributable to equity holders of the Bank		**119,128**	108,310	**114,612**	104,161
Non-controlling interests		**7,674**	7,525	**-**	-
Total equity		**126,802**	115,835	**114,612**	104,161
Liabilities					
Amounts owed to banks	20	**5,871**	854	**5,871**	854
Amounts owed to customers	21	**864,993**	788,044	**868,832**	790,073
Provisions for liabilities and other charges	22	**3,236**	3,135	**1,173**	1,107
Current tax liabilities		**1,128**	-	**1,124**	-
Deferred tax liabilities	14	**6,832**	5,264	**5,804**	4,236
Other liabilities	23	**21,949**	27,138	**13,271**	14,070
Accruals and deferred income	24	**11,486**	9,799	**5,472**	4,735
Total liabilities		**915,495**	834,234	**901,547**	815,075
Total equity and liabilities		**1,042,297**	950,069	**1,016,159**	919,236
Memorandum items					
Contingent liabilities	25	**11,671**	14,148	**11,773**	14,167
Commitments	25	**225,826**	202,384	**226,934**	202,384

The notes on pages 55 to 167 are an integral part of these financial statements.

These financial statements on pages 46 to 167 are approved and authorised for issue by the Board of Directors on 23 March 2020 and signed on its behalf by:

Michael C. Bonello
Chairman

Joseph Said
Director and Chief Executive Officer

LOMBARD

Income Statements

For the Year Ended 31 December 2019

	Notes	Group 2019 € 000	Group 2018 € 000	Bank 2019 € 000	Bank 2018 € 000
Interest receivable and similar income					
- on loans and advances, balances with Central Bank of Malta and treasury bills	26	**23,298**	21,470	**23,238**	21,430
- on debt and other fixed income instruments	26	**1,987**	1,718	**1,859**	1,594
Interest expense	26	**(5,605)**	(5,677)	**(5,541)**	(5,677)
Net interest income		**19,680**	17,511	**19,556**	17,347
Fee and commission income	27	**5,622**	5,051	**4,421**	3,889
Fee and commission expense	27	**(217)**	(335)	**(217)**	(336)
Net fee and commission income		**5,405**	4,716	**4,204**	3,553
Postal sales and other revenues	28	**33,559**	39,254	**567**	425
Dividend income	29	**211**	369	**1,868**	1,970
Net trading income	30	**992**	880	**927**	862
Other operating income		**90**	55	**417**	377
Operating income		**59,937**	62,785	**27,539**	24,534
Employee compensation and benefits	31	**(23,044)**	(20,765)	**(7,029)**	(6,368)
Other operating costs	33	**(18,936)**	(26,477)	**(5,171)**	(4,634)
Depreciation and amortisation	11,12	**(2,054)**	(1,588)	**(775)**	(625)
Provisions for liabilities and other charges	22	**(60)**	(60)	**(18)**	(20)
Credit impairment losses	32	**(549)**	(234)	**(551)**	(258)
Operating profit		**15,294**	13,661	**13,995**	12,629
Share of profit of investment accounted for using the equity method, net of tax	10	**-**	109	**-**	-
Profit before taxation		**15,294**	13,770	**13,995**	12,629
Income tax expense	34	**(5,424)**	(4,831)	**(4,977)**	(4,448)
Profit for the year		**9,870**	8,939	**9,018**	8,181
Attributable to:					
Equity holders of the Bank		**9,320**	8,447	**9,018**	8,181
Non-controlling interests		**550**	492	**-**	-
Profit for the year		**9,870**	8,939	**9,018**	8,181
Earnings per share	35	**21c1**	19c1		

The notes on pages 55 to 167 are an integral part of these financial statements.

Statements of Comprehensive Income

For the Year Ended 31 December 2019

Group	Notes	**2019 € 000**	2018 € 000
Profit for the year		**9,870**	8,939
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss			
Investments measured at FVOCI			
Net gain/(loss) in fair value, before tax	6	**6,555**	(1,621)
Net loss on financial assets reclassified to profit or loss on disposal, before tax		**(150)**	(59)
Net gain attributable to change in credit risk		**20**	107
Income taxes	34	**(2,182)**	538
Items that will not be reclassified to profit or loss			
Net (loss)/gain on investments in equity instruments measured at FVOCI	6	**(1,824)**	2,846
Surplus arising on revaluation of land and buildings		**-**	5,564
Remeasurements of defined benefit obligations		**(146)**	(11)
Income taxes	34	**689**	(1,855)
Other comprehensive income for the year, net of income tax		**2,962**	5,509
Total comprehensive income for the year, net of income tax		**12,832**	14,448
Attributable to:			
Equity holders of the Bank		**12,254**	13,228
Non-controlling interests		**578**	1,220
Total comprehensive income for the year, net of income tax		**12,832**	14,448

Bank	Notes	**2019 € 000**	2018 € 000
Profit for the year		**9,018**	8,181
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss			
Investments measured at FVOCI			
Net gain/(loss) in fair value, before tax	6	**6,367**	(1,587)
Net loss on financial assets reclassified to profit or loss on disposal, before tax		**(150)**	(59)
Net gain attributable to change in credit risk		**20**	107
Income taxes	34	**(2,182)**	538
Items that will not be reclassified to profit or loss			
Net (loss)/gain on investments in equity instruments measured at FVOCI	6	**(1,824)**	2,847
Surplus arising on revaluation of land and buildings		**-**	2,717
Income taxes	34	**638**	(1,608)
Other comprehensive income for the year, net of income tax		**2,869**	2,955
Total comprehensive income for the year, net of income tax		**11,887**	11,136

The notes on pages 55 to 167 are an integral part of these financial statements.

Statements of Changes in Equity

For the Year Ended 31 December 2019

Group	Notes	Share capital € 000	Share premium € 000	Revaluation and other reserves € 000	Retained earnings € 000	Total € 000	Non-controlling interests € 000	Total equity € 000
		Attributable to equity holders of the Bank						
At 31 December 2017		11,044	18,530	12,662	53,904	96,140	6,734	102,874
Changes on initial application of IFRS 9	1.2	-	-	36	53	89	-	89
At 1 January 2018 - restated balance		11,044	18,530	12,698	53,957	96,229	6,734	102,963
Comprehensive income								
Profit for the year		-	-	-	8,447	8,447	492	8,939
Other comprehensive income								
Fair valuation of land and buildings, net of tax		-	-	3,962	-	3,962	739	4,701
Fair valuation of financial assets measured at FVOCI:								
Net changes in fair value arising during the year		-	-	794	-	794	(11)	783
Reclassification adjustments - net amounts reclassified to profit or loss		-	-	(38)	-	(38)	-	(38)
Net change attributable to changes in credit risk		-	-	70	-	70	-	70
Remeasurements of deferred benefit obligations		-	-	(5)	-	(5)	(2)	(7)
Transfers and other movements		-	-	(125)	125	-	-	-
Total other comprehensive income for the year		-	-	4,658	125	4,783	726	5,509
Total comprehensive income for the year		-	-	4,658	8,572	13,230	1,218	14,448
Transactions with owners, recorded directly in equity								
Contributions by and distributions to owners								
Dividends to equity holders	36	-	-	-	(1,149)	(1,149)	(427)	(1,576)
Total transactions with owners		-	-	-	(1,149)	(1,149)	(427)	(1,576)
At 31 December 2018		11,044	18,530	17,356	61,380	108,310	7,525	115,835

The notes on pages 55 to 167 are an integral part of these financial statements.

LOMBARD

Statements of Changes in Equity

For the Year Ended 31 December 2019

Group		Attributable to equity holders of the Bank						
	Note	Share capital € 000	Share premium € 000	Revaluation and other reserves € 000	Retained earnings € 000	Total € 000	Non-controlling interests € 000	Total equity € 000
At 1 January 2019		**11,044**	**18,530**	**17,356**	**61,380**	**108,310**	**7,525**	**115,835**
Comprehensive income								
Profit for the year		-	-	-	**9,320**	**9,320**	**550**	**9,870**
Other comprehensive income								
Fair valuation of financial assets measured at FVOCI:								
Net changes in fair value arising during the year		-	-	**3,088**	-	**3,088**	**54**	**3,142**
Reclassification adjustments - net amounts reclassified to profit or loss		-	-	**(98)**	-	**(98)**	-	**(98)**
Net change attributable to changes in credit risk		-	-	**13**	-	**13**	-	**13**
Remeasurements of deferred benefit obligations		-	-	**(69)**	-	**(69)**	**(26)**	**(95)**
Transfers and other movements		-	-	**(458)**	**458**	-	-	-
Total other comprehensive income for the year		-	-	**2,476**	**458**	**2,934**	**28**	**2,962**
Total comprehensive income for the year		-	-	**2,476**	**9,778**	**12,254**	**578**	**12,832**
Transactions with owners, recorded directly in equity								
Contributions by and distributions to owners								
Dividends to equity holders	36	-	-	-	**(1,436)**	**(1,436)**	**(429)**	**(1,865)**
Total transactions with owners		-	-	-	**(1,436)**	**(1,436)**	**(429)**	**(1,865)**
At 31 December 2019		**11,044**	**18,530**	**19,832**	**69,722**	**119,128**	**7,674**	**126,802**

The notes on pages 55 to 167 are an integral part of these financial statements.

LOMBARD

Statements of Changes in Equity

For the Year Ended 31 December 2019

Bank

	Notes	Share capital € 000	Share premium € 000	Revaluation and other reserves € 000	Retained earnings € 000	Total € 000
At 31 December 2017		11,044	18,530	12,624	51,887	94,085
Changes on initial application of IFRS 9	1.2	-	-	36	53	89
At 1 January 2018 - restated balance		11,044	18,530	12,660	51,940	94,174
Comprehensive income						
Profit for the year		-	-	-	8,181	8,181
Other comprehensive income						
Fair valuation of land and buildings, net of tax		-	-	2,105	-	2,105
Fair valuation of financial assets measured at FVOCI:						
Net changes in fair value arising during the year		-	-	818	-	818
Reclassification adjustments - net amounts reclassified to profit or loss		-	-	(38)	-	(38)
Net change attributable to changes in credit risk		-	-	70	-	70
Transfers and other movements		-	-	(125)	125	-
Total other comprehensive income for the year		-	-	2,830	125	2,955
Total comprehensive income for the year		-	-	2,830	8,306	11,136
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Dividends to equity holders	36	-	-	-	(1,149)	(1,149)
Total transactions with owners		-	-	-	(1,149)	(1,149)
At 31 December 2018		11,044	18,530	15,490	59,097	104,161

The notes on pages 55 to 167 are an integral part of these financial statements.

Statements of Changes in Equity

For the Year Ended 31 December 2019

Bank

	Note	Share capital € 000	Share premium € 000	Revaluation and other reserves € 000	Retained earnings € 000	Total € 000
At 1 January 2019		**11,044**	**18,530**	**15,490**	**59,097**	**104,161**
Comprehensive income						
Profit for the year		-	-	-	**9,018**	**9,018**
Other comprehensive income						
Fair valuation of financial assets measured at FVOCI:						
Net changes in fair value arising during the year		-	-	**2,954**	-	**2,954**
Reclassification adjustments - net amounts reclassified to profit or loss		-	-	**(98)**	-	**(98)**
Net change attributable to changes in credit risk		-	-	**13**	-	**13**
Transfers and other movements		-	-	**(458)**	**458**	-
Total other comprehensive income for the year		-	-	**2,411**	**458**	**2,869**
Total comprehensive income for the year		-	-	**2,411**	**9,476**	**11,887**
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Dividends to equity holders	36	-	-	-	**(1,436)**	**(1,436)**
Total transactions with owners		-	-	-	**(1,436)**	**(1,436)**
At 31 December 2019		**11,044**	**18,530**	**17,901**	**67,137**	**114,612**

The notes on pages 55 to 167 are an integral part of these financial statements.

Statements of Cash Flows

For the Year Ended 31 December 2019

	Notes	Group 2019 € 000	Group 2018 € 000	Bank 2019 € 000	Bank 2018 € 000
Cash flows from operating activities					
Interest and commission receipts		**30,442**	27,546	**30,775**	27,871
Receipts from customers relating to postal sales and other revenue		**34,457**	51,778	**567**	425
Interest and commission payments		**(5,133)**	(5,844)	**(5,136)**	(5,844)
Payments to employees and suppliers		**(49,085)**	(51,464)	**(11,938)**	(11,070)
Cash flows from operating profit before changes in operating assets and liabilities		**10,681**	22,016	**14,268**	11,382
Decrease/(Increase) in operating assets:					
Treasury bills		**5,515**	(16,549)	**5,515**	(16,549)
Deposits with Central Bank of Malta		**(390)**	(529)	**(390)**	(529)
Loans and advances to banks and customers		**(34,248)**	(84,792)	**(34,748)**	(83,792)
Other receivables		**739**	(394)	**794**	(284)
Increase/(decrease) in operating liabilities:					
Amounts owed to banks and to customers		**76,961**	54,893	**78,759**	53,378
Other payables		**(2,002)**	(899)	**(2,057)**	(1,007)
Net cash generated from/(used in) operations		**57,256**	(26,254)	**62,141**	(37,401)
Income tax paid		**(4,131)**	(4,628)	**(3,767)**	(3,860)
Net cash flows generated from/(used in) operating activities		**53,125**	(30,882)	**58,374**	(41,261)
Cash flows from investing activities					
Dividends received		**211**	369	**1,868**	1,970
Interest received from investments		**2,325**	2,011	**2,145**	1,845
Purchase of investments		**(15,905)**	(27,850)	**(15,680)**	(27,350)
Proceeds on maturity/disposal of investments		**8,163**	4,406	**7,850**	4,156
Purchase of property, plant and equipment and intangible assets		**(3,345)**	(2,921)	**(1,597)**	(1,576)
Net cash flows used in investing activities		**(8,551)**	(23,985)	**(5,414)**	(20,955)
Cash flows from financing activities					
Dividends paid to equity holders of the Bank	36	**(1,436)**	(1,149)	**(1,436)**	(1,149)
Dividends paid to non-controlling interests		**(429)**	(427)	**-**	-
Net cash flows used in financing activities		**(1,865)**	(1,576)	**(1,436)**	(1,149)
Net increase/(decrease) in cash and cash equivalents		**42,709**	(56,443)	**51,524**	(63,365)
Cash and cash equivalents at beginning of year		**212,193**	268,636	**199,848**	263,213
Cash and cash equivalents at end of year	37	**254,902**	212,193	**251,372**	199,848

The notes on pages 55 to 167 are an integral part of these financial statements.

LOMBARD

Notes to the Financial Statements
For the Year Ended 31 December 2019

1 **Summary of significant accounting policies**

The principal accounting policies adopted in the preparation of these financial statements are set out below. Unless otherwise stated, these policies have been consistently applied to all the years presented and relate to both the Group and the Bank.

1.1 *Basis of preparation*

The consolidated financial statements include the financial statements of Lombard Bank Malta p.l.c. (the Bank) and its subsidiary undertakings (together referred to as 'the Group' and individually as 'Group entities'). The Bank's financial statements have been prepared in accordance with the requirements of International Financial Reporting Standards (IFRSs) as adopted by the EU and with the requirements of the Banking Act, 1994 (Chapter 371 of the Laws of Malta) and the Companies Act, 1995 (Chapter 386 of the Laws of Malta). These consolidated financial statements are prepared under the historical cost convention, as modified by the fair valuation of financial assets and financial liabilities.

The preparation of financial statements in conformity with IFRSs as adopted by the EU requires the use of certain accounting estimates. It also requires the Directors to exercise their judgement in the process of applying the Group's accounting policies (see note 3.1 – Critical accounting estimates, and judgements in applying the Group's accounting policies).

1.2 *Standards, interpretations and amendments to published standards effective in 2019*

In 2019, the Group adopted new standards, amendments and interpretations to existing standards that are mandatory for the Group's accounting period beginning on 1 January 2019.

IFRS 16 'Leases'

On 1 January 2019, the Group adopted the requirements of IFRS 16 using a modified retrospective approach. The adoption of the standard increased assets by €3.5m for the Group and €1.3m for the Bank. The financial liabilities increased by the same amount with no effect on net assets or retained earnings. Comparatives were not restated.

On adoption of IFRS 16, the Group recognised lease liabilities in relation to leases that had previously been classified as 'operating leases' in accordance with IAS 17 'Leases'. These liabilities were recognised in 'other liabilities' and measured at the present value of the remaining lease payments, discounted at the lessee's incremental borrowing rate at 1 January 2019. The associated right-of-use (ROU) assets were recognised and included with 'property, plant and equipment' on the face of the statements of financial position and measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments or provisions for onerous leases recognised on the balance sheet at 31 December 2018. In addition, the following practical expedients permitted by the standard were applied:

- applying a single discount rate to a portfolio of leases with reasonable similar characteristics;
- relying on previous assessments on whether leases are onerous as an alternative to performing an impairment review - there were no onerous contracts as at 1 January 2019;
- accounting for operating leases with a remaining lease term of less than 12 months as at 1 January 2019 as short-term leases;
- excluding initial direct costs for the measurement of the right-of-use asset at the date of initial application; and
- using hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

1 **Summary of significant accounting policies** *(continued)*

The differences between IAS 17 and IFRS 16 are summarised in the table below:

IAS 17	*IFRS 16*
Leases were classified as either finance or operating leases. Payments made under operating leases were charged to profit or loss on a straight-line basis over the period of the lease.	Leases are recognised as an ROU asset and a corresponding liability at the date at which the leased asset is made available for use. Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease term so as to produce a constant period rate of interest on the remaining balance of the liability. The ROU asset is depreciated over the shorter of the ROU asset's useful economic life and the lease term on a straight-line basis. In determining the lease term, the Group considers all facts and circumstances that create an economic incentive to exercise an extension option or not exercise a termination option over the planning horizon of five years. In general, it is not expected that the discount rate implicit in the lease is available so the Group's incremental borrowing rate is used. This is the rate that the Group would have to pay to borrow the funds necessary to obtain an asset of a similar value in a similar economic environment with similar terms and conditions.

In addition, the Group has adopted a number of interpretations and amendments to standards, which have had an insignificant effect on the consolidated financial statements of the Group and the separate financial statements of the Bank. In 2018, the Group adopted IFRS 9. The impact of this is included in the changes in equity for the respective financial year end.

1.3 *Standards, interpretations and amendments to published standards that are not yet effective*

Certain new standards, amendments and interpretations to existing standards which are mandatory for accounting periods beginning after 1 January 2020 have been published by the date of authorisation for issue of this financial information. The Group has not early adopted these requirements of IFRSs as adopted by the EU and the Group's Directors are of the opinion that, there are no requirements that will have a possible significant impact on the Bank's financial statements in the period of initial application.

1.4 *Consolidation*

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

The Group manages and administers investment vehicles on behalf of investors. The financial statements of these entities are not included in these financial statements, except when the Group controls the entity.

1 **Summary of significant accounting policies** *(continued)*

The Group uses the acquisition method of accounting to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets.

The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill. If this aggregate is less than the fair value of the identifiable net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in profit or loss.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. The accounting policies of the subsidiaries are consistent with the policies adopted by the Group. In the Bank's separate financial statements, investments in subsidiaries are accounted for by the cost method of accounting, i.e. at cost less impairment. Provisions are recorded where, in the opinion of the Directors, there is an impairment in value. Where there has been an impairment in the value of an investment, it is recognised as an expense in the period in which the diminution is identified. The results of subsidiaries are reflected in the Bank's separate financial statements only to the extent of dividends receivable. On disposal of an investment, the difference between the net disposal proceeds and the carrying amount is charged or credited to profit or loss.

1.5 *Segment reporting*

Operating segments are reported in a manner consistent with the internal reporting provided to the Board of Directors which is the Group's chief operating decision-maker.

An operating segment's operating results are reviewed regularly by the Board of Directors to make decisions about resources to be allocated to the segment and to assess its performance executing the function of the chief operating decision-maker.

1.6 *Foreign currency translation*

The financial statements are presented in euro (€), which is the Group's presentation currency.

1.6.1 Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in euro, which is the Group's functional and presentation currency.

1.6.2 Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are remeasured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

1 **Summary of significant accounting policies** *(continued)*

1.7 *Financial assets*

1.7.1 Initial recognition and measurement

The Group recognises a financial asset in its statement of financial position when it becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of financial assets are recognised on the trade date, which is the date on which the Group commits to purchase or sell the asset. Accordingly, the Bank uses trade date accounting for regular way contracts when recording financial asset transactions.

At initial recognition, the Bank measures a financial asset at its fair value plus or minus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset, such as fees and commissions. Transaction costs of financial assets carried at fair value through profit or loss are expensed in profit or loss. At initial recognition, an Expected Credit Loss allowance (ECL) is recognised for financial assets measured at amortised cost and investments in debt instruments measured at FVOCI, which results in an accounting loss being recognised in profit or loss when an asset is newly originated.

When the fair value of financial assets differs from the transaction price on initial recognition, the Group recognises the difference as follows:

- when the fair value is evidenced by a quoted price in an active market for an identical asset (i.e. a Level 1 input) or based on a valuation technique that uses only data from observable markets, the difference is recognised as a gain or loss;
- in all other cases, the difference is deferred and the timing of recognition of deferred day one profit or loss is determined individually. It is either amortised over the life of the instrument, deferred until the instrument's fair value can be determined using market observable inputs, or realised through settlement.

1.7.2 Classification and subsequent measurement

The Group classifies its financial assets in the following measurement categories:

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

1.7.2.1 Debt instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans, government and corporate bonds and trade receivables purchased from clients in factoring arrangements without recourse.

Classification and subsequent measurement of debt instruments depend on:

- the Group's business model for managing the asset; and
- the cash flow characteristics of the asset.

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

- Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest (SPPI), and that are not designated at FVPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any Expected Credit Loss allowance recognised and measured as described in note 1.7.3. Interest income from these financial assets is included in 'interest and similar income' using the effective interest rate method.

1 **Summary of significant accounting policies** *(continued)*

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

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

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

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset (i.e. its amortised cost before any impairment allowance) or to the amortised cost of a financial liability.

The calculation does not consider Expected Credit Losses and includes transaction costs, premiums or discounts and fees and points paid or received that are integral to the effective interest rate, such as origination fees. For purchased or originated credit-impaired (POCI) financial assets - assets that are credit-impaired at initial recognition - the Bank calculates the credit-adjusted effective interest rate, which is calculated based on the amortised cost of the financial asset instead of its gross carrying amount and incorporates the impact of Expected Credit Losses in estimated future cash flows.

When the Bank revises the estimates of future cash flows, the carrying amount of the respective financial assets or financial liability is adjusted to reflect the new estimate discounted using the original effective interest rate. Any changes are recognised in profit or loss.

The Bank reclassifies debt instruments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent and none occurred during the period.

1 **Summary of significant accounting policies** *(continued)*

(a) Business model assessment

Key management personnel determine the Group's business model by considering the way financial instruments are managed in order to generate cash flows. That is, whether the Group's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable (for example financial assets are held for trading purposes), then the financial assets are classified as part of 'other' business model and measured at FVPL. Such assessment is performed at a 'portfolio level' as it best reflects the way the business is managed and information is provided to management.

The information that will be considered in such assessment includes:

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

Financial assets that are held for trading and those that are managed and whose performance is evaluated on a fair value basis will be measured at FVPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets. Securities held for trading are held principally for the purpose of selling in the near term or are part of a portfolio of financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking.

The Bank may also irrevocably designate financial assets at fair value through profit or loss if doing so significantly reduces or eliminates a mismatch created by assets and liabilities being measured on different bases.

(b) Cash flows that represent solely payment of principal and interest (SPPI)

In respect of assets where the intention of the business model is to hold the financial assets to collect the contractual cash flows or to hold to collect and to sell, the Group assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the SPPI test). In making this assessment, the Group considers whether the contractual cash flows are consistent with a basic lending agreement. 'Principal' is the fair value of the financial asset at initial recognition. It is not the amount that is due under the contractual terms of an instrument. 'Interest' is the compensation for time value of money and credit risk of a basic lending-type return. A basic lending-type return could also include consideration for other basic lending risks (for example, liquidity risk) and consideration for costs associated with holding the financial asset for a particular period of time (for example, servicing or administrative costs) and/or a profit margin. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

1 **Summary of significant accounting policies** *(continued)*

Unlike the business model assessment, the SPPI assessment is performed for each individual product or portfolio of products. The following considerations are made when assessing consistency with SPPI:

- contingent events that would change the amount and timing of cash flows such as contractual term resetting interest to a higher amount in the event of a missed payment;
- leverage features, being contractual cash flow characteristics that increase the variability of the contractual cash flows with the result that they do not have economic characteristics of interest;
- contractual terms that allow the issuer to prepay (or the holder to put a debt instrument back to the issuer) before maturity and the prepayment amount substantially represents unpaid amounts of principal and interest, which may include reasonable compensation for early termination of the contract;
- contractual terms that allow the issuer or holder to extend the contractual term and the terms of the extension option result in contractual cash flows during the extension period that are solely payments of principal and interest, which may include reasonable compensation for the extension of the contract; and
- features that modify consideration for the time value of money (for example, periodic reset of interest rates).

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

1.7.2.2 Equity instruments

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

The Group subsequently measures all equity investments at fair value through profit or loss, except where the Group's management has elected, at initial recognition, to irrevocably designate an equity investment at fair value through other comprehensive income. The Group's policy is to designate equity investments as FVOCI when those investments are held for purposes other than to generate investment returns. When this election is used, fair value gains and losses are recognised in OCI and are not subsequently reclassified to profit or loss, including on disposal.

Impairment losses (and reversal of impairment losses) are not reported separately from other changes in fair value. Dividends, when representing a return on such investments, continue to be recognised in profit or loss as other income when the Group's right to receive payments is established.

Gains and losses on equity investments at FVPL are included in the 'net trading income' line in the income statement.

1 **Summary of significant accounting policies** *(continued)*

1.7.3 Impairment of financial assets

The Group assesses on a forward-looking basis the Expected Credit Losses (ECLs) associated with its debt instruments carried at amortised cost and FVOCI and with the exposure arising from loan commitments and financial guarantee contracts. The Group recognises a loss allowances for such losses at each reporting date. The measurement of ECLs reflects:

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

Note 2.3.4 provides more detail of how the Expected Credit Loss allowance is measured.

Expected credit loss allowances are presented in the statement of financial position as follows:

- financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- loan commitments and financial guarantee contracts: generally, as a provision;
- financial instrument with both a drawn and undrawn component, whereby the Group cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Group presents a combined loss allowance for both components, as a deduction from the gross carrying amount of the drawn component; and
- debt instruments measured at FVOCI: no loss allowance is recognised in the statement of financial position against the carrying amount of the asset because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the fair value reserve, i.e. presented within other comprehensive income.

1.7.4 Modification of loans and advances to customers

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer.

The Group renegotiates loans and advances to customers in financial difficulties (referred to as 'forbearance activities') to maximise collection opportunities and minimise the risk of default. Under the Group's forbearance policy, loan forbearance is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms, and the debtor is expected to be able to meet the revised terms. The revised terms usually include extending the maturity, revision of interest rate and changing the timing of interest payments. Both retail and corporate loans are subject to the forbearance policy.

When modification happens, the Group assesses whether or not the new terms are substantially different to the original terms. The Group does this by considering, among others, the following factors:

- if the borrower is in financial difficulty, whether the modification merely reduces the contractual cash flows to amounts the borrower is expected to be able to pay;
- whether any substantial new terms are introduced;
- significant extension of the loan term when the borrower is not in financial difficulty;
- significant change in the interest rate; and
- insertion of collateral, other security or credit enhancements that significantly affect the credit risk associated with the loan.

1 **Summary of significant accounting policies** *(continued)*

If the terms are substantially different, the Group derecognises the original financial asset and recognises a 'new' asset at fair value, and recalculates a new effective interest rate for the asset. The date of renegotiation is consequently considered to be the date of initial recognition for impairment calculation purposes, including for the purpose of determining whether a significant increase in credit risk has occurred. However, the Group also assesses whether the new financial asset recognised is deemed to be credit-impaired at initial recognition, especially in circumstances where the renegotiation was driven by the debtor being unable to make the originally agreed payments. Differences in the carrying amount are also recognised in profit or loss as a gain or loss on derecognition.

If the terms are not substantially different, the renegotiation or modification does not result in derecognition, and the Group recalculates the gross carrying amount based on the revised cash flows of the financial asset and recognises a modification gain or loss in profit or loss.

The new gross carrying amount is recalculated by discounting the modified cash flows at the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets). The impact of modifications of financial assets on the Expected Credit Loss calculation is discussed in note 2.3.9.

1.7.5 Derivative financial instruments

The Group deploys no hedging strategies that achieve hedge accounting in terms of IAS 39.

Derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into, and are subsequently remeasured at their fair value. Fair values are obtained from valuation techniques for over-the-counter derivatives, including discounted cash flow models. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative. Fair values for currency forwards are determined using forward exchange market rates at the end of the reporting period. Discounting techniques, reflecting the fact that the respective exchange or settlement will not occur until a future date, are used when the time value of money has a significant effect on the fair valuation of these instruments.

Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in profit or loss.

The Group uses derivatives such as cross currency swaps and forward foreign exchange contracts.

1.8 *Offsetting financial instruments*

Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is possible that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to profit or loss during the financial period in which they are incurred.

1 **Summary of significant accounting policies** *(continued)*

1.9 *Investments in subsidiaries*

The Group classifies investments in entities which it controls as subsidiaries.

The Group's investments in subsidiaries are stated at cost less impairment losses in the Group's stand-alone financial statements. Impairment losses recognised in prior periods are reversed through profit or loss if there has been a change in the estimates used to determine the investment's recoverable amount since the last impairment loss was recognised.

1.10 *Investment in associate*

Associates are all entities over which the Group has significant influence but not control or joint control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting in the consolidated financial statements, after initially being recognised at cost. Under the equity method of accounting, the investment is initially recognised at cost, and the carrying amount is adjusted thereafter to recognise the Group's share of the post-acquisition profits or losses of the investee in profit or loss, and the Group's share of movements in other comprehensive income of the investee in other comprehensive income. The Group's investment in associates includes goodwill identified on acquisition. Dividends received or receivable from associates are recognised as a reduction in the carrying amount of the investment.

When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the associate.

The Group determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognises the amount adjacent to 'share of profit/(loss) of associates' in the income statement.

Profits and losses resulting from upstream and downstream transactions between the Group and its associate are recognised in the Group's financial statements only to the extent of unrelated investor's interests in the associates. Unrealised losses are eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income is reclassified to profit or loss where appropriate.

Dilution gains and losses arising in investments in associates are recognised in the income statement.

In the Bank's separate financial statements, investments in associates are accounted for by the cost method of accounting, i.e. at cost less impairment. Provisions are recorded where, in the opinion of the Directors, there is impairment in value. Where there has been impairment in the value of an investment, it is recognised as an expense in the period in which the diminution is identified. The results of the associate are reflected in the Bank's separate financial statements only to the extent of dividends receivable. On disposal of an investment, the difference between the net disposal proceeds and the carrying amount is charged or credited to profit or loss.

1 **Summary of significant accounting policies** *(continued)*

1.11 *Intangible assets*

1.11.1 Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable net assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in 'intangible assets'.

Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose, identified according to operating segment. A cash-generating unit to which goodwill has been allocated is tested for impairment annually, and whenever there is an indication that the unit may be impaired by comparing the carrying amount of the unit, including the goodwill, with the recoverable amount of the unit. The recoverable amount is the higher of fair value less costs to sell and value in use.

1.11.2 Computer software

Costs incurred to acquire and bring to use specific software are capitalised and amortised on the basis of the expected useful lives. Software has a maximum expected useful life of four years.

1.12 *Property, plant and equipment*

All property, plant and equipment used by the Group is initially recorded at historical cost, including transaction costs and borrowing costs. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Freehold and long leasehold properties (land and buildings) comprise mainly branches and offices. Land and buildings are shown at fair value based on periodic valuations by external independent valuers, less subsequent depreciation for buildings. Valuations are carried out on a regular basis such that the carrying amount of property does not differ materially from that which would be determined using fair values at the end of the reporting period. 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.

All other property, plant and equipment is stated at historical cost less accumulated depreciation.

Borrowing costs which are incurred for the purpose of acquiring or constructing a qualifying asset are capitalised as part of its cost. Borrowing costs are capitalised while acquisition or construction is actively underway. Capitalisation of borrowing costs is ceased once the asset is substantially complete, and is suspended if the development of the asset is suspended.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to profit or loss during the financial period in which they are incurred.

Increases in the carrying amount arising on revaluation of land and buildings are credited to other comprehensive income and shown as a revaluation reserve in shareholders' equity. Decreases that offset previous increases of the same asset are charged to other comprehensive income and debited against the revaluation reserve directly in equity; all other decreases are charged to profit or loss.

1 **Summary of significant accounting policies** *(continued)*

Land is not depreciated as it is deemed to have an indefinite life. Depreciation on other assets is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives, as follows:

	Years
Buildings	100 or over period of lease/arrangement
Leasehold property	Over period of lease/arrangement
Computer equipment	4
Other	4 – 8

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see note 1.13).

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised in profit or loss. When revalued assets are sold, the amounts included in the revaluation reserve relating to that asset are transferred to retained earnings.

1.13 *Impairment of non-financial assets*

Assets that have an indefinite useful life, for example goodwill or certain intangible assets, are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows (cash-generating units). The impairment test also can be performed on a single asset when the fair value less costs to sell or the value in use can be determined reliably. Non-financial assets other than goodwill that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

1.14 *Repossessed property*

In certain circumstances, property is repossessed following the foreclosure on loans that are in default. Repossessed properties are measured at the lower of carrying amount and fair value less costs to sell.

1.15 *Non-current assets held for sale*

Non-current assets are classified as assets held for sale and are stated at the lower of carrying amount and fair value less costs to sell when their carrying amount is to be recovered principally through a sale transaction rather than through continuing use and a sale is considered highly probable.

1.16 *Current and deferred income tax*

The tax expense for the period comprises current and deferred tax. Tax is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, respectively.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period.

1 **Summary of significant accounting policies** *(continued)*

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill; deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

1.17 *Inventories*

Inventories are stated at the lower of cost and net realisable value. The cost of postal stationery and inventories held for resale is determined on a weighted average cost basis. The cost of inventories is determined on a first-in first-out basis. The cost of inventories comprise the invoiced value of goods sold and in general includes transport and handling costs. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

1.18 *Trade and other receivables*

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets.

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provisions for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in profit or loss. When a receivable is uncollectible, it is written off against the allowance account for trade and other receivables. Subsequent recoveries of amounts previously written off are credited in profit or loss.

1.19 *Share capital*

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new ordinary shares are shown in equity as a deduction, net of tax, from the proceeds.

1 **Summary of significant accounting policies** *(continued)*

1.20 *Financial liabilities*

1.20.1 Initial recognition and measurement

The Group recognises a financial liability on its statement of financial position when it becomes a party to the contractual provisions of the instrument. Financial liabilities not at fair value through profit or loss are recognised initially at fair value, being the fair value of consideration received, net of transaction costs that are directly attributable to the acquisition or the issue of the financial liability.

1.20.2 Classification and subsequent measurement

Financial liabilities are classified as subsequently measured at amortised cost, except for:

- financial liabilities at fair value through profit or loss: this classification is applied to derivatives, financial liabilities held for trading (for example, short positions in the trading booking) and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at fair value through profit or loss are presented partially in other comprehensive income (the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability, which is determined as the amount that is not attributable to changes in market conditions that give rise to market risk) and partially profit or loss (the remaining amount of change in the fair value of the liability). This is unless such a presentation would create, or enlarge, an accounting mismatch, in which case the gains and losses attributable to changes in the credit risk of the liability are also presented in profit or loss;
- financial liabilities arising from the transfer of financial assets which did not qualify for derecognition, whereby a financial liability is recognised for the consideration received for the transfer. In subsequent periods, the Group recognises any expense incurred on the financial liability; and
- financial guarantee contracts and loan commitments (see note 1.30).

The Group's financial liabilities were classified as financial liabilities which were not at fair value through profit or loss (classified as 'other liabilities') under IAS 39. These liabilities were subsequently measured at amortised cost.

Financial liabilities measured at amortised cost comprise principally amounts owed to banks, amounts owed to customers, debt securities in issue together with other liabilities.

1.20.3 Derecognition

The Group derecognises a financial liability from its statement of financial position when the obligation specified in the contract or arrangement is discharged, is cancelled or expires.

The exchange between the Group and its original lenders of debt instruments with substantially different terms, as well as substantial modifications of the terms of existing financial liabilities, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10% different from the discounted present value of the remaining cash flows of the original financial liability.

1 **Summary of significant accounting policies** *(continued)*

In addition, other qualitative factors, such as the currency that the instrument is denominated in, changes in the type of interest rate, new conversion features attached to the instrument and change in covenants are also taken into consideration. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.

1.21 *Repurchase and reverse repurchase agreements*

Securities sold under agreements to repurchase at a specified future date are not derecognised from the statement of financial position as the Group retains substantially all of the risks and rewards of ownership. The corresponding cash received is recognised in the statement of financial position as an asset with a corresponding obligation to return it, including accrued interest as a liability, reflecting the transaction's economic substance as a loan to the Group. The difference between the sale and repurchase prices is treated as interest expense and is accrued over the life of agreement using the effective interest rate.

When the counterparty has the right to sell or repledge the securities, the Bank reclassifies those securities in its statement of financial position to financial assets held for trading pledged as collateral or to financial investments available-for-sale pledged as collateral, as appropriate.

Conversely, securities purchased under agreements to resell at a specified future date are not recognised in the statement of financial position. The consideration paid, including accrued interest, is recorded in the statement of financial position, reflecting the transaction's economic substance as a loan by the Bank. The difference between the purchase and resale prices is recorded in net interest income and is accrued over the life of the agreement using the effective interest rate.

If securities purchased under agreement to resell are subsequently sold to third parties, the obligation to return the securities is recorded as a short sale within financial liabilities held for trading and measured at fair value with any gains or losses included in net trading income.

1.22 *Trade and other payables*

Trade payables comprise obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities. Trade and other payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

1.23 *Provisions for legal and other claims*

Provisions for legal and other claims are recognised when: the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

1 **Summary of significant accounting policies** *(continued)*

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

1.24 *Provision for pension obligations*

A subsidiary of the Bank provides for the obligation arising in terms of Article 8A of the Pensions Ordinance, (Chapter 93 of the Laws of Malta), covering those former Government employees who opted to become full-time employees of the subsidiary of the Bank, and who continued to be entitled to pension benefits which go beyond the National Insurance Scheme.

The pension related accounting costs are assessed using the projected unit credit method. Under this method, the cost of the subsidiary's obligation is charged to profit or loss so as to spread the cost over the years of service giving rise to entitlement to benefits in accordance with actuarial techniques. The obligation is measured as the present value of the estimated future cash outflows using interest rates of long-term Government bonds which have terms to maturity approximating the terms of the related liability. Subsequent to the adoption of IAS 19 (revised 2011), all actuarial gains and losses are charged or credited to equity in other comprehensive income in the period in which they arise.

1.25 *Interest income and expense*

Interest income and expense for all interest-bearing financial instruments are recognised within 'interest income' and 'interest expense' in the profit or loss using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset (i.e. its amortised cost before any impairment allowance) or to the amortised cost of a financial liability.

The calculation does not consider Expected Credit Losses and includes transaction costs, premiums or discounts and fees and points paid or received that are integral to the effective interest rate, such as origination fees. For purchased or originated credit-impaired (POCI) financial assets - assets that are credit-impaired at initial recognition - the Group calculates the credit-adjusted effective interest rate, which is calculated based on the amortised cost of the financial asset instead of its gross carrying amount and incorporates the impact of Expected Credit Losses in estimated future cash flows.

1.26 *Fees and commissions*

Fee and commission income and expense that are an integral part of the effective interest rate on a financial asset or liability are included in the calculation of the effective interest rate and treated as part of effective interest. Other fees and commissions are generally recognised on an accrual basis when the service has been provided.

Fee and commission income, comprising account servicing fees, investment management fees, placement fees and other similar fees, are recognised as the related services are performed.

1 **Summary of significant accounting policies** *(continued)*

Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan. When a loan commitment is not expected to result in the drawdown of a loan, the related loan commitment fees are recognised on a straight-line basis over the commitment period. Fee and commission expense, relating mainly to transaction and service fees, are expensed as the services are received.

1.27 *Postal sales and service income*

Postal sales and service revenue comprises the fair value of the consideration received or receivable for the sale of services in the ordinary course of the subsidiary's activities. Revenue is shown net of sales taxes and discounts. It comprises revenue directly received from customers, commissions earned on postal and non-postal transactions and income from foreign outbound mail receivable from overseas postal administrators.

Income from sale of stamps, commission earned on postal and non-postal transactions and revenue from foreign outbound mail from overseas postal administrators is recognised when the service is rendered. Allowance is made for the assessed amount of revenue from prepaid product sales at the end of the reporting period for which the service has not yet been provided. In the case of services rendered to postal administrators in countries subject to severe exchange control restrictions and undue delays in settlement, revenue is not recognised until the subsidiary is in a position to ensure that the economic benefits associated with the transaction will flow to it, which is often upon or shortly before actual receipt.

1.28 *Dividend income*

Dividends are recognised in profit or loss in 'dividend income' when the entity's right to receive payment is established.

1.29 *Leases*

1.29.1 When a Group company is the lessee

(a) Applicable as from 1 January 2019

The Group recognises lease liabilities in relation to leases within 'other liabilities'. The lease liability is measured at the present value of the remaining lease payments, discounted at the Group's incremental borrowing rate. The associated right-of-use (ROU) assets are recognised and included within 'property, plant and equipment' and are measured at the amount equal to the lease liability.

The Group applies the following practical expedients:

- a single discount rate is applied to a portfolio of leases with reasonable similar characteristics;
- an assessment is performed on whether leases are onerous; and
- hindsight is used in determining the lease term where the contract contains options to extend or terminate the lease.

Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease term.

The ROU asset is depreciated over the shorter of the ROU asset's useful economic life and the lease term on a straight-line basis.

1 **Summary of significant accounting policies** *(continued)*

The leases with a remaining lease term of less than 12 months are accounted as short-term operating leases.

Payments made under operating leases (net of any incentives received from the lessor) were charged to profit or loss on a straight-line basis over the period of the lease.

(b) Applicable until 31 December 2018

Leases in which a significant portion of the risks and rewards of ownership were retained by the lessor were classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) were charged to profit or loss on a straight-line basis over the period of the lease.

1.30 *Financial guarantee contracts and loan commitments*

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and other bodies on behalf of customers.

In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit, guarantees and acceptances.

Financial guarantee contracts are initially measured at fair value and subsequently measured at higher of:

- the amount of the loss allowance (calculated as described in note 1.7.3); and
- the premium received on initial recognition less income recognised in accordance with the principles of IFRS 15.

'Loan commitments' are the Bank's commitments to provide credit under pre-specified terms and conditions, and are measured as the amount of the loss allowance (calculated as described in note 1.7.3).

For loan commitments and financial guarantee contracts, the loss allowance is recognised as a provision. However, for contracts that include both a loan and an undrawn commitment and the Bank cannot separately identify the Expected Credit Losses on the undrawn commitment component from those on the loan component, the Expected Credit Losses on the undrawn commitment are recognised together with the loss allowance for the loan. To the extent that the combined Expected Credit Losses exceed the gross carrying amount of the loan, the Expected Credit Losses are recognised as a provision.

1 Summary of significant accounting policies *(continued)*

1.31 *Cash and cash equivalents*

Cash and cash equivalents are carried in the statement of financial position at face value. Cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less.

1.32 *Dividend distribution*

Dividend distribution to the Bank's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Bank's shareholders.

2 Financial risk management

2.1 *Introduction*

2.1.1 Preamble

The Group's business involves taking on risks in a targeted manner and managing them professionally. The core functions of the Group's risk management are to identify all key risks for the Group, measure these risks, manage the risk positions and determine capital allocations. The Group regularly reviews its risk management policies and systems to reflect changes in markets, products and best market practice. The Group's aim is to achieve an appropriate balance between risk and return and minimise potential adverse effects on the Group's financial performance. The Group defines risk as the possibility of losses or profits foregone, which may be caused by internal or external factors.

The Group considers risk management a core competency that helps produce consistently high returns for its various stakeholders. The Group aims to manage all major types of risk by applying methods that meet best practice. The Group considers it important to have a clear distribution of responsibilities within the area of risk management. One of the main tasks of the Group's executive management is to set the framework for this area. An understanding of risk-taking and transparency in risk-taking are key elements in the Group's business strategy and thus in its ambition to be a strong financial entity. The Group's internal risk management processes support this objective.

Risk management within the Bank is mainly carried out on a unified basis, using an integrated and entity-wide framework. This framework is based on local and international guidelines, such as the Basel III Accord, corresponding Directives and Regulations of the European Union, including technical standards, as well as contemporary international banking practices. The Bank has adopted the Standardised Approach and the Basic Method with respect to the calculation of capital requirements in relation to, and management of, credit and market risks, and the Basic Indicator Approach with respect to operational risk. The Bank regularly updates its Internal Capital and Liquidity Adequacy Assessment Processes (ICAAP and ILAAP), that are approved by the Board of Directors.

2 **Financial risk management** *(continued)*

2.1.2 Organisation

The Bank's Board of Directors is responsible for ensuring that adequate processes and procedures exist to ensure effective internal control systems for the Group. These internal control systems ensure that decision-making capability and the accuracy of the reporting and financial results are maintained at a high level at all times. The Board assumes responsibility for:

- setting business objectives, goals and the general strategic direction for Management with a view to maximise value;
- selecting and appointing the Chief Executive Officer who is entrusted with the day-to-day operations of the Group;
- management of the Group's operations;
- ensuring that significant business risks are identified and appropriately managed; and
- setting the highest business standards and code for ethical behaviour, and monitoring adherence with these.

In deciding how best to discharge its responsibilities, the Board upholds a policy of clear demarcation between its role and responsibilities and those of Management. It has defined the level of authority that it retains over strategy formulation and policy determination, and delegated authority and vested accountability for the Bank's day-to-day business in the Assets & Liabilities Committee and Credit Committee, and, for the Group's day-to-day operations, in an Executive Team comprising the Chief Executive Officer and Chief Officers. The Audit & Risk Committee reviews the processes and procedures to ensure the effectiveness of the Group's system of internal control, as well as the implementation of the Board's risk strategy by management. The Audit & Risk Committee is supported by the Internal Audit and the Bank's Risk Management functions.

Authority to operate the Bank and its subsidiaries is delegated to the Chief Executive Officer within the limits set by the Board. The Board is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can provide only reasonable, and not absolute, assurance against material misstatement or loss.

The Group is committed to the highest standards of business conduct and seeks to maintain these standards across all operations. Group policies and procedures are in place for the reporting and addressing of fraudulent activities.

The Group has an appropriate organisational structure for planning, executing, controlling and monitoring business operations in order to achieve Group objectives.

2.1.3 Risk policies

The Bank's Board of Directors is empowered to set out the overall risk policies and limits for all material risk types. The Board also decides on the general principles for managing and monitoring risks. The Board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments.

2 **Financial risk management** *(continued)*

Internal controls, procedures and processes are managed within the following areas:

- Finance
- Treasury
- Credit
- Internal Audit
- Risk Management
- Compliance
- Anti-Money Laundering

2.1.4 Risk appetite

The risk appetite determines the maximum risk that the Group is willing to assume to meet business targets. To ensure coherence between the Group's strategic considerations regarding risk-taking and day-to-day decisions, from time to time, the Group formulates and updates its risk appetite for the purposes of strategic direction. The Group's risk appetite is set in a process based on a thorough analysis of its current risk profile. The Group identifies a number of key risk components and for each, determines a target that represents the Group's view of the component in question. The following are the key risk components:

- Financial strength
- Earnings robustness
- Core markets
- Credit risk
- Concentration risk
- Market risk
- Liquidity risk
- Operational risk
- Compliance

2.1.5 Reporting

The Group allocates considerable resources to ensure the ongoing compliance with approved limits and to monitor its asset portfolio. In particular, the Bank has a fixed reporting cycle to ensure that the relevant management bodies, including the Board of Directors and the Executive Team, are kept informed on an ongoing basis of developments in the asset portfolio, such matters as non-performing loans and other relevant information.

2.2 *Risk exposures*

In terms of the CRR, 'an exposure' is the amount at risk arising from the reporting credit institution's assets and off-balance sheet items. Consistent with this, an exposure would include the amount at risk arising from the Bank's:

- claims on a customer including actual and potential claims which would arise from the drawing down in full of undrawn advised facilities, which the Bank has committed itself to provide;
- contingent liabilities arising in the normal course of business, and those contingent liabilities which would arise from the drawing down in full of undrawn advised facilities which the Bank has committed itself to provide; and
- other on and off-balance sheet financial assets and commitments.

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

2 **Financial risk management** *(continued)*

The main categories of risk are:

- Credit risk: Credit risk stems from the possible non-prompt repayment or non-payment of existing and contingent obligations by the Group's counterparties, resulting in the loss of equity and profit. It is the risk that deterioration in the financial condition of a borrower will cause the asset value to decrease or be extinguished. Country risk and settlement risk are included in this category. Country risk refers to the risk of losses arising from economic or political changes that affect the country from which the asset originates. Settlement risk refers to the risk of losses through failure of the counterparty to settle outstanding dues on the settlement date owing to bankruptcy or other causes.
- 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 may be divided into two sub-categories:
  - Market (product) liquidity risk: Risk of losses arising from difficulty in accessing a product or market at the required time, price and amount.
  - Funding liquidity risk: Risk of losses arising from a timing mismatch between investing, placements and fund raising activities resulting in obligations missing the settlement date or satisfied at higher than normal rates.
- Operational risk: Risk of loss resulting from the lack of skilful management or good governance within the Group and the inadequacy of proper control, which might involve internal operations, personnel, systems or external occurrences that in turn affect the income and capital funds of financial institutions. The Bank has adopted an operational risk management framework and procedures, which provide for the identification, assessment, management, monitoring and reporting of the Bank's operational risks.

The Bank's approach to management of the above risks is addressed in this note.

2.3 *Credit risk*

2.3.1 Introduction

Credit risk is the risk of suffering financial loss, should any of the Group's customers, clients or market counterparties fail to fulfil their contractual obligations to the Group. Credit risk arises mainly from consumer loans and advances and loan commitments arising from such lending activities, but can also arise from credit enhancement provided, such as financial guarantees and letters of credit.

The Group is also exposed to other credit risks arising from investments in debt securities and other exposures arising from its investing activities.

Credit risk constitutes the Bank's largest risk in view of its significant lending and securities portfolios, which is monitored in a structured and formal manner through several mechanisms and procedures. The credit risk management and control functions are centralised.

2 **Financial risk management** *(continued)*

2.3.2 Credit risk management

The granting of a credit facility (including loans and advances, loan commitments and guarantees) is based on the Bank's insight into the customer's financial position, which is reviewed regularly to assess whether the basis for the granting of credit has changed. Furthermore, the customer must be able to demonstrate, in all probability, the ability to repay the debt. Internal approval limits are in place starting from Bank operational managers leading up to the Credit Committee and the Board of Directors depending on the magnitude and the particular risks attached to the facility. Facilities are generally adequately secured either by property and/or guarantees and are reviewed periodically by management in terms of the exposure to the Bank and to ensure that collateral still covers the facility.

In order to minimise the credit risk undertaken, counterparty credit limits are defined with respect to investment activities, which limits consider a counterparty's creditworthiness, the value of collateral and guarantees pledged, which can reduce the overall credit risk exposure, as well as the type and the duration of the asset. In order to examine a counterparty's creditworthiness, the following are considered: country risk, quantitative and qualitative characteristics, as well as the industry sector in which the counterparty operates.

The Group has set limits of authority and has segregation of duties so as to maintain impartiality and independence during the approval process and control new and existing assets or credit facilities.

The Group manages, limits and controls concentrations of credit risk wherever they are identified in particular, to individual counterparties and groups, and to industries and countries. The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review, when considered necessary. The exposure to any one borrower including banks and brokers is further restricted by sublimits covering on and off-balance sheet exposures. Actual exposures against limits are monitored at end of day on a daily basis and on a real-time basis too.

2.3.3 Credit risk measurement

The measurement of credit exposure for risk management purposes considers that an exposure varies with changes in market conditions, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties. The Group measures credit risk using Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD). This is similar to the approach used for the purposes of measuring Expected Credit Loss (ECL) under IFRS 9. Refer to note 2.3.4 for more details.

(a) Loans and advances to customers

The Group uses internal credit risk gradings (note 2.3.8) to reflect its assessment of the Probability of Default of individual counterparties. Internal credit risk gradings are based on payment behaviour, loan specific information and expert judgement.

Information considered by the Group when determining the internal credit risk grades include the payment behaviour of the borrower and other information about borrowers which impact their creditworthiness, including level of income and/or financial performance.

2 **Financial risk management** *(continued)*

Corporate

The Group determines its internal rating grades at a borrower level. The Group incorporates any updated or new information/credit assessments on an ongoing basis. In addition, the Group also updates information about the creditworthiness of the borrower from sources such as financial statements.

The creditworthiness of the borrower is considered in every periodic review - normally on a yearly basis; or more frequently on an exceptions basis. This determines the updated internal credit risk gradings.

(b) Other financial assets

Other financial assets include Balances with Central Bank of Malta, investments and loans and advances to banks. The Group uses external risk grades to reflect its assessment of the Probability of Default of individual counterparties. These published grades are continuously monitored and updated. The PDs associated with each grade are determined based on realised default rates over the prior 12 months, as published by rating agencies.

In determining the Probability of Default of individual counterparties, the Group distinguishes between exposures considered 'investment-grade' and 'non-investment grade' based on credit ratings by recognised external rating agencies.

2.3.4 Expected Credit Loss measurement

IFRS 9 outlines a 'three-stage' model for impairment based on changes in credit quality since initial recognition as summarised below:

- a financial instrument that is not credit-impaired on initial recognition is classified in 'Stage 1' and has its credit risk continuously monitored by the Group;
- if a significant increase in credit risk (SICR) since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired. Please refer to note 2.3.4.1 for a description of how the Bank determines when a significant increase in credit risk has occurred;
- if the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'. Please refer to note 2.3.4.2 for a description of how the Group defines credit-impaired and default;
- financial instruments in 'Stage 1' have their ECL measured at an amount equal to the portion of lifetime Expected Credit Losses that result from default events possible within the next 12 months. Instruments in 'Stages 2' or '3' have their ECL measured based on Expected Credit Losses on a lifetime basis. Please refer to note 2.3.4.3 for a description of inputs, assumptions and estimation techniques used in measuring the ECL;
- a pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward looking information. Note 2.3.4.4 includes an explanation of how the Group has incorporated this in its ECL models; and
- purchased or originated credit-impaired financial assets are those financial assets that are credit-impaired on initial recognition. Their ECL is always measured on a lifetime basis ('Stage 3').

2 **Financial risk management** *(continued)*

Further explanation is also provided in respect of how the Group determines appropriate groupings of loans and advances to customers for ECL measurement (refer to note 2.3.4.5).

The Expected Credit Loss requirements apply to financial assets measured at amortised cost and FVOCI, and certain loan commitments and financial guarantee contracts. At initial recognition, an impairment allowance (or provision in the case of commitments and guarantees) is required for ECL resulting from default events that are possible within the next 12 months (12-month ECL). In the event of a significant increase in credit risk, an allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument (lifetime ECL). Financial assets where 12-month ECL is recognised are considered 'Stage 1'. Financial assets which are considered to have experienced a significant increase in credit risk would be classified as 'Stage 2' and financial assets for which there is objective evidence of impairment, thus considered to be in default or otherwise credit-impaired, would be classified as 'Stage 3'.

The Group recognises loss allowances at an amount equal to 12-month ECL for debt investment securities that are determined to have low credit risk at the reporting date. The Group considers a debt security to have low credit risk when it is considered 'investment-grade', as defined by recognised external rating agencies.

The following diagram summarises the impairment requirements under IFRS 9 (other than purchased or originated credit-impaired financial assets):

Change in credit quality since initial recognition

Stage 1	**Stage 2**	**Stage 3**
(Initial recognition)	(Significant increase in credit risk since initial recognition)	(Credit-impaired financial assets)
12-month Expected Credit Losses	Lifetime Expected Credit Losses	Lifetime Expected Credit Losses

2.3.4.1 Significant increase in credit risk (SICR)

To determine whether the credit risk (i.e. risk of default) on a financial instrument has increased significantly since initial recognition, the Group considers reasonable and supportable information that is relevant and available without undue cost or effort, including both quantitative and qualitative information. Such analysis is based on the Group's historical experience, credit assessment and forward-looking information.

The Group primarily identifies whether a SICR has occurred for an exposure within the loans and advances to customers, through the Group's internal risk gradings. The Group allocates each exposure to an internal rating grade based on a variety of data that is determined to be predictive of the risk of default and applying experienced credit judgement. These factors vary depending on the nature of the exposure and the type of borrower. Exposures are subject to ongoing monitoring, which may result in an exposure being moved to a different internal rating grade.

2 **Financial risk management** *(continued)*

The Group identifies SICR and classifies non-defaulted exposures into 'Stage 2', which fulfil at least one of the following conditions:

- the exposure is considered forborne;
- the credit quality of any other exposure(s) of the same customer is/are not considered 'regular' (except where otherwise stated in the Group's Credit Policy for example cash covered facilities); and
- the borrower's internal rating grade is not considered 'performing', as defined in note 2.3.8.

The monitoring typically involves use of the following data:

Corporate exposures	Retail exposures	All exposures
• Information obtained during periodic review of customer files - for example audited financial statements, management accounts, budgets and projections. Examples of areas of particular focus are: gross profit margins, financial leverage ratios, debt service coverage, compliance with contractual conditions, quality of management and senior management changes • Data from credit reference agencies, press articles • Actual and expected significant changes in the political, regulatory and technological environment of the borrower or in its business activities	• Internally collected data on customer behaviour - for example utilisation of credit card facilities • Affordability metrics • External data from credit reference agencies including industry-standard credit scores	• Payment record - this includes overdue status as well as a range of variables about payment ratios • Utilisation of the granted limit • Requests for and granting of forbearance • Existing and forecast changes in business, financial and economic conditions

The assessment of SICR incorporates forward-looking information (refer to note 2.3.4.4 for further information) and is performed at the counterparty level on a periodic basis. The criteria used to identify SICR are monitored and reviewed periodically for appropriateness by the independent Risk Management function.

As a backstop, and as required by IFRS 9, the Group presumptively considers that a SICR occurs when an asset is more than 30 days past due. The Group determines days past due by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received.

In the case of other financial assets (including loans and advances to banks and investments in debt securities), the Group applies the low credit risk simplification to all its exposures considered 'investment-grade', thus they are not subject to the SICR assessment. Moving from 'investment-grade' to 'non-investment grade' does not automatically mean that there has been a SICR.

2.3.4.2 Definition of default and credit-impaired assets

The Group's assessment to determine the extent of increase in credit risk of a financial instrument since initial recognition is performed by considering the change in the risk of default occurring over the remaining life of the financial instrument. As a result, the definition of default is important.

2 **Financial risk management** *(continued)*

The Group applies the definition of default in a consistent manner with internal credit risk management practices for the relevant instruments and the definition considers qualitative and quantitative factors where appropriate.

The Group defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the criteria below.

The Group determines that a financial instrument is credit-impaired (in default and in 'Stage 3' for IFRS 9 purposes) by considering relevant objective evidence, primarily whether:

- contractual payments of either principal or interest are past due for more than 90 days for any material credit obligations to the Group;
- there are other indications that the borrower is unlikely to pay such as that a concession has been granted to the borrower for economic or legal reasons of an enduring nature relating to the borrower's financial condition, unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty; and
- the loan is otherwise considered to be in default. If unlikeliness to pay is not identified at an earlier stage, it is seemed to occur when an exposures is 90 days past due.

Therefore, the definitions of credit-impaired and default are aligned so that 'Stage 3' represents all loans which are considered defaulted or credit-impaired.

In assessing whether a borrower is in default, the Group will consider indicators that are:

- qualitative - such as non-adherence to terms and conditions of sanction and/or other breaches of covenant;
- quantitative - such as overdue status and non-payment of another obligation of the same obligor to the Group; and
- based on data developed internally and obtained from external sources.

The default definition has been applied consistently to model the Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD) throughout the Bank's expected loss calculations.

Except for forborne exposures, an instrument is considered to no longer be in default (i.e. to have been cured) when it no longer meets any of the default criteria for a consecutive period of three months. This period has been determined based on an analysis which considers the likelihood of a financial instrument returning to default status after cure using different possible cure definitions.

In the case of forborne exposures, the cure period comprises 12 consecutive monthly repayments made in a timely manner with a minimal grace period of one day (i.e. one or more repayments may be made no more than one day late).

The Group considers other financial assets to be in default when a payment due including a coupon payment is not effected.

2 **Financial risk management** *(continued)*

2.3.4.3 Measuring ECL – Explanation of inputs, assumptions and estimation techniques

The Expected Credit Loss (ECL) is measured on either a 12-month (12M) or on a lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether an asset is considered to be credit-impaired. Expected Credit Losses are the discounted product of the Probability of Default (PD), Exposure at Default (EAD), and Loss Given Default (LGD).

The ECL is determined by projecting the PD, EAD and LGD for each future month and for each individual exposure. These three components are multiplied together and adjusted for the likelihood of survival (i.e. the exposure has not prepaid or defaulted in an earlier month). This effectively calculates an ECL for each future month, which is then discounted back to the reporting date and summed. The discount rate used in the ECL calculation is the originated effective interest rate or an approximation thereof.

The 12-month ECL is calculated by multiplying the 12-month PD, LGD, and EAD. Lifetime ECL is calculated on a similar basis for the residual life of the exposure.

The PD, EAD and LGD parameters are derived from internally developed statistical models and other historical data, adjusted to reflect forward-looking information as described below.

The PD represents the likelihood of a borrower defaulting on its financial obligation (as per 'definition of default and credit-impaired' above), either over the next 12 months (12M PD), or over the remaining lifetime (Lifetime PD) of the obligation. Accordingly, the 12-month and lifetime PDs represent the Probability of Default occurring over the next 12 months and the remaining maturity of the instrument, respectively.

PD estimates are estimates at a certain date, which, for the loans and advances to customers, are calculated based on statistical rating models and assessed using rating tools tailored to the various categories of counterparties and exposures. These statistical models are based on internally-compiled data comprising both quantitative and qualitative factors. The PD calculation is based on a transition matrix approach. The main assumptions underlying such approach is that the PD does not depend on the particular periods after origination ('months on book') and that the future PD depends only on current characteristics of the exposure or borrower. Default is considered to be an absorbing state, whereby if an exposure is defaulted, it remains in this state during all next years. Market data is used for the PD of loans and advances to banks and investment securities. If a counterparty or exposure migrates between internal rating grades or external credit ratings, then this will lead to a change in the associated PD.

The lifetime PD is developed by utilising statistical methodologies to analyse historical observed data to estimate the probability of a borrower's transition from one internal rating class to another (or stays in the same class) within a given horizon. The conditional PD is adjusted to consider forward-looking information through macro-economic modelling.

EAD is based on the amounts the Group expects to be owed at the time of default, over the next 12 months (12M EAD) or over the remaining lifetime (Lifetime EAD). For example, for a revolving commitment, the Group includes the current drawn balance plus any further amount that is expected to be drawn up to the current contractual limit by the time of default, should it occur.

2 **Financial risk management** *(continued)*

EAD represents the expected exposure in the event of a default (including any expected drawdowns of committed facilities). The Group derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract. The EAD of a financial asset is the gross carrying amount at default.

The 12-month and lifetime EADs are determined based on the expected payment profile, which varies by product type:

- for amortising products and bullet repayment loans, this is based on the contractual repayments owed by the borrower over a 12-month or lifetime basis;
- for revolving products, the Exposure at Default is predicted by taking current drawn balance and adding a 'credit conversion factor' which allows for the expected drawdown of the remaining limit by the time of default. These assumptions vary by product type and current limit utilisation band, based on analysis of the Group's recent default data.

The Loss Given Default (LGD) represents the Bank's expectation of the extent of loss on a defaulted exposure. Hence, the LGD represents Expected Credit Losses on the EAD given the event of default, taking into account, among other attributes, the mitigating effect of collateral values at the time it is expected to be realised and the time value of money. The 12-month and lifetime LGD are determined based on the factors which impact the recoveries made post default.

For secured products, this is primarily based on collateral type and projected collateral values, historical discounts to market/book values due to forced sales, time to repossession and recovery costs observed. The LGD for exposures secured by real estate will be derived from the adjusted loan-to-value ratio of the individual facilities, and takes into account the expected recovery by applying a costs to sell and a market value haircut to the property haircut, and by discounting (using the effective interest rate) the updated market value of the property after haircuts, over a period of time equivalent to the perceived time to sell. The LGD for other exposures is based on the Group's perceived risk on the collateral. For unsecured products, LGD's are typically set at product level due to the limited differentiation recoveries achieved across different borrowers. These LGDs are influenced by collective strategies.

The ECL is measured from the initial recognition of the financial asset. The maximum period considered when measuring ECL (be it 12-month or lifetime ECL) is the maximum contractual period over which the Group is exposed to credit risk. With respect to non-revolving credit facilities, the contractual life of the facility is considered. In the case of revolving credit facilities, provided that such facilities do not have a fixed term or repayment structure, the Group defines the lifetime of such exposures as 12 months, in case the next substantive credit review is within the next 12 months. For the credit cards portfolio, the Group also applied a lifetime of 12 months.

Forward-looking economic information is also included in determining the 12-month and lifetime PD and LGD. Refer to note 2.3.4.4 for an explanation of forward-looking information and its inclusion in ECL calculations.

There have been no significant changes in estimation techniques or significant assumptions made during the reporting period.

2 **Financial risk management** *(continued)*

2.3.4.4 Forward-looking information incorporated in the ECL model

The calculation of ECL incorporates forward-looking information. The Group performs a historical analysis to identify the key economic variables affecting credit risk and Expected Credit Losses for each portfolio. These economic variables and their associated impact on the PD, EAD and LGD may vary by portfolio.

In this respect, the Group has identified key drivers of credit risk and credit losses for each portfolio of financial instruments and, using an analysis of historical data, has analysed relationships between macro-economic variables, credit risk and credit losses. The key driver is predominantly Gross Domestic Product (GDP) at constant prices.

The impact of this economic variable on the PD, EAD and LGD has been determined by performing statistical regression analysis to understand the impact changes in these variables have had historically on default rates and on the components of LGD and EAD.

Three possible scenarios are considered to capture non-linearity across credit portfolios. The 'base line' scenario represents the most-likely outcome. It is based on authoritative sources forecasting these economic variables referred to above and providing the best estimate view of the economy. Apart from the 'base line' scenario, the Group considers two other macro-economic scenarios - Upside and Downside scenarios – which respectively represent a more optimistic and a more pessimistic outcome. Such scenarios reflect the current top and emergent risks and opportunities. The more optimistic and more pessimistic scenarios are economically plausible and will not necessarily be as severe as scenarios used in stress testing.

Each scenario is weighted by a probability of occurrence, determined by a combination of macro-economic research and expert credit judgement, taking account the range of possible outcomes each chosen scenario represents. The Group measures ECL as either a probability weighted 12-month ECL (Stage 1), or a probability weighted lifetime ECL (Stages 2 and 3). These probability-weighted ECLs are determined by running each scenario through the relevant ECL model and multiplying it by the appropriate scenario weighting (as opposed to weighting the inputs).

As with any macro-economic forecasts, the projections and likelihoods of occurrence are subject to a high degree of uncertainty and therefore, the actual outcomes may be significantly different to those projected. The Group considers these forecasts to represent its best estimate of the possible outcomes.

The most significant period-end assumptions used for the ECL estimate as at 31 December 2019 are set out below. The 'base', 'upside' and 'downside' scenarios were used for all portfolios:

- The 'Base' Scenario captures business-as-usual macro-economic expectations, whereby the current rhythm of economic activity is maintained;
- The 'Downside' Scenario is based on a subdued level of economic activity hypothesized to correspond to an economic recession;
- The 'Upside' Scenario is based on the assumption that it would be possible to marginally improve further over the already benign economic conditions.

2 **Financial risk management** *(continued)*

	As of 31 December 2019				
	2020	**2021**	**2022**	**2023**	**2024**
Gross Domestic Product, constant prices (YoY)*					
'Base'	6.39%	5.82%	5.54%	5.47%	5.47%
Range of forecasts for alternative scenarios	[2.3 – 10.4]%	[1.8 – 9.9]%	[1.6 – 9.5]%	[1.6 – 9.4]%	[1.7 – 9.3]%

*YoY = year on year % change

	As of 31 December 2018				
	2019	**2020**	**2021**	**2022**	**2023**
Gross Domestic Product, constant prices (YoY)*					
'Base'	6.97%	6.39%	5.82%	5.54%	5.47%
Range of forecasts for alternative scenarios	[2.8 – 11.1]%	[2.3 – 10.4]%	[1.8 – 9.9]%	[1.6 – 9.5]%	[1.6 – 9.4]%

*YoY = year on year % change

The weightings assigned to each economic scenario were 80% for the 'Base' scenario, 10% for the 'Downside' scenario and 10% for the 'Upside' scenario. The number of scenarios used is based on the analysis of each major product type to ensure that non-linearities are captured. The number of scenarios and their attributes are reassessed at each reporting date. The economic scenarios were simulated over a full economic cycle.

Such weightings take into account the current strong performance of the Maltese economy over the foreseeable future and that at this relatively strong level of performance, further ameliorations would be affected by the law of diminishing returns. The Board considers that the probability weightings assigned to the respective scenarios reflect an unbiased evaluation of range of possible outcomes.

Other forward-looking considerations not otherwise incorporated within the above scenarios, such as the impact of any regulatory, legislative or political changes, have also been considered, but are not deemed to have a material impact and therefore no adjustment has been made to the ECL for such factors. This is reviewed and monitored for appropriateness on an ongoing basis.

The most significant assumption affecting the ECL allowance is the GDP, given the significant impact it has on the performance of corporate entities.

2.3.4.5 Categorisation of loans and advances to customers for ECL measurement

As part of the ECL model, the Group classifies its exposures to loans and advances to customers into homogeneous groups with similar credit risk characteristics that include instrument type and credit risk gradings. In this respect, the Group considers the following categories for ECL measurement:

- retail portfolio, which includes loans and advances to individual customers such as mortgages, credit cards and other consumer credit;
- construction and real estate portfolio, which includes loans and advances to customers for the purpose of financing construction of real estate projects for the purpose of re-sale or rental; and

2 **Financial risk management** *(continued)*

- corporates portfolio, which includes loans and advances to business entities, other than construction and real estate related borrowers.

2.3.5 Maximum exposure to credit risk

An 'exposure' is defined as the amount at risk arising from the Group's assets and off-balance sheet items. The Group's maximum credit risk with respect to on- and off-balance sheet items can be classified into the following categories:

- Financial assets recognised on-balance sheet comprising principally balances with Central Bank of Malta, financial investments and loans and advances to banks and customers. The maximum exposure to credit risk of these financial assets equals their gross carrying amounts.
- Documentary credits and guarantee obligations incurred on behalf of third parties. The latter carry the same credit risk as loans, whilst documentary credits are collateralised by the underlying shipments of goods to which they relate, and therefore carry less risk than a loan to a customer. The maximum exposure to credit risk is the full amount that the Group would have to pay if the guarantees are called upon or if documentary credits are exercised.
- Loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities. The maximum exposure to credit risk is the full amount of the committed facilities. However, the likely amount of loss is less than the total unused commitments as most commitments to extend credit are contingent upon customers maintaining specific credit standards. These exposures are monitored in the same manner in respect of loans and advances.

2 **Financial risk management** *(continued)*

The Group's credit risk exposures relating to on-balance sheet assets and off-balance sheet instruments, reflecting the maximum exposure to credit risk before collateral held or other credit enhancements include the following:

	Group				**Bank**			
	2019		2018		**2019**		2018	
	Gross exposure € 000	**ECL allowance € 000**	Gross exposure € 000	ECL allowance € 000	**Gross exposure € 000**	**ECL allowance € 000**	Gross exposure € 000	ECL allowance € 000
Credit risk exposures relating to on-balance sheet assets:								
Subject to IFRS 9 impairment allowance								
Financial assets measured at amortised cost:								
Balances with Central Bank of Malta	**74,976**	**-**	30,155	-	**74,976**	**-**	30,155	-
Cheques in course of collection	**1,214**	**-**	1,422	-	**1,214**	**-**	1,422	-
Loans and advances to banks	**121,060**	**-**	140,581	-	**115,678**	**-**	125,819	-
Financial investments measured at FVOCI	**211,872**	**(183)**	193,704	(163)	**207,947**	**(183)**	189,879	(163)
Loans and advances to customers	**577,138**	**(25,095)**	534,537	(23,413)	**577,150**	**(25,095)**	534,537	(23,413)
Trade and other receivables	**5,625**	**-**	5,010	-	**1,817**	**-**	1,812	-
Accrued income and other assets	**4,173**	**-**	4,218	-	**4,115**	**-**	4,173	-
Credit risk exposure	**996,058**	**(25,278)**	909,627	(23,576)	**982,897**	**(25,278)**	887,797	(23,576)
Credit risk exposures relating to off-balance sheet instruments:								
Contingent liabilities	**11,671**	**(1)**	14,148	(2)	**11,773**	**(1)**	14,167	(2)
Undrawn commitments to lend	**223,499**	**(39)**	200,392	-	**224,607**	**(39)**	200,392	-
Credit risk exposure	**235,170**	**(40)**	214,540	(2)	**236,380**	**(40)**	214,559	(2)

2 **Financial risk management** *(continued)*

Accrued income substantially arises from loans and advances to customers. Expected Credit Losses in respect of accrued income have been allocated to loans and advances to customers.

2.3.6 Credit concentration risk

Within the Bank, concentration risk of losses results from inadequate diversification of the credit exposures. This risk is managed by actively measuring, reporting and monitoring on a regular and ongoing basis risk concentration levels against reasonable thresholds for industry sectors, counterparties, products, and collateral types.

Credit concentration risk by industry sector

The Bank's financial investments measured at FVOCI (gross of Expected Credit Losses) are composed of local government debt securities and treasury bills, and other debt and equity instruments as shown in the following table:

	Group		**Bank**	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Government	**186,296**	169,671	**184,122**	167,491
Corporate				
Tourism	**803**	818	**474**	483
Trade	**231**	239	**-**	-
Property and construction	**6,815**	8,025	**6,184**	7,519
Financial institutions	**11,251**	8,852	**10,690**	8,284
Other sectors	**6,476**	6,099	**6,477**	6,102
Gross financial investments	**211,872**	193,704	**207,947**	189,879

The industry sector analysis of the Bank's loans and advances to customers (gross of Expected Credit Losses) is described in the following table:

	Group		**Bank**	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Manufacturing	**10,960**	17,417	**10,960**	17,417
Tourism	**30,689**	17,398	**30,689**	17,398
Trade	**52,637**	47,461	**52,637**	47,461
Property and construction	**220,069**	251,315	**220,069**	251,315
Personal, professional and home loans	**113,441**	87,359	**113,441**	87,359
Financial institutions	**124,145**	92,508	**124,145**	92,508
Other sectors	**25,197**	21,079	**25,209**	21,079
Gross advances to customers	**577,138**	534,537	**577,150**	534,537

2 **Financial risk management** *(continued)*

Credit concentration risk for counterparties

The majority of the Bank's loans and advances to customers comprise exposures to corporates.

As at 31 December 2019, no loans and advances to customers were deemed to be prohibited large exposures, prior to any eligible exemptions, in accordance with the requirements of Part Four: Large Exposures, of the CRR. A limited number of customers account for a certain percentage of the Bank's loans and advances. Whilst no individual customer or group of dependent customers is considered by management as a significant concentration of credit risk in the context of the CRR, these exposures are monitored and reported more frequently and rigorously.

Credit concentration risk by geographical region

The Group also monitors credit concentration risk by geographical region. The majority of the Group's exposures are in Malta in view of the Group's lending operations being conducted with Maltese corporate entities. Moreover, the Group investments in debt securities are all issued by local sovereigns and corporate entities in Malta.

The Group's balances with correspondent banks in different jurisdictions are split by geographical region, as shown in the following table:

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Loans and advances to banks				
Germany	**20,872**	30,177	**20,872**	30,177
United Kingdom	**16,749**	28,844	**16,749**	28,844
France	**13,978**	15,978	**13,978**	15,978
Norway	**55**	15,407	**55**	15,407
Spain	**12,052**	15,319	**12,052**	15,319
Belgium	**11,996**	8,508	**11,996**	8,508
Denmark	**3,526**	5,567	**3,526**	5,567
Malta	**5,387**	14,766	**5**	4
Other	**36,445**	6,015	**36,445**	6,015
Gross loans and advances to banks	**121,060**	140,581	**115,678**	125,819

2 **Financial risk management** *(continued)*

2.3.7 Information on credit quality of balances with banks, investments and treasury bills

The Group holds debt instruments that are issued by local government, local banks and other local corporate entities. All such counterparties are listed on the Malta Stock Exchange, which is currently the only locally-based Recognised Investment Exchange (RIE) in Malta. The Bank acquires debt securities and similar instruments issued by counterparties having strong financial background. These issuers are approved and regularly reviewed considering the process previously highlighted, focusing on market developments. The Group's investments include a significant amount of treasury bills and other debt securities issued by the Government of Malta.

Within its daily operations the Bank transacts with banks and other financial institutions. The Bank primarily places short-term funds with pre-approved banks subject to limits in place and subject to the respective institution's credit rating being within controlled parameters. By conducting these transactions the Bank is running the risk of losing funds due to the possible delays in the repayment to the Bank of the existing and future obligations of the counterparty banks. Actual exposures are monitored against the limits on a daily basis and in a real-time manner. The credit status of the pre-authorised banks is monitored on an ongoing basis. At 31 December 2019, loans and advances to banks consisted primarily of term placements maturing within one month.

The Bank runs the risk of loss of funds due to the possible political, economic and other events in a particular country where funds have been placed or invested with several counterparties domiciled in the same country or region. Countries are assessed according to their size, economic data and prospects together with credit ratings issued by international rating agencies. Existing country credit risk exposures, based on groupings of individual counterparties, are monitored and reviewed periodically. The Bank's assets are predominantly in Malta. The Bank's exposures to other countries are mainly limited to bank balances and money market placements with a total carrying amount of €115,678,000 (2018: €125,819,000) at the end of the reporting period.

At the end of the reporting period, none of these financial assets mentioned were past due or impaired.

The following tables set out information about the credit quality of financial assets of the Bank measured at amortised cost and financial investments at FVOCI (2018). The credit quality of financial assets is based on external credit ratings assigned to issuers or counterparties by recognised external rating agencies:

	2019			
	Stage 1 12-month ECL	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Total**
	€ 000	**€ 000**	**€ 000**	**€ 000**
Balances with Central Bank of Malta at amortised cost				
Gross carrying amount	**74,976**	-	-	**74,976**
Loss allowance	-	-	-	-
Carrying amount – net of loss allowance	**74,976**	-	-	**74,976**

2 **Financial risk management** *(continued)*

	2018			
	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
	€ 000	€ 000	€ 000	€ 000
Balances with Central Bank of Malta at amortised cost				
Gross carrying amount	30,155	-	-	30,155
Loss allowance	-	-	-	-
Carrying amount – net of loss allowance	30,155	-	-	30,155

The credit rating of the Government of Malta as at 31 December 2019 was considered as 'investment-grade' and hence no loss allowances in respect of balances with the Central Bank of Malta were recognised.

	2019			
	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
	€ 000	€ 000	€ 000	€ 000
Financial investments at FVOCI				
AAA to AA-	-	-	-	-
A+ to A-	**184,122**	-	-	**184,122**
BBB+ to BBB-	**9,429**	-	-	**9,429**
BB+ to BB-	-	-	-	-
Unrated	**14,396**	-	-	**14,396**
Carrying amount – fair value	**207,947**	-	-	**207,947**
Loss allowance	**(183)**	-	-	**(183)**
Carrying amount – net of loss allowance	**207,764**	-	-	**207,764**
Loans and advances to banks at amortised cost				
AAA to AA-	**11,956**	-	-	**11,956**
A+ to A-	**93,976**	-	-	**93,976**
BBB+ to BBB-	**9,738**	-	-	**9,738**
BB+ to BB-	**3**	-	-	**3**
Unrated	**5**	-	-	**5**
Carrying amount	**115,678**	-	-	**115,678**
Loss allowance	-	-	-	-
Carrying amount – net of loss allowance	**115,678**	-	-	**115,678**

2 **Financial risk management** *(continued)*

	2018			
	Stage 1 12-month ECL	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Total**
	€ 000	**€ 000**	**€ 000**	**€ 000**
Financial investments at FVOCI				
AAA to AA-	-	-	-	-
A+ to A-	167,491	-	-	167,491
BBB+ to BBB-	6,676	-	-	6,676
BB+ to BB-	-	-	-	-
Unrated	15,712	-	-	15,712
Carrying amount – fair value	189,879	-	-	189,879
Loss allowance	(163)	-	-	(163)
Carrying amount – net of loss allowance	189,716	-	-	189,716
Loans and advances to banks at amortised cost				
AAA to AA-	25,694	-	-	25,694
A+ to A-	82,492	-	-	82,492
BBB+ to BBB-	17,624	-	-	17,624
BB+ to BB-	5	-	-	5
Unrated	4	-	-	4
Carrying amount	125,819	-	-	125,819
Loss allowance	-	-	-	-
Carrying amount – net of loss allowance	125,819	-	-	125,819

At 31 December 2019 and 2018, there were no purchased credit-impaired assets.

After the end of the reporting period there were no significant changes in credit ratings reflected in the tables above which have a material impact on the credit quality of the financial assets.

2 **Financial risk management** *(continued)*

2.3.8 Information on credit quality of loans and advances to customers

The Bank manages the credit quality of its loans and advances to customers by using internal risk grades, which provide a progressively increasing risk profile ranging from 'P1' (best quality, less risky) to 'NP'. These risk grades are an essential tool for the Bank to identify both non-performing exposures and better-performing customers. The internal risk grades used by the Bank are as follows:

- Performing: Internal grade 'P1';
- Under performing: Internal grades 'P2' and 'P3'; and
- Non-performing: Internal grade 'NP'.

P1

The Bank's loans and advances to customers which are categorised as 'P1' are principally debts in respect of which the payment of interest and/or capital is not overdue by 30 days and no recent history of customer default exists. Management does not expect any losses from non-performance by these customers.

P2

Loans and advances which attract a 'P2' grading are those which are receiving the close attention of the Bank's management and are being reviewed periodically in order to determine whether such advances should be reclassified to either the 'P1' or the 'P3' classification. Credit facilities that attract this category include those where the payment of interest and/or capital becomes overdue by 30 days and over but not exceeding 60 days.

P3

Loans and advances which attract a 'P3' grading are those having the weaknesses inherent in those loans and advances classified as 'P2' with the added characteristics that repayment is inadequately protected by the current sound worth and paying capacity of the borrower. Loans and advances so graded have a well-defined weakness or weaknesses that could jeopardise the repayment of the debt. They are characterised by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Credit facilities that attract this category include those where the payment of interest and/or capital becomes overdue by 60 days and over but not exceeding 90 days.

NP

Loans and advances which attract a 'NP' grading are those facilities where the Bank deems the recoverability of principal to be remote as a result of worsening conditions of loans and advances classified as 'P3'. Credit facilities that attract this category include those where the payment of interest and/or capital becomes overdue by 90 days and over. These loans and advances are generally past due by more than 90 days and comprise those exposures which are deemed by the Bank as credit-impaired (see definition in note 2.3.4.2).

The following table set out information about the credit quality of financial assets measured at amortised cost. Explanation of the terms: 12-month ECL, lifetime ECL and credit-impaired are included in note 2.3.4.3.

2 **Financial risk management** *(continued)*

	2019			
	Stage 1 12-month ECL	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Total**
	€ 000	**€ 000**	**€ 000**	**€ 000**
Loans and advances to customers at amortised cost				
P1	**479,843**	**-**	**-**	**479,843**
P2	**-**	**43,005**	**-**	**43,005**
P3	**-**	**2,922**	**-**	**2,922**
NP	**-**	**-**	**51,380**	**51,380**
Gross carrying amount	**479,843**	**45,927**	**51,380**	**577,150**
Loss allowance	**(3,832)**	**(1,346)**	**(19,917)**	**(25,095)**
Carrying amount	**476,011**	**44,581**	**31,463**	**552,055**

	2018			
	Stage 1 12-month ECL	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Total**
	€ 000	**€ 000**	**€ 000**	**€ 000**
Loans and advances to customers at amortised cost				
P1	422,800	-	-	422,800
P2	-	49,621	-	49,621
P3	-	2,343	-	2,343
NP	-	-	59,773	59,773
Gross carrying amount	422,800	51,964	59,773	534,537
Loss allowance	(2,827)	(1,739)	(18,847)	(23,413)
Carrying amount	419,973	50,225	40,926	511,124

As at 31 December 2019, undrawn commitments to lend amounted to €224,607,000 (2018: €200,392,000) and predominantly comprise of sanctioned but not yet drawn facilities which are classified as 'Stage 1' (12-month ECL) upon drawdown by customers. Undrawn facilities in respect of existing 'Stage 2' and 'Stage 3' (Lifetime ECL) facilities as at 31 December 2019 have not been considered significant. ECL allowances on undrawn commitments to lend as at 31 December 2019 amounted to €39,000 (2018: nil).

Contingent liabilities and financial guarantee contracts as at 31 December 2019 amounting to €11,773,000 (2018: €14,167,000) are all classified as 'Stage 1' (12-month ECL) by the Bank. ECL allowances on contingent liabilities and financial guarantee contracts as at 31 December 2019 amounted to €1,000 (2018: €2,000).

2 **Financial risk management** *(continued)*

As at 31 December 2019 and 2018, there are no purchased credit-impaired assets.

The following table analyses the impaired loans and advances, gross of impairment allowances, by industry sector:

	2019 € 000	2018 € 000
Manufacturing	**735**	5,364
Tourism	**2,482**	3,564
Trade	**3,783**	3,969
Property and construction	**31,087**	35,997
Personal, professional and home loans	**8,837**	9,836
Financial institutions	-	154
Other sectors	**4,456**	889
Gross impaired advances to customers	**51,380**	59,773

The following table provides a detailed analysis of the credit quality of the Bank's lending portfolio as at 31 December 2019:

	Non-forborne exposures 2019 € 000	**Forborne exposures 2019 € 000**	**Total 2019 € 000**
Performing - Stage 1			
Loans which are not past due	**470,116**	-	**470,116**
Loans which are past due by less than 30 days	**9,727**	-	**9,727**
	479,843	-	**479,843**
Performing - Stage 2			
Loans which are not past due			
P2	**37,195**	**4,208**	**41,403**
P3	**2,922**	-	**2,922**
Loans which are past due by less than 90 days			
Past due between 1 and 30 days	**1,262**	-	**1,262**
Past due between 31 and 89 days	**340**	-	**340**
	41,719	**4,208**	**45,927**
Non-performing - Stage 3			
Past due loans by 90 days or more and credit-impaired loans:	**31,363**	**20,017**	**51,380**
Gross loans and advances	**552,925**	**24,225**	**577,150**
12-month ECL	**(3,833)**	-	**(3,833)**
Lifetime ECL	**(15,777)**	**(5,485)**	**(21,262)**
Net loans and advances	**533,315**	**18,740**	**552,055**

2 **Financial risk management** *(continued)*

Interest income recognised during the financial year ended 31 December 2019 in respect of forborne exposures amounted to €2,066,000.

The following table provides a detailed analysis of the credit quality of the Bank's lending portfolio as at 31 December 2018:

	Non-forborne exposures 2018 € 000	Forborne exposures 2018 € 000	Total 2018 € 000
Performing - Stage 1			
Loans which are not past due	405,677	-	405,677
Loans which are past due by less than 30 days	17,123	-	17,123
	422,800	-	422,800
Performing - Stage 2			
Loans which are not past due			
P2	29,886	8,542	38,428
P3	1,742	-	1,742
Loans which are past due by less than 90 days			
Past due between 1 and 30 days	11,158	-	11,158
Past due between 31 and 89 days	636	-	636
	43,422	8,542	51,964
Non-performing - Stage 3			
Past due loans by 90 days or more and credit-impaired loans:	33,465	26,308	59,773
Gross loans and advances	499,687	34,850	534,537
12-month ECL	(2,827)	-	(2,827)
Lifetime ECL	(15,341)	(5,245)	(20,586)
Net loans and advances	481,519	29,605	511,124

Interest income recognised during the financial year ended 31 December 2018 in respect of forborne exposures amounted to €2,456,000.

2.3.9 Modification of financial assets

The contractual terms of a loan may be revised for a number of reasons, including changes in market conditions, customer retention and other factors that are not related to the credit quality of a customer. Forbearance measures comprise concessions made on the contractual terms of a loan in response to a customer's financial difficulties. The Group categorises loans on which concessions have been granted under conditions of financial difficulties as 'forborne loans' when their contractual payment terms have been revised, because of significant concerns about the customer's ability to meet contractual payments when due.

2 **Financial risk management** *(continued)*

When considering whether there is significant concern regarding a customer's ability to meet contractual loan repayments when due, the Group assesses the customer's delinquency status, account behaviour, repayment history, current financial situation and continued ability to repay.

If the customer is not meeting contractual repayments or it is evident that the client will be unable to do so without the renegotiation, there will be a significant concern regarding the ability to meet contractual payments. Indicators of significant concerns regarding a borrower's ability to pay include:

- the customer is currently in default on any of its debt;
- the customer has declared or is in the process of declaring bankruptcy or entering into a similar process;
- there is significant doubt as to whether the customer will continue to be a going concern; and
- the Group forecasts that the customer's entity-specific cash flows will be insufficient to service the debt (both interest and principal) in accordance with the contractual terms of the existing agreement through maturity.

A range of forbearance measures are employed by the Group in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid default or call-in of facilities. They include extended payment terms, a reduction in principal repayments, the deferral of call-in of facilities and other forms of loan modifications. The Group's policies and procedures in this area allow the Group to provide a customer with terms and conditions that are more favourable than those provided initially. Loan forbearance is only granted in situations where the customer has shown a willingness to repay the loan and is expected to be able to meet the revised obligations. The Group's credit risk management policies set out restrictions on the number and frequency of forbearance measures and the minimum period an account must have been opened before any forbearance measure can be considered.

For the purposes of determining whether changes to a customer's agreement should be treated as forbearance the following types of modification could be regarded as concessionary in cases where the customer is in financial difficulty:

- reduction of the stated interest rate for the remaining original life of the debt;
- extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk;
- reduction of the face amount or maturity amount of the debt; and
- reduction of accrued interest.

Term extension is the most common type of modification granted by the Group. Other types of concession, namely transfer to an interest-only arrangement or interest rate changes, occur less often.

In assessing whether forbearance is a sustainable strategy, the customer's entire exposures are reviewed and the customer's ability to meet the terms in relation to the revised obligations and other unchanged credit facilities is considered. In all cases, forbearance is only granted when the customer is expected to be able to meet the revised terms. When considering acceptable modified terms the Group considers the ability of the customer to be able to service the revised interest payments as a necessity. When principal payment modifications are utilised, the Group requires the customer to be able to comply with the revised terms as a necessary pre-condition for the restructuring to proceed.

2 **Financial risk management** *(continued)*

Generally, forbearance is a qualitative indicator of a significant increase in credit risk.

The risk of default of modified assets is assessed at the reporting date and compared with the risk under the original terms at initial recognition, when the modification is not substantial it does not result in derecognition of the original asset (refer to notes 1.7.4).

The Group monitors the subsequent performance of modified assets and may determine that the credit risk has significantly improved after restructuring:

- Modified assets are moved from 'Stage 3' (Lifetime ECL) to 'Stage 1' (12-month ECL) only if they have performed in accordance with the new terms for 36 consecutive months or more.
- Modified assets are moved from 'Stage 2' (Lifetime ECL) to 'Stage 1' (12-month ECL) only if they have performed in accordance with the new terms for 24 consecutive months or more.

The gross carrying amount of such assets held as at 31 December 2019 amount to €10,012,000 (2018: €4,357,000).

The Group continues to monitor if there is a subsequent significant increase in credit risk in relation to modified assets that moved from 'Stage 3' (Lifetime ECL) or 'Stage 2' (Lifetime ECL) to 'Stage 1'.

There were no material changes to the Bank's policies and procedures regarding forbearance or forborne loans in 2019.

The movement in the carrying amount of forborne loans and advances, before impairment allowances, is analysed below:

	Forborne exposures 2019 € 000	Forborne exposures 2018 € 000
At 1 January	**34,850**	42,964
Loans to which forbearance measures have been extended during the year	**1,543**	2,375
Repayments	**(2,156)**	(6,132)
Retired from forborne	**(10,012)**	(4,357)
At 31 December	**24,225**	34,850

2 **Financial risk management** *(continued)*

Forborne loans, gross of Expected Credit Losses, are analysed by industry sector as follows:

	2019	2018
	€ 000	€ 000
Manufacturing	**122**	332
Tourism	**710**	106
Trade	**3,695**	4,442
Property and construction	**10,332**	18,575
Personal, professional and home loans	**9,361**	11,395
Financial institutions	**-**	-
Other sectors	**5**	-
	24,225	34,850

As at 31 December 2019 and 2018, forborne loans mainly comprise exposures to customers based in Malta.

2.3.10 Loss allowances

Reconciliation of 12-month and Lifetime ECL provision

The loss allowance recognised in the period is impacted by a variety of factors, as described below:

- Transfers between 'Stage 1' and 'Stages 2' or '3' due to financial instruments experiencing significant increases (or decreases) of credit risk or becoming credit-impaired in the period, and the consequent 'step up' (or 'step down') between 12-month and Lifetime ECL;
- Additional allowances for new financial instruments recognised during the period, as well as releases for financial instruments derecognised in the period;
- Impact on the measurement of ECL due to changes in PDs, EADs and LGDs in the period, arising from regular refreshing of inputs to models;
- Impacts on the measurement of ECL due to changes made to models and assumptions;
- Discount unwind within ECL due to the passage of time, as ECL is measured on a present value basis;
- Foreign exchange retranslations for assets denominated in foreign currencies and other movements; and
- Financial assets derecognised during the period and write-offs of allowances related to assets that were written off during the period.

2 **Financial risk management** *(continued)*

The following tables explain the changes in the loss allowance between the beginning and the end of the annual period:

	2019			
	Stage 1 12-month ECL € 000	Stage 2 Lifetime ECL € 000	Stage 3 Lifetime ECL € 000	Total € 000
Balances with Central Bank of Malta at amortised cost				
Loss allowance as at 1 January 2019	-	-	-	-
Total net profit and loss charge during the year	-	-	-	-
Loss allowance as at 31 December 2019	-	-	-	-
Financial investments measured at FVOCI				
Loss allowance as at 1 January 2019	163	-	-	163
Changes to risk parameters (model inputs: PDs/LGDs/EADs)	20	-	-	20
Total net profit and loss charge during the year	20	-	-	20
Loss allowance as at 31 December 2019	183	-	-	183
Loans and advances to banks at amortised cost				
Loss allowance as at 1 January 2019	-	-	-	-
Total net profit and loss charge during the year	-	-	-	-
Loss allowance as at 31 December 2019	-	-	-	-
Undrawn commitments				
Loss allowance as at 1 January 2019	-	-	-	-
Changes to risk parameters (model inputs: PDs/LGDs/EADs)	39	-	-	39
Total net profit and loss charge during the year	39	-	-	39
Loss allowance as at 31 December 2019	39	-	-	39

2 **Financial risk management** *(continued)*

	2019			
	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
	€ 000	€ 000	€ 000	€ 000
Loans and advances to customers at amortised cost				
Loss allowance as at 1 January 2019	2,827	1,739	18,847	23,413
Transfers of financial instruments				
Transfer from Stage 1 to Stage 2	(2)	2	-	-
Transfer from Stage 1 to Stage 3	(3)	-	8	5
Transfer from Stage 2 to Stage 1	320	(640)	-	(320)
Transfer from Stage 2 to Stage 3	-	(2)	2	-
Transfer from Stage 3 to Stage 1	6	-	(6)	-
Transfer from Stage 3 to Stage 2	-	1	(1)	-
Total remeasurement of loss allowance arising from transfers in stages	321	(639)	3	(315)
New financial assets originated or purchased	1,020	33	1	1,054
Changes to risk parameters (model inputs: PDs/LGDs/EADs)	92	225	275	592
Financial assets derecognised during the year	(428)	(12)	(399)	(839)
Write-offs	-	-	-	-
Total net profit and loss charge during the year	1,005	(393)	(120)	492
Other movements				
Write-offs	-	-	(134)	(134)
Unwind of discount	-	-	1,324	1,324
Loss allowance as at 31 December 2019	3,832	1,346	19,917	25,095

2 **Financial risk management** *(continued)*

	2018			
	Stage 1 12-month ECL	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Total**
	€ 000	**€ 000**	**€ 000**	**€ 000**
Balances with Central Bank of Malta at amortised cost				
Loss allowance as at 1 January 2018	-	-	-	-
Total net profit and loss charge during the year	-	-	-	-
Loss allowance as at 31 December 2018	-	-	-	-
Financial investments measured at FVOCI				
Loss allowance as at 1 January 2018	56	-	-	56
Changes to risk parameters (model inputs: PDs/LGDs/EADs)	107	-	-	107
Total net profit and loss charge during the year	107	-	-	107
Loss allowance as at 31 December 2018	163	-	-	163
Loans and advances to banks at amortised cost				
Loss allowance as at 1 January 2018	-	-	-	-
Total net profit and loss charge during the year	-	-	-	-
Loss allowance as at 31 December 2018	-	-	-	-

2 **Financial risk management** *(continued)*

	2018			
	Stage 1 12-month ECL € 000	**Stage 2 Lifetime ECL € 000**	**Stage 3 Lifetime ECL € 000**	**Total € 000**
Loans and advances to customers at amortised cost				
Loss allowance as at 1 January 2018	513	10,255	11,943	22,711
Transfers of financial instruments				
Transfer from Stage 1 to Stage 2	(51)	155	-	104
Transfer from Stage 2 to Stage 1	1,256	(3,488)	-	(2,232)
Transfer from Stage 2 to Stage 3	-	(6,625)	6,625	-
Transfer from Stage 3 to Stage 2	-	81	(81)	-
Total remeasurement of loss allowance arising from transfers in stages	1,205	(9,877)	6,544	(2,128)
New financial assets originated or purchased	591	1,023	113	1,727
Changes to risk parameters (model inputs: PDs/LGDs/EADs)	613	365	248	1,226
Financial assets derecognised during the year	(95)	(27)	(557)	(679)
Write-offs	-	-	3	3
Total net profit and loss charge during the year	2,314	(8,516)	6,351	149
Other movements				
Write-offs	-	-	(714)	(714)
Unwind of discount	-	-	1,267	1,267
Loss allowance as at 31 December 2018	2,827	1,739	18,847	23,413

The unwind of discount on ‘Stage 3’ financial assets is reported within ‘interest income’ so that interest income is recognised on the amortised cost (after deducting the ECL allowance).

Remeasurement of loss allowances arising on contingent liabilities and financial guarantee contracts was not considered significant. Similarly, remeasurement of loss allowance arising from foreign-exchange and other movements were not considered significant.

Changes in the gross carrying amount that contributed to changes in loss allowance

The significant change in the gross carrying amount of financial assets that contributed to changes in loss allowances was mainly due to growth in the loan book, which was aligned with the Group’s growth objectives.

2 **Financial risk management** *(continued)*

The following table explains changes in the gross carrying amount of the financial assets to help explain their significance to the changes in the loss allowance for the same portfolios as discussed above:

	2019			
	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
	€ 000	€ 000	€ 000	€ 000
Balances with Central Bank of Malta				
Gross carrying amount as at 1 January 2019	30,155	-	-	30,155
New financial assets originated or purchased	66,276	-	-	66,276
Financial assets derecognised during the year	(21,455)	-	-	(21,455)
Gross carrying amount as at 31 December 2019	74,976	-	-	74,976
Financial investments measured at FVOCI				
Gross carrying amount as at 1 January 2019	193,704	-	-	193,704
New financial assets originated or purchased	22,412	-	-	22,412
Financial assets derecognised during the year	(8,311)	-	-	(8,311)
Other movements	4,067	-	-	4,067
Gross carrying amount as at 31 December 2019	211,872	-	-	211,872
Loans and advances to banks at amortised cost				
Gross carrying amount as at 1 January 2019	140,581	-	-	140,581
New financial assets originated or purchased	76,489	-	-	76,489
Financial assets derecognised during the year	(96,010)	-	-	(96,010)
Gross carrying amount as at 31 December 2019	121,060	-	-	121,060

2 **Financial risk management** *(continued)*

	2019			
	Stage 1 12-month ECL € 000	**Stage 2 Lifetime ECL € 000**	**Stage 3 Lifetime ECL € 000**	**Total € 000**
Loans and advances to customers at amortised cost				
Gross carrying amount as at 1 January 2019	**422,800**	**51,964**	**59,773**	**534,537**
Transfers of financial instruments				
Transfer from Stage 1 to Stage 2	**(6,717)**	**6,717**	**-**	**-**
Transfer from Stage 1 to Stage 3	**(1,302)**	**-**	**1,302**	**-**
Transfer from Stage 2 to Stage 1	**12,414**	**(12,414)**	**-**	**-**
Transfer from Stage 2 to Stage 3	**-**	**(163)**	**163**	**-**
Transfer from Stage 3 to Stage 1	**52**	**-**	**(52)**	**-**
Transfer from Stage 3 to Stage 2	**-**	**2,156**	**(2,156)**	**-**
Total changes in gross carrying amounts arising from transfers in stages	**4,447**	**(3,704)**	**(743)**	**-**
New financial assets originated or purchased	**117,691**	**260**	**33**	**117,984**
Changes in gross carrying amount due to facilities present as at 1 January 2019	**2,857**	**(664)**	**(103)**	**2,090**
Financial assets derecognised during the year	**(67,964)**	**(1,929)**	**(7,444)**	**(77,337)**
Write-offs	**-**	**-**	**(136)**	**(136)**
Total net change during the year	**57,031**	**(6,037)**	**(8,393)**	**42,601**
Gross carrying amount as at 31 December 2019	**479,831**	**45,927**	**51,380**	**577,138**

2 **Financial risk management** *(continued)*

	2018			
	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
	€ 000	€ 000	€ 000	€ 000
Balances with Central Bank of Malta				
Gross carrying amount as at 1 January 2018	130,303	-	-	130,303
Financial assets derecognised during the year	(100,148)	-	-	(100,148)
Gross carrying amount as at 31 December 2018	30,155	-	-	30,155
Financial investments measured at FVOCI				
Gross carrying amount as at 1 January 2018	155,985	-	-	155,985
New financial assets originated or purchased	41,393	-	-	41,393
Financial assets derecognised during the year	(4,445)	-	-	(4,445)
Other movements	771	-	-	771
Gross carrying amount as at 31 December 2018	193,704	-	-	193,704
Loans and advances to banks at amortised cost				
Gross carrying amount as at 1 January 2018	97,048	-	-	97,048
New financial assets originated or purchased	43,533	-	-	43,533
Gross carrying amount as at 31 December 2018	140,581	-	-	140,581

2 **Financial risk management** *(continued)*

	2018			
	Stage 1 12-month ECL € 000	**Stage 2 Lifetime ECL € 000**	**Stage 3 Lifetime ECL € 000**	**Total € 000**
Loans and advances to customers at amortised cost				
Gross carrying amount as at 1 January 2018	344,942	41,528	64,989	451,459
Transfers of financial instruments				
Transfer from Stage 1 to Stage 2	(23,467)	23,467	-	-
Transfer from Stage 1 to Stage 3	(335)	-	335	-
Transfer from Stage 2 to Stage 1	18,220	(18,220)	-	-
Transfer from Stage 2 to Stage 3	-	(10,026)	10,026	-
Transfer from Stage 3 to Stage 1	680	-	(680)	-
Transfer from Stage 3 to Stage 2	-	7,222	(7,222)	-
Total changes in gross carrying amounts arising from transfers in stages	(4,902)	2,443	2,459	-
New financial assets originated or purchased	110,261	14,066	307	124,634
Changes in gross carrying amount due to facilities present as at 1 January 2018	4,825	(1,945)	(2,186)	694
Financial assets derecognised during the year	(32,326)	(4,128)	(5,083)	(41,537)
Write-offs	-	-	(713)	(713)
Total net change during the year	77,858	10,436	(5,216)	83,078
Gross carrying amount as at 31 December 2018	422,800	51,964	59,773	534,537

Undrawn commitments to lend as at 31 December 2019 amounted to €223,499,000 (2018: €200,392,000) and predominantly comprise of sanctioned but not yet drawn facilities which are classified as ‘Stage 1’ (12-month ECL) upon drawdown by customers. Changes in gross carrying amount of undrawn commitments to lend mainly relate to existing facilities drawn down by customers and new facilities sanctioned during 2019 and 2018.

Contingent liabilities and financial guarantee contracts as at 31 December 2019 amounting to €11,671,000 (2018: €14,148,000) are all classified as ‘Stage 1’ (12-month ECL) by the Group. Changes in gross carrying amount of contingent liabilities and financial guarantee contracts mainly related to the expiry or enforcement of existing financial guarantees and the issuance of new financial guarantees during 2019 and 2018.

Changes in gross carrying amount arising from a foreign-exchange and other movements was not significant.

2 **Financial risk management** *(continued)*

2.3.11 Write-off policy

The Group writes off loans and advances to customers when it determines that these are uncollectible and it has exhausted all practical recovery efforts and has concluded there is no reasonable expectation of recovery. This is generally the case when the Group determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-offs.

The Group may write-off financial assets that are still subject to enforcement activity. The Group still seeks to recover amounts it is legally owed in full, but which have been partially written off due to no reasonable expectation of full recovery.

2.3.12 Collateral

The Group employs a range of policies and practices to mitigate credit risk. The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. The Group's Board establishes a policy regarding the acceptability of types of collateral and valuation parameters.

Longer-term finance and lending to corporate entities are generally secured; revolving individual credit facilities are generally unsecured.

The main types of collateral obtained are as follows:

- For corporate lending, charges over real estate properties, cash or securities;
- For retail lending (including home loans and consumer credit), mortgages over residential properties, cash or securities; and
- For exposures arising from reverse repurchase transactions, a pledge on liquid sovereign debt securities.

Collateral held as security for financial assets other than loans and advances depends on the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured.

Management assesses the market value of collateral as part of the loan origination process. This assessment is reviewed periodically through ongoing credit file reviews. The Group requests additional collateral in accordance with the underlying agreement when necessary.

The Group's policies regarding obtaining collateral have not significantly changed during the reporting period and there has been no significant change in the overall quality of the collateral held by the Group since the prior period.

A portion of the Group's financial assets has sufficiently low 'loan-to-value' (LTV) ratios, which result in no loss allowance being recognised in accordance with the Group's Expected Credit Loss model. As at 31 December 2019, the carrying amount of such financial assets is €333,854,000 (2018: €305,261,000).

2 **Financial risk management** *(continued)*

The Group closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Group will take possession of collateral to mitigate potential credit losses. Financial assets that are credit-impaired and related collateral held in order to mitigate potential losses are shown below:

Credit-impaired assets	**Gross exposure € 000**	**Impairment allowance € 000**	**Carrying amount € 000**	**Fair value of collateral held € 000**
As at 31 December 2019				
- Overdrafts	**17,200**	**3,430**	**13,770**	**20,160**
- Term loans	**30,370**	**13,779**	**16,591**	**53,817**
- Credit cards	**25**	**-**	**25**	**31**
Total credit-impaired assets	**47,595**	**17,209**	**30,386**	**74,008**
As at 31 December 2018				
- Overdrafts	18,971	3,909	15,062	31,400
- Term loans	37,189	12,824	24,365	66,253
- Credit cards	33	-	33	41
Total credit-impaired assets	56,193	16,733	39,460	97,694

Financial assets that are credit-impaired and no collateral is held are shown below:

Credit-impaired assets	**Gross exposure € 000**	**Impairment allowance € 000**	**Carrying amount € 000**
As at 31 December 2019			
- Overdrafts	**550**	**494**	**56**
- Term loans	**3,224**	**2,201**	**1,023**
- Credit cards	**11**	**11**	**-**
Total credit-impaired assets	**3,785**	**2,706**	**1,079**
As at 31 December 2018			
- Overdrafts	475	475	-
- Term loans	3,095	2,104	991
- Credit cards	10	10	-
Total credit-impaired assets	3,580	2,589	991

It is the Bank’s policy to dispose of properties acquired through judicial action in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Bank does not occupy properties acquired through judicial action for business use.

2 **Financial risk management** *(continued)*

The following tables show the distribution of LTV ratios for the Group's credit-impaired loans and advances to customers.

	Non-forborne exposures 2019 € 000	**Forborne exposures 2019 € 000**	**Total 2019 € 000**	Non-forborne exposures 2018 € 000	Forborne exposures 2018 € 000	Total 2018 € 000
Performing - Stage 1						
Not collateralised	**70,160**	-	**70,160**	68,144	-	68,144
Fully collateralised						
Less than 50% LTV	**246,146**	-	**246,146**	199,448	-	199,448
51% to 75% LTV	**106,008**	-	**106,008**	103,260	-	103,260
76% to 90% LTV	**37,323**	-	**37,323**	22,538	-	22,538
91% to 100% LTV	**3,411**	-	**3,411**	13,545	-	13,545
	392,888	-	**392,888**	338,791	-	338,791
Partially collateralised						
Greater than 100% LTV	**16,795**	-	**16,795**	15,865	-	15,865
Total performing – Stage 1	**479,843**	-	**479,843**	422,800	-	422,800
Performing – Stage 2						
Not collateralised	**400**	-	**400**	5,413	4	5,417
Fully collateralised						
Less than 50% LTV	**25,995**	**3,708**	**29,703**	23,391	7,716	31,107
51% to 75% LTV	**62**	-	**62**	68	650	718
76% to 90% LTV	**14**	**500**	**514**	291	-	291
91% to 100% LTV	**11,066**	-	**11,066**	13,628	121	13,749
	37,137	**4,208**	**41,345**	37,378	8,487	45,865
Partially collateralised						
Greater than 100% LTV	**4,182**	-	**4,182**	631	51	682
Total performing – Stage 2	**41,719**	**4,208**	**45,927**	43,422	8,542	51,964
Non-Performing – Stage 3						
Not collateralised	**3,229**	**556**	**3,785**	3,099	481	3,580
Fully collateralised						
Less than 50% LTV	**2,295**	**7,377**	**9,672**	4,068	8,894	12,962
51% to 75% LTV	**1,303**	**4,350**	**5,653**	6,393	6,106	12,499
76% to 90% LTV	**4,449**	**1,405**	**5,854**	710	3,587	4,297
91% to 100% LTV	**-**	**106**	**106**	-	127	127
	8,047	**13,238**	**21,285**	11,171	18,714	29,885
Partially collateralised						
Greater than 100% LTV	**20,087**	**6,223**	**26,310**	19,195	7,113	26,308
Total non-performing – Stage 3	**31,363**	**20,017**	**51,380**	33,465	26,308	59,773
At 31 December	**552,925**	**24,225**	**577,150**	499,687	34,850	534,537

2 **Financial risk management** *(continued)*

2.3.13 Trade and other receivables

The Bank's subsidiary assesses the credit quality of its customers taking into account financial position, past experience and other factors. It has policies in place to ensure that sales of products and services are effected to customers with an appropriate credit history in the case of credit sales. The subsidiary monitors the performance of these financial assets on a regular basis to identify incurred collection losses which are inherent in the subsidiary's receivables taking into account historical experience in collection of accounts receivable.

Standard credit terms are in place for individual clients, however, wherever possible, new corporate customers are analysed individually for creditworthiness before the subsidiary's standard payment and service delivery terms and conditions are offered. The entity's review includes external creditworthiness databases when available. The subsidiary establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables. This allowance represents Expected Credit Losses against individual exposures. The movement in provisions for impairment in respect of trade receivables is disclosed in note 16. Other overdue trade receivables amounted to €281,000 (2018: €376,000), principally overdue by nine months, but were not impaired.

The subsidiary's receivables, which are not impaired financial assets, are principally in respect of transactions with customers for whom there is no recent history of default. Management does not expect any material losses from non-performance by these customers.

2.3.14 Contingencies and commitments

Guarantees and standby letters of credit carry the same credit risk as loans. Documentary and commercial letters of credit – which are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions – are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct loan. Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments as most commitments to extend credit are contingent upon customers maintaining specific credit standards. These exposures are monitored in the same manner outlined above in respect of loans and advances.

2.4 *Market risk*

The Group takes on exposure to market risk, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads, foreign exchange rates and equity prices.

Accordingly, market risk for the Group 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 Group's positions in foreign currency because of changes in exchange rates; and
- Equity price risk, which is the risk of losses because of changes in investment prices.

2 **Financial risk management** *(continued)*

2.4.1 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. Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Group, through its banking operations, takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but losses may occur in the event that unexpected movements arise.

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 reprice within different time periods or on different terms. The Bank accepts deposits from customers at both fixed and floating rates and for varying terms. This poses a risk to the Bank, which risk is managed by monitoring on a continuous basis the level of mismatch of interest rate repricing taking cognisance of the terms of the Bank's principal assets, loans and advances to customers, that are repriceable at the Bank's discretion. The Bank also invests in highly liquid quality assets and other short-term instruments for the purposes of mitigating exposures to fluctuations in interest rates. The Bank is accordingly in a position to manage the interest rate terms of its financial assets and simultaneously to effect changes to interest terms of liabilities reflecting the Bank's strategy together with market developments. The Group seeks to manage its net interest spread, considering the cost of capital, by investing funds in a portfolio of assets with a longer term than the liabilities funding them (therefore normally giving rise to a negative maturity gap position) but with shorter repricing periods or terms. The Bank manages the shorter term nature of the liabilities funding the assets for the purposes of ensuring a steady base of deposits with differing terms over the medium to longer term. The Bank's Assets & Liabilities Committee is primarily responsible for oversight over the Bank's interest rate risk management process and monitors actively the interest rate risk measures utilised by the Bank.

Credit facilities and commitments to lend funds to customers are granted at prevailing market interest rates at drawdown date.

2 **Financial risk management** *(continued)*

The following tables summarise the Group's exposures to interest rate risks. These analyse the Group's financial instruments, which were interest-bearing at their carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

Group	Carrying amount	Effective interest rate	Less than 3 months	Between 3 months and 1 year	Between 1 year and 5 years	More than 5 years	Non-interest bearing
At 31 December 2019	**€ 000**	**%**	**€ 000**	**€ 000**	**€ 000**	**€ 000**	**€ 000**
Financial assets							
Balances with Central Bank of Malta, treasury bills and cash	182,348	0.02	133,038	42,079	-	-	7,231
Debt and other fixed income instruments measured at FVOCI	100,945	2.08	46	12,952	24,373	63,574	-
Loans and advances to banks	121,060	0.76	120,060	1,000	-	-	-
Loans and advances to customers	552,043	4.20	462,847	12,425	32,424	35,248	9,099
Total financial assets	**956,396**	**7.06**	**715,991**	**68,456**	**56,797**	**98,822**	**16,330**
Financial liabilities							
Amounts owed to banks	5,871	0.10	5,492	-	-	-	379
Amounts owed to customers	864,993	0.70	507,139	74,515	127,871	48,920	106,548
Total financial liabilities	**870,864**	**0.80**	**512,631**	**74,515**	**127,871**	**48,920**	**106,927**
Interest repricing gap			**203,360**	**(6,059)**	**(71,074)**	**49,902**	**(90,597)**
Cumulative gap			**203,360**	**197,301**	**126,227**	**176,129**	

2 **Financial risk management** *(continued)*

Group **At 31 December 2018**	**Carrying amount** **€ 000**	**Effective interest rate** **%**	**Less than 3 months** **€ 000**	**Between 3 months and 1 year** **€ 000**	**Between 1 year and 5 years** **€ 000**	**More than 5 years** **€ 000**	**Non-interest bearing** **€ 000**
Financial assets							
Balances with Central Bank of Malta, treasury bills and cash	128,726	0.09	87,206	36,583	-	-	4,937
Debt and other fixed income instruments measured at FVOCI	87,481	3.05	102	8,181	20,016	59,182	-
Loans and advances to banks	140,581	0.97	129,581	11,000	-	-	-
Loans and advances to customers	511,124	4.38	409,138	16,632	40,941	35,797	8,616
Total financial assets	867,912		626,027	72,396	60,957	94,979	13,553
Financial liabilities							
Amounts owed to banks	854	0.10	503	-	-	-	351
Amounts owed to customers	788,044	0.73	476,269	68,325	88,406	61,590	93,454
Total financial liabilities	788,898		476,772	68,325	88,406	61,590	93,805
Interest repricing gap			149,255	4,071	(27,449)	33,389	(80,252)
Cumulative gap			149,255	153,326	125,877	159,266	

2 **Financial risk management** *(continued)*

Bank At 31 December 2019	Carrying amount € 000	Effective interest rate %	Less than 3 months € 000	Between 3 months and 1 year € 000	Between 1 year and 5 years € 000	More than 5 years € 000	Non-interest bearing € 000
Financial assets							
Balances with Central Bank of Malta, treasury bills and cash	181,701	0.02	133,038	42,079	-	-	6,584
Debt and other fixed income instruments measured at FVOCI	97,020	1.96	-	12,952	22,962	61,106	-
Loans and advances to banks	115,678	0.79	115,678	-	-	-	-
Loans and advances to customers	552,055	4.20	462,859	12,425	32,424	35,248	9,099
Total financial assets	946,454		711,575	67,456	55,386	96,354	15,683
Financial liabilities							
Amounts owed to banks	5,871	0.10	5,492	-	-	-	379
Amounts owed to customers	868,832	0.70	510,019	74,715	127,871	48,920	107,307
Total financial liabilities	874,703		515,511	74,715	127,871	48,920	107,686
Interest repricing gap			196,064	(7,259)	(72,485)	47,434	(92,003)
Cumulative gap			196,064	188,805	116,320	163,754	

2 **Financial risk management** *(continued)*

Bank **At 31 December 2018**	**Carrying amount** **€ 000**	**Effective interest rate** **%**	**Less than 3 months** **€ 000**	**Between 3 months and 1 year** **€ 000**	**Between 1 year and 5 years** **€ 000**	**More than 5 years** **€ 000**	**Non-interest bearing** **€ 000**
Financial assets							
Balances with Central Bank of Malta, treasury bills and cash	128,143	0.09	87,206	36,583	-	-	4,354
Debt and other fixed income instruments measured at FVOCI	83,656	2.97	-	7,967	18,921	56,768	-
Loans and advances to banks	125,819	1.07	117,819	8,000	-	-	-
Loans and advances to customers	511,124	4.38	409,138	16,632	40,941	35,797	8,616
Total financial assets	848,742		614,163	69,182	59,862	92,565	12,970
Financial liabilities							
Amounts owed to banks	854	0.10	503	-	-	-	351
Amounts owed to customers	790,073	0.73	477,025	68,539	88,406	61,590	94,513
Total financial liabilities	790,927		477,528	68,539	88,406	61,590	94,864
Interest repricing gap			136,635	643	(28,544)	30,975	(81,894)
Cumulative gap			136,635	137,278	108,734	139,709	

2 **Financial risk management** *(continued)*

2.4.2 Interest rate profile

At the end of the reporting periods the interest rate profile of the Group's interest-bearing financial instruments was:

Group	**Fixed rate**		**Variable rate**	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Interest-earning assets				
Balances with Central Bank of Malta and treasury bills	**120,807**	115,089	**54,311**	8,700
Debt and other fixed income instruments measured at FVOCI	**100,945**	86,475	**-**	1,006
Loans and advances to banks	**64,686**	79,789	**56,374**	60,792
Loans and advances to customers	**81,041**	95,259	**461,904**	407,249
	367,479	376,612	**572,589**	477,747
Interest-bearing liabilities				
Amounts owed to banks	**23**	23	**5,470**	480
Amounts owed to customers	**318,959**	264,553	**439,486**	430,037
	318,982	264,576	**444,956**	430,517

At the end of the reporting periods the interest rate profile of the Bank's interest-bearing financial instruments was:

Bank	**Fixed rate**		**Variable rate**	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Interest-earning assets				
Balances with Central Bank of Malta and treasury bills	**120,807**	115,089	**54,311**	8,700
Debt and other fixed income instruments measured at FVOCI	**97,020**	82,650	**-**	1,006
Loans and advances to banks	**63,685**	76,789	**51,993**	49,030
Loans and advances to customers	**81,041**	95,259	**461,916**	407,249
	362,553	369,787	**568,220**	465,985
Interest-bearing liabilities				
Amounts owed to banks	**23**	23	**5,470**	480
Amounts owed to customers	**321,659**	265,268	**439,866**	430,292
	321,682	265,291	**445,336**	430,772

2 **Financial risk management** *(continued)*

2.4.3 Fair value sensitivity analysis for fixed rate instruments

The Group's instruments exposing the Bank to fair value interest rate risk consist of quoted debt securities measured at (also refer to note 6) since these are fair valued with fair value changes recognised in other comprehensive income. Considering the nature and carrying amount of the investments, with the majority of investments comprising securities issued by the Government of Malta, a sensitivity analysis disclosing how equity would have been affected by changes in interest rates that were reasonably possible at the end of the reporting period is not deemed necessary.

2.4.4 Cash flow sensitivity analysis for variable rate instruments

At the end of the reporting periods, if interest rates had increased/decreased by 100 basis points (assuming a parallel shift of 100 basis points in yields) with all other variables held constant, the pre-tax result for the year would change by the following amounts determined by applying the shift to the net variable interest exposure of the Group/Bank at the end of the reporting periods:

Group	**2019** **€ 000**	2018 € 000
(+) 100bp	**1,276**	472
(-) 100bp	**(1,276)**	(472)

Bank	**2019** **€ 000**	2018 € 000
(+) 100bp	**1,229**	352
(-) 100bp	**(1,229)**	(352)

2.4.5 Currency risk

The Group takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows particularly within the Bank's operations. Foreign exchange risk to the Bank is the risk that earnings and values fluctuate as a result of changes in foreign exchange rates. The Bank's foreign exchange risk arises when financial assets or liabilities are denominated in currencies which are different from the Bank's functional currency.

The Bank essentially manages this risk by ensuring that foreign currency liabilities are utilised to fund assets denominated in the same foreign currency thereby matching asset and liability positions as much as is practicable. This mechanism is reflected in the figures reported in the tables below which present this matching process.

The Bank maintains its exposure to foreign currencies within prescribed limits set by the Bank's ALCO. ALCO sets limits on the level of exposure by currency and in aggregate for both overnight and intra-day positions which are monitored on a real-time basis.

2 **Financial risk management** *(continued)*

The Bank enters into forward foreign exchange contracts with customers in the normal course of its business. Generally, it is the Bank's policy to cover the exposure arising from forward contracts. As a result, the Group is not exposed to any significant exchange risk in respect of outstanding derivative financial instruments at the end of the reporting periods. The Bank also retains a deposit margin covering a portion of the notional amount of the respective contract from the customer thereby reducing the extent of credit risk should the derivative client default. The Bank did not have any derivative financial instruments as at 31 December 2019 and 2018.

The following tables summarise the Group's exposures to foreign currency risk. Included in the tables are the entity's financial instruments which are subject to foreign exchange risk at carrying amounts, categorised by currency.

Group **At 31 December 2019**	**Total** **€ 000**	**EUR** **€ 000**	**GBP** **€ 000**	**USD** **€ 000**	**Other** **€ 000**
Financial assets					
Balances with Central Bank of Malta, treasury bills and cash	**182,348**	**160,567**	**12,435**	**9,340**	**6**
Investments measured at FVOCI	**111,731**	**111,331**	**-**	**400**	**-**
Loans and advances to banks	**121,060**	**38,409**	**27,249**	**51,666**	**3,736**
Loans and advances to customers	**552,043**	**549,037**	**2,846**	**160**	**-**
Other assets	**8,876**	**5,929**	**357**	**1,779**	**811**
Total financial assets	**976,058**	**865,273**	**42,887**	**63,345**	**4,553**
Financial liabilities					
Amounts owed to banks	**5,871**	**5,871**	**-**	**-**	**-**
Amounts owed to customers	**864,993**	**758,625**	**42,432**	**60,272**	**3,664**
Other liabilities	**34,560**	**31,420**	**399**	**2,049**	**692**
Total financial liabilities	**905,424**	**795,916**	**42,831**	**62,321**	**4,356**
Net currency exposure in financial assets/liabilities		**69,357**	**56**	**1,024**	**197**
Commitments and contingent liabilities	**235,130**	**233,262**	**1,095**	**773**	**-**

2 **Financial risk management** *(continued)*

Group **At 31 December 2018**	**Total** **€ 000**	**EUR** **€ 000**	**GBP** **€ 000**	**USD** **€ 000**	**Other** **€ 000**
Financial assets					
Balances with Central Bank of Malta, treasury bills and cash	128,726	106,508	8,728	13,475	15
Investments measured at FVOCI	100,070	99,675	-	395	-
Loans and advances to banks	140,581	53,382	26,364	53,449	7,386
Loans and advances to customers	511,124	509,098	2,026	-	-
Other assets	10,650	7,844	362	1,660	784
Total financial assets	891,151	776,507	37,480	68,979	8,185
Financial liabilities					
Amounts owed to banks	854	854	-	-	-
Amounts owed to customers	788,044	679,131	36,644	64,840	7,429
Other liabilities	36,937	32,365	735	3,223	614
Total financial liabilities	825,835	712,350	37,379	68,063	8,043
Net currency exposure in financial assets/liabilities		64,157	101	916	142
Commitments and contingent liabilities	214,538	213,520	144	874	-

Under the scenario that the euro appreciates by 20% against all currencies the effect would be a decrease of €256,000 (2018: €231,000) in the carrying amount of financial instruments with the adverse impact recognised in profit or loss. Should the euro depreciate against all currencies by 20%, the effect would be a gain of €256,000 (2018: €231,000) in the carrying amount of financial instruments and the favourable impact would be recognised in profit or loss.

2 **Financial risk management** *(continued)*

The following tables summarise the Bank's exposures to foreign currency risk. Included in the tables are the entity's financial instruments which are subject to foreign exchange risk at carrying amounts, categorised by currency.

Bank **At 31 December 2019**	**Total** **€ 000**	**EUR** **€ 000**	**GBP** **€ 000**	**USD** **€ 000**	**Other** **€ 000**
Financial assets					
Balances with Central Bank of Malta, treasury bills and cash	**181,701**	**159,920**	**12,435**	**9,340**	**6**
Investments measured at FVOCI	**107,806**	**107,406**	**-**	**400**	**-**
Loans and advances to banks	**115,678**	**32,957**	**27,250**	**51,736**	**3,735**
Loans and advances to customers	**552,055**	**549,049**	**2,846**	**160**	**-**
Other assets	**5,010**	**4,972**	**17**	**21**	**-**
Total financial assets	**962,250**	**854,304**	**42,548**	**61,657**	**3,741**
Financial liabilities					
Amounts owed to banks	**5,871**	**5,871**	**-**	**-**	**-**
Amounts owed to customers	**868,832**	**762,306**	**42,433**	**60,429**	**3,664**
Other liabilities	**19,866**	**18,878**	**147**	**749**	**92**
Total financial liabilities	**894,569**	**787,055**	**42,580**	**61,178**	**3,756**
Net currency exposure in financial assets/liabilities		**67,249**	**(32)**	**479**	**(15)**
Commitments and contingent liabilities	**236,340**	**234,472**	**1,095**	**773**	**-**

2 **Financial risk management** *(continued)*

Bank **At 31 December 2018**	**Total** **€ 000**	**EUR** **€ 000**	**GBP** **€ 000**	**USD** **€ 000**	**Other** **€ 000**
Financial assets					
Balances with Central Bank of Malta, treasury bills and cash	128,143	105,929	8,724	13,475	15
Investments measured at FVOCI	96,245	95,850	-	395	-
Loans and advances to banks	125,819	38,650	26,363	53,420	7,386
Loans and advances to customers	511,124	509,098	2,026	-	-
Other assets	7,407	7,319	43	18	27
Total financial assets	868,738	756,846	37,156	67,308	7,428
Financial liabilities					
Amounts owed to banks	854	854	-	-	-
Amounts owed to customers	790,073	681,076	36,667	64,900	7,430
Other liabilities	18,805	16,382	483	1,924	16
Total financial liabilities	809,732	698,312	37,150	66,824	7,446
Net currency exposure in financial assets/liabilities		58,534	6	484	(18)
Commitments and contingent liabilities	214,557	213,539	144	874	-

Under the scenario that the euro appreciates by 20% against all currencies the effect would be a decrease of €86,000 (2018: €95,000) in the carrying amount of financial instruments with the adverse impact recognised in profit or loss. Should the euro depreciate against all currencies by 20%, the effect would be a gain of €86,000 (2018: €95,000) in the carrying amount of financial instruments and the favourable impact would be recognised in profit or loss.

2.4.6 Equity price risk

The exposure of the Group to this risk is not significant in view of the extent of the Group's holdings of equity investments measured at FVOCI (refer to note 6) which are not deemed material in the context of the Group's statement of financial position. These investments are principally locally quoted equity instruments issued by local well-known corporates. Frequent management reviews are carried out to ensure continued high quality of the portfolio.

2.5 *Liquidity risk*

Liquidity risk is defined as the risk of losses due to:

- the Group's funding costs increasing disproportionately;
- lack of funding preventing the Group from establishing new business; and
- lack of funding which will ultimately prevent the Group from meeting its obligations.

2 **Financial risk management** *(continued)*

In relation to the Bank's operations, liquidity risk is the risk that the Bank is unable to meet its obligations when they fall due as a result of customer deposits being withdrawn, cash requirements from contractual commitments, or other cash outflows. The Group is exposed to daily calls on its available cash resources from overnight deposits, current and call deposits, maturing term deposits, loan draw-downs and guarantees together with other related off-balance sheet instruments. Such outflows would deplete available cash resources for client lending and investments. In extreme circumstances, lack of liquidity could result in sales of assets, or potentially an inability to fulfil lending commitments. The risk that the Group will be unable to do so is inherent in all banking operations and can be affected by a range of institution-specific and market-wide events including, but not limited to, credit events, systemic shocks and natural disasters.

The objective of the Group's liquidity and funding management is to ensure that all foreseeable funding commitments and deposit withdrawals can be met when due. It is the Bank's objective to maintain a diversified and stable funding base with the objective of enabling it to respond quickly and smoothly to unforeseen liquidity requirements.

The Group manages this risk by ensuring that its assets and liabilities are matched in terms of maturities as much as is practicable. However, the Bank ought to manage its net interest spread by investing funds in a portfolio of assets with a longer term than the liabilities funding them (therefore giving rise to a negative maturity gap position). To mitigate exposures arising in this respect, the Bank holds significant liquid assets in the form of Malta Government treasury bills, money market placements and other short-term instruments for managing liquidity risk to support payment obligations and contingent funding in a stressed market environment.

The Bank's Advances-to-Deposit ratio of 63.5% (2018: 64.7%) at the end of the reporting period reflects management's prudent stance in the context of liquidity management.

Liquidity Coverage Ratio

The Liquidity Coverage Ratio (LCR) is designed to promote the short-term resilience of a bank's liquidity profile. This ratio became a minimum regulatory standard from 1 October 2015, under the European Commission Delegated Regulation 2015/61.

The LCR aims to ensure that a bank has adequate unencumbered high-quality liquid assets (HQLA) to meet its liquidity requirements within a 30-calendar-day liquidity stress scenario. Generally, HQLA consists of cash or assets that can be converted into cash at little or no loss of value in markets.

The Bank's LCR as at 31 December 2019 was 301.5% (2018: 385.6%).

Net Stable Funding Ratio

The Net Stable Funding Ratio (NSFR) is a metric showing how a bank is able to maintain sufficient stable funding relative to required stable funding, and reflects a bank's long-term funding profile (typically, with a term of more than one year).

The Bank calculates its NSFR ratio in line with the Basel Committee on Banking Supervision (publication 295), given that the European calibration is still subject to implementation by the European Commission.

2 **Financial risk management** *(continued)*

The Bank's NSFR as at 31 December 2019 was 140.2% (2018: 133.1%).

The Bank's ALCO focuses on the Bank's management process with respect to market and funding liquidity risks.

The Group's liquidity management process, focusing on the liquidity of the Bank and that of its principal subsidiary, includes:

- management of day-to-day funding, by monitoring future cash flows to ensure that requirements can be met. This includes replenishment of funds as they mature or are borrowed by customers. The starting point for those projections is an analysis of the contractual maturity of the financial liabilities and the expected collection date of the financial assets;
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
- monitoring the liquidity ratios of the Bank against internal and regulatory requirements; and
- managing the concentration and profile of debt maturities.

The Bank also monitors the level and type of undrawn lending commitments and the impact of contingent liabilities such as guarantees as part of the liquidity management process previously referred to.

As at 31 December 2019, the Bank had outstanding guarantees on behalf of third parties amounting to €8,942,000 (2018: €11,206,000), which are cancellable upon the request of the third parties. The Group's liquidity exposures arising from these commitments and contingencies are expected to expire principally within a period of twelve months from the end of the reporting period.

The following tables analyse the Group's principal financial assets and liabilities into relevant maturity groupings based on the remaining period at the end of the reporting period to the contractual maturity date.

2 **Financial risk management** *(continued)*

Group At 31 December 2019	Less than 3 months € 000	Between 3 months and 1 year € 000	Between 1 year and 5 years € 000	More than 5 years € 000	No maturity date € 000	Total € 000
Financial assets						
Balances with Central Bank of Malta, treasury bills and cash	**133,038**	**42,079**	**-**	**-**	**7,231**	**182,348**
Investments measured at FVOCI	**46**	**12,952**	**24,373**	**63,574**	**10,786**	**111,731**
Loans and advances to banks	**120,060**	**1,000**	**-**	**-**	**-**	**121,060**
Loans and advances to customers	**136,209**	**58,722**	**110,949**	**246,163**	**-**	**552,043**
Other assets	**8,456**	**420**	**-**	**-**	**-**	**8,876**
Total financial assets	**397,809**	**115,173**	**135,322**	**309,737**	**18,017**	**976,058**
Financial liabilities						
Amounts owed to banks	**5,871**	**-**	**-**	**-**	**-**	**5,871**
Amounts owed to customers	**613,687**	**74,515**	**127,871**	**48,920**	**-**	**864,993**
Other liabilities	**19,401**	**322**	**784**	**5,596**	**8,457**	**34,560**
Total financial liabilities	**638,959**	**74,837**	**128,655**	**54,516**	**8,457**	**905,424**
Maturity gap	**(241,150)**	**40,336**	**6,667**	**255,221**		
Cumulative gap	**(241,150)**	**(200,814)**	**(194,147)**	**61,074**		

Group At 31 December 2018						
Financial assets						
Balances with Central Bank of Malta, treasury bills and cash	87,206	36,583	-	-	4,937	128,726
Investments measured at FVOCI	102	8,181	20,016	59,182	12,589	100,070
Loans and advances to banks	129,581	11,000	-	-	-	140,581
Loans and advances to customers	107,966	55,362	127,765	220,031	-	511,124
Other assets	10,210	440	-	-	-	10,650
Total financial assets	335,065	111,566	147,781	279,213	17,526	891,151
Financial liabilities						
Amounts owed to banks	854	-	-	-	-	854
Amounts owed to customers	569,725	68,325	88,406	61,588	-	788,044
Other liabilities	31,857	358	565	2,234	1,923	36,937
Total financial liabilities	602,436	68,683	88,971	63,822	1,923	825,835
Maturity gap	(267,371)	42,883	58,810	215,391		
Cumulative gap	(267,371)	(224,488)	(165,678)	49,713		

2 **Financial risk management** *(continued)*

Bank	**Less than 3 months**	**Between 3 months and 1 year**	**Between 1 year and 5 years**	**More than 5 years**	**No maturity date**	**Total**
At 31 December 2019	**€ 000**	**€ 000**	**€ 000**	**€ 000**	**€ 000**	**€ 000**
Financial assets						
Balances with Central Bank of Malta, treasury bills and cash	**133,038**	**42,079**	**-**	**-**	**6,584**	**181,701**
Investments measured at FVOCI	**-**	**12,952**	**22,962**	**61,106**	**10,786**	**107,806**
Loans and advances to banks	**115,678**	**-**	**-**	**-**	**-**	**115,678**
Loans and advances to customers	**136,221**	**58,722**	**110,949**	**246,163**	**-**	**552,055**
Other assets	**4,590**	**420**	**-**	**-**	**-**	**5,010**
Total financial assets	**389,527**	**114,173**	**133,911**	**307,269**	**17,370**	**962,250**
Financial liabilities						
Amounts owed to banks	**5,871**	**-**	**-**	**-**	**-**	**5,871**
Amounts owed to customers	**617,326**	**74,715**	**127,871**	**48,920**	**-**	**868,832**
Other liabilities	**12,701**	**322**	**784**	**3,616**	**2,443**	**19,866**
Total financial liabilities	**635,898**	**75,037**	**128,655**	**52,536**	**2,443**	**894,569**
Maturity gap	**(246,371)**	**39,136**	**5,256**	**254,733**		
Cumulative gap	**(246,371)**	**(207,235)**	**(201,979)**	**52,754**		

Bank						
At 31 December 2018						
Financial assets						
Balances with Central Bank of Malta, treasury bills and cash	87,206	36,583	-	-	4,354	128,143
Investments measured at FVOCI	-	7,967	18,921	56,768	12,589	96,245
Loans and advances to banks	117,819	8,000	-	-	-	125,819
Loans and advances to customers	107,966	55,362	127,765	220,031	-	511,124
Other assets	6,967	440	-	-	-	7,407
Total financial assets	319,958	108,352	146,686	276,799	16,943	868,738
Financial liabilities						
Amounts owed to banks	854	-	-	-	-	854
Amounts owed to customers	571,538	68,539	88,406	61,590	-	790,073
Other liabilities	13,726	358	565	2,233	1,923	18,805
Total financial liabilities	586,118	68,897	88,971	63,823	1,923	809,732
Maturity gap	(266,160)	39,455	57,715	212,976		
Cumulative gap	(266,160)	(226,705)	(168,990)	43,986		

2 **Financial risk management** *(continued)*

The tables below analyse the Group's principal non-derivative financial liabilities into relevant maturity groupings based on the remaining period at the end of the reporting period to the contractual maturity date. The amounts disclosed in the tables are the contractual undiscounted cash flows.

Group **At 31 December 2019**	**Less than 3 months € 000**	**Between 3 months and 1 year € 000**	**Between 1 year and 5 years € 000**	**More than 5 years € 000**	**Total € 000**
Financial liabilities					
Amounts owed to banks	**5,871**	**-**	**-**	**-**	**5,871**
Amounts owed to customers	**614,079**	**75,440**	**136,072**	**59,010**	**884,601**
Total financial liabilities	**619,950**	**75,440**	**136,072**	**59,010**	**890,472**

At 31 December 2018					
Financial liabilities					
Amounts owed to banks	854	-	-	-	854
Amounts owed to customers	570,136	69,315	93,300	71,864	804,615
Total financial liabilities	570,990	69,315	93,300	71,864	805,469

2 **Financial risk management** *(continued)*

The tables below analyse the Bank's principal non-derivative financial liabilities into relevant maturity groupings based on the remaining period at the end of the reporting period to the contractual maturity date. The amounts disclosed in the tables are the contractual undiscounted cash flows.

Bank **At 31 December 2019**	**Less than 3 months € 000**	**Between 3 months and 1 year € 000**	**Between 1 year and 5 years € 000**	**More than 5 years € 000**	**Total € 000**
Financial liabilities					
Amounts owed to banks	**5,871**	**-**	**-**	**-**	**5,871**
Amounts owed to customers	**617,718**	**75,640**	**136,072**	**59,010**	**888,440**
Total financial liabilities	**623,589**	**75,640**	**136,072**	**59,010**	**894,311**
At 31 December 2018					
Financial liabilities					
Amounts owed to banks	854	-	-	-	854
Amounts owed to customers	571,950	69,530	93,300	71,864	806,644
Total financial liabilities	572,804	69,530	93,300	71,864	807,498

2 **Financial risk management** *(continued)*

2.6 *Operational risk*

Operational risk is the risk of losses due to:

- deficient or erroneous internal procedures;
- human or system errors;
- external events, including legal events;
- internal and external fraud;
- employment practices and workplace safety;
- clients, products and business practices;
- damage to physical assets;
- business disruption and system failures; and
- execution, delivery and process management.

Operational risk is thus often associated with specific and one-off events, such as failure to observe business or working procedures, defects or breakdowns of the technical infrastructure, criminal acts, fire and storm damage or litigation. Operational risks are, thus, non-financial risks. Operational risk management relies on a framework of policies implemented by the different operational functions and which implementation is overseen by the Risk Management Function.

A financial measurement of this risk is arrived at by the Group for the purpose of allocating risk capital using the Basic Indicator Approach under the European Union Directive on Capital Requirements (CRD) rules. The capital requirement for operational risk under this method was calculated at €3,667,000 (2018: €3,337,000).

2.7 *Capital risk management*

The Group's objectives when managing capital, which is a broader concept than the 'equity' on the consolidated statement of financial position, are:

- to comply with the capital requirements set by the MFSA with respect to the Bank's operations;
- to safeguard the Group's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders; and
- to maintain a strong capital base to support the development of its business.

Accordingly, the purpose of the Group's capital management is essentially that of ensuring efficient use of capital taking cognisance of the Group's risk appetite and profile as well as its objectives for business development. The Group is subject to externally imposed capital requirements only in respect of the Bank's activities as a credit institution. The Bank is a licensed financial services provider and must therefore comply with the capital requirements under the relevant laws and regulations.

The Bank's Executive Team and ALCO are predominately responsible for the Bank's capital risk management process. Capital adequacy and the use of regulatory capital are monitored regularly by the Bank's management, employing techniques based on the guidelines developed by the Basel Committee and the European Union Directives, as implemented by the MFSA for supervisory purposes. The Bank's capital management is based on the regulatory requirements established by local laws and regulations which are modelled on the requisites of the CRD rules. The CRD consists of three pillars: Pillar I contains a set of rules for a mathematical calculation of the capital requirement; Pillar II describes the supervisory review process and contains requirements for the internal calculation of the capital requirement while Pillar III deals with market discipline and sets forth disclosure requirements for risk and capital management.

2 **Financial risk management** *(continued)*

The following is an analysis of the Bank's Capital Base in accordance with the CRD's requirements:

	2019	2018
	€ 000	€ 000
Common Equity Tier 1 (CET1) capital		
Share capital	**11,044**	11,044
Share premium	**18,530**	18,530
Revaluation and other reserves	**17,901**	15,490
Retained earnings	**67,137**	59,097
	114,612	104,161
Adjustments:		
Final dividend	**(2,010)**	(1,436)
Depositor Compensation Scheme	**(3,045)**	(3,502)
Intangible assets	**(399)**	(375)
Minimum loss coverage for non-performing exposures	-	(171)
Transfer of unrealised gains to Tier 2 capital	-	-
Total CET1 capital	**109,158**	98,677
Tier 2 capital		
Property revaluation reserve	-	-
Investment revaluation reserve	-	-
Total Tier 2 capital	-	-
Total own funds	**109,158**	98,677

Minimum capital requirements are computed for credit, market and operational risks. The MFSA requires a bank to maintain a ratio of total regulatory capital to risk-weighted assets and instruments (the Capital requirements ratio) at or above the prescribed minimum of 8%. The Capital requirements ratio expresses Own funds as a proportion of risk-weighted assets and off-balance sheet instruments in relation to Credit Risk together with notional risk-weighted assets in respect of Operational Risk and Market Risk.

The risk-weighted assets are measured by means of a hierarchy of risk weights classified according to the nature of – and reflecting an estimate of credit, market and other risks associated with – each asset and counterparty, taking into account any eligible collateral or guarantees. A similar treatment is adopted for off-balance sheet instruments, with some adjustments to reflect the more contingent nature of the potential losses. Risk-weighted assets are measured using the 'Standardised Approach' for credit risk with risk-weights being assigned to assets and off-balance sheet instruments according to their asset class and credit risk mitigation. For the determination of credit assessments, independent rating agencies are nominated as required.

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.

2 **Financial risk management** *(continued)*

2.8 *Fair value of financial assists and liabilities*

2.8.1 Financial instruments measured at fair value

The Group's financial instruments which are carried at fair value include the Group's financial assets measured at FVOCI (note 6). The Group is required to disclose fair value measurements by level of the following fair value measurement hierarchy for financial instruments that are measured in the statement of financial position at fair value:

- quoted prices (unadjusted) in active markets for identical assets (Level 1).
- inputs other than quoted prices included within Level 1 that are observable for the asset either directly i.e. as prices, or indirectly i.e. derived from prices (Level 2).
- inputs for the asset that are not based on observable market data i.e. unobservable inputs (Level 3).

The IFRS 7 hierarchy of valuation techniques is based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Bank's market assumptions.

The Bank considers only relevant and observable market prices in its valuations. Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations.

The fair value of the Bank's financial assets measured at FVOCI, which are principally traded in active markets, is mainly based on quoted market prices.

As at 31 December 2019 and 2018, the principal financial instruments that are measured at fair value, consisted of the investments measured at FVOCI, that were valued using principally Level 1 inputs. No transfers of financial instruments between different levels of the fair value hierarchy have occurred during the financial years ended 31 December 2019 and 2018.

2.8.2 Financial instruments not measured at fair value

Loans and advances to banks and customers

These categories of assets are presented net of impairment allowances to reflect the estimated recoverable amounts. As at 31 December 2019, the Group's aggregate carrying amount in this respect was €673,103,000 (2018: €651,705,000). The loans and advances to customers, which are principally subject to floating interest rates, are measured at the amount of €552,043,000 (2018: €511,124,000). This carrying value approximates to fair value in view of the fact that these loans and advances are repriceable at the Group's discretion. The loans and advances to banks, comprising term placements maturing within one month from the end of the reporting period, are carried at the amount of €63,685,000 (2018: €68,789,000). Rates on advances reflect current market rates, and the Directors consider the carrying amounts to be a reasonable estimate of their fair value principally in view of the relatively short periods to repricing or maturity from the end of the reporting periods. The current market interest rates utilised for fair value estimation, which reflect essentially the respective instruments' contractual interest rates, are deemed observable and accordingly these fair value estimates have been categorised as Level 2.

Trade and other receivables

This category principally represents short-term trade receivables arising from postal operations in respect of which the carrying amount is a reasonable approximation of its fair value.

2 **Financial risk management** *(continued)*

Amounts owed to banks and customers

These categories of financial liabilities are carried at amortised cost and amount to €870,863,000 as at 31 December 2019 (2018: €788,899,000). 12.3% (2018: 11.9%) of this liability is non-interest bearing, 58.9% (2018: 60.4%) of the liability has a contractual repricing term of three months or less, 8.6% (2018: 8.7%) reprices between three months and one year, 14.7% (2018: 11.2%) reprices between one year and five years while 5.6% (2018: 7.8%) is repriceable after more than five years. Accordingly, in view of their profile, the fair value of these financial liabilities is not deemed to be significantly different from their carrying amounts. This applies to variable rate deposits in view of the short periods to repricing, but also applies to liabilities subject to fixed interest rates, based on discounting future contractual cash flows at current market interest rates, taking into account the short periods to maturity. The current market interest rates utilised for discounting purposes, which were almost equivalent to the respective instruments' contractual interest rates, are deemed observable and accordingly these fair value estimates have been categorised as Level 2.

Other financial instruments

The fair values of certain other financial assets, including balances with the Central Bank of Malta and accrued income, are considered to approximate their respective carrying values due to their short-term nature.

3 **Accounting estimates and judgements**

3.1 *Critical accounting estimates and judgements in applying the Group's accounting policies*

Estimates and judgements are continually evaluated and based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances.

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. These estimates and assumptions present a risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. The Group's management also makes judgements, apart from those involving estimations, in the process of applying the entity's accounting policies that may have a significant effect on the amounts recognised in the financial statements.

3.2 *Measurement of the Expected Credit Losses*

The measurement of the Expected Credit Loss allowance for financial assets measured at amortised cost and FVOCI is an area that requires the use of complex models and significant assumptions about future economic conditions and credit behaviour. Explanation of the inputs, assumptions and estimation techniques used in measuring ECL is further detailed in note 2.

A number of significant judgements are required in measurement of Expected Credit Loss, such as:

- determining criteria for significant increase in credit risk;
- choosing appropriate models and assumptions for the measurement of ECL; and
- establishing the number and relative weightings of forward-looking scenarios and associated ECL.

3 **Accounting estimates and judgements** *(continued)*

Detailed information about the judgements and estimates made by the Bank in the above areas is set out in note 2.

3.3 *Assessment of estimates and judgements*

In the opinion of the Directors, the accounting estimates and judgements made in the course of preparing these consolidated financial statements, which have been highlighted above, are not difficult, subjective or complex to a degree which would warrant their description as critical in terms of the requirements of IAS 1.

However, the Directors would like to draw attention to these accounting judgements, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In this respect these primarily comprise assumptions and estimates relating to the calculation of impairment allowances in respect of loans and advances to customers (see notes 2.3, 8 and 32).

4 **Segmental information**

The Group has two reporting segments, as described below, which are the Group's strategic business units and cash-generating units. The strategic business units offer different services and are managed separately because they require different technology and marketing strategies. For each of the strategic business units, the Board of Directors reviews internal management reports. The following summary describes the operations in each of the Group's reportable segments:

- banking services comprise the Group's banking services and other activities carried out as a licensed credit institution, an authorised currency dealer and financial intermediary. Stockbroking activities may also be carried out since the Bank is a member of the Malta Stock Exchange; and
- postal services comprise the Group's postal services activities, being the sole licensed Universal Service Provider of postal services in Malta.

4 **Segmental information** *(continued)*

The Group's internal reporting to the Board of Directors and senior executives is analysed according to the below segments. Information about reportable segments:

	Banking services		Postal services		Total	
	2019	2018	**2019**	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000	**€ 000**	€ 000
Interest receivable	**25,094**	23,024	**191**	164	**25,285**	23,188
Interest expense	**(5,535)**	(5,677)	**(70)**	-	**(5,605)**	(5,677)
Postal sales and other revenue	**347**	272	**33,212**	38,982	**33,559**	39,254
Net fee and commission income	**4,200**	3,549	**1,205**	1,167	**5,405**	4,716
Other	**1,228**	1,285	**65**	19	**1,293**	1,304
Segment operating income	**25,334**	22,453	**34,603**	40,332	**59,937**	62,785
Depreciation and amortisation	**(765)**	(624)	**(1,289)**	(964)	**(2,054)**	(1,588)
Credit impairment (losses)/reversals	**(551)**	(258)	**2**	24	**(549)**	(234)
Employee compensation and benefits	**(7,029)**	(6,108)	**(16,015)**	(14,657)	**(23,044)**	(20,765)
Other costs	**(4,654)**	(4,438)	**(14,342)**	(22,099)	**(18,996)**	(26,537)
Operating profit	**12,335**	11,025	**2,959**	2,636	**15,294**	13,661
Share of profit of investment accounted for using the equity method, net of tax	**-**	109	**-**	-	**-**	109
Profit before taxation	**12,335**	11,134	**2,959**	2,636	**15,294**	13,770
Income tax expense	**(4,397)**	(3,923)	**(1,027)**	(908)	**(5,424)**	(4,831)
Profit for the year	**7,938**	7,211	**1,932**	1,728	**9,870**	8,939
Segment total assets	**997,087**	902,139	**45,210**	47,390	**1,042,297**	950,069
Capital expenditure during the year	**1,598**	1,575	**2,036**	1,309	**3,634**	2,884
Segment total liabilities	**897,222**	812,720	**18,273**	21,514	**915,495**	834,234

There are no material inter-segment transactions.

The Group mainly provides banking and postal services within the local market and economic sectors. From a customers' perspective, MaltaPost p.l.c. generated 20.6% (2018: 36.9%) of its revenue for 2019 internationally.

The Group's reliance on any single customer is not considered significant for disclosure purposes.

5 **Balances with Central Bank of Malta, treasury bills and cash**

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Balances with Central Bank of Malta	**74,976**	30,155	**74,976**	30,155
Malta Government treasury bills	**100,141**	93,634	**100,141**	93,634
Cash in hand	**7,231**	4,937	**6,584**	4,354
	182,348	128,726	**181,701**	128,143

The balances with the Central Bank of Malta include a reserve deposit amounting to €51,502,000 (2018: €5,892,000) held in terms of Regulation (EC) No. 1745/2003 of the European Central Bank. The average reserve deposit balance held for the relevant maintenance period amounted to €6,282,000 (2018: €5,892,000).

At 31 December 2019, the Bank had pledged a deposit with the Central Bank of Malta amounting to €2,809,000 (2018: €2,809,000) in favour of the Depositor Compensation Scheme to comply with local regulatory requirements.

At 31 December 2019 and 2018, the impairment allowance on balances with Central Bank of Malta and Malta Government treasury bills was insignificant.

6 **Investments**

Financial investments measured at FVOCI include the following:

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Debt and other fixed income instruments	**100,945**	87,419	**97,020**	83,594
Equity instruments	**10,786**	12,651	**10,786**	12,651
	111,731	100,070	**107,806**	96,245

Debt and other fixed income instruments measured at FVOCI which are listed on the Malta Stock Exchange comprise:

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Issued by public bodies:				
- local government	**86,155**	76,037	**83,981**	73,857
Issued by public issuers:				
- local banks	**9,040**	6,162	**8,480**	5,594
- local corporates	**5,750**	5,220	**4,559**	4,143
	100,945	87,419	**97,020**	83,594

6 **Investments** *(continued)*

At 31 December 2019, the impairment allowance measured in accordance with IFRS 9 expected loss model was €183,000 (2018: €163,000).

At 31 December 2019, the Bank held Malta Government Stocks investments measured at FVOCI pledged with the Central Bank of Malta amounting to €8,494,000 (2018: €8,855,000) in terms of Directive No.8 (Chapter 204 of the Central Bank of Malta Act) as security for a facility that was not utilised during the reporting period.

Equity instruments measured at FVOCI include equities listed on the Malta Stock Exchange, except for investments with a carrying amount of €385,000 (2018: €440,000) which are measured at cost in view of the absence of a reliable fair valuation of these investments.

The movement in financial investments measured at FVOCI is summarised as follows:

	Group		**Bank**	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
At 1 January	**100,070**	75,895	**96,245**	72,282
Exchange differences	**8**	18	**8**	18
Amortisation	**(672)**	(472)	**(672)**	(469)
Acquisitions	**15,905**	27,849	**15,682**	27,350
Redemptions/disposals	**(8,311)**	(4,445)	**(8,000)**	(4,196)
Fair value movement	**4,731**	1,225	**4,543**	1,260
At 31 December	**111,731**	100,070	**107,806**	96,245

The disclosure requirements in paragraph 93 of IFRS 13 in respect of Level 3 fair value measurements were not deemed necessary by the Directors taking cognisance of the insignificance of the carrying amount of the interest as at 31 December 2019 and 2018.

7 **Loans and advances to banks**

	Group		**Bank**	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Repayable on call and at short notice	**100,784**	129,581	**97,402**	117,819
Term loans and advances	**20,276**	11,000	**18,276**	8,000
	121,060	140,581	**115,678**	125,819

8 **Loans and advances to customers**

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Repayable on call and at short notice	**93,997**	99,577	**94,009**	99,577
Term loans and advances	**483,141**	434,960	**483,141**	434,960
Gross loans and advances to customers	**577,138**	534,537	**577,150**	534,537
Impairment allowances	**(25,095)**	(23,413)	**(25,095)**	(23,413)
Net loans and advances to customers	**552,043**	511,124	**552,055**	511,124
Impairment allowances				
Stage 1	**3,832**	2,827	**3,832**	2,827
Stage 2	**1,346**	1,739	**1,346**	1,739
Stage 3	**19,917**	18,847	**19,917**	18,847
	25,095	23,413	**25,095**	23,413

Assets acquired in settlement of debt amounting to €134,000 (2018: €778,000) are presented as assets classified as held for sale.

9 **Investment in subsidiaries**

Name of company	Country of incorporation	Nature of business	Equity interest		Carrying amount	
			2019	2018	**2019**	2018
			%	%	**€ 000**	€ 000
Redbox Limited	Malta	Holding Company	**100**	100	**15,732**	15,732

At 31 December 2019, Redbox Limited held 71.5% (2018: 71.5%) of the equity share capital and voting rights of MaltaPost p.l.c., a listed company incorporated and operating in Malta, comprising the Group's postal services reportable segment (see note 4). The remaining 28.5% (2018: 28.5%) is held by the general public.

The profit or loss allocated to non-controlling interests of MaltaPost p.l.c. during the financial year under review, accumulated non-controlling interests of the subsidiary at the end of the reporting period and dividends paid to non-controlling interests are presented within the Group's statement of changes in equity. Financial information about the assets, liabilities, revenues, profit or loss, total comprehensive income and cash flows of the subsidiary are disclosed within the annual report and financial statements of MaltaPost p.l.c., which are publicly available in view of the company's listed status. Financial information about the subsidiary is also disclosed within note 4 to these financial statements dealing with segmental information.

The end of the reporting period of the audited financial statements of MaltaPost p.l.c. that have been utilised in the preparation of these consolidated financial statements is 30 September 2019, since the financial statements prepared as of this date constitute the most recent audited financial statements of MaltaPost p.l.c..

10 **Investment in associate**

Name of company	Country of incorporation	Nature of business	Equity interest		Carrying amount	
			2019	2018	**2019**	2018
			%	%	**€ 000**	€ 000
Gozo Hotels Company Limited	Malta	Accommodation	**33.3**	33.3	**1,684**	1,684

With effect from 31 December 2015 the exposure with Gozo Hotels Company Limited with a carrying amount of €1,645,000 has been recognised as an investment in associate on the basis that the Bank controls 33.3% of the shares (and holds an equivalent amount of voting rights). The Group is deemed to have significant influence over the investee in accordance with the requirements of IAS 28 'Investments in Associates'.

Gozo Hotels Company Limited is an unlisted company incorporated and operating in Malta. Its principal activity is the operation of the Hotel Calypso in Marsalforn, Gozo, and its registered address is 'Calypso', Għar Qawqla Street, Żebbuġ, Gozo.

The investment in associate is measured using the equity method of accounting.

The Group's associate is not deemed material to Lombard Bank Malta p.l.c. as a reporting entity in terms of the requirements of IFRS 12 'Disclosure of interest in other entities' and the disclosure of summarised financial information of the associate and other information is accordingly not deemed necessary.

11 **Intangible assets**

	Group			Bank
	Goodwill € 000	**Computer software € 000**	**Total € 000**	**Computer software € 000**
At 1 January 2018				
Cost	857	5,063	5,920	2,948
Accumulated amortisation	-	(4,272)	(4,272)	(2,468)
Net book amount	857	791	1,648	480
Year ended 31 December 2018				
At 1 January 2018	857	791	1,648	480
Acquisitions	-	506	506	167
Amortisation for the year	-	(453)	(453)	(272)
At 31 December 2018	857	844	1,701	375
At 31 December 2018				
Cost	857	5,569	6,426	3,115
Accumulated amortisation	-	(4,725)	(4,725)	(2,740)
Net book amount	857	844	1,701	375
Year ended 31 December 2019				
At 1 January 2019	**857**	**844**	**1,701**	**375**
Acquisitions	**-**	**794**	**794**	**273**
Amortisation for the year	**-**	**(495)**	**(495)**	**(249)**
At 31 December 2019	**857**	**1,143**	**2,000**	**399**
At 31 December 2019				
Cost	**857**	**6,363**	**7,220**	**3,388**
Accumulated amortisation	**-**	**(5,220)**	**(5,220)**	**(2,989)**
Net book amount	**857**	**1,143**	**2,000**	**399**

11 **Intangible assets** *(continued)*

11.1 *Impairment test for the cash-generating unit to which goodwill has been allocated*

The recognised goodwill represents payments made by the Group in anticipation of future economic benefits from assets that are not capable of being individually identified and separately recognised. As at 31 December 2019 and 2018 the recognised goodwill amounted to €857,000 and related to the acquisition of MaltaPost p.l.c..

In applying the requirements of IAS 36, 'Impairment of assets', in relation to goodwill arising in business combinations, the Directors carried out an impairment test at the end of the reporting period to obtain comfort that the recoverable amount of the cash-generating unit to which goodwill has been allocated is at least equal to its carrying amount.

The recoverable amount of the cash-generating unit is based on fair value less costs to sell.

This calculation takes into account the market capitalisation of MaltaPost p.l.c. based on the quoted price of its equity on the Malta Stock Exchange at a price per share of €1.31 as at 31 December 2019 (2018: €1.58). On this basis, the recoverable amount of the cash-generating unit is higher than its carrying amount.

12 **Property, plant and equipment**

Group	**Land and buildings € 000**	**Computer equipment € 000**	**Other € 000**	**Total € 000**
Year ended 31 December 2018				
At 1 January 2018	27,658	688	3,407	31,753
Acquisitions	1,530	237	612	2,379
Disposals	-	(43)	(48)	(91)
Revaluation	5,119	-	-	5,119
Depreciation charge for the year	(262)	(293)	(580)	(1,135)
Depreciation released on disposals	445	37	736	1,218
Other movements	(32)	5	(662)	(689)
At 31 December 2018	34,458	631	3,465	38,554
At 31 December 2018				
Cost or valuation	35,845	4,468	11,987	52,300
Accumulated depreciation	(1,387)	(3,837)	(8,522)	(13,746)
Net book amount	34,458	631	3,465	38,554
Impact of application of IFRS 16	3,144	-	370	3,514
Year ended 31 December 2019				
At 1 January 2019 - restated balance	**37,602**	**631**	**3,835**	**42,068**
Acquisitions	**1,714**	**454**	**671**	**2,839**
Disposals	**(114)**	**(304)**	**(213)**	**(631)**
Depreciation charge for the year	**(605)**	**(326)**	**(628)**	**(1,559)**
Depreciation released on disposals	**115**	**305**	**211**	**631**
At 31 December 2019	**38,712**	**760**	**3,876**	**43,348**
At 31 December 2019				
Cost or valuation	**40,589**	**4,618**	**12,815**	**58,022**
Accumulated depreciation	**(1,877)**	**(3,858)**	**(8,939)**	**(14,674)**
Net book amount	**38,712**	**760**	**3,876**	**43,348**

12 **Property, plant and equipment** *(continued)*

Bank	**Land and buildings € 000**	**Computer equipment € 000**	**Other € 000**	**Total € 000**
Year ended 31 December 2018				
At 1 January 2018	17,067	260	349	17,676
Acquisitions	1,219	126	63	1,408
Disposals	-	(37)	(48)	(85)
Revaluation	2,498	-	-	2,498
Depreciation charge for the year	(123)	(122)	(108)	(353)
Depreciation released on disposals	220	37	48	305
At 31 December 2018	20,881	264	304	21,449
At 31 December 2018				
Cost or valuation	21,706	2,142	2,640	26,488
Accumulated depreciation	(825)	(1,878)	(2,336)	(5,039)
Net book amount	20,881	264	304	21,449
Impact of application of IFRS 16	1,289	-	-	1,289
Year ended 31 December 2019				
At 1 January 2019 - restated balance	**22,170**	**264**	**304**	**22,738**
Acquisitions	**841**	**334**	**149**	**1,324**
Disposals	**(105)**	**(304)**	**(173)**	**(582)**
Depreciation charge for the year	**(276)**	**(142)**	**(108)**	**(526)**
Depreciation released on disposals	**105**	**304**	**173**	**582**
At 31 December 2019	**22,735**	**456**	**345**	**23,536**
At 31 December 2019				
Cost or valuation	**23,731**	**2,172**	**2,616**	**28,519**
Accumulated depreciation	**(996)**	**(1,716)**	**(2,271)**	**(4,983)**
Net book amount	**22,735**	**456**	**345**	**23,536**

Property, plant and equipment of the Group and the Bank includes right-of-use assets of €3,204,000 and €1,239,000, respectively, as disclosed in note 13.

12.1 *Fair valuation of land and buildings*

The Bank's land and buildings were revalued on 1 August 2018 by management, while the subsidiary's land and buildings were revalued on 30 September 2018, by an independent firm of property valuers having appropriate recognised professional qualifications and experience in the location and category of the property being valued. The Directors have reviewed the carrying amounts of the Group's properties, on the basis of the valuations carried out by the independent property valuers.

12 **Property, plant and equipment** *(continued)*

Valuations were made on the basis of open market value taking cognisance of the specific location of the properties, the size of the sites, the availability of similar properties in the area, and whenever possible, having regard to recent market transactions for similar properties in the same location. During 2018, the carrying values of the properties, classified within property, plant and equipment, have been adjusted to the valuations and the net resultant adjustment comprised an increase of €5,564,000 in the carrying values for the Group and an increase of €2,717,000 in the carrying values for the Bank, to reflect the property's estimated open market value on an individual asset level. This increase was recognised in other comprehensive income in the property revaluation reserve.

The revaluation surplus net of applicable deferred income taxes is accordingly shown in 'other reserves' in shareholders' equity (note 19).

The Group is required to analyse non-financial assets carried at fair value by level of the fair value hierarchy within which the recurring fair value measurements are categorised in their entirety (Level 1, 2 or 3). The different levels of the fair value hierarchy have been defined as fair value measurements using:

- quoted prices (unadjusted) in active markets for identical assets (Level 1);
- inputs other than quoted prices included within Level 1 that are observable for the asset, either directly (i.e. as prices) or indirectly (i.e. derived from prices) (Level 2);
- inputs for the asset that are not based on observable market data (i.e. unobservable inputs) (Level 3).

The Bank's land and buildings comprise various offices and operational premises, including the Bank's head office. The subsidiary's land and buildings, within property, plant and equipment, comprises the head office, mail delivery hubs and retail outlets. All the Group's recurring property fair value measurements use significant unobservable inputs and are accordingly categorised within Level 3 of the fair valuation hierarchy.

The Group's policy is to recognise transfers into and out of fair value hierarchy levels as of the beginning of the reporting period. There were no transfers between different levels of the fair value hierarchy during the years ended 31 December 2019 and 2018.

A reconciliation from the opening balance to the closing balance of land and buildings for recurring fair value measurements categorised within Level 3 of the value hierarchy, is reflected in the table above. The principal movements reflect changes in fair value, additions and depreciation charge for the years ended 31 December 2019 and 2018.

For all Group properties, their current use equates to the highest and best use.

12.2 *Valuation processes*

The valuations of the properties are performed on a periodic basis taking into consideration the valuation reports prepared by independent and qualified valuers. These reports are based on both:

- information provided by the Bank such as current terms and conditions of lease agreements. This information is derived from the Bank's systems and is subject to the Bank's overall control environment; and
- assumptions and valuation models used by the valuers – the assumptions are typically market related, such as rental yields, discount rates and sales prices. These are based on professional judgement and market observation.

The information provided to the valuers – and the assumptions and the valuation models used by the valuers – are reviewed by management.

When management considers that the valuation report is appropriate, the valuations are considered by the Audit & Risk Committee as part of its monitoring responsibility for effective financial reporting.

12 **Property, plant and equipment** *(continued)*

12.3 *Valuation techniques*

The Level 3 fair valuation of the Bank's property was determined using discounted cash flow (DCF) projections based on significant unobservable inputs. These inputs include estimated rental values per square metre, estimated growth rate in rental values and the discount rate applied.

The external valuations of the subsidiary's Level 3 property have been performed using an adjusted sales comparison approach for the land component and the replacement cost approach for the buildings component.

In view of a limited number of similar sales in the local market, the valuations have predominately been performed using unobservable inputs. The significant input to the adjusted sales comparison approach is generally a sales price per square metre related to transactions in comparable properties located in proximity to the subsidiary's property, with significant adjustments for differences in size, age, exact location and condition of the property. The significant input to the replacement cost approach is the estimated development costs per square metre.

12.4 *Information about fair value measurements using significant unobservable inputs (Level 3)*

			Range of significant unobservable inputs		
Description by class based on highest and best use	**Fair value €**	**Valuation technique**	**Rental value €/sqm**	**Growth rate %**	**Discount rate %**
Current use as Bank's offices and operational premises	19.1 million	Discounted cash flows	130 - 400	2	5

Description by class based on highest and best use	**Fair value €**	**Valuation technique**	**Significant unobservable input**	**Range of unobservable inputs (weighted average) €**
Current use as subsidiary's office premises, retail outlets and mail delivery hubs	12.8 million	Adjusted sales comparison approach	Sales price per square metre	800 – 19,000 (885)
		Replacement cost approach	Development costs per square metre	250 – 600 (300)

The higher the rental value or the growth rate, the higher the resultant fair value. Conversely, the lower the discount rate, the higher the resultant fair value.

The higher the sales price per square metre or the development costs per square metre, the higher the resultant fair valuation.

12 **Property, plant and equipment** *(continued)*

12.5 *Historical cost of land and buildings*

If the land and buildings were stated on the historical cost basis, the carrying amounts would be as follows:

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Cost	**25,153**	23,622	**14,210**	13,473
Accumulated depreciation	**(2,355)**	(2,116)	**(1,950)**	(1,755)
Net book amount at 31 December	**22,798**	21,506	**12,260**	11,718

13 **Leases**

The Group leases various offsite ATMs, offices and branches as well as low value items such as IT equipment. Rental contracts are typically made for fixed periods but may have extension options. Extension and termination options are included in a number of property leases across the Group. These are used to maximise operational flexibility in terms of managing the assets used in the Group's operations. The majority of extension and termination options held are exercisable only by the Group and not by the respective lessor.

Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The lease agreements do not impose any covenants other than the security interests in the leased assets that are held by the lessor. Leased assets may not be used as security for borrowing purposes.

Until the 2018 financial year, leases of property, plant and equipment were classified as 'operating leases'. From 1 January 2019, leases are recognised as a right-of-use asset within the 'property, plant and equipment' (note 12) and a corresponding liability at the date at which the leased asset is available for use by the Group within the 'other liabilities' (note 23).

	Group		Bank	
	31 December 2019	**1 January 2019**	**31 December 2019**	**1 January 2019**
	€ 000	**€ 000**	**€ 000**	**€ 000**
Right-of-use assets				
Buildings	**2,891**	**3,144**	**1,239**	**1,289**
Other	**313**	**370**	**-**	**-**
	3,204	**3,514**	**1,239**	**1,289**
Lease liabilities				
Current	**333**	**3,144**	**29**	**1,289**
Non-current	**2,908**	**370**	**1,232**	**-**
	3,241	**3,514**	**1,261**	**1,289**

13 **Leases** *(continued)*

When measuring lease liabilities for leases that were classified as operating leases, the Group discounted lease payments using its incremental borrowing rate at 1 January 2019. The weighted-average rate applied by the Bank is 2.65% whilst MaltaPost p.l.c. applied a weighted-average rate of 3%.

	Group 2019 € 000	Bank 2019 € 000
The income statement reflects the following amounts relating to leases:		
Depreciation charge of right-of-use assets	**310**	**50**
Interest expense	**101**	**34**
Expense relating to short-term leases (included in administrative expenses)	**786**	**152**
Expense relating to leases of low-value assets that are not shown above as short-term leases (included in administrative expenses)	**21**	**21**

The total cash payments for leases, including short-term and low-value leases, in 2019 was €1,176,000 for the Group and €190,000 for the Bank.

14 **Deferred tax assets and liabilities**

Deferred tax assets and liabilities are attributable to the following:

Group	**Assets 2019 € 000**	**Liabilities 2019 € 000**	**Net 2019 € 000**	Assets 2018 € 000	Liabilities 2018 € 000	Net 2018 € 000
Differences between depreciation and capital allowances	**131**	**(109)**	**22**	223	(85)	138
Provisions for liabilities and charges	**796**	**-**	**796**	719	-	719
Impairment allowances	**8,874**	**-**	**8,874**	8,279	-	8,279
Revaluation of property	**-**	**(2,661)**	**(2,661)**	-	(2,661)	(2,661)
Fair value movements on investments	**-**	**(4,062)**	**(4,062)**	-	(2,518)	(2,518)
	9,801	**(6,832)**	**2,969**	9,221	(5,264)	3,957

14 **Deferred tax assets and liabilities** *(continued)*

Bank	**Assets 2019 € 000**	**Liabilities 2019 € 000**	**Net 2019 € 000**	Assets 2018 € 000	Liabilities 2018 € 000	Net 2018 € 000
Differences between depreciation and capital allowances	**-**	**(109)**	**(109)**	-	(85)	(85)
Provisions for liabilities and charges	**411**	**-**	**411**	387	-	387
Impairment allowances	**8,847**	**-**	**8,847**	8,252	-	8,252
Revaluation of property	**-**	**(1,633)**	**(1,633)**	-	(1,633)	(1,633)
Fair value movements on investments	**-**	**(4,062)**	**(4,062)**	-	(2,518)	(2,518)
	9,258	**(5,804)**	**3,454**	8,639	(4,236)	4,403

Movement in temporary differences relate to:

Group

	At 1 January 2018 € 000	Impact of adopting IFRS 9 recognised in retained earnings € 000	Recognised in profit or loss € 000	Recognised in other comprehensive income € 000	**At 31 December 2018 € 000**	**Recognised in profit or loss € 000**	**Recognised in other comprehensive income € 000**	**At 31 December 2019 € 000**
Differences between depreciation and capital allowances	131	-	7	-	**138**	**(116)**	**-**	**22**
Provisions for liabilities and charges	699	-	16	4	**719**	**26**	**51**	**796**
Impairment allowances	8,033	(28)	274	-	**8,279**	**595**	**-**	**8,874**
Revaluation of property	(1,798)	-	-	(863)	**(2,661)**	**-**	**-**	**(2,661)**
Fair value movements on investments	(2,040)	(20)	-	(458)	**(2,518)**	**-**	**(1,544)**	**(4,062)**
Other temporary differences	41	-	(41)	-	**-**	**-**	**-**	**-**
	5,066	(48)	256	(1,317)	**3,957**	**505**	**(1,493)**	**2,969**

14 **Deferred tax assets and liabilities** *(continued)*

Bank

	At 1 January 2018 € 000	Impact of adopting IFRS 9 recognised in retained earnings € 000	Recognised in profit or loss € 000	Recognised in other comprehensive income € 000	**At 31 December 2018 € 000**	**Recognised in profit or loss € 000**	**Recognised in other comprehensive income € 000**	**At 31 December 2019 € 000**
Differences between depreciation and capital allowances	(75)	-	(10)	-	**(85)**	**(24)**	**-**	**(109)**
Provisions for liabilities and charges	372	-	15	-	**387**	**24**	**-**	**411**
Impairment allowances	7,997	(28)	283	-	**8,252**	**595**	**-**	**8,847**
Revaluation of property	(1,021)	-	-	(612)	**(1,633)**	**-**	**-**	**(1,633)**
Fair value movements on investments	(2,040)	(20)	-	(458)	**(2,518)**	**-**	**(1,544)**	**(4,062)**
	5,233	(48)	288	(1,070)	**4,403**	**595**	**(1,544)**	**3,454**

The recognised deferred tax assets and liabilities are expected to be recovered or settled principally after more than twelve months from the end of the reporting period. The deferred tax liabilities reflected in other comprehensive income relate principally to the revaluation of property, plant and equipment and the fair valuation of investments measured at FVOCI.

15 **Inventories**

	Group		**Bank**	
	2019 € 000	2018 € 000	**2019 € 000**	2018 € 000
Postal supplies and materials	**223**	234	**-**	-
Merchandise	**441**	372	**-**	-
Stocks for resale	**759**	734	**759**	734
Other stock items	**45**	20	**45**	20
	1,468	1,360	**804**	754

16 **Trade and other receivables**

	Group		**Bank**	
	2019 € 000	2018 € 000	**2019 € 000**	2018 € 000
Trade receivables - net of expected impairment allowances	**4,169**	3,504	**-**	-
Others	**1,456**	1,506	**1,817**	1,812
	5,625	5,010	**1,817**	1,812

16 **Trade and other receivables** *(continued)*

The Expected Credit Loss allowances in respect of trade receivables are analysed as follows:

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Loss allowance as at 1 January	**79**	103	**-**	-
Net profit and loss charge during the year	**(2)**	(24)	**-**	-
Loss allowance as at 31 December	**77**	79	**-**	-

17 **Accrued income and other assets**

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Accrued income	**2,038**	2,085	**1,980**	2,040
Prepayments	**5,475**	4,755	**265**	445
Other assets	**2,135**	2,133	**2,135**	2,133
	9,648	8,973	**4,380**	4,618

18 **Share capital**

Bank	**2019**		2018	
	No. of shares 000s	**€ 000**	No. of shares 000s	€ 000
Authorised				
Ordinary shares of 25 cent each	**80,000**	**20,000**	80,000	20,000
Issued				
Ordinary shares of 25 cent each	**44,178**	**11,044**	44,178	11,044

19 **Reserves**

These reserves are non-distributable.

19.1 *Share premium*

The share premium arises on premium attributable to scrip issues of ordinary shares. Utilisation of the share premium account is governed by the requirements of Article 114 within the Companies' Act, Chapter 386 of the Laws of Malta.

19.2 *Revaluation and other reserves*

The Group and the Bank had the following reserves as at end of the reporting period:

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Property revaluation reserve	**6,384**	6,384	**4,445**	4,445
Investment revaluation reserve	**7,978**	4,975	**7,509**	4,640
Reserve for General Banking Risks	**2,903**	2,903	**2,903**	2,903
Other reserve	**2,567**	3,094	**3,044**	3,502
	19,832	17,356	**17,901**	15,490

The property revaluation reserve relates to the fair valuation of the land and buildings component of property, plant and equipment, and the balance represents the cumulative net increase in fair value of such property, net of related deferred tax.

The investment revaluation reserve represents the cumulative net change in fair values of financial assets measured at FVOCI held by the Group and by the Bank, net of related deferred tax impacts.

Banking Rule BR/09 'Measures addressing credit risks arising from the assessment of the quality of asset portfolios of credit institutions authorised under the Banking Act, 1994', issued by the MFSA, requires banks in Malta to hold additional reserves for general banking risks in respect of non-performing loans. This reserve is required to be funded from planned dividends.

The other reserve represents amounts set aside by the Bank from its retained earnings in relation to the Depositor Compensation Scheme reflecting the carrying amount of assets pledged in favour of the Scheme to comply with local regulatory requirements.

20 **Amounts owed to banks**

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Term deposits with agreed maturity dates or periods of notice	**23**	23	**23**	23
Repayable on demand	**5,848**	831	**5,848**	831
	5,871	854	**5,871**	854

21 **Amounts owed to customers**

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Term deposits with agreed maturity dates	**318,959**	264,553	**321,659**	265,268
Repayable on demand	**546,034**	523,491	**547,173**	524,805
	864,993	788,044	**868,832**	790,073

22 **Provisions for liabilities and other charges**

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Obligation to Government	**2,009**	1,963	**-**	-
Legal	**1,186**	1,170	**1,132**	1,105
Other Expected Credit Losses on off-balance sheet items	**41**	2	**41**	2
	3,236	3,135	**1,173**	1,107

22 **Provisions for liabilities and other charges** *(continued)*

These provisions are predominantly non-current in nature.

Group	**2019**				2018			
	Obligation to Government	**Legal**	**Expected Credit Loss allowance**	**Total**	Obligation to Government	Legal	Expected Credit Loss allowance	Total
	€ 000	**€ 000**	**€ 000**	**€ 000**	€ 000	€ 000	€ 000	€ 000
At 1 January	**1,963**	**1,170**	**2**	**3,135**	2,047	1,129	-	3,176
Exchange differences recognised in profit or loss	**-**	**10**	**-**	**10**	-	22	-	22
Charge - recognised in other comprehensive income	**146**	**-**	**-**	**146**	11	-	-	11
Charge - recognised in profit or loss	**42**	**18**	**-**	**60**	41	19	-	60
Crystallised obligations	**(142)**	**(12)**	**-**	**(154)**	(136)	-	-	(136)
ECL provision on off-balance sheet items	**-**	**-**	**39**	**39**	-	-	2	2
At 31 December	**2,009**	**1,186**	**41**	**3,236**	1,963	1,170	2	3,135

The obligation to Government arises in terms of Article 8A of the Pensions Ordinance (Chapter 93 of the Laws of Malta), covering former Government employees who opted to become full-time employees of MaltaPost p.l.c., and who continued to be entitled to pension benefits which go beyond the National Insurance Scheme. The pension benefits scheme is a final salary defined benefit plan and is unfunded.

Obligation to Government recognised in the statement of financial position is arrived at as follows:

	2019	2018
	€ 000	€ 000
Present value of unfunded obligations	**3,971**	3,783
Crystallised obligations	**(1,263)**	(1,121)
Fair value of obligations to be reimbursed by Government	**(699)**	(699)
	2,009	1,963

22 **Provisions for liabilities and other charges** *(continued)*

The amount recognised in other comprehensive income is as follows:

	2019 € 000	2018 € 000
Net actuarial losses		
- attributable to financial assumptions	**146**	(11)
- attributable to demographic assumptions	**-**	-
	146	(11)

In computing the provision, the Group used a weighted average discount rate of 0.73% (2018: 1.63%). Assumptions regarding future mortality experience are based on published mortality tables in Malta, which translate into an average life expectancy of 83 (2018: 83) depending on age and gender of the beneficiaries.

These factors are deemed to be the key assumptions used in the computation of the liability. The sensitivity of the obligation to changes in the key assumptions is considered immaterial for disclosure purposes.

Bank

		2019			2018	
	Legal € 000	**Expected Credit Loss allowance € 000**	**Total € 000**	Legal € 000	Expected Credit Loss allowance € 000	Total € 000
At 1 January	**1,105**	**2**	**1,107**	1,064	-	1,064
Exchange differences recognised in profit or loss	**10**	**-**	**10**	21	-	21
Charge - recognised in profit or loss	**18**	**-**	**18**	20	-	20
Crystallised obligations	**(1)**	**-**	**(1)**	-	-	-
Expected Credit Losses on off-balance sheet items	**-**	**39**	**39**	-	2	2
At 31 December	**1,132**	**41**	**1,173**	1,105	2	1,107

In addition, the Bank is also a defendant in legal actions by other customers as a result of which the Directors are of the opinion that no liability will be incurred.

23 **Other liabilities**

	Group		**Bank**	
	2019 € 000	2018 € 000	**2019 € 000**	2018 € 000
Trade payables	**5,538**	3,672	**-**	-
Bills payable	**2,620**	2,745	**2,620**	2,745
Leases	**3,241**	-	**1,261**	-
Other payables	**10,550**	20,721	**9,390**	11,325
	21,949	27,138	**13,271**	14,070

24 **Accruals and deferred income**

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Accrued interest	**4,120**	3,497	**4,121**	3,498
Other	**7,366**	6,302	**1,351**	1,237
	11,486	9,799	**5,472**	4,735

25 **Commitments and contingent liabilities**

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Contingent liabilities				
Guarantee obligations incurred on behalf of third parties	**8,840**	11,197	**8,942**	11,206
Documentary credits	**2,831**	2,951	**2,831**	2,961
	11,671	14,148	**11,773**	14,167
Commitments				
Credit facilities and other commitments to lend	**223,499**	200,392	**224,607**	200,392
Capital commitments	**2,327**	1,992	**2,327**	1,992
	225,826	202,384	**226,934**	202,384

Credit facilities and other commitments to lend funds to customers are granted at prevailing market interest rates at drawdown date. Capital commitment as at 31 December 2019 and 2018 mainly relate to the acquisition of property, plant and equipment.

At 31 December 2019, the Group was party to non-cancellable operating lease agreements of properties, in respect of which the future minimum lease payments extended over a number of years. The leases run for an initial period of up to one hundred and fifty years. Specific lease arrangements include an option to renew the lease after the original term but the amounts presented in the table below do not reflect lease charges applicable to the renewal period.

Total future minimum lease net payments under non-cancellable property operating leases:

	2019	2018
	€ 000	€ 000
Current		
Within 1 year	**41**	86
Non-current		
Between 1 and 2 years	**77**	77
Between 2 and 5 years	**94**	132
	212	295

The Group is also committed to pay a licence fee of 1.50% (2018: 0.75%) of its total gross revenue from postal services within the scope of the universal services.

26 **Net interest income**

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Interest income				
On loans and advances to banks	**1,413**	978	**1,353**	938
On loans and advances to customers	**22,006**	20,574	**22,006**	20,574
On balances with Central Bank of Malta	**220**	250	**220**	250
On Malta Government treasury bills	**(341)**	(332)	**(341)**	(332)
	23,298	21,470	**23,238**	21,430
On debt and other fixed income instruments	**2,662**	2,190	**2,530**	2,063
Net amortisation of premiums and discounts	**(675)**	(472)	**(671)**	(469)
	1,987	1,718	**1,859**	1,594
Total interest income	**25,285**	23,188	**25,097**	23,024
Interest expense				
On amounts owed to banks	**-**	(1)	**-**	(1)
On amounts owed to customers	**(5,504)**	(5,676)	**(5,507)**	(5,676)
On finance leases	**(101)**	-	**(34)**	-
Total interest expense	**(5,605)**	(5,677)	**(5,541)**	(5,677)
Net interest income	**19,680**	17,511	**19,556**	17,347

27 **Net fee and commission income**

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Fee and commission income				
Retail banking customer fees	**3,135**	2,829	**3,135**	2,829
Brokerage	**199**	56	**199**	56
Other	**2,288**	2,166	**1,087**	1,004
Total fee and commission income	**5,622**	5,051	**4,421**	3,889
Fee and commission expense				
Interbank transaction fees	**(217)**	(328)	**(217)**	(328)
Other	**-**	(7)	**-**	(8)
Total fee and commission expense	**(217)**	(335)	**(217)**	(336)
Net fee and commission income	**5,405**	4,716	**4,204**	3,553

28 **Postal sales and other revenues**

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Stamps, parcel post and postal stationery including income from foreign inbound mail	**29,392**	35,799	**-**	-
Collectibles and philatelic sales	**934**	792	**567**	425
Other	**3,233**	2,663	**-**	-
	33,559	39,254	**567**	425

29 **Dividend income**

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Subsidiary company	**-**	-	**1,657**	1,601
Equity shares measured at FVOCI	**211**	369	**211**	369
	211	369	**1,868**	1,970

30 **Net trading income**

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Gains on foreign exchange activities	**992**	880	**927**	862

31 **Employee compensation and benefits**

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Staff costs				
Wages, salaries and allowances	**21,549**	19,408	**6,677**	6,042
Social security costs	**1,495**	1,357	**352**	326
	23,044	20,765	**7,029**	6,368

	Group		Bank	
	2019	2018	**2019**	2018
Average number of employees				
Managerial	**106**	100	**57**	57
Others	**825**	784	**123**	110
	931	884	**180**	167

32 **Credit impairment losses**

Credit impairment losses during 2019 were as follows:

	Group			Bank		
	Write-downs € 000	Reversals of write-downs € 000	Total € 000	Write-downs € 000	Reversals of write-downs € 000	Total € 000
Trade receivables						
Stage 3	2	-	2	-	-	-
Total trade receivables	2	-	2	-	-	-
Loans and advances to customers						
Stage 1	(1,005)	-	(1,005)	(1,005)	-	(1,005)
Stage 2	-	393	393	-	393	393
Stage 3	-	120	120	-	120	120
Bad debts written off	-	-	-	-	-	-
Total loans and advances to customers	(1,005)	513	(492)	(1,005)	513	(492)
Financial investments measured at FVOCI						
Stage 1	(20)	-	(20)	(20)	-	(20)
Total financial investments measured at FVOCI	(20)	-	(20)	(20)	-	(20)
Off-balance sheet items						
Stage 1	(39)	-	(39)	(39)	-	(39)
Total off-balance sheet items	(39)	-	(39)	(39)	-	(39)
Credit impairment losses	(1,062)	513	(549)	(1,064)	513	(551)

32 **Credit impairment losses** *(continued)*

Credit impairment losses during 2018 were as follows:

	Group			Bank		
	Write-downs € 000	Reversals of write-downs € 000	Total € 000	Write-downs € 000	Reversals of write-downs € 000	Total € 000
Trade receivables						
Stage 3	(9)	33	24	-	-	-
Total trade receivables	(9)	33	24	-	-	-
Loans and advances to customers						
Stage 1	(2,314)	-	(2,314)	(2,314)	-	(2,314)
Stage 2	-	8,516	8,516	-	8,516	8,516
Stage 3	(6,348)	-	(6,348)	(6,348)	-	(6,348)
Bad debts written off	(3)	-	(3)	(3)	-	(3)
Total loans and advances to customers	(8,665)	8,516	(149)	(8,665)	8,516	(149)
Financial investments measured at FVOCI						
Stage 1	(107)	-	(107)	(107)	-	(107)
Total financial investments measured at FVOCI	(107)	-	(107)	(107)	-	(107)
Off-balance sheet items						
Stage 1	(2)	-	(2)	(2)	-	(2)
Total off-balance sheet items	(2)	-	(2)	(2)	-	(2)
Credit impairment losses	(8,783)	8,549	(234)	(8,774)	8,516	(258)

33 Profit before taxation

Profit before taxation is stated after charging and crediting the following:

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
After charging				
Directors' emoluments				
- fees	**73**	69	**49**	49
- other emoluments	**386**	355	**386**	355
After crediting				
Net income from investment services	**395**	347	**395**	347

Other operating costs are analysed as follows:

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Foreign outbound mail	**8,023**	15,328	**-**	-
Utilities and insurance	**891**	1,087	**469**	687
IT support and telecommunication costs	**441**	409	**264**	208
Repairs and maintenance	**1,949**	1,771	**622**	420
Operating lease rental charges	**1,318**	1,424	**723**	574
Other administrative expenses	**6,314**	6,458	**3,093**	2,745
Total other operating costs	**18,936**	26,477	**5,171**	4,634

From time to time the Board of Directors of the Bank approves the allocation of a financial contribution towards Retirement Gratuities that it may decide to grant and /or a Staff Pension fund that may be formally established in the future. Gratuities that it may make, on an *ex gratia* basis, to its employees, including its Chief Executive Officer, are made upon retirement. Amounts contributed for this purpose in 2019 amounted to €100,000 (2018: €100,000). Once contributed, these amounts are held in a separate bank account which is not controlled by the Bank and is therefore not included in the Bank's financial statements. The Board of Directors has resolved that a retirement gratuity be eventually paid on an *ex gratia* basis, to the Chief Executive Officer on his retirement. Amounts intended as a contribution to an eventual pension fund will be regulated by rules yet to be determined in light of relevant legislation.

Other administrative expenses mainly comprise professional expenses, subcontracted services and other services or expense items which are incurred in the course of the operations of the Group and the Bank.

33 **Profit before taxation** *(continued)*

Fees charged by the auditors for services rendered during the financial year related to the following:

	Audit	Other assurance/ advisory services	Tax compliance services
	€ 000	€ 000	€ 000
Auditors of the parent			
2019	**111**	**5**	**4**
2018	76	-	4
Auditors of subsidiary companies			
2019	**29**	**59**	**1**
2018	27	120	1

34 **Income tax expense**

Recognised in profit or loss:

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Current taxation				
Current tax expense	**5,929**	5,087	**5,572**	4,736
Deferred taxation				
Deferred tax income (note 14)	**(505)**	(256)	**(595)**	(288)
	5,424	4,831	**4,977**	4,448

34 **Income tax expense** *(continued)*

The tax on the profit before income tax differs from the theoretical amount that would arise using the tax rate applicable as follows:

	Group		Bank	
	2019	2018	**2019**	2018
	€ 000	€ 000	**€ 000**	€ 000
Profit before income tax	**15,294**	13,770	**13,995**	12,629
Tax on profit at 35%	**5,353**	4,820	**4,898**	4,420
Tax effect of:				
Income not subject to tax	**(33)**	-	**(33)**	(36)
Expenses non-deductible for tax purposes	**47**	51	**43**	41
Income taxed at different tax rates	**(10)**	(43)	**31**	(11)
Depreciation expense not deductible by way of capital allowances	**209**	73	**99**	49
Other differences	**(142)**	(70)	**(61)**	(15)
	5,424	4,831	**4,977**	4,448

34 **Income tax expense** *(continued)*

The tax impacts, which are entirely attributable to deferred taxation, relating to components of other comprehensive income and accordingly presented directly in equity are as follows:

Group	**2019**			2018		
	Before tax	**Tax (charge) /credit**	**Net of tax**	Before tax	Tax (charge) /credit	Net of tax
	€ 000	**€ 000**	**€ 000**	€ 000	€ 000	€ 000
Fair valuation of financial assets measured at FVOCI:						
- Net changes in fair value	**4,751**	**(1,597)**	**3,154**	1,332	(479)	853
- Net changes on financial assets reclassified to profit or loss	**(150)**	**53**	**(97)**	(59)	21	(38)
- Remeasurements of defined benefit obligations	**(146)**	**51**	**(95)**	(11)	4	(7)
- Fair valuation of land and buildings	**-**	**-**	**-**	5,564	(863)	4,701
	4,455	**(1,493)**	**2,962**	6,826	(1,317)	5,509
Bank						
Fair valuation of financial assets measured at FVOCI:						
- Net changes in fair value	**4,563**	**(1,597)**	**2,966**	1,367	(479)	888
- Reclassification adjustments to profit or loss	**(150)**	**53**	**(97)**	(59)	21	(38)
- Fair valuation of land and buildings	**-**	**-**	**-**	2,717	(612)	2,105
	4,413	**(1,544)**	**2,869**	4,025	(1,070)	2,955

35 **Earnings per share**

Earnings per share is based on the net profit for the year divided by the weighted average number of ordinary shares in issue during the year.

	Group	
	2019	2018
Net profit attributable to equity holders of the Bank (€ 000)	**9,320**	8,447
Number of ordinary shares in issue	**44,177,914**	44,177,914
Earnings per share (€ cent)	**21c1**	19c1

The Bank has no instruments or arrangements which give rise to dilutive potential ordinary shares, and accordingly diluted earnings per share is equivalent to basic earnings per share.

36 Dividends

	2019	2018
Dividends declared and paid by the Bank (€ 000)	**1,436**	1,149
€ cent per share – gross	**3c25**	4c0

Subsequent to the end of the reporting period, a gross dividend of 7 cent per nominal 25 cent share (net dividend of 4.55 cent for a total amount of €2,010,000) for the twelve months ended 31 December 2019 is being proposed for approval by the shareholders to be distributed. A resolution to this effect will be proposed to the Annual General Meeting.

37 Cash and cash equivalents

Cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less.

	Group		Bank	
	2019 € 000	2018 € 000	**2019 € 000**	2018 € 000
Malta Government treasury bills (note 5)	**69,073**	57,051	**69,073**	57,051
Loans and advances to banks (notes 5 and 7)	**184,446**	151,036	**181,563**	139,274
Cash (note 5)	**7,231**	4,937	**6,584**	4,354
Amounts owed to banks (note 20)	**(5,848)**	(831)	**(5,848)**	(831)
Cash and cash equivalents	**254,902**	212,193	**251,372**	199,848

38 Related parties

38.1 *Identity of related parties*

The Bank has a related party relationship with its subsidiaries, its major shareholder, Cyprus Popular Bank Public Co Ltd (up till 10 August 2018) and the National Department and Social Fund (as from 10 August 2018), its associates, the Bank's Directors (deemed to be key management personnel together with a number of chief officers) and other related parties, including entities controlled by key management personnel.

The Government of Malta is also considered to be a related party, through its control over the National Development and Social Fund. Nevertheless, in its Company Announcement dated 10 August 2018, the Bank reported that the NDSF had reaffirmed that:

38 **Related parties** *(continued)*

Quote

- it does not intend to increase its holdings in the Bank;
- it shall not act in concert with any other shareholders;
- it will seek to reduce its shareholding in the Bank in an orderly manner, at the right market conditions and by agreement with the regulatory authorities;
- it has no intention of exerting any influence on the operations of the Bank; and
- this acquisition will not result in a change in control of the Bank.

Unquote

The Group's exposure with the Government of Malta arises through its investment in Government debt securities and treasury bills which are disclosed in note 2 and other obligations disclosed in note 22.

38.2 *Transaction arrangements and agreements involving key management personnel and entities controlled by the latter*

	Loans and advances 2019 € 000	**Commitments 2019 € 000**	Loans and advances 2018 € 000	Commitments 2018 € 000
At 1 January	**1,611**	**(5,555)**	1,092	(5,214)
Additions	**5,284**	**(2,033)**	1,079	(792)
Repayments	**(889)**	**2,679**	(560)	451
At 31 December	**6,006**	**(4,909)**	1,611	(5,555)

The above banking facilities are part of long-term commercial relationships and were made in the ordinary course of business on substantially the same terms, including rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

38.3 *Compensation to key management personnel*

Details of Directors' fees and emoluments are stated in note 33 and other key manangement personnel within the Remuneration Report.

38 **Related parties** *(continued)*

38.4 *Transactions with other related parties*

38.4.1 Subsidiaries

Information relating to transactions undertaken by the Bank with its subsidiary companies during the year:

	2019	2018
	€ 000	€ 000
Income statement		
Fee and commission income	**4**	4
Postal sales and other expenses	**11**	38
Other operating income	**326**	321
Interest payable	**3**	-
Administrative expenses	**209**	116
Statement of financial position		
Loans and advances to customers	**12**	95
Trade and other receivables	**361**	306
Amounts owed to customers	**3,839**	1,894
Accruals and deferred income	**46**	19
Contingent liabilities	**102**	9
Commitments	**1,108**	-

During the year, the Bank made payments in settlement of transactions carried out by MaltaPost amounting to €7,000 (2018: €7,100).

During the year, the Bank received gross dividend of €1,660,000 (2018: €1,602,000).

38.4.2 Associates

Information relating to transactions undertaken by the Bank with its associates during the year:

	2019	2018
	€ 000	€ 000
Income statement		
Interest receivable and similar income	**19**	24
Administrative expenses	**7**	-
Statement of financial position		
Loans and advances to customers	**1,900**	1,900
Investment in associate	**1,645**	1,645
Prepayments and accrued income	**431**	453
Accruals and deferred income	**-**	4

39 **Investor Compensation Scheme**

In accordance with the requirements of the Investor Compensation Scheme Regulations, 2003 issued under the Investment Services Act, 1994 (Chapter 370 of the Laws of Malta) licence holders are required to transfer a variable contribution to an Investor Compensation Scheme Reserve and place the equivalent amount with a bank, pledged in favour of the Scheme. Alternatively licence holders can elect to pay the amount of variable contribution directly to the Scheme. Lombard Bank Malta p.l.c. has elected to pay the amount of the variable contribution directly to the Scheme.

40 **Events occurring after the reporting period**

Following the developments, after the balance sheet date, of events pertaining to the COVID-19 pandemic, which is deemed to be a non-adjustable subsequent event, the Group has announced that it is closely monitoring the situation resulting from these events - and the effects which these may have on its stakeholders, operations and performance.

In a company announcement dated 17 March 2020, the Directors stated that the Bank has in place a contingency plan which includes various measures that are being executed as the situation unfolds and circumstances evolve. It was further noted that this plan is also being monitored and updated while constant risk assessments are undertaken in line with developments and recommended measures issued by the Government of Malta, Public Health Authorities and regulators from time to time.

The Directors consider that it is premature to forecast the impact of the pandemic on the financial and operational performance of the Bank itself, more so since developments continue to unfold on a daily basis. Nevertheless, the Bank has stated that it is confident that it has in place robust financial fundamentals, proper technical resources and a competent staff complement which together will enable it to meet the challenges that the pandemic may present.

Upon signing these financial statements, the Directors have considered, amongst other matters, developments since the year end in loans and advances to customers – with a special focus on the Bank's larger exposures, customers' deposits, financial investments, counter-party exposure and the operational resilience of the Bank and the Group after taking cognisance of the events occurring after the reporting period described above.

The range of policies and practices employed by the Group to mitigate credit, market and liquidity, operational and capital risk are illustrated in notes 2.3, 2.4, 2.5, 2.6 and 2.7 respectively.

The Loan-to-Value (LTV) as at 31 December 2019 stood at 0.39.

As of 31 December 2019, the Bank's Advances-to-Deposits ratio stood at 63.5%. Note 2.5 in these financial statements discloses the Liquidity Coverage and Net Sable Funding ratios of the Bank, which as at 31 December 2019 stood at 301.5% and 140.2% respectively.

The Additional Regulatory Disclosures included within this Annual Report disclose the Bank's Total Capital and Leverage ratios which stand at 16.01% and 10.46% - all of which are in excess of the minimum regulatory requirements.

41 **Statutory information**

Lombard Bank Malta p.l.c. is a limited liability company domiciled and incorporated in Malta.

1 Risk management

1.1 *Overview of risk disclosures*

The Additional Regulatory Disclosures seek to increase public disclosure with respect to a bank's capital structure and adequacy as well as its risk management policies and practices. These disclosures have been prepared by the Bank in accordance with the Pillar III quantitative and qualitative disclosure requirements as governed by Banking Rule BR/07: Publication of Annual Report and Audited Financial Statements of Credit Institutions authorised under the Banking Act, 1994, issued by the Malta Financial Services Authority. These disclosures are published by the Bank on an annual basis as part of the Annual Report. The rule follows the disclosure requirements of Directive 2013/36/EU (Capital Requirements Directive) and EU Regulation No. 575/2013 (Capital Requirements Regulation) of the European Parliament and of the Council of 26 June 2013.

Consistent with the requirements of banking regulations, these disclosures are not subject to an external audit, except to the extent that any disclosures are equivalent to those made in the Financial Statements which have been prepared in accordance with the requirements of International Financial Reporting Standards ('IFRS') as adopted by the EU. The Bank is satisfied that internal verification procedures ensure that these Additional Regulatory Disclosures are presented fairly.

1.2 *Risk Management Framework*

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework.

To enhance its risk oversight efforts, the Board of Directors established an Audit & Risk Committee with a mandate to supervise and monitor *inter alia*, the Bank's compliance with its risk management policies and procedures, review any financial information, statements and disclosures to be issued and the adequacy of the Bank's risk management framework, including its risk appetite statement and strategy.

The Bank has also established the Assets & Liabilities Committee (ALCO) and the Credit Committee that are responsible for developing the Bank's risk management policies in their specific areas.

The Bank also has an independent Risk Management function as the Bank's second line of defence and independent of operations which also reports directly to the ARC and is represented during meetings of the above-mentioned committees. It is responsible for ensuring that the Bank's Risk Management Policy, Risk Appetite Statement and any other guidelines support the Bank's objectives. It is also responsible for further identifying any unmitigated risks and for formulating suitable action plans for their treatment. The function monitors the high-level principles that guide staff in its day-to-day management of risk through oversight of policies, limits, procedures, processes and systems as well as by using methods and tools for risk measuring, monitoring, controlling and reporting.

The Bank considers risk management a core competency that helps produce consistently high returns for its various stakeholders. The Bank's business involves taking on risks in a targeted manner and managing them professionally. The Bank aims to manage all major types of risk by applying methods that meet best practice. The Bank considers it important to have a clear distribution of responsibilities within risk management. One of the main tasks of the Bank's executive management is to set the framework for this area. The core functions of the Bank's risk management are to identify all key risks for the Bank, measure these risks, manage the risk positions and determine capital allocations. The Bank regularly reviews its risk management policies and systems to reflect changes in markets, products and best market practice.

1 **Risk management** *(continued)*

An understanding of risk-taking and transparency in risk-taking are key elements in the Bank's business strategy and thus in its ambition to be a strong financial institution. The Bank's internal risk management processes support this objective.

Risk management within the Bank is mainly carried out on a unified basis, using an integrated and global framework. This framework is based on local and international guidelines, such as the Basel III Accord and corresponding Directives and Regulations of the European Union, including technical standards, as well as on contemporary international banking practices guided by the Basel Committee on Banking Supervision.

The Bank has adopted the Standardised Approach and the Basic Method with respect to the calculation of capital requirements and management of credit and foreign exchange risk respectively, as well as the Basic Indicator Approach with respect to operational risk.

The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Board deems the risk management framework adopted by the Bank to be adequate and gives assurance to the Bank's stakeholders that the risk management systems are appropriate in relation to the Bank's risk profile and strategy.

The Bank's different operational functions, on an entity-wide basis, are primarily responsible for risk management procedures and activities in their respective areas. All the operational functions have a primary role in risk management at Bank-wide level. The Risk Management Function provides oversight, independently from operations. The Bank's risk management is implemented and handled properly by the operational functions. The Bank's Internal Audit Function, through verification, ensures that effective risk management procedures and activities are adequately designed and operating as prescribed.

1.3 *Board and Senior Management Committees*

The Bank's Board of Directors is responsible for ensuring that adequate processes and procedures exist to ensure effective internal control systems for the Bank. These internal control systems ensure that decision-making capability and the accuracy of the reporting and financial results are maintained at a high level at all times. The Board assumes responsibility for:

- setting business objectives, goals and the general strategic direction for Management with a view to maximise value;
- selecting and appointing the Chief Executive Officer who is entrusted with the day-to-day operations of the Bank;
- management of the Bank's operations, as well as appointment of members of Management;
- ensuring that significant business risks are identified and appropriately managed; and
- setting the highest business standards and code for ethical behaviour, and monitoring performance in this respect.

1 **Risk management** *(continued)*

In deciding how best to discharge its responsibilities, the Board upholds a policy of clear demarcation between its role and responsibilities and those of Management. It has defined the level of authority that it retains over strategy formulation and policy determination, and delegated authority and vested accountability for the Bank's day-to-day business in the Assets & Liabilities Committee and Credit Committee and, for the Bank's day-to-day operations, in an Executive Team comprising the Chief Executive Officer and Chief Officers. The Audit & Risk Committee reviews the processes and procedures to ensure the effectiveness of the Bank's system of internal control, as well as the implementation of the Board's risk strategy by Management. The Audit & Risk Committee is supported by the Internal Audit and the Bank's Risk Management Function. Internal Audit is one of the principal internal control mechanisms within the Bank.

The ALCO monitors the Bank's financial performance, considers investment policy and overseas counterparty limits. Membership of this Committee is made up of a number of Chief Officers and Senior Managers including managers from Finance and Treasury Departments. The Chief Executive Officer is Chairman of ALCO and retains primary responsibility for asset and liability management. The ALCO oversees risk management practices in relation to asset and liability management.

The Credit Committee considers the development of general lending principles and oversees risk management practices in lending operations. The Credit Committee is chaired by the Chief Executive Officer and is composed of other Chief Officers as well as other Senior Officers engaged in lending.

The Audit & Risk Committee assists the Board in fulfilling its supervisory and monitoring responsibility by reviewing the financial statements and disclosures, the system of internal control established by management as well as the external and internal audit processes. The Audit & Risk Committee is also responsible for monitoring compliance with the Bank's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit & Risk Committee is assisted by the Internal Audit Function and the Bank's independent Risk Management Function.

The Bank's independent Internal Audit Department reviews the adequacy and proper operation of internal controls in individual areas of operation and reports its findings to the Audit & Risk Committee. The Internal Audit Function carries out both regular and ad-hoc reviews of risk management controls and procedures, in both cases reporting its findings.

The Bank has an appropriate organisational structure for planning, executing, controlling and monitoring business operations in order to achieve the Bank's objectives.

Authority to operate the Bank and its subsidiaries is delegated to the Chief Executive Officer within the limits set by the Board. The Board is ultimately responsible for the Bank's system of internal control and for reviewing its effectiveness. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can provide only reasonable, and not absolute, assurance against material misstatement or loss.

The Bank is committed to the highest standards of business conduct and seeks to maintain these standards across all of its operations. Bank policies and procedures are in place for the reporting and resolution of fraudulent activities.

1.4 *Key risk components*

The Bank's Board of Directors is empowered to set out the overall risk policies and limits for all material risk types. The Board also decides on the general principles for managing and monitoring risks.

1 **Risk management** *(continued)*

To ensure coherence between the Bank's strategic considerations regarding risk-taking and day-to-day decisions, from time to time, the Bank establishes its risk appetite as a strategic tool. Risk appetite is the maximum risk that the Bank is willing to assume to meet business targets. The Bank's risk appetite is set in a process based on a thorough analysis of its current risk profile. The Bank identifies a number of key risk components and for each determines a target that represents the Bank's views on the component in question.

In terms of the Capital Requirements Regulation (CRR), an 'exposure' is the amount at risk arising from the reporting credit institution's assets and off-balance sheet instruments. Consistent with this, an exposure would include the amount at risk arising from the Bank's:

- claims on a customer including actual and potential claims which would arise from the drawing down in full of undrawn advised facilities, which the Bank has committed itself to provide;
- contingent liabilities arising in the normal course of business, and those contingent liabilities which would arise from the drawing down in full of undrawn advised facilities which the Bank has committed itself to provide; and
- other on and off-balance sheet financial assets and commitments.

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

The main categories of risk are:

- *Credit risk:* Credit risk stems from the possible non-prompt repayment or non-payment of existing and contingent obligations by the Bank's counterparties, resulting in the loss of equity and profit. It comprises the risk that deterioration in the financial condition of a borrower will cause the asset value to decrease or be extinguished. Country risk and Settlement risk are included in this category. Country risk refers to the risk of losses arising from economic or political changes that affect the country from which the asset originates. Settlement risk refers to the risk of losses through failure of the counterparty to settle outstanding dues on the settlement date owing to bankruptcy or other causes.
- *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 may be divided into two sub-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 fund raising activities resulting in obligations missing the settlement date or satisfied at higher than normal rates.
- *Operational risk:* Risk of loss resulting from the lack of skilful management or good governance within the Bank and the inadequacy of internal control, which might involve internal operations, staff, systems or external occurrences that in turn affect the income and capital funds of financial institutions. The Bank has adopted an operational risk management framework and procedures, which provide for the identification, assessment, management, monitoring and reporting of the Bank's operational risks.

1 **Risk management** *(continued)*

1.5 *Risk statement by the Board of Directors*

The Bank's business model throughout the years has been that of retaining a stable deposit base and granting credit principally to the commercial real estate sector, particularly because the Board strongly believes that despite the increased capital requirements introduced by the CRR, an active commercial real estate market is a fundamental source of employment and economic growth in Malta. Nonetheless, the Bank is conscious of the risks involved in commercial real estate lending, and thus ensures it prices loans by reference to underlying risks. In this respect, the Bank's return on assets, expressed as a percentage of profit after tax to average total assets, for the reporting period ended 31 December 2019 amounts to 0.9%.

The Bank manages its credit risk in this respect by selecting its customers and the projects it finances with prudence and caution, and by actively monitoring the value of collateral in relation to its exposure amounts such that in the event of default, the Bank would have sufficient collateral to secure recoverability.

In this respect, the loan loss coverage ratio, calculated as total provisions for impairment to total non-performing exposures, which as at 31 December 2019, amounted to 48.7% differs from that experienced within the sector, which generally tends to fluctuate between 50% to 55%. This clearly illustrates the robustness of the Bank's risk management practices particularly in respect of credit risk.

2 **Credit risk**

2.1 *Introduction to Credit risk*

Credit risk is the risk of suffering financial loss, should any of the Bank's customers, clients or market counterparties fail to fulfil their contractual obligations to the Bank. Credit risk arises mainly from commercial and consumer loans and advances and loan commitments arising from such lending activities, but can also arise from credit enhancement provided, such as financial guarantees, letters of credit, endorsements and acceptances.

Credit risk constitutes the Bank's largest risk in view of its significant lending and securities portfolios, which are monitored in several ways. The Bank is fully aware of such risk and places great importance on its effective management.

The Bank allocates considerable resources in ensuring the ongoing compliance with approved credit limits and to monitor its credit portfolio. In particular, the Bank has a fixed reporting cycle to ensure that the relevant management bodies, including the Board of Directors and the Executive Team, are kept informed on an ongoing basis of developments in the credit portfolio, non-performing loans and other relevant information.

2.2 *Credit risk management*

The Board of Directors has delegated the responsibility for the monitoring of management of credit risk to the Credit Committee. The granting of a credit facility is based on the Bank's insight into the customer's financial position, which is reviewed regularly to assess whether the basis for the granting of credit has changed. Furthermore, the customer must be able to demonstrate a reasonable ability to repay the debt. Approval limits are graded starting from authorised staff members and leading up to the Credit Committee and the Board of Directors depending on the size and the particular risk attached to the loan. Facilities are generally adequately secured either by property and/or guarantees and are reviewed periodically by Management both in terms of the exposure to the Bank and to ensure that security is still valid.

2 **Credit risk** *(continued)*

The Bank's Credit Department is responsible for undertaking and managing credit risk in relation to the entity's lending activities; covering all the stages in the lending cycle comprising credit proposal, loan approval, effecting advances, credit and collateral monitoring, processing repayments and credit recovery procedures. The Bank manages, limits and controls concentrations of credit risk arising from loans and advances wherever they are identified – in particular, to individual customers and groups, and to industry sectors. Such risks are monitored on a revolving basis and subject to frequent review, as considered necessary. The exposure to any one borrower is further restricted by sub-limits covering on and off-balance sheet exposures. Actual exposures against limits are monitored at end of day on a daily basis and on a real-time basis too. As highlighted previously, the Bank's reporting framework with respect to lending credit risk is comprehensive with regular reporting by the Credit Department to the Board, Credit Committee and Executive Team on adherence to limits, activity levels, performance measures and specific credit risk events.

In order to minimise the credit risk undertaken, counterparty credit limits may be defined, which consider a counterparty's creditworthiness, the value of collateral and guarantees which can reduce the overall credit risk exposure, as well as the type and the duration of the credit facility. In order to examine a counterparty's creditworthiness, the following are considered: country risk, quantitative and qualitative characteristics, as well as the industry sector in which the counterparty operates. The Bank has set limits of authority and has segregated duties so as to maintain impartiality and independence during the approval process and control for new and existing credit facilities.

The Bank's maximum exposure amount to credit risk before taking account of any collateral held or other credit enhancements can be classified in the following categories:

- Financial assets recognised on-balance sheet comprising principally balances with Central Bank of Malta, Malta Government treasury bills, cheques in course of collection, financial assets measured at FVOCI as well as loans and advances to banks and customers. The maximum exposure of these financial assets to credit risk equals their carrying amount.
- Guarantee obligations incurred on behalf of third parties. The maximum exposure to credit risk is the full amount that the Bank would have to pay if the guarantees are called upon.
- Loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities. The maximum exposure to credit risk is the full amount of the committed facilities.

The Bank's credit risk exposure amounts reflect the maximum exposure to credit risk before collateral held or other credit enhancements in accordance with the regulatory information submitted to the MFSA and are as follows:

	2019	**2019**
		Year end
	Average value	**Exposure value**
	€ 000	**€ 000**
Central governments or central banks	**214,549**	**262,552**
Institutions	**133,300**	**124,329**
Corporates	**78,315**	**84,311**
Retail	**21,135**	**19,693**
Secured by mortgages on immovable property	**371,885**	**377,550**
Exposures in default	**30,761**	**26,817**
Items associated with particularly high risk	**60,880**	**65,808**
Equity	**22,833**	**22,582**
Other items	**38,609**	**38,468**
	972,267	**1,022,110**

2 **Credit risk** *(continued)*

The exposures set out in the table above are based on the sum of on-balance sheet exposures and off-balance sheet exposures adjusted for the credit conversion factors stipulated in Article 166(10) of the CRR.

The following is an analysis of the Bank's exposure to credit risk split by on-balance sheet assets and off-balance sheet instruments:

	2019
	€ 000
On-balance sheet assets	**1,010,355**
Deduction for intangible assets	**(399)**
Minimum loss coverage for non-performing exposures	-
Off-balance sheet instruments	**12,154**
	1,022,110

2.3 *Concentration risk*

Concentration risk arises as a result of the concentration of exposures within the same category, whether the category relates to geographical location, industry sector or counterparty type.

As at 31 December 2019, no loans and advances to customers were deemed to be prohibited large exposures, prior to any eligible exemptions, in accordance with the requirements of Part Four of the CRR, Large Exposures. A limited number of customers account for a certain percentage of the Bank's loans and advances.

Credit risk attributable to concentration of investments is not considered by the Directors to be significant in view of the credit standing of the issuers.

The following tables analyse the concentration of credit risk by geographical region, industry sector and residual maturity at the end of the reporting period.

2 **Credit risk** *(continued)*

2.3.1 Credit risk exposures analysed by geographical region

The Bank monitors concentration of credit risk by geographical region. The following table summarises the country of risk by exposure class:

At 31 December 2019	**Total € 000**	**Malta € 000**	**Eurozone € 000**	**Other European countries € 000**	**Other € 000**
Central governments or central banks	**262,552**	**262,552**	**-**	**-**	**-**
Institutions	**124,329**	**8,655**	**61,978**	**28,351**	**25,345**
Corporates	**84,311**	**84,311**	**-**	**-**	**-**
Retail	**19,693**	**19,693**	**-**	**-**	**-**
Secured by mortgages on immovable property	**377,550**	**377,550**	**-**	**-**	**-**
Exposures in default	**26,817**	**26,817**	**-**	**-**	**-**
Items associated with particularly high risk	**65,808**	**65,808**	**-**	**-**	**-**
Equity	**22,582**	**22,182**	**-**	**-**	**400**
Other items	**38,468**	**38,468**	**-**	**-**	**-**
	1,022,110	**906,036**	**61,978**	**28,351**	**25,745**

2.3.2 Credit risk exposures analysed by industry sector

The following are the exposure amounts split by exposure class according to the respective industry concentration:

At 31 December 2019	**Total € 000**	**Manufacturing € 000**	**Tourism € 000**	**Trade € 000**	**Property and construction € 000**	**Personal, professional and home loans € 000**	**Financial institutions € 000**	**Other sectors € 000**
Central governments or central banks	**262,552**	**-**	**-**	**-**	**-**	**-**	**262,552**	**-**
Institutions	**124,329**	**-**	**-**	**-**	**-**	**-**	**124,329**	**-**
Corporates	**84,311**	**4,586**	**2,132**	**22,775**	**12,020**	**344**	**34,488**	**7,966**
of which: SME	**11,675**	**-**	**-**	**7,954**	**149**	**23**	**3,536**	**13**
Retail	**19,693**	**3,326**	**1,919**	**180**	**1,630**	**5,743**	**5,871**	**1,024**
of which: SME	**11,730**	**3,263**	**1,900**	**80**	**355**	**104**	**5,870**	**158**
Secured by mortgages on immovable property	**377,550**	**2,099**	**24,584**	**27,906**	**133,857**	**94,729**	**78,197**	**16,178**
of which: SME	**74,947**	**116**	**1,212**	**7,354**	**41,727**	**2,941**	**14,855**	**6,742**
Exposures in default	**26,817**	**626**	**535**	**3,370**	**11,853**	**6,773**	**-**	**3,660**
of which: SME	**15,767**	**273**	**-**	**3,113**	**9,309**	**-**	**-**	**3,072**
Items associated with particularly high risk	**65,808**	**74**	**-**	**106**	**52,116**	**10,349**	**3,163**	**-**
of which: SME	**28,719**	**74**	**-**	**-**	**28,224**	**-**	**421**	**-**
Equity	**22,582**	**309**	**1,645**	**-**	**-**	**-**	**2,210**	**18,418**
Other items	**38,468**	**-**	**420**	**-**	**22,870**	**-**	**8,453**	**6,725**
	1,022,110	**11,020**	**31,235**	**54,337**	**234,346**	**117,938**	**519,263**	**53,971**

2 **Credit risk** *(continued)*

2.3.3 Credit risk exposures analysed by residual maturity

The residual maturity breakdown by exposure class at the end of the reporting period was as follows:

At 31 December 2019	Total € 000	Less than 1 year € 000	Over 1 but less than 5 years € 000	Over 5 years € 000
Central governments or central banks	**262,552**	**191,335**	**20,661**	**50,556**
Institutions	**124,329**	**115,848**	**-**	**8,481**
Corporates	**84,311**	**34,499**	**20,920**	**28,892**
Retail	**19,693**	**10,595**	**3,146**	**5,952**
Secured by mortgages on immovable property	**377,550**	**104,337**	**64,835**	**208,378**
Exposures in default	**26,817**	**22,840**	**3,183**	**794**
Items associated with particularly high risk	**65,808**	**40,424**	**21,166**	**4,218**
Equity	**22,582**	**22,582**	**-**	**-**
Other items	**38,468**	**38,468**	**-**	**-**
	1,022,110	**580,928**	**133,911**	**307,271**

2.3.4 Counterparty banks' risk

The Bank runs the risk of loss of funds due to the possible delay in the repayment of existing and future obligations by counterparty banks.

Within its daily operations, the Bank transacts with banks and other financial institutions. By conducting these transactions, the Bank is running the risk of losing funds due to the possible delays in the repayment to the Bank of the existing and future obligations of the counterparty banks. The Bank primarily places short-term funds with pre-approved banks subject to the limits in place and subject to the respective institutions' credit rating being within controlled parameters. The positions are checked against the limits in real time and at end of day on a daily basis.

2.3.5 Country risk

The Bank runs the risk of loss of funds due to the possible political, economic and other events in a particular country where funds have been placed or invested with several counterparties. Countries are assessed according to their size, economic data and prospects and their credit ratings from international rating agencies. Existing country credit risk exposures are monitored and reviewed periodically. The Bank's exposures are predominantly in Malta as reflected within the table in section 2.3.1 which discloses country risk by exposure class. Other country risks are mainly bank balances and money market placements with a total carrying amount of €115,678,000.

2.4 *Use of External Credit Assessment Institutions*

In calculating its risk-weighted exposure amounts, the Bank uses an External Credit Assessment Institution (ECAI) for Central governments, Institutions, Corporates and Items associated with particularly high risk for which a credit assessment is available. The credit quality of such exposures is determined by reference to external credit ratings applicable to issuers or counterparties. The Bank maps the external ratings to the credit quality steps prescribed in the CRR as required by CEBS publication '*Standardised Approach: Mapping of ECAIs' credit assessments to credit quality steps*'.

2 **Credit risk** *(continued)*

The following are the exposure values for which an ECAI is used:

At 31 December 2019	**Credit quality step**	**Central governments or central banks € 000**	**Institutions € 000**	**Total € 000**
AAA to AA-	**1**	-	**11,956**	**11,956**
A+ to A-	**2**	**262,552**	**94,799**	**357,351**
BBB+ to BBB-	**3**	-	**17,565**	**17,565**
BB+ to BB-	**4**	-	-	-
B+ to B-	**5**	-	**4**	**4**
CCC+ and below	**6**	-	**5**	**5**
		262,552	**124,329**	**386,881**

2.5 *Credit quality of the Bank's lending portfolio*

The Bank manages the credit quality of its loans and advances to customers by using internal risk grades, which provide a progressively increasing risk profile ranging from 'P1' (best quality, less risky) to 'NP'. These risk grades are an essential tool for the Bank to identify both non-performing exposures and better-performing customers. The internal risk grades used by the Bank are as follows:

- Performing: Internal grade 'P1';
- Under performing: Internal grades 'P2' and 'P3'; and
- Non-performing: Internal grade 'NP'.

P1

The Bank's loans and advances to customers which are categorised as 'P1' are principally debts in respect of which the payment of interest and/or capital is not overdue by 30 days and with no recent history of customer default. Management does not expect any losses from non-performance by these customers.

P2

Loans and advances which attract a 'P2' grading are those which are receiving the close attention of the Bank's Management and are being reviewed periodically in order to determine whether such advances should be reclassified to either 'P1' or 'P3' classification. Credit facilities that attract this category include those where the payment of interest and/or capital becomes overdue by 30 days and over but not exceeding 60 days.

2 **Credit risk** *(continued)*

P3

Loans and advances which attract a 'P3' grading are those having the weaknesses inherent in those loans and advances classified as 'P2' with the added characteristics that repayment is inadequately protected by the current sound worth and paying capacity of the borrower. Loans and advances so graded have a well-defined weakness or weaknesses that could jeopardise the repayment of the debt. They are characterised by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Credit facilities that attract this category include those where the payment of interest and/or capital becomes overdue by 60 days and over but not exceeding 90 days.

NP

Loans and advances which attract a 'NP' grading are those facilities where the Bank deems the recoverability of principal to be remote as a result of worsening conditions of loans and advances classified as 'P3'. Credit facilities that attract this category include those where the payment of interest and/or capital becomes overdue by 90 days and over. These loans and advances are generally past due by more than 90 days and comprise those exposures which are deemed by the Bank as credit-impaired (see definition in note 2.3.10).

The following table provides a detailed analysis of the credit quality of the Bank's lending portfolio.

	2019 **€ 000**
Gross loans and advances to customers	
Performing ('*Stage 1' assets*)	**479,843**
Under-performing ('*Stage 2' assets*)	**45,927**
Non-performing ('*Stage 3' assets*)	**51,380**
	577,150

2.5.1 Credit-impaired loans and advances to customers

Credit-impaired loans and advances are advances which are either more than 90 days past due, or for which the Bank determines as probable that it will be unable to collect all principal and interest due according to the contractual terms of the loans and advances agreement(s). The Bank's credit-impaired loans and advances mainly relate to a number of independent customers which are not meeting repayment obligations or deemed by the Bank as unlikely to pay their obligations to the Bank without recourse by the Bank to realising the collateral.

2 **Credit risk** *(continued)*

2.5.2 Past due but not credit-impaired loans

Past due but not credit-impaired loans include loans and advances where contractual interest or principal payments are past due. Credit losses that may arise are covered through the Bank's assessment of Expected Credit Loss allowances.

Loans and advances to customers are analysed into credit-impaired, past due and other exposures as follows:

	2019
	€ 000
Gross loans and advances to customers	
Credit-impaired	**51,380**
Past due but not credit-impaired	**11,329**
Neither past due nor credit-impaired	**514,441**
	577,150

The table below analyses the impaired and the past due but not impaired gross loans and advances to customers by industry sector.

At 31 December 2019	**Credit-impaired € 000**	**Past due but not credit-impaired € 000**
Manufacturing	**735**	**93**
Tourism	**2,482**	**-**
Trade	**3,783**	**1,847**
Property and construction	**31,087**	**2,805**
Personal, professional and home loans	**8,837**	**2,110**
Financial institutions	**-**	**376**
Other sectors	**4,456**	**4,098**
	51,380	**11,329**

The majority of the impaired and past due but not impaired loans and advances to customers were concentrated within Malta.

2 **Credit risk** *(continued)*

2.5.3 Collateral

The Bank holds collateral against exposures in the form of hypothecs over property, other registered securities over assets and guarantees. The nature and level of collateral required depends on a number of factors, including, but not limited to, the amount of the exposure, the type of facility provided, the term of the facility, the amount of the counterparty's contribution and an evaluation of the level of the credit risk or Probability of Default involved. Collateral is an important mitigant of credit risk. Nevertheless, it is the Bank's policy to establish that facilities are within the customer's capacity to repay rather than to over rely on security. In certain cases, depending on the customer's standing and the type of product, facilities may be unsecured. The Bank applies various measures to reduce the risk on individual transactions, including collateral in the form of physical assets and guarantees.

The principal collateral types used as credit risk mitigants are mortgages on residential properties and commercial real estate. For regulatory purposes, none of the Bank's collateral in the form of commercial real estate qualifies as eligible collateral, as these properties fail to meet the conditions of Article 126(2) of the CRR.

Out of the €552.1 million exposures arising from the Bank's lending, €371.3 million are secured by mortgages on immovable property, while €60.1 million are secured by mortgages on immovable property but are classified within the high risk exposures since these are associated with speculative immovable property financing. From the €371.3 million exposures secured by mortgages on immovable property, €100.1 million qualify as fully and completely secured by mortgages on residential immovable property, and accordingly attract a risk-weight of 35%.

2.5.4 Loss allowances

The Bank assesses on a forward-looking basis the Expected Credit Losses associated with its loans and advances portfolio. The Bank recognises a loss allowances for such losses at each reporting date.

Expected Credit Losses	**Total € 000**	**Manufacturing € 000**	**Tourism € 000**	**Trade € 000**	**Property and construction € 000**	**Personal, professional and home loans € 000**	**Financial institutions € 000**	**Other sectors € 000**
At 1 January 2019	**23,413**	**1,360**	**1,763**	**1,528**	**14,104**	**1,973**	**2,553**	**132**
Additions	**5,383**	**137**	**270**	**628**	**1,915**	**454**	**1,023**	**956**
Reversals	**(3,701)**	**(1,072)**	**(7)**	**(614)**	**(752)**	**(359)**	**(855)**	**(42)**
At 31 December 2019	**25,095**	**425**	**2,026**	**1,542**	**15,267**	**2,068**	**2,721**	**1,046**

2.5.5 Write-off policy

The Bank writes off loan or advance balances (and any related allowances for impairment losses) when it determines that these are uncollectible. This decision is reached after considering information such as the occurrence of significant changes in the borrower's financial position, such that the borrower can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

3 Market risk

The Bank takes on exposure to market risk, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads, foreign exchange rates and equity prices.

Accordingly, 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; and
- Equity price risk, which is the risk of losses because of changes in investment prices.

3.1 *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 reprice 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 on repricing dates on assets and liabilities as much as it is practicable. The Bank monitors on a continuous basis the level of mismatch of interest rate repricing taking cognisance of the terms of the Bank's principal assets, comprising loans and advances to customers, that are repriceable at the Bank's discretion. Accordingly, the Bank is in a position to manage the interest rate terms of its financial assets and simultaneously modify the interest terms of its liabilities. The Bank seeks to manage its net interest spread, taking cognisance of the cost of capital, by investing funds in a portfolio of loans and advances and securities with a longer tenure than the funding liabilities (therefore normally giving rise to a negative maturity gap position) through the effective management of shorter term deposit liabilities with a view to securing steady base deposits with differing terms over the medium to longer term.

Interest rate risk is managed principally through monitoring interest rate gaps and by having pre-approved limits for repricing bands which are set by ALCO. ALCO is the monitoring body for compliance with these limits and is assisted by Treasury through its day-to-day operational activities. The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to interest rate movements.

Accordingly, the Bank's ALCO is primarily responsible for the interest rate risk management process and for monitoring actively the interest rate risk measures utilised by the Bank. Reporting of interest rate risk measures exposures vis-à-vis limits flows to the ALCO and Board on a regular systematic basis. The Bank's independent Risk Management Function provides oversight in respect of the interest rate risk management process ensuring that it is designed in an appropriate manner and is functioning properly.

The Bank's repricing gaps at 31 December 2019 are disclosed in the tables within note 2.4.1 to the financial statements. The measures applied for the monitoring of the fair value sensitivity of the fixed rate instruments and the cash flow sensitivity for variable rate instruments are disclosed within notes 2.4.3 and 2.4.4 to the financial statements.

3 **Market risk** *(continued)*

3.2 *Currency risk*

The Bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. Foreign exchange risk is the risk to earnings and value caused by a change in foreign exchange rates. Foreign exchange risk arises when financial assets or liabilities are denominated in currencies which are different from the Bank's functional currency.

The Bank manages this risk principally by ensuring that its foreign currency denominated liabilities are matched with corresponding assets in the same currency.

Accordingly, foreign currency liabilities are utilised to fund assets denominated in the same foreign currency thereby matching asset and liability positions as much as is practicable. This mechanism is reflected in the figures reported in the table below which presents this matching process.

The Bank's foreign exchange risks are managed actively and monitored by the Treasury Function, which process ensures that the Bank maintains its exposure to foreign currencies within prescribed limits set by the Bank's ALCO. ALCO sets limits on the level of exposure by currency and in aggregate for both overnight and intra-day positions which are monitored on a real-time basis. Reporting of exposures vis-à-vis limits flows to the ALCO and Board on a regular systematic basis. The Bank's independent Risk Management Function is responsible for assuring that the foreign exchange risk management process is designed in an appropriate manner and is functioning effectively.

The Bank enters into forward foreign currency exchange contracts with customers in the normal course of its business. Generally, it is the Bank's policy to cover these contracts by other forward positions. As a result, the Bank is not open to any significant exchange risk in respect of derivative contracts. The Bank also takes a deposit margin of the nominal value from the customer thereby reducing its credit risk should the client default. The Bank had no open forward foreign currency contracts at the end of the reporting period.

3 **Market risk** *(continued)*

The following table summarises the Bank's net exchange position by currency taking into account the Bank's financial assets and liabilities as well as off-balance sheet instruments exposing the Bank to foreign exchange risk.

Bank **At 31 December 2019**	**Total** **€ 000**	**EUR** **€ 000**	**GBP** **€ 000**	**USD** **€ 000**	**Other** **€ 000**
Financial assets					
Balances with Central Bank of Malta, treasury bills and cash	181,701	159,920	12,435	9,340	6
Investments measured at FVOCI	107,806	107,406	-	400	-
Loans and advances to banks	115,678	32,957	27,250	51,736	3,735
Loans and advances to customers	552,055	549,049	2,846	160	-
Other assets	5,010	4,972	17	21	-
Total financial assets	962,250	854,304	42,548	61,657	3,741
Financial liabilities					
Amounts owed to banks	5,871	5,871	-	-	-
Amounts owed to customers	868,832	762,306	42,433	60,429	3,664
Other liabilities	19,866	18,878	147	749	92
Total financial liabilities	894,569	787,055	42,580	61,178	3,756
Net currency exposure in financial assets/liabilities		67,249	(32)	479	(15)
Commitments and contingent liabilities	236,340	234,472	1,095	773	-

3.3 *Equity price risk*

The exposure of the Bank to this risk is not significant given the low holdings of equity instruments by the Bank, which are not deemed material in the context of the Bank's statement of financial position. Such holdings are limited to locally quoted equity instruments issued by local well-known corporate issuers. Frequent management reviews are carried out to obtain comfort on the high quality of the portfolio.

4 **Liquidity risk**

4.1 *Management of liquidity risk*

Liquidity risk is defined as the risk of losses due to:

- the Bank's funding costs increasing disproportionately;
- lack of funding preventing the Bank from establishing new business; and
- lack of funding ultimately preventing the Bank from meeting its obligations.

Liquidity risk may result from an inability to sell a financial asset quickly at close to its fair value. The Bank is exposed to daily calls on its available cash resources from overnight deposits, current and call deposits, maturing term deposits, loan drawdowns and guarantees.

4 **Liquidity risk** *(continued)*

The objective of the Bank's liquidity and funding management is to ensure that all foreseeable funding commitments and deposit withdrawals can be met when due. It is the Bank's objective to maintain a diversified and stable funding base with the objective of enabling the Bank to respond quickly and smoothly to unforeseen liquidity requirements.

The Bank manages this risk by ensuring that its assets and liabilities are matched in terms of maturities as much as is practicable. However, the Bank ought to manage its net interest spread by investing funds in a portfolio of assets with a longer term than the liabilities funding them. To mitigate exposures arising in this respect, the Bank holds significant liquid assets in the form of Malta Government treasury bills, money market placements and other short-term instruments for managing liquidity risk to support payment obligations and contingent funding in a stressed market environment.

The Bank maintains internal liquidity buffers established by ALCO made up of cash and financial assets which are also eligible for collateral against borrowing from the European Central Bank. In order to ensure that maturing funds are always available to meet unexpected demand for cash, the Board sets parameters within which maturities of assets and liabilities may be mismatched in line with the stance referred to previously. Unmatched positions potentially enhance profitability, but also increase risks. The Bank's ALCO focuses on the entity's management process with respect to market and funding liquidity risks. ALCO maintains ongoing oversight of forecast and actual cash flows, by monitoring the availability of funds to meet commitments associated with financial instruments. ALCO is supported by the Bank's Executive Team and Treasury Function in this respect, at operational level. ALCO monitors the Bank's Liquidity Gap analysis on a monthly basis. The Bank's liquidity management process comprises management of day-to-day funding, by monitoring future cash flows to ensure that requirements can be met and that funds are replenished as they mature or are borrowed by customers. This implies a structured ongoing analysis of the contractual maturity of the financial liabilities and the expected collection date of the financial assets. The Bank's liquidity management focuses on maintaining a portfolio of highly marketable assets, subject to pre-established limits, that can easily be liquidated in case of any unforeseen interruption to cash flow; and monitoring the liquidity ratios of the Bank against internal and regulatory requirements. In this respect, the Bank's Advances-to-Deposit ratio of 63.5% at the end of the reporting period reflects management's prudent stance in the context of liquidity management. Also, the Liquidity Coverage ratio at 31 December 2019 is 301.5%, which is significantly higher than the prudential parameters set by Regulation.

Reporting of measures of liquidity risk and liquidity ratios vis-à-vis internal limits flows to the ALCO and Board on a regular basis. The Bank's Risk Management Function provides oversight in respect of the liquidity risk management process ensuring that it is functioning effectively.

The Bank also monitors the level and type of undrawn lending commitments and the impact of contingent liabilities such as guarantees as part of the liquidity management process previously referred to.

As at 31 December 2019, the Bank had outstanding guarantees on behalf of third parties amounting to €8,942,000, which are cancellable upon the request of the third parties. The Bank's liquidity exposures arising from these commitments and contingencies are expected to expire principally within a period of twelve months from the end of the reporting period.

4 **Liquidity risk** *(continued)*

4.2 *Asset Encumbrance*

The disclosure on asset encumbrance is a requirement introduced in Banking Rule BR/07 transposing the provisions of the EBA Guidelines on Disclosure of Encumbered and Unencumbered Assets (EBA/GL/2014/03).

The objective of this disclosure is to facilitate an understanding of available and unrestricted assets that could be used to support potential future funding and collateral needs. An asset is defined as encumbered if it has been pledged as collateral against an existing liability, and as a result is no longer available to the Bank to secure funding, satisfy collateral needs or be sold to reduce the funding requirement.

The disclosure is not designed to identify assets which would be available to meet the claims of creditors or to predict assets that would be available to creditors in the event of a resolution or bankruptcy.

In accordance with the EBA 'Guidelines on Disclosure of Encumbered and Unencumbered Assets', the amounts disclosed in the table below represent median values, being the rolling quarterly amounts over the previous 12 months.

	Carrying amount of encumbered assets € 000	Fair value of encumbered assets € 000	Carrying amount of unencumbered assets € 000	Fair value of unencumbered assets € 000
At 31 December 2019				
Assets of the reporting institution	**12,367**	**12,367**	**944,418**	**944,418**
Loans on demand	**2,809**	**2,809**	**73,588**	**73,588**
Equity instruments	**-**	**-**	**12,138**	**12,138**
Debt securities	**8,738**	**8,738**	**177,450**	**177,450**
Loans and advances	**-**	**-**	**620,481**	**620,481**
Other assets	**820**	**820**	**60,760**	**60,760**

The Bank does not encumber any of the collateral received. Moreover, as at 31 December 2019, the Bank did not have any outstanding liabilities associated with encumbered assets and collateral received.

The Bank undertakes encumbrance by pledging debt securities against the provision of credit lines by the Central Bank of Malta and in favour of the Depositor Compensation Scheme.

5 **Operational risk**

Operational risk is the risk of loss resulting from the lack of skilful management or good governance within the Bank and the inadequacy of internal control, which might involve internal operations, staff, systems or external occurrences that in turn affect the income and capital funds of financial institutions. The Bank has adopted an operational risk management framework and procedures, which provide for the identification, assessment, management, monitoring and reporting of the Bank's operational risks. Operational risk is also addressed through proper insurance cover.

Operational risk management relies on a framework of policies and procedures implemented by the different operational functions within the Bank through transaction processing and business execution. Regular reporting of operational risk events to the Board of Directors is carried out as required. The implementation of such policies and procedures by the Bank's operational functions is overseen by the Risk Management Function.

The Bank currently uses the Basic Indicator Approach to assess the operational risk capital requirements and accordingly allocates 15% of average gross income for a three year period in accordance with regulatory requirements. The operational risk capital regulatory requirement as at 31 December 2019 amounted to €3,667,000.

6 **Capital risk management**

The Bank is a licensed credit institution and must therefore comply with the capital requirements under the relevant capital requirements within laws and regulations. Maltese law and regulations on capital adequacy are naturally based on EU capital requirements.

The prudent and efficient management of capital remains one of the Bank's top priorities. 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. Capital management is managed primarily through the capital planning process that determines the optimal amount and mix of capital that should be held by the Bank, subject to regulatory limits.

Capital adequacy and the use of regulatory capital are monitored regularly by the Bank's management, employing techniques based on the guidelines developed by the Basel Committee, European Union Regulations and Directives, as implemented by the MFSA for supervisory purposes. The Bank's capital management is based on the regulatory requirements established within the CRR and by local regulations which are modelled on the requisites of the CRD rules.

The Bank's Executive Team and ALCO are predominately responsible for the Bank's capital risk management process. Capital adequacy ratios together with the level and quality of Own funds are reported on a regular basis to the Board and the ALCO by the Finance Function.

6 **Capital risk management** *(continued)*

6.1 *Own funds*

Own funds represent the Bank's available capital and reserves for the purposes of capital adequacy. Capital adequacy is a measure of the financial strength of a bank, expressed as a ratio of its capital to its assets. The Bank adopts processes to ensure that the minimum regulatory requirements are met at all times, through the assessment of its capital resources and requirements given current financial projections. During the year ended 31 December 2019, the Bank complied with all of the externally imposed capital requirements to which it was subject.

In July 2013, the European Banking Authority (EBA) issued its final draft Implementing Technical Standards (ITS) on Own funds disclosures. The disclosure requirements of these technical standards have been integrated within the Bank's disclosures set out below.

The Bank's capital base comprises Common Equity Tier 1 (CET1) capital, which includes the following items:

- ordinary share capital;
- share premium;
- retained earnings;
- revaluation and other reserves; and
- other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes including deductions relating to amounts pledged in favour of the Depositor Compensation Scheme.

(a) Share capital

The Bank's share capital as at 31 December 2019 is analysed as follows:

	2019	
	No. of shares 000s	**€ 000**
Authorised		
Ordinary shares of 25 cent each	**80,000**	**20,000**
Issued		
Ordinary shares of 25 cent each	**44,178**	**11,044**

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 meetings of the Bank. All shares rank equally with regard to the Bank's residual assets.

6 **Capital risk management** *(continued)*

The following table describes the terms and conditions of the ordinary share capital issued by the Bank.

Capital Instruments	**Ordinary share capital and share premium**
Unique Identifier	MT0000040106
Governing law(s) of the instrument	Maltese Law
Regulatory treatment	
Transitional CRR rules	Common Equity Tier 1
Post-transitional CRR rules	Common Equity Tier 1
Eligible at solo/(sub-)consolidated / solo &(sub-) consolidated	Solo
Amount recognised in regulatory capital	€11,044,479
Nominal amount of instrument	€11,044,479
Nominal amounts of each share	€0.25
Accounting classification	Share capital
Issuer call subject to prior supervisory approval	No
Position in subordination hierarchy in liquidation	Subordinated to creditors and depositors
Non-compliant transitioned features	No

(b) Share premium

The share premium represents the amounts at which ordinary shares were issued in excess of their nominal value, normally arising as a result of rights issues approved by the shareholders during the Annual General Meetings. The amount is not distributable by way of dividend to shareholders.

(c) Retained earnings

The retained earnings represent earnings not paid out as dividends.

Retained earnings form part of Own funds only if those profits have been verified by the Bank's independent external auditor. The Bank has demonstrated to the satisfaction of the competent authority that any foreseeable charge or dividend has been deducted from the amount of those profits.

Subsequent to the end of the reporting period, a gross dividend of 7 cent per nominal 25 cent share (net dividend of 4.55 cent for a total amount of €2,010,000) for the twelve months ended 31 December 2019 is being proposed for approval by the shareholders to be distributed. A resolution to this effect will be proposed to the Annual General Meeting.

6 **Capital risk management** *(continued)*

(d) Reserve for General Banking Risks

Banking Rule BR/09 'Measures addressing credit risks arising from the assessment of the quality of asset portfolios of credit institutions authorised under the Banking Act 1994', issued by the MFSA, requires banks in Malta to hold additional reserves for general banking risks in respect of non-performing loans. This reserve is required to be funded from planned dividends. As at the reporting date, this reserve amounted to €2,903,000 (representing 100% of the total estimated amount). The amount has not changed during the year under review.

(e) Property revaluation reserve

This represents the surplus arising on the revaluation of the Bank's freehold property net of related deferred tax effects. The revaluation reserve is not available for distribution.

(f) Investment revaluation reserve

This represents the cumulative net change in fair values of assets measured at FVOCI held by the Bank, net of related deferred tax effects.

6 **Capital risk management** *(continued)*

The Bank's Own funds and capital ratio calculations are set out below:

At 31 December 2019	**€ 000**
Common Equity Tier 1 (CET1) capital	
Common Equity Tier 1 (CET1) capital: instruments and reserves	
Capital instruments and the related share premium accounts	**29,574**
Retained earnings	**65,127**
Accumulated other comprehensive income (and other reserves)	**11,953**
Reserve for General Banking Risks	**2,903**
CET1 capital before regulatory adjustments	**109,557**
Common Equity Tier 1 (CET1) capital: regulatory adjustments	
Intangible assets	**(399)**
Minimum loss coverage for non-performing exposures	-
Total regulatory adjustments to CET1	**(399)**
CET1 capital	**109,158**
Total risk-weighted assets	**682,016**
Capital ratios	
CET1 capital	16.01%
Total capital	16.01%
Institution specific buffer requirement	7.00%
of which: capital conservation buffer requirement	2.50%
CET1 available to meet buffers in excess of the CRR 4.5% minimum requirement	11.51%
CET1 available to meet buffers	9.01%
	€ 000
Items not deducted from own funds in accordance with Article 48 of CRR	3,453

6.2 *Capital requirements*

The allocation of capital between specific operations and activities is, to a large extent, driven by optimisation of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily upon the regulatory capital, though in some cases the regulatory requirements do not reflect differing risk profiles, subject to the overall level of capital to support a particular operation or activity not falling below the minimum required for regulatory purposes. The process of allocating capital to specific operations and activities is undertaken independently of those responsible for the operation.

6 **Capital risk management** *(continued)*

Although maximisation of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Bank to particular operations or activities, it is not the sole basis used for decision-making. Account is also taken of synergies with other operations and activities, the availability of management and other resources, and the fit of the activity with the Bank's long-term strategic objectives. The Bank's policies in respect of capital management and allocation are reviewed regularly by the Board of Directors.

The Pillar I minimum capital requirements are calculated for credit, market and operational risks. During the year, the Bank continued to use the Standardised Approach for credit risk, the Basic Method for foreign exchange risk and the Basic Indicator Approach for operational risk in order to calculate the Pillar I minimum capital requirements. For credit risk, under the Standardised Approach, risk weights are determined according to the asset class, credit risk mitigation and external credit ratings - or by using the applicable regulatory risk weights for unrated exposures. Capital charge for foreign exchange risk using the Basic Method is calculated at 8% of the higher of the sum of all the net short positions and the sum of all the net long positions in each foreign currency. The Basic Indicator Approach requires that the Bank allocates capital for operational risk by taking 15% of the average gross income of the preceding three years.

The Total Capital Ratio is calculated using the definition of regulatory capital and risk-weighted assets. As required by the CRR, the minimum level of the Capital Requirements Ratio stands at 8%. The Capital Requirements Ratio expresses Own funds as a proportion of risk-weighted assets and off-balance sheet instruments for credit risk purposes, together with notional risk-weighted assets in respect of operational risk and market risk. 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.

The Bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Bank fully implemented the CRD IV capital requirements with effect from January 2019. Although it is not yet certain whether the Bank will be required to maintain an additional countercyclical capital buffer as required by the CRR, given that the Bank's exposures are mainly contained within Malta, this buffer is expected to be marginal, since the deviation of Malta's credit-to-GDP ratio is not expected to be significant taking cognisance of its long-term trend.

Additionally, the Bank will be required to maintain a capital conservation buffer of 2.5%, made up of CET1 capital, on the risk-weighted exposures of the Bank as from 1 January 2020. This buffer was phased in over the period from 1 January 2016 to 31 December 2019.

6 **Capital risk management** *(continued)*

The Bank's capital requirements and Total Capital Ratio computation are as follows:

At 31 December 2019	Exposure value € 000	Risk-weighted assets € 000	Capital required € 000
Central governments or central banks	**262,552**	**8,634**	**691**
Institutions	**124,329**	**27,462**	**2,197**
Corporates	**84,311**	**84,311**	**6,745**
Retail	**19,693**	**14,770**	**1,182**
Secured by mortgage on immovable property	**377,550**	**308,422**	**24,674**
Exposures in default	**26,817**	**40,226**	**3,218**
Items associated with particularly high risk	**65,808**	**98,712**	**7,897**
Equity	**22,582**	**22,582**	**1,807**
Other items	**38,468**	**30,914**	**2,473**
Credit risk	**1,022,110**	**636,033**	**50,884**
Foreign exchange risk		**141**	**11**
Operational risk		**45,842**	**3,667**
Total capital required		**682,016**	**54,562**
Own funds			
Common Equity Tier 1 capital			**109,158**
Total own funds			**109,158**
Total capital ratio			**16.01%**

6.3 *Other disclosures on Own funds*

The Bank has opted not to apply the transitional arrangements laid down in Regulation (EU) 2017/2395 to mitigate the impact of the introduction of IFRS 9 on own funds. Under Regulation (EU) 2017/2395, during the transitional period ending 31 December 2023, the Bank would have had the option to add back a proportion of:

- the Day 1 impact as a result of the introduction of IFRS 9, being the difference between IFRS 9 Expected Credit Losses (ECLs) on 1 January 2018 and IAS 39 provisions determined at 31 December 2017; and
- on difference in the IFRS 9 ECLs determined at reporting date and the ECLs determined on 'day 1' of the introduction of IFRS 9 (being 1 January 2018 for the Bank) for 'Stage 1' (12-months ECLs) and 'Stage 2' (lifetime ECLs) assets.

The factors used to adjust the above ECLs declines across the transitional period, starting at 95% during the financial year ended 31 December 2019 to 25% in the final transitional financial year ended 31 December 2023. The above treatment is in accordance with the requirements laid down in paragraph 2 and paragraph 4 of Regulation (EU) 2017/2395.

6 **Capital risk management** *(continued)*

In line with Section 2 of the EBA 'Guidelines on uniform disclosures under Article 473a of Regulation (EU) No. 575/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds', the Bank is required to disclose a comparison of the institutions' own funds, Common Equity Tier 1 capital, Tier 1 capital, risk-weighted assets, Common Equity Tier 1 capital ratio, Tier 1 capital ratio, total capital ratio and leverage ratio with and without the application of transitional arrangements for IFRS 9 or analogous ECLs.

Given that the Bank has opted not to apply the transitional arrangements emanating from Regulation (EU) 2017/2395, and thus, reflect in full the impact of the adoption of IFRS 9 on own funds upon initial adoption without adding back any portion of the impact throughout the transitional period. On this basis, the Bank has opted not to disclose a table illustrating a comparison between its capital and leverage ratios with and without the application of the transitional arrangements of IFRS 9.

6.4 *Internal Capital Adequacy Assessment Process (ICAAP)*

The Bank considers the Internal Capital Adequacy Assessment Process (ICAAP) embedded in Pillar II as a tool that ensures the proper measurement of material risks and capital and allows for better capital management and improvements in risk management. Therefore, it facilitates a better alignment between material risks and regulatory capital in order to have better capital deployment and improvements in the risk management and mitigation techniques adopted by the Bank. The ICAAP as required by the MFSA Banking Rule BR/12: The Supervisory Review Process of Credit Institutions authorised under the Banking Act, 1994, is performed on an annual basis.

Therefore, ICAAP is a process that the Bank utilises to ensure that:

- there is adequate identification, measurement, aggregation and monitoring of the Bank's risks;
- adequate internal capital is held by the institution in relation to its risk profile; and
- the Bank uses sound risk management systems and there is the intention to develop them further.

The Board and the Bank's Executive Team take overall responsibility for the conceptual design and technical details of the ICAAP document. Apart from the responsibility for the conceptual design, the Board discussed, approved, endorsed and delivered the yearly ICAAP submission. The Bank's independent Risk Management Function is involved in the ICAAP with a view to ensuring that the process reflects and takes cognisance of the Bank's risk management activities and processes.

The ICAAP is an ongoing process which starts with defining risk strategy followed by identifying, quantifying and aggregating risks, determining risk-bearing ability, allocating capital, establishing limits and ongoing risk monitoring. The individual elements of the process are performed with varying regularity. All the activities described are examined at least once a year to ensure that they are up to date, adequate and also adjusted to current underlying conditions when necessary.

The process involves a quantitative assessment of individual types of risk and an assessment of the existing methods and systems for monitoring and managing risk (qualitative assessment). The risk assessment concept is based on a scoring procedure, thus providing a comprehensive overview of the risk situation of the Bank.

6 **Capital risk management** *(continued)*

The basis for the quantitative implementation of the ICAAP is the risk-bearing capacity calculation which demonstrates that adequate capital is in place at all times to provide sufficient cover for risks that have been entered into and which also ensures such cover is available for the future. The Bank's ICAAP is based upon a 'Pillar I Plus' approach whereby the Pillar I capital requirement for credit, market and operational requirements are supplemented by the capital allocation for other material risks not fully addressed within Pillar I. The risks considered for ICAAP include concentration, liquidity, reputational and strategic risks, interest rate risk in the banking book, and risks arising from the macro-economic environment.

The Bank's ICAAP 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 Bank's plan and the associated risks.

The Bank also covers Pillar II capital requirements through stress testing processes to forecast the Bank's projected capital requirements and resources in a range of stress scenarios. This enables the Bank to guarantee that it can meet its minimum regulatory capital requirements in a stressed environment. The results of the ICAAP once again show that the Bank maintains a comfortable level of excess capital and substantial liquidity that ensured the flexibility and resources needed to achieve the long-term strategic objectives of the Bank, even in situations of market stress.

7 **Leverage**

The leverage ratio is a regulatory and supervisory tool intended to provide a transparent and non-risk based measurement of an institution to supplement the risk-based capital requirements.

The leverage ratio is calculated on a three-month average of capital as a proportion of total exposures. Capital is defined as Tier 1 capital in line with Article 25 of the CRR, while total exposure relates to the total on- and off-balance sheet exposures less the deductions applied to Tier 1 capital.

During 2016, the European Commission published a Proposal to amend Regulation 575/2013 (CRR), which included the introduction of a 3% leverage ratio as a binding Pillar I requirement by 2018. The Bank complies with a 3% leverage ratio based on fully-transitioned Basel III standards.

7 **Leverage** *(continued)*

The following table represents the Bank's estimated leverage ratio determined in accordance with the requirements stipulated by Implementing Regulation EU 2016/200.

	2019 **€ 000**
Tier 1 capital	**109,158**
Leverage ratio total exposure measure	**1,043,322**
Leverage ratio	**10.46%**

The table shown hereunder represents the amounts making up the leverage ratio exposures.

	2019 **€ 000**
On-balance sheet exposures (excluding derivatives and SFTs)	
On-balance sheet items (excluding derivatives and SFTs, but including collateral)	**1,010,355**
Asset amounts deducted in determining Tier 1 capital	**(399)**
On-balance sheet exposures (excluding derivatives and SFTs)	**1,009,956**
Off-balance sheet exposures	
Off-balance sheet exposures at gross notional amount	**236,380**
Adjustments for conversion to credit equivalent amounts	**(203,014)**
Off-balance sheet exposures	**33,366**

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

	2019 **€000**
Total assets as per published financial statements	**1,016,159**
Adjustment for off-balance sheet items	**33,366**
Other adjustments:	
Deduction for Deferred Tax Liability	**(5,804)**
Deduction for minimum loss coverage on non-performing exposures	**-**
Deduction for intangible assets	**(399)**
Leverage ratio total exposure measure	**1,043,322**

7 **Leverage** *(continued)*

The table below shows the different on-balance sheet exposures in relation to the calculation of the leverage ratio.

	2019 € 000
Total on-balance sheet exposures (excluding derivatives and SFTs), of which:	
Exposures treated as sovereigns	**262,552**
Institutions	**124,159**
Secured by mortgages on immovable property	**371,303**
Retail	**18,459**
Corporate	**79,890**
Exposures in default	**26,817**
Other exposures	**126,776**
	1,009,956

The leverage ratio is a regulatory and supervisory instrument used by Regulator to limit the build-up of excessive leverage. The leverage ratio has increased between 2017 and 2018 to 10.4%. The leverage ratio at 31 December 2019 stood at 10.5%.

The Bank is currently not at risk at curtailing excessive leverage since the growth of CET1 capital of 10.6% was in line with the Bank's increase of 10.0% in the total exposure measure. As a result, the leverage ratio is expected to remain well above the mandatory requirement with the re-investment of profits matching the growth in assets. Board limits to the leverage ratio are set and reviewed annually and the ratio is monitored at every Audit & Risk Committee to ensure that it remains above the tolerance limit set by the Board of Directors. This limit supports the Bank's attitude towards finding a suitable balance between risk and returns provided to shareholders.

8 **Remuneration policy**

Information on the Bank's remuneration policy and practices is disclosed in the Remuneration Report within the Annual Report located on page 28.

9 **Other Directorships**

In terms of Article 91 of Directive 2013/36/EU (CRD IV), directors of an institution that is significant in terms of its size, internal organisation and the nature, scope and complexity of its activities shall not hold more than one of the following combinations of directorships at the same time:

(a) one executive directorship with two non-executive directorships;
(b) four non-executive directorships.

9 **Other Directorships** *(continued)*

According to the 'Guide to banking supervision' issued by the European Central Bank in November 2014, a credit institution will be considered significant if any one of the following conditions is met:

- the total value of its assets exceeds €30 billion or – unless the total value of its assets is below €5 billion – exceeds 20% of national GDP;
- it is one of the three most significant credit institutions established in a Member State;
- it is a recipient of direct assistance from the European Stability Mechanism; or
- the total value of its assets exceeds €5 billion and the ratio of its cross-border assets/liabilities in more than one other participating Member State to its total assets/liabilities is above 20%.

Lombard Bank Malta p.l.c. does not meet any of the above criteria, and therefore is currently not considered significant by banking supervisors. Accordingly, the Bank is exempt from the requirements of Article 91 of CRD IV.

The Bank is not disclosing the number of directorships held by the members of the Bank's Board of Directors on the basis of materiality in terms of Article 432 of the CRR.

10 **Recruitment and Diversity policy**

The Bank is aware that a vigorous and professional approach to recruitment and selection of prospective staff members within the Bank helps it to attract and appoint those individuals having the necessary skills and attributes compatible with achieving the Bank's overall objectives. Thus, the Bank ensures that appointments at all levels are based on each individual's knowledge, skills, expertise and merit, as required by laws, rules, regulations, etc. and in line with policy.

The Bank undertakes a rigorous selection process for all prospective staff members bearing in mind the key activities, tasks and skills required. As part of the selection process, multiple interviews are conducted, during which the individual's knowledge, experience, skills and competence are evaluated against those of other individuals.

The Bank continues to promote diversity with no discrimination as to gender, race, family, disability, sexual orientation, identity or preference, etc.

Bearing its objectives in mind, the Bank, particularly by virtue of the Board appointed Suitabilities & Evaluations Committee, endeavours to have a Board of Directors composed of members possessing diverse skills and expertise that allow the Board to create value for shareholders by ensuring that the specific risks pursued by the Bank as well as risks that are intrinsic to banking business are appropriately managed and mitigated within the Bank's risk appetite.

Five Year Summary
Statements of Financial Position
As at 31 December

Group

	2019	2018	2017	2016	2015
	€ 000	€ 000	€ 000	€ 000	€ 000
Assets					
Balances with Central Bank of Malta, treasury bills and cash	**182,348**	128,726	215,133	218,148	115,884
Cheques in course of collection	**1,214**	1,422	1,755	1,374	475
Investments	**111,731**	100,070	75,895	80,515	76,246
Loans and advances to banks	**121,060**	140,581	97,048	161,728	229,788
Loans and advances to customers	**552,043**	511,124	428,611	343,487	305,891
Investment in associate	**1,684**	1,684	1,575	1,681	1,645
Intangible assets	**2,000**	1,701	1,648	1,809	1,490
Property, plant and equipment	**43,348**	38,554	31,753	30,198	26,931
Assets classified as held for sale	**134**	778	822	833	1,023
Current tax assets	**193**	865	1,557	190	533
Deferred tax assets	**9,801**	9,221	8,980	8,973	7,695
Inventories	**1,468**	1,360	1,164	1,197	1,106
Trade and other receivables	**5,625**	5,010	8,826	8,136	8,170
Accrued income and other assets	**9,648**	8,973	7,979	4,462	5,043
Total assets	**1,042,297**	950,069	882,746	862,731	781,920
Equity and liabilities					
Equity					
Share capital	**11,044**	11,044	11,044	11,044	10,943
Share premium	**18,530**	18,530	18,530	18,530	17,746
Property revaluation reserve	**6,384**	6,384	2,420	2,420	2,420
Investment revaluation reserve	**7,978**	4,975	4,113	5,204	4,865
Reserve for General Banking Risks	**2,903**	2,903	2,903	2,903	2,620
Other reserves	**2,567**	3,094	3,226	3,196	3,247
Retained earnings	**69,722**	61,380	53,904	50,541	47,556
Equity attributable to equity holders of the Bank	**119,128**	108,310	96,140	93,838	89,397
Non-controlling interests	7,674	7,525	6,734	6,510	6,101
Total equity	**126,802**	115,835	102,874	100,348	95,498
Liabilities					
Amounts owed to banks	**5,871**	854	5,362	9,036	1,059
Amounts owed to customers	**864,993**	788,044	733,151	721,559	650,516
Provisions for liabilities and other charges	**3,236**	3,135	3,177	2,823	2,378
Current tax liabilities	**1,128**	-	229	310	346
Deferred tax liabilities	**6,832**	5,264	3,914	4,449	4,377
Other liabilities	**21,949**	27,138	23,217	16,100	18,404
Accruals and deferred income	**11,486**	9,799	10,822	8,106	9,342
Total liabilities	**915,495**	834,234	779,872	762,383	686,422
Total equity and liabilities	**1,042,297**	950,069	882,746	862,731	781,920
Memorandum items					
Contingent liabilities	**11,671**	14,148	9,078	8,775	7,479
Commitments	**225,826**	202,384	247,737	182,919	106,925

Five Year Summary
Income Statements
For the Year Ended 31 December

Group

	2019	2018	2017	2016	2015
	€ 000	€ 000	€ 000	€ 000	€ 000
Interest receivable and similar income	**25,285**	23,188	21,426	20,905	20,742
Interest expense	**(5,605)**	(5,677)	(5,992)	(6,703)	(7,603)
Net interest income	**19,680**	17,511	15,434	14,202	13,139
Other operating income	**40,474**	45,609	42,747	33,285	29,348
Other operating charges	**(44,311)**	(49,225)	(46,372)	(35,337)	(31,569)
Credit impairment losses	**(549)**	(234)	(2,835)	(3,950)	(3,081)
Share of profit/(loss) of investment accounted for using equity method	**-**	109	(106)	35	-
Profit before taxation	**15,294**	13,770	8,868	8,235	7,837
Income tax expense	**(5,424)**	(4,831)	(3,165)	(2,905)	(2,800)
Profit for the year	**9,870**	8,939	5,703	5,330	5,037
Attributable to:					
Equity holders of the Bank	**9,320**	8,447	5,129	4,726	4,382
Non-controlling interests	**550**	492	574	604	655
Profit for the year	**9,870**	8,939	5,703	5,330	5,037

Five Year Summary
Statements of Cash Flows
For the Year Ended 31 December

Group

	2019	2018	2017	2016	2015
	€ 000	€ 000	€ 000	€ 000	€ 000
Net cash flows generated from/(used in) operating activities	**53,125**	(30,882)	(27,882)	(5,617)	92,464
Cash flows from investing activities					
Dividends received	**211**	369	326	361	240
Interest received from investments	**2,325**	2,011	2,196	2,157	2,274
Proceeds on maturity/disposal of investments	**8,163**	4,406	3,285	2,995	2,687
Purchase of investments	**(15,905)**	(27,850)	(905)	(5,873)	(19,353)
Purchase of property, plant and equipment	**(3,345)**	(2,921)	(2,943)	(4,604)	(3,174)
Proceeds from disposal of property, plant and equipment	-	-	-	-	-
Acquisition of non-controlling interests	-	-	(429)	(283)	-
Net cash flows (used in)/generated from operating activities	**(8,551)**	(23,985)	1,530	(5,247)	(17,326)
Cash flows from financing activities					
Dividends paid to equity holders of the Bank	**(1,436)**	(1,149)	(1,149)	(252)	(1,084)
Dividends paid to non-controlling interests	**(429)**	(427)	(244)	(228)	(218)
Net cash flows used in financing activities	**(1,865)**	(1,576)	(1,393)	(480)	(1,302)