FCM Bank Limited

Annual Report and Financial Statements
31 December 2018

Company Registration Number: C 50343

Directors' report

The directors present their report and the audited financial statements of FCM Bank Limited ('the Bank') for the year ended 31 December 2018.

Principal activities

The Bank is licensed as a credit institution under the Maltese Banking Act (Cap. 371).

Performance Review

The year 2018 was crucial for the Bank in terms of a change in the business model, which was focused on investing into the future growth and profitability of the Bank through corporate banking solutions whilst managing a loss-making period. The Bank recognised a loss of €3.6 millions for the year under review, compared to a loss of €1.0 million in the previous year as a result of significant investments in the new business model as specified in detail below. As outlined in the shareholder's acquisition plan, and following the disposal of most of the investment portfolio which was held under the previous administration, the Bank received significant contributions from its shareholder in order to invest in the infrastructure functions including growth of the employee base and new systems and processes, which will support the new products and services launched during the year. The Bank also continued to invest in its IT infrastructure in 2018. The shareholder's capital injections contributed to a major increase in the capital strength of the Bank and a very good base for the growth of loan portfolio.

The operating loss for the year stood at €1.5 millions compared to an operating profit of €0.4 million for the previous year. Following the development of the new business lines and a soft-launch to an initial counterparty in August 2018, the Bank launched its corporate lending business in November 2018. The Bank sanctioned credit facilities amounting to €5.0 millions during November and December 2018, however these remained undrawn at year-end. The new start resulting from the change in the shareholder of the Bank and the de-risking of the balance sheet by selling the portfolio of legacy investments, together with the launch of the corporate lending business bore fruit in late 2018. Furthermore, the other income generating services were in a pilot testing phase at the end of the reporting period. The operating loss for the year therefore stems from the interest expense due to customers. The Bank remained highly liquid and very well capitalised as it focussed its efforts on developing its business.

During the year, customer deposits decreased by €15.5 millions bringing total deposits down to €45.5 millions. The decrease in deposits was a managed process, with the Bank allowing a number of deposits to mature and naturally transition out due to the excess liquidity on the balance sheet. As part of the retail strategy, average interest rates were reduced from 2.9% at the beginning of the year, to 2.1% by year-end. Notwithstanding historically low interest rates, the Bank still maintained a deposit portfolio with above-average interest rates allowing the depositors to benefit from such rates.

In 2018 the Bank increased its issued share capital by a further €7.0 millions bringing the total share capital to €20.3 millions with a total equity of €11.3 millions after deducting the accumulated losses.

The Bank measures the achievement of its objectives through the use of the following financial and non-financial measures:

The Bank measures its Liquidity Risk with a minimum regulatory ratio at 30% as per BR/05/2007 Liquidity Requirements Of Credit Institutions Authorised Under The Banking Act 1994, and its Liquidity Coverage Ratio with a minimum of 90%. In both cases, the Bank's ratios were significantly higher by a very large margin.

With reduced interest rates, the average deposit cost of the Bank came down from 2.9% at 31 December 2017 to 2.1% at 31 December 2018.

Directors' report - continued

Following the change in ownership in November 2017, the Bank implemented and fine-tuned the new business model during 2018. Throughout the year, the Bank built its business functions and invested significantly in its infrastructure and staff compliment. This involved, inter alia, the establishment of a new Corporate Department, a Foreign Exchange Department, a Legal Department, an in-house IT Department, strengthening the Risk Department and the Operations Department. Recruitment efforts spanned the first half of the year and product development was undertaken between June and December 2018.

The directors approved a five year business strategy in December 2018, which is based on the current infrastructure and business model with the Bank reaching profitability during the fourth quarter of 2019. The early results of 2019 show that the Bank is on track to reach this important milestone, which is also confirmed by the going concern basis of the issued financial statements and recognised deferred tax asset, which will be utilised against taxation on the future generated profits.

Key performance indicators

The Board of Directors tracks the Bank's progress in implementing its strategy with a range of financial measures or key performance indicators ('KPIs'). Progress is assessed by comparison with the Bank's budgets and historical performance. The financial KPIs tracked by the Board of the Bank are presented in the following table.

	2018	2017
	€	€
Loss for the year	**(3,638,209)**	(975,476)
Total own funds	**10,010,614**	6,876,151
Capital adequacy ratio	**287%**	243%
Leverage ratio	**17%**	10%

The Board of Directors does not monitor any specific non-financial KPIs.

Principal risks and uncertainties

The Board has designed a solid risk management framework and set the prudent risk appetite for the Bank. The Bank's risk management approach depends on the interaction of a number of key components from risk identification through to assessment, quantification and mitigation. This ensures that the Bank's plans are consistent with the Board's risk appetite and ensures that optimal risk-return decisions are taken within appropriate review and challenge structures. The ultimate responsibility for risk management rests with the directors who have identified the following principal risks and uncertainties facing the Bank:

Directors' report - continued

People risk

In spite of its small size and growth in staff numbers, the Bank is exposed to people risk arising principally from the loss of, or dependency on, key employees and more difficult succession planning. The Bank mitigates the risk of single dependency through ensuring continuity in the absence of any individual.

Strategy risk

The overall costs and length of time to introduce the new business model led to delayed profit generation with a consequent protracted loss making position. The Bank is well capitalised and has in place a clearly defined strategy. A turnaround of the business is expected in Q4 of 2019 and beyond.

Reputation risk

The Bank's reputation is, of course, of vital importance to its continued progress and is essential in attracting deposits, since any damage to its good standing would negatively impact the trust that depositors require in order to be willing to place their savings at an institution. The Bank is fully focused on developing and maintaining its good name.

Business risk management

Strategic and Business risk is the risk of losses due to failed or inadequate strategy execution, marketing and sales practices, distribution channels, pricing, handling of customer complaints or late reaction to changes in the business environment. The Bank has a strong governance framework to mitigate this risk.

Financial risk management

Note 2 to the financial statements provides details in connection with the Bank's use of financial instruments, its financial risk management objectives and policies and the financial risks to which it is exposed.

Result and dividends

The result for the year ended 31 December 2018 is shown in the statement of profit or loss and other comprehensive income on pages fifteen and sixteen. The loss for the year was €3.6 millions. This is mainly due to the Bank being in a transitional phase as it changed its business model, it invested heavily in the introduction of new income streams and it had to cope with excess liquidity for most of the year.

No dividend is being recommended as the Bank did not have any distributable reserves at the end of the reporting period.

Future business developments

The Bank will continue to develop its product portfolio in line with its strategy and business plan. Following the balance sheet date, the Bank continued to sanction additional credit facilities with drawdowns gathering the expected momentum. The outlook is considered to be positive.

Directors' report - continued

Directors

The directors who served during the period were (including the changes after year-end):

John Soler
Peter Cumba
Ondrej Korecky (appointed on 31st January 2018)
Martin Farsky (appointed on 20th April 2018)
Michael Borg Costanzi (appointed on 27th August 2018)
Lino Casapinta (appointed on 22nd March 2019)
Dusan Benda (resigned on 01st January 2019)
Joseph Falzon (appointed on 20th April 2018, resigned on 01st January 2019)
Anthony Mahoney (resigned on 17th May 2018)
Ronald Huggett (resigned on 11th April 2018)
Luke Calleja (resigned on 11th April 2018)
Roman Koch (resigned on 31st January 2018)

Changes in the board of directors have been in accordance with the Bank's articles of association and all the current directors are to remain in office.

Statement of Directors' responsibilities for the financial statements

The directors are required by the Maltese Banking Act (Cap. 371) and the Maltese Companies Act (Cap. 386) to prepare financial statements that give a true and fair view of the state of affairs of the Bank 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 Bank will continue in business as a going concern.

The financial statements of the Bank for the year ended 31 December 2018 are included in the Annual Report 2018, which is published in hard-copy printed form and is 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.

The directors are also responsible for designing, implementing and maintaining 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, and that comply with the Maltese Banking Act (Cap. 371) and the Maltese Companies Act (Cap. 386). They are also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Directors' report - continued

Auditors

PricewaterhouseCoopers have indicated their willingness to continue in office and a resolution for their re-appointment will be proposed at the Annual General Meeting.

Approved by the Board of Directors on 30 April 2019 and signed on its behalf by:

John Soler
Director

Michael Borg Costanzi
Director

Registered Office:
Suite 3, Tower Business Centre,
Tower Street, Swatar
Birkirkara, BKR 4013
Malta

Independent auditor's report

To the Shareholders of FCM Bank Limited

Report on the audit of the financial statements

Our opinion

In our opinion:

- FCM Bank Limited's financial statements give a true and fair view of the Bank's financial position as at 31 December 2018, and of the 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 Committee.

What we have audited

FCM Bank Limited's financial statements, set out on pages 14 to 56, comprise:

- the statement of financial position as at 31 December 2018;
- the income statement and statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement 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 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 FCM Bank Limited

To the best of our knowledge and belief, we declare that non-audit services that we have provided to the Bank 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 Bank, in the period from 1 January 2018 to 31 December 2018 are disclosed in note 23 to the financial statements.

Our audit approach

Overview

Overall materiality: €0.6 million, which represents 1% of total assets.

Existence and completeness of investments

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the 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.

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the financial statements as a whole, taking into account the structure of the Bank, the accounting processes and controls, and the industry in which the Bank operates.

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 financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall materiality for the 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.

Overall materiality	€574,000
How we determined it	1% of total assets
Rationale for the materiality benchmark applied	We chose total assets as the benchmark because, in our view, the assets held are considered as the key driver of the business and the determinant of the Bank's value due to the implementation of new business model following recent change in Bank's ownership. We selected 1% based on our professional judgement, noting that it is also within the range of commonly accepted asset-related benchmarks.
We have applied a lower materiality of €136,000 solely for financial statement line items in the income statement, since the engagement team deemed that misstatements in those line items of a lower amount than overall materiality might reasonably influence stakeholders.	

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above €29,000 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Key audit matters

Key audit matter	How our audit addressed the Key audit matter
Existence of and completeness of investments	
The investment portfolio as at period-end comprised of listed debt securities. We focused on the existence and completeness of investments as these have a direct effect on the return generated for shareholders. Relevant references in the Annual Report and Financial Statements: • Accounting policy: Note 1.3; • Note on financial investments: Note 7	We agreed all investment holdings to independent third party confirmations including details such as nominal amount, interest rates, term and origination cost. We performed reconciliation of balances including loans and advances to banks and investigate any reconciling items. We also considered the Bank's disclosures in Note 1 of the accounting policies for compliance with IFRS adopted by the EU. In addition, we evaluated the adequacy of the disclosures made in Note 7 of the financial statements. The results of our procedures did not identify any material misstatements.

Other information

The directors are responsible for the other information. The other information comprises the Directors' report, Additional regulatory disclosures and Five-year summary (but 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).

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 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 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 Bank or to cease operations, or have no realistic alternative but to do so.

Those charged with governance are responsible for overseeing 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 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 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, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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.

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Independent auditor's report - continued

To the Shareholders of FCM Bank Limited

Report on other legal and regulatory requirements

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.

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

Appointment

We were first appointed as auditors of the Bank on 29 May 2018.

PricewaterhouseCoopers
78, Mill Street
Qormi
Malta

F Axisa

Fabio Axisa
Partner

30 April 2019

Statement of financial position

	Notes	As at 31 December 2018 €	2017 €
ASSETS			
Cash and balances with Central Bank of Malta	4	**42,919,512**	57,023,963
Loans and advances to banks	5	**4,558,166**	9,320,142
Loans and advances to customers	6	**1,757,511**	-
Financial investments	7	**6,772,622**	2,272,941
Property, plant and equipment	8	**21,739**	11,258
Intangible assets	9	**130,456**	196,811
Deferred tax assets	10	**903,774**	877,882
Prepayment and other assets	11	**360,244**	159,805
Total assets		**57,424,024**	69,862,802
EQUITY AND LIABILITIES			
Equity			
Share capital	12	**20,250,000**	13,250,000
Fair value reserve	13	**-**	48,082
Accumulated losses		**(8,910,515)**	(5,168,426)
Total equity		**11,339,485**	8,129,656
Liabilities			
Amounts owed to customers	14	**45,456,878**	60,955,858
Other liabilities	15	**627,661**	777,288
Total liabilities		**46,084,539**	61,733,146
Total equity and liabilities		**57,424,024**	69,862,802

The notes on pages 19 to 56 are an integral part of these financial statements.

The financial statements on pages 14 to 56 were authorised for issue by the board on 30 April 2019 and were signed on its behalf by:

John Soler
Director

Michael Borg Costanzi
Director

Income statement

	Notes	Year ended 31 December 2018 €	2017 €
Interest income	17	**131,526**	768,389
Interest expense	18	**(1,608,632)**	(1,815,000)
Net interest income		**(1,477,106)**	(1,046,611)
Fee income	19	**3,025**	-
Fee expense	19	**(72,703)**	(70,779)
Net fee expense		**(69,678)**	(70,779)
Net trading income	20	**3,971**	11,745
Realised gain on disposal of financial investments		**-**	633,569
Dividend income		**-**	851,555
Operating income		**(1,542,813)**	379,479
Change in expected credit losses	21	**(78,550)**	-
Employee compensation and benefits	22	**(780,475)**	(453,365)
Administrative expenses	23	**(1,236,371)**	(901,590)
Loss for the year		**(3,638,209)**	(975,476)

The notes on pages 19 to 56 are an integral part of these financial statements.

Statement of comprehensive income

	Year ended 31 December	
	2018	2017
	€	€
Loss for the year	**(3,638,209)**	(975,476)
Other comprehensive income		
Items that may be subsequently reclassified to profit or loss		
Available-for-sale financial assets:		
Net changes in fair value arising during the year, before tax	-	(113,705)
Income tax relating to components of other comprehensive income	-	37,908
Other comprehensive income for the year, net of tax	-	(75,797)
Total comprehensive loss for the year	**(3,638,209)**	(1,051,273)

The notes on pages 19 to 56 are an integral part of these financial statements.

Statement of changes in equity

	Notes	Share capital €	Fair value reserve €	Accumulated losses €	Total equity €
Balance at 1 January 2017		12,250,000	123,879	(4,192,950)	8,180,929
Comprehensive income					
Loss for the year		-	-	(975,476)	(975,476)
Other comprehensive income:					
Fair valuation of available-for-sale financial assets					
Net changes in fair value arising during the year, net of tax		-	(75,797)	-	(75,797)
Total comprehensive income		-	(75,797)	(975,476)	(1,051,273)
Transaction with owners					
Issue of share capital	12	1,000,000	-	-	1,000,000
Balance at 31 December 2017		13,250,000	48,082	(5,168,426)	8,129,656
Impact on adoption of IFRS 9	1.1	-	(48,082)	(103,880)	(151,962)
Balance at 1 January 2018 – as restated		13,250,000	-	(5,272,306)	7,977,694
Comprehensive income					
Loss for the year		-	-	(3,638,209)	(3,638,209)
Transaction with owners					
Issue of share capital	12	7,000,000	-	-	7,000,000
Balance at 31 December 2018		**20,250,000**	**-**	**(8,910,515)**	**11,339,485**

The notes on pages 19 to 56 are an integral part of these financial statements.

Statement of cash flows

	Notes	As at 31 December 2018 €	2017 €
Cash flows from operating activities			
Interest and fee income received		**112,205**	1,263,332
Dividend and other income		**1,522**	851,555
Interest and fee expense paid		**(1,681,335)**	(1,790,666)
Cash payments to employees and suppliers		**(2,077,110)**	(689,148)
Cash flows used in operating activities before changes in operating assets and liabilities		**(3,644,718)**	(364,927)
Net increase in loans and advances to customers		**(1,757,511)**	-
Net (increase)/decrease in other assets		**(133,130)**	39,116
Net (decrease)/increase in amounts owed to customers		**(15,498,982)**	4,106,856
Net increase in other liabilities		**-**	30,711
Net cash (used in)/from operating activities		**(21,034,341)**	3,811,756
Cash flows from investing activities			
Purchase of property, plant and equipment	8	**(18,711)**	(6,094)
Purchase of intangible assets	9	**(14,778)**	(82,768)
Purchase of financial investments		**(4,833,139)**	(8,060,083)
Proceeds from sale of financial investments		**-**	60,129,801
Net cash (used in)/from investing activities		**(4,866,628)**	51,980,856
Cash flows from financing activities			
Proceeds from issue of share capital	12	**7,000,000**	1,000,000
Net movement in cash and cash equivalents		**(18,900,969)**	56,792,612
Cash and cash equivalents at beginning of year		**65,834,631**	9,042,019
Cash and cash equivalents at end of year	25	**46,933,662**	65,834,631

The notes on pages 19 to 56 are an integral part of these financial statements.

Notes to the financial statements

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.

1.1 Basis of preparation

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 (Cap. 371) and the Maltese Companies Act (Cap. 386). These financial statements are prepared under the historical cost convention, as modified by the fair valuation of financial investments measured at fair value through other comprehensive income (FVOCI) as well as the fair valuation of financial investments designated as at fair value through profit or loss in 2017.

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 judgment in the process of applying the Bank's accounting policies (see Note 3 - Critical accounting estimates, and judgments in applying accounting policies).

Standards, interpretations and amendments to published standards effective in 2018

During the financial year ended 31 December 2018, the Bank adopted new standards, amendments and interpretations to existing standards that are mandatory for the Bank's accounting period beginning on 1 January 2018. In particular, the Bank has adopted the requirements of IFRS 9 'Financial Instruments' from 1 January 2018.

The classification and measurement, and impairment requirements are applied retrospectively by adjusting the opening statement of financial position at the date of initial application. As permitted by IFRS 9, the Bank has not restated comparatives. Adoption reduced net assets at 1 January 2018 by €151,962 as a result of the changes in measurement bases of investments reclassified to different category and the estimation of expected credit loss ('ECL') allowances, net of deferred income taxes.

In addition, the Bank has adopted the requirements of IFRS 15 'Revenue from contracts with customers' and a number of interpretations and amendments to standards, which have had an insignificant effect on the financial statements of the Bank.

1. Summary of significant accounting policies - continued

1.1 Basis of preparation - continued

IFRS 9 transitional requirements

The adoption of IFRS 9 has resulted in changes in the Bank's accounting policies for recognition, classification and measurement of financial assets and impairment of financial assets. IFRS 9 also significantly amend other standards dealing with financial instruments such as IFRS 7 'Financial Instruments: Disclosures'.

Set out below are disclosures relating to the impact of the adoption of IFRS 9 in the Bank. Further details of the specific IFRS 9 accounting policies applied in the current period (as well as the previous IAS 39 accounting policies applied in the comparative period) are described in more detail in section 1.3.

The measurement category and the carrying amount of financial assets in accordance with IAS 39 and IFRS 9 as at 1 January 2018 are compared as follows:

	IAS 39		IFRS 9	
	Measurement category	**Carrying amount** €	**Measurement category**	**Carrying amount** €
Balances with Central Bank of Malta	Amortised cost (Loans and receivables)	57,023,909	Amortised cost	57,021,622
Loans and advances to banks	Amortised cost (Loans and receivables)	9,320,142	Amortised cost	9,319,137
Investment securities:				
- Debt securities	Fair value through profit or loss	2,121,882	Amortised cost	2,121,079
- Debt securities	Fair value through other comprehensive Income (Available-for-sale)	151,059	Fair value through other comprehensive Income	77,085
Other assets	Amortised cost (Loans and receivables)	25,412	Amortised cost	25,412

There were no changes to the classification and measurement of financial liabilities.

1. **Summary of significant accounting policies** - continued

1.1 Basis of preparation - continued

IFRS 9 transitional requirements - continued

The following table reconciles the carrying amounts of financial assets, from their previous measurement categories in accordance with IAS 39 to their new measurement categories upon transition to IFRS 9 on 1 January 2018:

	IAS 39 Carrying amount 31 December 2017	**Reclassification**	**Remeasurement**	**IFRS 9 Carrying amount 1 January 2018**
	€	**€**	**€**	**€**
Amortised cost				
Balances with Central Bank of Malta	57,023,909	-	(2,287)	57,021,622
Loans and advances to banks	9,320,142	-	(1,005)	9,319,137
Investments securities				
- Debt securities	-	2,121,882	(100,588)	2,021,294
Other assets	25,412	-	-	25,412
	66,369,463	**2,121,882**	**(103,880)**	**68,387,465**
Fair value through profit or loss				
Financial investments				
- Debt securities	2,121,882	(2,121,882)	-	-
Fair value through other comprehensive income				
Financial investments				
- Debt securities	151,059	-	(73,974)	77,085

€2,121,882 of financial assets measured at fair value through profit or loss have been reclassified as financial assets at 'Amortised cost' in accordance with IFRS 9. This reclassification resulted in an adjustment to retained earnings amounting to €99,784.

Further to the above, as at 31 December 2017, the Bank held an available-for-sale financial asset with a fair value of €151,059, upon which an impairment loss amounting to €114,070 had been recognised in prior years through a direct write down to its fair value. As from 1 January 2018, the fair value of the financial instrument was re-measured to €77,085.

The differences in the measurement category and the gross amount of financial assets in accordance with IAS 39 and IFRS 9 at the date of initial application, 1 January 2018, are analysed through the following elements:

- Reclassifications, reflecting the movement of balances between categories of financial assets with no impact on shareholders' equity. There is no change to the carrying value of financial instruments as a result of reclassifications.
- Remeasurements, which are adjustments due to changes to the measurement bases resulting in a change to the carrying value of the financial instrument, with a corresponding impact on shareholders' equity.

1. **Summary of significant accounting policies** - continued

1.1 Basis of preparation - continued

IFRS 9 transitional requirements - continued

	IAS 39 carrying amount at 31 December 2017	IFRS 9 reclassification	Carrying amount post reclassification	IFRS 9 remeasurement including expected credit losses	Carrying amount at 1 January 2018
	€	€	€	€	€
Equity					
Called up share capital	13,250,000	-	13,250,000	-	13,250,000
Other reserves	48,082	-	48,082	(48,082)	-
Accumulated losses	(5,168,426)	-	(5,168,426)	(103,880)	(5,272,306)
Total shareholders' equity	**8,129,656**	**-**	**8,129,656**	**(151,962)**	**7,977,694**

The following table reconciles the impairment allowance as at 31 December 2017 measured in line with the IAS 39 incurred loss model, to the new impairment allowance measured in accordance with the expected loss model under IFRS 9 at 1 January 2018 for financial assets measured at amortised cost.

	Loss allowance under IAS 39	Remeasurement	Expected credit loss allowance under IFRS 9
	€	€	€
Balances with Central Bank of Malta	-	2,287	2,287
Loans and advances to banks	-	1,005	1,005
Financial investments	-	803	803
Total	**-**	**4,095**	**4,095**

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

Certain new accounting standards and interpretations have been published that are not mandatory for 31 December 2018 reporting periods and have not been early adopted by the Bank. The Bank's assessment of the impact of the new standard and interpretation is set out below.

IFRS 16 '*Leases*'
IFRS 16 was issued in January 2016. It will result in almost all leases being recognised on the statement of financial position by lessees, as the distinction between operating and finance leases is removed. Under the new standard, an asset (the right to use the leased item) and a financial liability to pay rentals are recognised. The only exceptions are short-term and low-value assets.

The Bank will apply the standard from its mandatory adoption date of 1 January 2019. The Bank does not need to restate comparative amounts for the year prior to first adoption. The Bank will measure the lease liability at the present value of the remaining lease payments. Right-of-use assets will be measured on transition at the amount equal to the lease liability, adjusted for any prepaid or accrued expenses. Accordingly, the implementation is expected to increase assets and liabilities by the same amount, with no effect on net assets and retained earnings.

1. **Summary of significant accounting policies** - continued

1.2 Foreign currency transactions and balances

a) Functional and presentation currency

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

b) 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 profit or loss.

1.3 Financial assets

1.3.1 Financial assets – policy applied after 1 January 2018

i. Initial recognition

The Bank 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 Bank commits to purchase or sell the asset. Accordingly, the Bank uses trade date accounting for regular way contracts when recording financial asset transactions. All financial assets are initially recognised at fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the financial asset.

ii. Classification and subsequent measurement

The classification varies depending on whether the financial asset is a debt or an equity instrument.

Equity instruments are contracts that evidence a residual interest in an entity's assets after deducting all of its liabilities. Examples of equity instruments include non-puttable ordinary shares, some types of preference shares, and share warrants or written call options that allow the holder to subscribe for or purchase a fixed number of non-puttable ordinary shares in the issuing entity in exchange for a fixed amount of cash or another financial asset. The Bank does not have any investments in equity 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 units held in collective investment schemes (also known as puttable shares).

On initial recognition the Bank classifies its debt instruments in the following measurement categories: (a) amortised cost; (b) fair value through profit or loss (FVPL); or FVOCI.

Classification and subsequent measurement of debt instruments depends on:

- The Bank's business model for managing the asset; and
- The cash flow characteristic of the asset.

1. **Summary of significant accounting policies** - continued

1.3 Financial assets - continued

1.3.1 Financial assets – policy applied after 1 January 2018 – continued

Based on these factors, the Bank classified its debt instruments into one of the following two 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 are adjusted by any expected credit loss allowance recognised and measured as described in Note 1.3.1(iv). Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

- 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 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 all recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in 'Net gain or loss on disposal of financial assets measured at fair value through other comprehensive income'. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

Business model assessment: the business model reflects how the Bank manages the assets in order to generate cash flows. That is, whether the Bank'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 (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of 'other' business model and measured at FVPL. Factors considered by the Bank in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the asset's performance is evaluated and reported to key management personnel, how risks are assessed and managed and how managers are compensated.

Assessment of whether contractual cash flows are solely payments of principal and interest (SPPI): Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Bank assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the 'SPPI test'). In making this assessment, the Bank considers whether the contractual cash flows are consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement. 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 FVPL. For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the outstanding principal and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

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

1.3 Financial assets - continued

1.3.1 Financial assets – policy applied after 1 January 2018 - continued

iii. De-recognition of financial assets

Financial assets are derecognised when the contractual rights to receive cash flows from the assets have expired or when the Bank has transferred its contractual right to receive the cash flows of the financial assets, and either:

- substantially all the risks and rewards of ownership have been transferred; or
- the Bank has neither retained nor transferred substantially all the risks and rewards, but has not retained control.

iv. Impairment of amortised cost and FVOCI financial assets

ECLs are recognised for loans and advances to banks, other financial assets measured at amortised cost and debt instruments measured at FVOCI.

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 as 'Stage 1' and has its credit risk continuously monitored by the Bank. At initial recognition, an impairment allowance (or provision) is required for ECLs resulting from default events that are possible within the next 12 months ('12-month ECLs').
- 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. An allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL').
- If the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'. Assets in Stage 3 also carry a lifetime ECL.

Unimpaired and without significant increase in credit risk (stage 1)

ECL resulting from default events that are possible within the next 12 months (12-month ECL) are recognised for financial instruments that remain in stage 1.

Significant increase in credit risk (stage 2)

The Bank's principal financial assets carried at 'Amortised cost' include balances with the Central Bank of Malta, loans and advances to banks and customers and debt securities, all of which attract an 'investment grade' rating from Rating agencies such as Standard & Poor's and Moody's. The Bank considers these financial assets as having 'low credit risk' in terms of paragraphs 5.5.10 and B5.5.23 of IFRS9. This consideration is made in the light of the fact that all obligors within these categories are considered by the Bank to have a strong capacity to meet their obligations, and that adverse changes in economic conditions should not reduce their ability to fulfil obligations.

The Bank assumes that the credit risk on these financial assets has not increased significantly since initial recognition if the financial instrument is determined to have low credit risk, within the meaning of paragraph 5.5.10 of IFRS 9, at the reporting date. If, on the other hand, these financial assets suffer a significant increase in credit risk, for example following a downgrade to below investment grade, the financial instrument will be re-classified as a Stage 2 exposure. This will impact the measurement of the loss allowance, moving from a 12-month ECL assumption to a lifetime ECL assumption.

1. **Summary of significant accounting policies** - continued

1.3 Financial assets - continued

1.3.1 Financial assets – policy applied after 1 January 2018 - continued

iv. Impairment of amortised cost and FVOCI financial assets - continued

Significant increase in credit risk (stage 2) - continued

The Bank also has unrated financial assets measured at 'Amortised cost'. In respect of these financial assets, an assessment of whether credit risk has increased significantly since initial recognition is performed at each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument. The assessment compares the risk of default occurring at the reporting date compared with that at initial recognition, taking into account reasonable and supportable information, including information about past events, current conditions and future economic conditions. While it is not possible to provide a single set of criteria that will determine what is considered to be a significant increase in credit risk, the Bank considers that a financial asset has experienced a significant increase in credit risk when on or more of the following backstop criteria have been met.

- Actual or expected forbearance or restructuring
- Actual or expected significant adverse change in operating results of the borrower
- Significant change in collateral value (secured facilities only) which is expected to increase risk of default
- Early signs of cashflow/liquidity problems such as delay in servicing of trade creditors/loans.

Further, unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when 30 days past due.

Definition of default and credit impaired assets (stage 3)

The Bank determines that a financial instrument is credit impaired and in stage 3 by considering relevant objective evidence, primarily when there are indications that the obligor is unlikely to pay. If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due.

Write-off

Financial assets (and the related impairment allowances) are normally written off, either partially or in full, when there is no realistic prospect of recovery.

Measurement of ECL

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

- The PDs estimates are estimates at date of calculating ECL allowances. In the absence of sufficient internal historical default data, in order to estimate its PDs, the Bank makes reference to external information published by S&P. More specifically, the Bank assigns a PD to each of its exposures on the basis of the credit rating of the counterparty or issuer, by reference to S&P default rates.

1. **Summary of significant accounting policies** - continued

1.3 Financial assets - continued

1.3.1 Financial assets – policy applied after 1 January 2018 - continued

iv. Impairment of amortised cost and FVOCI financial assets - continued

Measurement of ECL - continued

The Bank calibrates unrated counterparties to S&P default rates by reference to external ratings of comparable financial assets. The Bank assigns a 1-year default rate to all exposures deemed to have low credit risk, and for very short term financial assets, the 1 year default rate is scaled down to estimate a PD over a one or two day horizon, dependable on the said exposure. This is consistent within the meaning of paragraph 5.5.10 of IFRS 9, at the reporting date.

A 100% probability of default is assigned to exposures classified as 'stage 3'.

- EAD is based on the amounts the Bank expects to be owed at the time of default, over the next 12 months (12 EAD) or over the remaining lifetime (Lifetime EAD).

- LGD represents the Bank's expectation of the extent of loss on a defaulted exposure. In estimating LGD, the Bank refers to the historical recovery rates published by Moody's. Calibration is performed in the same manner as described for PD estimates above. In the case of credit impaired financial investment measured at FVOCI, 100% LGD is assumed.

The ECL is calculated as a factor of the 12-month PD, LGD and EAD.

The Bank applies forward economic scenarios into the calculation of ECL by incorporating the effect of macroeconomic variables into the estimation of the term structure of the PD under three scenarios. They represent a 'most likely outcome' (the Central scenario), and two, less likely 'outer' scenarios, referred to as the Upside and Downside scenarios, weighted by an appropriate probability of occurrence.

There were no changes to the model during the year.

Presentation of ECL in statement of financial position

For financial assets that are measured at amortised cost, the ECL allowance is presented against the carrying amount of the assets on the balance sheet, thereby reducing the carrying amount.

1.3.2 Financial assets – policy applied prior to 1 January 2018

Initial recognition and derecognition

The Bank 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 Bank commits to purchase or sell the asset. Accordingly, the Bank uses trade date accounting for regular way contracts when recording financial asset transactions.

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Bank has transferred substantially all risks and rewards of ownership or the Bank has not retained control of the asset.

1. **Summary of significant accounting policies** - continued

1.3 Financial assets - continued

1.3.2 Financial assets – policy applied prior to 1 January 2018 - continued

Initial recognition and derecognition - continued

The Bank classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables, held-to-maturity financial assets and available-for-sale investments. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets on initial recognition.

Financial assets at fair value through profit or loss

This category comprises two sub-categories: financial assets classified as held for trading, and financial assets designated by the Bank as at fair value through profit or loss upon initial recognition.

A financial asset is classified as held for trading if it is acquired principally for the purpose of selling it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking after initial recognition, financial assets at fair value through profit and loss are measured at their fair value. Gains and losses arising from a change in fair value are recognised in profit or loss in the period in which they arise.

Held-to-maturity financial assets

Non-derivative financial assets with fixed or determinable payments and fixed maturity that the Bank has the positive intention and ability to hold to maturity other than those that upon initial recognition are designated as at fair value through profit or loss, those that are designated as available-for-sale financial assets and those that meet the definition of loans and receivables are classified as held-to-maturity investments. If other than an insignificant amount of held-to-maturity assets were to be sold, the entire category would be tainted and reclassified as available-for-sale.

After initial recognition, held-to-maturity investments are measured at amortised cost using the effective interest method. Gains and losses are recognised in profit or loss when the financial asset is derecognised or impaired and through the amortisation process.

When applying the effective interest method, the annual amortisation of any discount or premium is aggregated with other investment income receivable over the term of the instrument, if any, so that the revenue recognised in each period represents a constant yield on the investment.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are either designated in this category by the Bank or not classified as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss. After initial recognition, available-for-sale financial assets are measured at their fair value. Gains and losses arising from a change in fair value are recognised in other comprehensive income, except for impairment losses and foreign exchange gains and losses on monetary assets, until the financial asset is derecognised, at which time the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment. Interest calculated using the effective interest method is recognised in profit or loss.

1. **Summary of significant accounting policies** - continued

1.3 Financial assets - continued

1.3.2 Financial assets – policy applied prior to 1 January 2018 - continued

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than those that are held for trading or are designated upon initial recognition as at fair value through profit or loss or as available-for-sale financial assets or those for which the company may not recover substantially all of its initial investment other than because of credit deterioration.

Impairment

All assets are tested for impairment except for financial assets measured at fair value through profit or loss.

The Bank assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated

In the case of financial assets that are either carried at amortised cost or classified as available-for-sale investments, objective evidence of impairment includes observable data about the following loss event – significant financial difficulty of the issuer or counterparty.

An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount.

For loans and receivables or held-to maturity investments, if there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's 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.

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

When a decline in the fair value of an available-for-sale financial asset has been recognised in other comprehensive income and there is objective evidence that the asset is impaired, the cumulative impairment loss that had been recognised in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment and is measured as the difference between the acquisition cost and current fair value, less any impairment loss on that financial asset previously recognised in profit or loss.

1. **Summary of significant accounting policies** - continued

1.4 Offsetting financial instruments

Financial assets and liabilities are offset and the net amount is reported in the 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.

1.5 Intangible assets

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use specific software. These costs are amortised over their estimated useful lives of five years. Costs associated with maintaining computer software programme are recognised as an expense as incurred.

Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the Bank are recognised as intangible assets when the following criteria are met:

- it is technically feasible to complete the software product so that it will be available for use;
- management intends to complete the software product and use it;
- there is an ability to use the software product;
- it can be demonstrated how the software product will generate probable future economic benefits;
- adequate technical, financial and other resources to complete the development and to use the software product are available; and
- the expenditure attributable to the software product during its development can be reliably measured.

At the end of each reporting period, intangible assets are reviewed for indications of impairment or changes in estimated future economic benefits. If such indications exist, the intangible assets are analysed to assess whether their carrying amount is fully recoverable (Note 1.7).

1.6 Property, plant and equipment

All property, plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank 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.

Depreciation is calculated using the straight-line method to allocate the cost of the assets to their residual values over their estimated useful lives, as follows:

	%
Furniture and fittings	10
Computer hardware	33

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 (Note 1.7).

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised in profit or loss.

1. Summary of significant accounting policies - continued

1.7 Impairment of non-financial assets

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 can also be performed on a single asset when the fair value less cost to sell or the value in use can be determined reliably.

1.8 Current and deferred 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.

Deferred 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 financial statements. Deferred 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 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 tax asset is realised or the deferred tax liability is settled.

Deferred 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.

1.9 Share capital

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

1.10 Financial liabilities

The Bank recognises a financial liability on its statement of financial position when it becomes a party to the contractual provisions of the instrument. The Bank's financial liabilities are not at fair value through profit or loss under IFRS 9.

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. These liabilities are subsequently measured at amortised cost using the effective interest method.

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

Financial liabilities measured at amortised cost comprise principally of accrued expenses and other liabilities.

1. **Summary of significant accounting policies** - continued

1.11 Provisions and contingent liabilities

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Provisions are measured at the directors' best estimate of the expenditure required to settle the present obligation at the end of the reporting period. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Provisions are not recognised for future operating losses.

A contingent liability is (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or (b) a present obligation that arises from past events but is not recognised because: (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or (ii) the amount of the obligation cannot be measured with sufficient reliability. Contingent liabilities are not recognised but are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

1.12 Interest income and expense

Interest income and expense for all interest-bearing financial instruments are recognised within 'Interest income' and 'Interest expense' in 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 instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses.

The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

1.13 Fee income and expense

Fee income and expense that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate and treated as part of interest income and expense.

Other fee income, including account servicing fees are recognised as the related services are performed. Fee expense relate mainly to transaction and service fees which are expensed as the services are received.

1.14 Leases - Bank is the lessee

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

1. Summary of significant accounting policies - continued

1.15 Cash and cash equivalents

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

1.16 Dividend distribution

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

2. Financial risk management

2.1 Financial risk factors

The Bank's activities expose it to a variety of financial risks and these activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. The Bank's aim is to achieve an appropriate balance between risk and return and minimise potential adverse effects on the entity's financial performance.

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. 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.

(a) Credit risk

The Bank takes on exposure to credit risk, which is the risk that a counterparty will cause a financial loss for the Bank by failing to discharge an obligation. Credit risk is the most important risk for the Bank's business; accordingly management carefully manages its exposure to this risk.

The following table presents the maximum exposure to credit risk from financial instruments, before taking into account of any collateral held or other credit enhancements. For financial assets recognised on the statement of financial position, the maximum exposure to credit risk equals their carrying amount.

	2018	2017
	€	€
Financial assets measured at fair value through other comprehensive income/available-for-sale financial assets:		
Debt securities	-	151,059
Amortised costs:		
Balances with the Central Bank of Malta	**42,919,223**	57,023,908
Loans and advances to banks	**4,558,166**	9,320,142
Loans and advances to customers	**1,757,511**	-
Financial investments	**6,772,622**	-
Other assets	**181,489**	25,412
	56,189,011	66,520,521

2. Financial risk management - continued

2.1 Financial risk factors - continued

(a) Credit risk - continued

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 and the value of collateral and guarantees pledged if any, which can reduce the overall credit risk exposure, as well as the type and the duration of the credit asset. In order to examine a counterparty's creditworthiness, country risk, quantitative and qualitative characteristics, as well as the industry sector in which the counterparty operates are considered. The Credit Committee approved facilities within defined parameters set by the Board of Directors. The Board of Directors has the final say in the approval of new and existing assets or credit facilities outside of these parameters.

The following disclosure presents the gross carrying amount of financial instruments measured at amortised cost, the associated allowance for ECL as well as the stage classification of loans in terms of IFRS 9.

	31 December 2018			1 January 2018		
	Stage classification	**Gross carrying amount**	**Allowance for ECL**	Stage classification	Gross carrying amount	Allowance for ECL
		€	**€**		€	€
Amortised cost						
Balances with Central Bank of Malta	Stage 1	42,920,978	1,755	Stage 1	57,023,909	2,287
Loans and advances to banks	Stage 1	4,558,744	578	Stage 1	9,320,142	1,005
Loans and advances to customers	Stage 1	1,759,848	2,337	Stage 1	-	-
Financial investments	Stage 1	6,775,378	2,756	Stage 1	2,121,882	803
		56,014,948	**7,426**		68,465,933	4,095

Further to the above, as at 31 December 2018, the Bank's financial asset at FVOCI was classified in 'Stage 3' (1 January 2018: Stage 3). As at the end of the financial reporting period, the fair value of this financial asset, originally acquired for an amount of €226,278, was written down in full. As at 1 January 2018, the write down to the fair value of the financial asset amounted to €114,070.

2. Financial risk management - continued

2.1 Financial risk factors - continued

(a) Credit risk - continued

As at 31 December 2018 and 1 January 2018, all the Bank's other financial assets, i.e. all financial assets except for financial investments at FVOCI, are classified in 'Stage 1'. The Bank recognises 12-month allowances for expected credit losses in respect of these financial assets.

At the end of the reporting period, the Bank has no past due or impaired financial assets within these asset categories, except for financial investments at FVOCI, which is classified as credit-impaired.

The change in allowances for financial assets measured at amortised costs during the year amounting to €3,331 is predominantly the result of volume movements, i.e. movements arising from new lending/investments and repayments. During the year, the Bank did not experience any transfer of financial assets between stages. As a result, there is no re-measurement of ECL arising from transfer of stages.

The impact of changes in risk parameters, i.e. changes in PDs and LGDs, is immaterial.

Asset quality

The Bank uses ratings of financial investments to highlight exposures which require closer management attention. The following tables present an analysis of the Bank's financial investments by rating agency based on Moody's ratings.

	2018	2017
	€	€
Aa	**284,592**	293,052
A	**6,488,030**	1,828,830
Caa	**-**	151,059
	6,772,622	2,272,941

(b) 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.

Foreign exchange 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 that are different from the Bank's functional currency.

The Bank was not materially exposed to currency risk through transactions in foreign currencies at the end of the reporting period.

2. Financial risk management - continued

2.1 Financial risk factors - continued

(b) Market risk - continued

Interest rate risk

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.

Interest rate risk is managed principally through monitoring interest rate gaps.

The exposure to cash flow and fair value interest rate risk as at 31 December is shown below:

	Floating rates	**Fixed rates**	**Total**
	€	**€**	**€**
As at 31 December 2018			
Interest bearing assets			
Amortised cost:			
Balances with Central Bank of Malta	42,375,442	-	42,375,442
Loans and advances to banks	-	1,687,461	1,687,461
Loans and advances to customers	-	1,757,511	1,757,511
Financial investments	-	6,772,622	6,772,622
	42,375,442	**10,217,594**	**52,593,036**
Interest bearing liabilities			
Amounts owed to customers	**6,266,715**	**39,190,163**	**45,456,878**
Net exposure	**36,108,727**	**(28,972,569)**	**7,136,158**

	Floating rates	**Fixed rates**	**Total**
	€	**€**	**€**
As at 31 December 2017			
Interest bearing assets			
Loans and receivables – at amortised cost:			
Balances with Central Bank of Malta	56,410,561	-	56,410,561
Loans and advances to banks	-	5,827,380	5,827,380
Financial assets measured at fair value through profit or loss:			
Financial investments	-	2,121,882	2,121,882
Financial assets measured at fair value through other comprehensive income:			
Financial investments	-	151,059	151,059
	56,410,561	8,100,321	64,510,882
Interest bearing liabilities			
Amounts owed to customers	3,474,383	57,481,475	60,955,858
Net exposure	52,936,178	(49,381,154)	3,555,024

2. Financial risk management - continued

2.1 Financial risk factors - continued

(b) Market risk - continued

Interest rate risk - continued

Financial instruments issued at fixed rates potentially expose the Bank to fair value interest rate risk. Loans and advances to banks and customers and amounts owed to customers are measured at amortised cost and are therefore not subject to fair value interest rate risk.

The Bank's instruments that are fair valued and which are subject to interest rate risk comprise the Bank's investments in debt securities measured at FVOCI which at the end of the reporting period are fully impaired. As at 31 December 2017, this also includes debt securities measured at fair value through profit or loss. A significant proportion of these investments were subject to fixed interest rates. The estimated impact of an immediate 100 basis point increase in yields as at 31 December 2017 on the fair valuation of its investments carried at fair value amounts to €22,460.

As outlined above, the Bank was also exposed to cash flow interest rate risk principally in respect of certain financial assets and liabilities which were subject to floating interest rates. Financial assets and liabilities issued at variable rates expose the Bank to cash flow interest rate risk.

At the end of the reporting period, if interest rates had increased by 1% (assuming a parallel shift of 100 basis points in yields) with all other variables held constant, in particular foreign currency rates, the post-tax result for the year would increase by €234,705 (2017: increase by €344,085). Taking cognisance of the current low interest rate environment, the Bank does not expect interest rate to decrease by a further 100 basis points. Accordingly, the disclosure relating to an assumed decrease in interest rates by a 100 basis points is not deemed necessary.

2. Financial risk management - continued

2.1 Financial risk factors - continued

(b) Market risk - continued

Interest rate risk - continued

The following table summarises the Bank's exposures to interest rate risk. It includes the entity's financial instruments at carrying amounts, categorised by re-pricing dates, taking cognisance of the instruments' interest rate terms. The re-pricing periods in respect of the entity's interest bearing assets and liabilities subject to fixed interest rates is equivalent to the remaining period to maturity.

	On demand or less than three months	Within one year but over three months	Within five year but over one year	More than five years	Total
	€	€	€	€	€
As at 31 December 2018					
Financial assets					
Interest bearing assets					
Balances with Central Bank of Malta	42,375,442	-	-	-	**42,375,442**
Loans and advances to banks	1,687,461	-	-	-	**1,687,461**
Loans and advances to customers	-	1,757,511	-	-	**1,757,511**
Financial investments	-	57,536	1,080,618	5,634,468	**6,772,622**
	44,062,903	**1,815,047**	**1,080,618**	**5,634,468**	**52,593,036**
Financial liabilities					
Interest bearing liabilities					
Amounts owed to customers	**24,137,413**	**8,056,098**	**13,263,367**	-	**45,456,878**
Interest rate gap	**19,925,490**	**(6,241,051)**	**(12,182,749)**	**5,634,468**	
Cumulative gap	**19,925,490**	**13,684,439**	**1,501,690**	**7,136,158**	

2. Financial risk management - continued

2.2 Financial risk factors - continued

(b) Market risk - continued

Interest rate risk – continued

	On demand or less than three months	Within one year but over three months	Within five year but over one year	More than five years	Total
	€	€	€	€	€
As at 31 December 2017					
Financial assets					
Interest bearing assets					
Balances with Central Bank of Malta	56,410,561	-	-	-	56,410,561
Loans and advances to banks	5,827,380	-	-	-	5,827,380
Financial investments	-	-	1,047,487	1,225,454	2,272,941
	62,237,941	-	1,047,487	1,225,454	64,510,882
Financial liabilities					
Interest bearing liabilities					
Amounts owed to customers	11,695,550	16,966,952	32,293,356	-	60,955,858
Interest rate gap	50,542,391	(16,966,952)	(31,245,869)	1,225,454	
Cumulative gap	50,542,391	33,575,439	2,329,570	3,555,024	

(c) Liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. The consequence may be the failure to meet obligations to repay depositors and fulfil commitments.

.The Bank manages this risk, by maintaining a strong base of shareholders' capital considering the stages of its operations. The Bank manages its asset base with liquidity in mind, and monitors future cash flows and changes in available liquidity on a regular basis.

The Bank monitors and manages this risk by maintaining sufficient cash and, where possible, financial assets for which there is a liquid market and that are readily saleable to meet liquidity needs. The Bank is exposed to calls on its available cash resources from maturing term deposits and withdrawals from savings. The Assets and Liabilities Committee ensures that funds are always available to meet the expected demand for cash. In addition, the Bank manages its risk to a shortage of funds by monitoring forecast and actual cash flows, by monitoring the availability of raising funds to meet commitments associated with financial instruments and by holding financial assets which are expected to generate cash inflows that will be available to meet cash outflows on liabilities.

2. Financial risk management - continued

2.1 Financial risk factors - continued

(c) Liquidity risk - continued

All liquidity policies and procedures are subject to review and approval by the Board of Directors.

The Bank uses four key liquidity measures to monitor its liquidity risk, namely the ratio of liquid assets to deposit liabilities, the maturity ladder which comprises projected cash flows, the Liquidity Coverage Ratio ('LCR'), the Net Stable Funding Ratio ('NSFR') and an internal cash flow model, which is a minimum buffer of liquid assets set based on expected gross outflows.

As at 31 December 2018 and 31 December 2017, the Bank's liquidity ratios were significantly above the regulatory liquidity ratios of 30% prescribed by Banking Rule 5 and 60% prescribed by the Capital Requirements Regulation.

The following table discloses financial assets and liabilities at the end of the reporting period by remaining period to maturity.

	On demand or less than three months	Within one year but over three months	Within five year but over one year	More than five years	Total
	€	€	€	€	€
As at 31 December 2018					
Financial assets					
Balances with Central Bank of Malta	42,919,223	-	-	-	**42,919,223**
Loans and advances to banks	4,558,166	-	-	-	**4,558,166**
Loans and advances to customers	-	1,757,511	-	-	**1,757,511**
Financial investments	-	57,536	1,080,618	5,634,468	**6,772,622**
Other assets	181,489	-	-	-	**181,489**
	47,658,878	**1,815,047**	**1,080,618**	**5,634,468**	**56,189,011**
Financial liabilities					
Amounts owed to customers	24,845,913	7,347,598	13,263,367	-	**45,456,878**
Other liabilities	578,669	-	-	-	**578,669**
	25,424,582	**7,347,598**	**13,263,367**	**-**	**46,035,547**
Maturity gap	**22,234,296**	**(5,532,551)**	**(12,182,749)**	**5,634,468**	
Cumulative gap	**22,234,296**	**16,701,745**	**4,518,996**	**10,153,464**	

2. Financial risk management - continued

2.1 Financial risk factors - continued

(c) Liquidity risk - continued

	On demand or less than three months	Within one year but over three months	Within five year but over one year	More than five years	Total
	€	€	€	€	€
As at 31 December 2017					
Financial assets					
Balances with Central Bank of Malta	57,023,909	-	-	-	57,023,909
Loans and advances to banks	9,320,142	-	-	-	9,320,142
Financial investments	-	-	1,047,487	1,225,454	2,272,941
Other assets	25,412	-	-	-	25,412
	66,369,463	-	1,047,487	1,225,454	68,642,404
Financial liabilities					
Amounts owed to customers	11,695,550	16,966,952	32,293,356	-	60,955,858
Other liabilities	730,102	-	-	-	730,102
	12,425,652	16,966,952	32,293,356	-	61,685,960
Maturity gap	53,943,811	(16,966,952)	(31,245,869)	1,225,454	
Cumulative gap	53,943,811	36,976,859	5,730,990	6,956,444	

(d) Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour.

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management. This responsibility is supported by the development of overall standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorisation of transactions;
- requirements for the reconciliation and monitoring of transactions;
- compliance with regulatory and other legal requirements;
- documentation of controls and procedures;
- requirements for the periodic assessment of operational risks faced and the adequacy of controls and procedures to address the risks identified;

2. Financial risk management - continued

2.1 Financial risk factors - continued

(d) Operational risk - continued

- requirements for the reporting of operational losses and proposed remedial action;
- development of contingency plans;
- training and professional development;
- ethical and business standards; and
- risk mitigation, including insurance where this is effective.

2.2 Capital risk management

The Bank's objectives when managing capital, which is a broader concept than the 'equity' as disclosed in the statement of financial position, are:

- to comply with the capital requirements set by the MFSA;
- to safeguard the Bank'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.

Capital adequacy and the use of regulatory capital are monitored on an ongoing basis by the Bank's management, employing techniques based on the guidelines developed by the Basel Committee and the European Union Directives and Regulations, as implemented by the MFSA for supervisory purposes.

The Bank is required to maintain a ratio of total regulatory capital to risk-weighted assets ("Capital requirements ratio") above the prescribed minimum level of 8% as well as a capital conservation buffer of 1.875% and countercyclical buffer requirement at a maximum 1.875%. During the year, the Bank has met all externally imposed capital requirements.

The minimum capital requirements are calculated for credit, market and operational risks. During the year, the Bank utilised the Standardised Approach for credit risk, the Basic Indicator Approach for operational risk and the Basic Method for foreign exchange risk in order to calculate the Pillar 1 minimum capital requirements. For credit risk, under the standardised approach, risk weights are determined according to credit ratings provided by internationally recognised credit agencies such as Fitch or their equivalents and by using the applicable regulatory risk weights for unrated exposures. The Basic Indicator Approach requires that the Bank allocates capital for operational risk by taking 15% of the average gross income, while the Basic Method requires the Bank to allocate 8% of its overall net foreign exchange position to calculate the capital requirement for foreign exchange risk.

2. Financial risk management - continued

2.2 Capital risk management - continued

The following table shows the components of own funds and accordingly the basis for the calculation of the Bank's capital adequacy ratio:

	2018	2017
	€	€
Common Equity Tier 1 (CET1) capital		
Share capital	**20,250,000**	13,250,000
Accumulated losses	**(8,910,515)**	(5,168,426)
Investment revaluation reserve	-	48,082
Less:		
Intangible assets	**(130,456)**	(196,811)
Deferred tax assets that rely on future profitability and arise from temporary differences	**(903,774)**	(877,882)
Depositor compensation scheme	**(492,236)**	(509,474)
Other transitional adjustments	**197,595**	330,662
CET1 capital	**10,010,614**	6,876,151
Total capital / own funds	**10,010,614**	6,876,151

2.2 Fair value of financial instruments

Financial instruments measured at fair value

IFRS 13 specifies a hierarchy of valuation techniques 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.

Fair values are consequently determined according to the following hierarchy:

- *Level 1 – quoted market price:* financial instruments with quoted prices for identical instruments in active markets.
- *Level 2 – valuation technique using observable inputs:* financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.
- *Level 3 – valuation technique with significant unobservable inputs:* financial instruments valued using models where one or more significant inputs are unobservable.

As at 31 December 2017, the Bank had debt securities designated as at fair value through profit or loss amounting to €2,121,882 and available for sale debt securities amounting to €151,059 classified in level 1 and level 3 respectively.

2. Financial risk management - continued

2.2 Fair value of financial instruments - continued

Financial instruments measured at fair value - continued

Instruments included in level 1 comprise debt instruments issued by the Government of Malta and listed on the Malta Stock Exchange as well as debt securities issued by another government.

The fair value of financial instruments traded in active markets (i.e. level 1) is based on quoted market prices at the end of the reporting period. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Bank is the current bid price.

The financial asset categorised within level 3 comprises of debt securities issued by a corporate, categorised as such in view of the fact that the market within which the securities trade is illiquid.

Financial instruments not measured at fair value

Loans and advances to banks and customers and amounts owed to customers are carried at amortised cost in the statement of financial position. The directors consider the carrying amounts of loans and advances to banks 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 fair value of the majority of fixed interest deposits, is not deemed to be significantly different from their carrying amounts, based on discounted cash flows at current market interest rates, particularly due to the relatively short periods to maturity. These estimates are considered level 2 fair value estimates.

3. Critical accounting estimates, and judgments in applying 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.

In the opinion of the directors, the accounting estimates and judgments made in the course of preparing these financial statements are not difficult, subjective or complex to a degree which would warrant their description as critical in terms of the requirements of IAS 1.

The directors believe that there are no areas involving a higher degree of judgement that have a significant risk of resulting in a material adjustment and that may have a significant effect on the amounts recognised in the financial statements; and there are no key assumptions and key sources of estimation uncertainty relating to estimates that require directors' most difficult, subjective or complex judgments.

4. Cash and balances with Central Bank of Malta

	2018	2017
	€	€
Balances with Central Bank of Malta	**42,920,978**	57,023,909
Cash in hand	**289**	54
Allowance for expected credit losses - balances with Central Bank of Malta	**(1,755)**	N/A
	42,919,512	57,023,963

Balances held with Central Bank of Malta include reserve deposits relating to the Minimum Reserve Requirement in terms of Regulation (EC) No 1745/2003 of the ECB amounting to €51,780 (2017: €101,850). Other balances with the Central Bank of Malta are charged interest at the deposit facility rate set by the European Central Bank (ECB).

Balances with Central Bank of Malta also include a balance of €492,236 (2017: €509,474) that is pledged in favour of the Depositor Compensation Scheme ("DCS") in terms of the Depositor Compensation Scheme Regulations (Subsidiary Legislation, 371.09) of the Laws of Malta.

5. Loans and advances to banks

	2018	2017
	€	€
Repayable on call and at short notice	**4,558,744**	9,320,142
Allowances for expected credit losses	**(578)**	N/A
	4,558,166	9,320,142

Loans and advances to banks are included in cash and cash equivalents for the purposes of the statement of cash flows (Note 25).

6. Loans and advances to customers

	2018	2017
	€	€
Term loans and advances	**1,759,848**	-
Allowances for expected credit losses	**(2,337)**	N/A
	1,757,511	-

7. Financial investments

	2018	2017
	€	€
Financial investments measured at fair value through profit or loss:		
Debt securities	**N/A**	2,121,882
Financial investments measured at fair value through other comprehensive income:		
Debt securities	**-**	N/A
Financial assets classified as available-for-sale:		
Debt securities	**N/A**	151,059
Financial investments measured at amortised cost:		
Debt securities	**6,775,378**	-
Allowance for expected credit losses	**(2,756)**	N/A
	6,772,622	2,272,941

The Bank's debt securities consist entirely of listed securities and are analysed by issuer as follows:

	2018	2017
	€	€
Financial investments measured at fair value through profit or loss:		
- local government	**N/A**	1,828,830
- foreign government	**N/A**	293,052
	N/A	2,121,882
Financial assets classified as available-for-sale:		
- foreign corporate	-	151,059
	-	151,059
Financial investments measured at amortised cost:		
- local government	6,487,385	-
- foreign government	285,237	-
	6,772,622	-

8. Property, plant and equipment

	Furniture and fittings €	Computer hardware €	Total €
At 1 January 2017			
Cost	91,835	38,792	130,627
Accumulated depreciation	(78,603)	(36,639)	(115,242)
Net book amount	13,232	2,153	15,385
Year ended 31 December 2017			
Opening net book amount	13,232	2,153	15,385
Additions	1,284	4,810	6,094
Depreciation charge	(9,513)	(708)	(10,221)
Closing net book amount	5,003	6,255	11,258
At 1 January 2018			
Cost	93,119	43,602	136,721
Accumulated depreciation	(88,116)	(37,347)	(125,463)
Net book amount	5,003	6,255	11,258
Year ended 31 December 2018			
Opening net book amount	5,003	6,255	11,258
Additions	-	18,711	18,711
Depreciation charge	(3,584)	(4,646)	(8,230)
Closing net book amount	**1,419**	**20,320**	**21,739**
At 31 December 2018			
Cost	93,119	62,313	155,432
Accumulated depreciation	(91,700)	(41,993)	(133,693)
Net book amount	**1,419**	**20,320**	**21,739**

9. Intangible assets

	Computer software €
At 1 January 2017	
Cost	356,703
Accumulated amortisation	(164,708)
Net book amount	191,995
Year ended 31 December 2017	
Opening net book amount	191,995
Additions	82,768
Amortisation charge	(77,952)
Closing net book amount	196,811
At 1 January 2018	
Cost	439,471
Accumulated amortisation	(242,660)
Net book amount	196,811
Year ended 31 December 2018	
Opening net book amount	196,811
Additions	14,778
Amortisation charge	(81,133)
Closing net book amount	**130,456**
At 31 December 2018	
Cost	454,249
Accumulated amortisation	(323,793)
Net book amount	**130,456**

10. Deferred tax assets

The movement in deferred tax assets during the year is as follows:

	2018 €	2017 €
At beginning of year	**877,882**	903,774
Impact arising on transition to IFRS 9	**25,892**	-
Recognised in other comprehensive income		
- Deferred taxes on fair valuation of available-for-sale financial investments	-	(25,892)
	903,774	877,882

The balance at 31 December represents temporary differences attributable to:

	2018 €	2017 €
Unabsorbed tax losses	**903,774**	903,774
Fair valuation of available-for-sale financial assets	-	(25,892)
	903,774	877,882

The recognised deferred tax assets are expected to be recovered after more than twelve months from the end of the reporting period.

Deferred tax assets are recognised for all unabsorbed tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. The directors believe that the Bank is well placed to manage its business risks successfully and have a reasonable expectation that the deferred tax asset will crystallise in the foreseeable future. In assessing whether the deferred tax asset should be recognised, the Directors have taken into account the business plan and commitments made by the new investor. The Directors will continue to monitor the position on an ongoing basis.

At 31 December 2018 the Bank had unabsorbed tax losses of €6,952,974 (2017: €5,672,512) for which no deferred tax asset is recognised in the statement of financial position. The crystallisation of the deferred tax asset amounting to €2,433,541 (2017: €1,985,379) is uncertain due to the expected pattern of income in future years and has therefore not been recognised. Unabsorbed tax losses have no expiry date.

11. Prepayment and other assets

	2018	2017
	€	€
Prepayment	**178,755**	134,393
Amounts due from immediate parent company	**72,334**	-
Other assets	**109,155**	25,412
	360,244	159,805

Amounts due from immediate parent company are unsecured, non-interest bearing and repayable on demand.

12. Share capital

	2018	2017
	€	€
Authorised:		
Ordinary shares at €1 each	**25,000,000**	20,000,000
Issued and paid up:		
Ordinary shares at €1 each fully paid	**20,250,000**	13,250,000

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 general meetings of the Bank. All shares rank equally with regard to the Bank's residual assets.

On 15 February 2018 and 14 December 2018, the issued share capital was increased by €3,000,000 and €4,000,000, respectively.

On 4 May 2017 and 10 October 2017, the issued share capital was increased by €500,000 and €500,000, respectively.

13. Fair value reserve

The fair value reserve reflects the effects of the fair value measurement of financial instruments classified as available-for-sale, net of deferred taxes. Any gains or losses are not recognised in profit or loss until the asset has been sold.

14. Amounts owed to customers

	2018	2017
	€	€
Term deposits	**39,190,163**	57,481,475
Repayable on call and at short notice	**6,266,715**	3,474,383
	45,456,878	60,955,858

15. Other liabilities

	2018	2017
	€	€
Accrued interest expense	**436,482**	657,305
Other accrued expenses	**142,187**	72,797
Other liabilities	**48,992**	47,186
	627,661	777,288

Other liabilities includes a provision amounting to €25,000 in relation to the Bank's litigation claim from a former member of staff relating to alleged unfair dismissal.

16. Lease commitments

The future minimum lease payments under non-cancellable operating leases where the Bank is a lessee are as follows:

	2018	2017
	€	€
Not later than one year	**67,125**	68,534
Later than one year and not later than five years	**-**	67,125
	67,125	135,659

The Bank's operating lease commitments relate to lease of office premises, with standard contractual terms.

17. Interest income

	2018	2017
	€	€
On loans and advances to banks	**13,648**	4,152
On financial investments	**65,932**	764,237
On loans and advances to customers	**51,946**	-
	131,526	768,389

18. Interest expense

	2018	2017
	€	€
On amounts owed to customers	**1,400,682**	1,782,269
Negative interest on balances with Central Bank of Malta	**207,950**	32,731
	1,608,632	1,815,000

19. Net fee expense

	2018	2017
	€	€
Fee income		
Loan servicing fees	**3,025**	-
Fee expense		
Bank charges	**63,254**	42,085
Other fee expense	**9,449**	28,694
	72,703	70,779
Net fee expense	**(69,678)**	(70,779)

20. Net trading income

	2018	2017
	€	€
Foreign exchange differences	**2,449**	(4,220)
Net gains on financial assets measured at fair value through profit or loss	**-**	15,965
Net income from foreign exchange activities	**1,522**	-
	3,971	11,745

21. Changes in expected credit losses

	2018	2017
	€	€
Change in expected credit losses in profit or loss on:		
- Balances with Central Bank of Malta	**(532)**	N/A
- Loans and advances to banks	**(427)**	N/A
- Loans and advances to customers	**2,337**	N/A
- Financial investments	**78,405**	N/A
Exchange differences	**(1,233)**	N/A
	78,550	N/A

22. Employee compensation and benefits

	2018	2017
	€	€
Wages and salaries		
- Directors' remuneration	**131,773**	131,935
- Other staff salaries	**617,096**	306,171
Social security costs	**31,606**	15,259
	780,475	453,365

Average number of persons employed by the Bank throughout the financial year:

	2018	2017
Managerial	**7**	3
Other	**9**	5
	16	8

23. Administrative expenses

	2018	2017
	€	€
IT support	**417,447**	406,470
Operating lease expenses	**84,956**	56,453
Legal and professional fees	**74,210**	13,822
Amortisation of intangible assets (Note 9)	**81,133**	77,952
Depositor compensation scheme contribution	**59,688**	74,149
Directors' fee	**58,328**	55,667
Depreciation of property, plant and equipment (Note 8)	**8,230**	10,221
Other administrative expenses	**452,379**	206,856
	1,236,371	901,590

Other administrative expenses mainly comprise of supervision fees, internal audit fee and other services or expense items that are incurred in the course of the Bank's operations.

Auditor's remuneration

Fees charged by the auditor for services rendered during the financial year relate to the following:

	2018	2017
	€	€
Annual statutory audit	**15,000**	15,000
Tax compliance and advisory services	**15,500**	4,482
Other non-audit services	**5,000**	-
	35,500	19,482

24. Income tax

The tax on the Bank's profit before tax differs from the theoretical amount that would arise using the effective tax rate applicable to the Bank as follows:

	2018	2017
	€	€
Loss before tax	**3,638,209**	975,476
Tax charge at applicable rate 35%	**1,273,373**	341,417
Tax effect of:		
Difference between depreciation and amortisation charge and capital allowances	**7,089**	(30,861)
Unabsorbed tax losses for the year	**(1,280,462)**	(310,556)
	-	-

25. Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise the following balances with contractual maturities of not more than three months and which form an integral part of the Bank's cash management:

	2018	2017
	€	€
Cash and balances with Central Bank of Malta	**42,375,496**	56,514,489
Loans and advances to banks	**4,558,166**	9,320,142
Per Statement of cash flows	**46,933,662**	65,834,631
Adjustments to reflect:		
Depositor compensation scheme and reserve deposit requirement	**544,016**	509,474
Per Statement of financial position	**47,477,678**	66,344,105

	2018	2017
	€	€
Analysed as follows		
Cash and balances with Central Bank of Malta (Note 4)	**42,919,512**	57,023,963
Loans and advances to banks (Note 5)	**4,558,166**	9,320,142
	47,477,678	66,344,105

26. Related party transactions

Related parties of the Bank include the ultimate parent company, SAB Finance A.S., all entities controlled by the ultimate parent company, key management personnel, close family members of key management personnel and entities which are controlled or jointly controlled by key management personnel or their close family members.

Key management personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of Bank, being the directors of the Bank.

26. Related party transactions - continued

The following table provides the total amount of transactions which have been entered into with, and balances with related parties by the Bank for the relevant financial year:

	2018	2017
	€	€
Assets		
Loans and advances to customers	**1,757,511**	
Prepayment and other assets	**72,334**	-
Liabilities		
Amounts owed to customers	**230,853**	92,040
Other liabilities	**330**	1,473
Income statement		
Interest expense	**1,393**	2,951
Directors' fee and remuneration	**190,101**	187,602
Administrative expenses	**44,548**	87,420

Loans and advances to customers represent loan to ultimate parent company that is subject to an interest rate of 5.5% per annum, unsecured and is due in 25 July 2019.

All transactions with related parties were carried out on an arm's length basis in accordance with the Bank's policy.

27. Statutory information

FCM Bank Limited is a limited liability company and is incorporated in Malta.

The immediate parent company of the Bank is SAB Europe Holding Ltd., a company incorporated and registered in Malta, the registered address of which is 60/2 Melita Street, Valletta, VLT 1122, Malta.

The ultimate parent company of the Bank is SAB Finance A.S. which is incorporated and registered in Czech Republic, the registered address of which is Senovážné nám. 1375/19 110 00 Praha 1.

Copies of the Annual Report and Accounts of the immediate and ultimate parent companies may be obtained from their registered address.

1. Risk management

1.1 Overview of risk disclosures

These disclosures have been prepared in accordance with the Pillar 3 quantitative and qualitative disclosure requirements as governed by Banking Rule 07: Publication of Annual report and Audited Financial Statements of Credit Institutions BR/07/2014 authorised under the Maltese Banking Act, (Cap. 371), issued by the Malta Financial Services Authority. These disclosures will be published by the Bank on an annual basis as part of the Annual Report.

As per banking regulations, this report is not subject to an external audit, except to the extent that any disclosures are equivalent to those made in the Financial Statements which adhere to 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.

In accordance with the Bank's Pillar 3 disclosure policy which sets out the disclosure process, verification and frequency, this report is currently published once a year.

1.2 Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Bank has in place a Credit and Risk Committee that is responsible for developing and monitoring the Bank's risk management policies in its specific areas. The aim of risk management is to create value for shareholders by supporting the Bank in achieving its goals and objectives, and ultimately ensuring that the risks are commensurate with the rewards.

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.

1.3 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.

To ensure coherence between the Bank's strategic considerations regarding risk-taking and day-to-day decisions, from time to time, the Bank establishes 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 perception of the component in question.

1. Risk management - continued

1.3 Key risk components - continued

The Bank has exposure to the following risks from its use of financial instruments:

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, as well as 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: Market risk is the risk of reductions in earnings and/or asset values arising from unexpected changes in financial prices, including interest rates, exchange rates and equity prices. It is managed by a variety of different techniques.

Liquidity risk: Liquidity risk may be divided into two sub-categories:
(1) Market (product) liquidity risk: Risk of losses arising from difficulty in accessing a product or market at the required time, price and amount.
(2) 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 damage resulting from the lack of skilful management or good governance within the Bank and the inadequacy of proper control, which might involve internal operations, personnel, the system 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.

2. 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 from deposits with other banks and on its securities portfolio.

The Credit Committee and Board of Directors are responsible for approving all credit facilities, acquisitions of securities and placements of deposits with banks. In accordance with policies set by the Board, decisions are based on the Bank's insight into the counterparty's financial position which is regularly monitored and reported to the Board.

In order to minimise the credit risk undertaken, counterparty credit limits are defined, which consider a counterparty's creditworthiness. In order to examine a counterparty's creditworthiness, country risk, quantitative and qualitative characteristics, as well as the industry sector in which the counterparty operates are considered.

Concentration risk arises as a result of the concentration of exposures within the same category, whether it is geographical locations, industry sector or counterparty type. These risks are managed through adherence to Board approved investment criteria. As at 31 December 2018, no securities were deemed to be prohibited large exposures.

2. Credit risk - continued

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.

Exposures analysed by location

	Europe	Total
	EUR	EUR
Central Government	49,692,134	49,692,134
Institutions	4,558,166	4,558,166
Corporates	1,757,511	1,757,511
	56,007,811	56,007,811

Exposures analysed by residual maturity

	On demand or less than three months	Within one year but over three months	Within five year but over one year	More than five years	Total
	€	€	€	€	€
As at 31 December 2018					
Financial assets					
Balances with Central Bank of Malta	42,919,223	-	-	-	**42,919,223**
Loans and advances to banks	4,558,166	-	-	-	**4,558,166**
Loans and advances to customers	-	1,757,511	-	-	**1,757,511**
Financial investments	-	57,536	1,080,618	5,634,468	**6,772,622**
Other assets	181,489	-	-	-	**181,489**
	47,658,878	**1,815,047**	**1,080,618**	**5,634,468**	**56,189,011**

2. Credit risk - continued

Asset quality

The Bank assigns risk weights to the credit risk of its assets in accordance with the rating assigned by Fitch, Moody's and S&P, all of which are MFSA eligible External Credit Assessment Institutions (ECAIs), in accordance with article 3.9 of Appendix 2 – Section 1.4 Credit Risk Standardised Approach – BR 04.

The credit quality of the securities as determined by the nominated ECAIs is as follows:

	2018	2017
	€	€
Aa	**284,592**	293,052
A	**6,488,030**	1,828,830
Caa	**-**	151,059
	6,772,622	2,272,941

3. Market risk

Market risk for the Bank consists of three elements:

- Interest rate risk, which is the risk of losses through changes in interest rates;
- Currency risk, which is the risk of losses on the Bank's positions in foreign currency through changes in exchange rates; and
- Price 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 (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

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 places deposits with Banks at both fixed and floating rates and for varying maturity periods. This risk is managed through the matching of the interest resetting dates on assets and liabilities as much as it is practicable. However, the Bank seeks to manage its net interest spread, after considering the cost of capital by investing funds in a portfolio of securities with a longer tenure than the liabilities (therefore carrying a negative maturity gap position).

3. Market risk - continued

3.1 Interest rate risk - continued

At the end of the reporting period the interest rate profile of the Bank's interest bearing financial instruments is as follows:

	Floating rates	Fixed rates	Total
	€	€	€
As at 31 December 2018			
Interest bearing assets			
Amortised cost:			
Balances with Central Bank of Malta	42,375,442	-	42,375,442
Loans and advances to banks	-	1,687,461	1,687,461
Loans and advances to customers	-	1,757,511	1,757,511
Financial investments	-	6,772,622	6,772,622
	42,375,442	**10,217,594**	**52,593,036**
Interest bearing liabilities			
Amounts owed to customers	**6,266,715**	**39,190,163**	**45,456,878**
Net exposure	**36,108,727**	**(28,972,569)**	**7,136,158**

The following table sets out the carrying amount, by reference to the earlier of the next contractual interest rate repricing date and maturity:

	On demand or less than three months	Within one year but over three months	Within five year but over one year	More than five years	Total
	€	€	€	€	€
As at 31 December 2018					
Financial assets					
Interest bearing assets					
Balances with Central Bank of Malta	42,375,442	-	-	-	**42,375,442**
Loans and advances to banks	1,687,461	-	-	-	**1,687,461**
Loans and advances to customers	-	1,757,511	-	-	**1,757,511**
Financial investments	-	57,536	1,080,618	5,634,468	**6,772,622**
	44,062,903	**1,815,047**	**1,080,618**	**5,634,468**	**52,593,036**
Financial liabilities					
Interest bearing liabilities					
Amounts owed to customers	**24,137,413**	**8,056,098**	**13,263,367**	-	**45,456,878**
Interest rate gap	**19,925,490**	**(6,241,051)**	**(12,182,749)**	**5,634,468**	
Cumulative gap	**19,925,490**	**13,684,439**	**1,501,690**	**7,136,158**	

3. Market risk - continued

3.2 Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Board of Directors sets limits on the level of exposure by currency and in total.

The Bank was not exposed to significant currency risk through transactions in foreign currencies at the end of the reporting period.

4. Liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. The consequence may be the failure to meet obligations to repay depositors and fulfil commitments.

The Bank manages this risk, by maintaining a strong base of shareholders' capital considering the stages of its operations. The Bank manages its asset base with liquidity in mind, and monitors future cash flows and changes in available liquidity on a regular basis.

The Bank monitors and manages this risk by maintaining sufficient cash and, where possible, financial assets for which there is a liquid market and that are readily saleable to meet liquidity needs. The Bank is exposed to calls on its available cash resources from maturing term deposits and withdrawals from savings. The Assets and Liabilities Committee ensures that funds are always available to meet the expected demand for cash. In addition, the Bank manages its risk to a shortage of funds by monitoring forecast and actual cash flows, by monitoring the availability of raising funds to meet commitments associated with financial instruments and by holding financial assets which are expected to generate cash inflows that will be available to meet cash outflows on liabilities.

All liquidity policies and procedures are subject to review and approval by the Board of Directors.

The Bank uses four key liquidity measures to monitor its liquidity risk, namely the ratio of liquid assets to deposit liabilities, the maturity ladder which comprises projected cash flows, the Liquidity Coverage Ratio ('LCR'), the Net Stable Funding Ratio ('NSFR') and an internal cash flow model, which is a minimum buffer of liquid assets set based on expected gross outflows.

As at 31 December 2018, the Bank's liquidity ratios were significantly above the regulatory liquidity ratios of 30% prescribed by Banking Rule 5 and 60% prescribed by the Capital Requirements Regulation.

4. Liquidity risk - continued

The following table discloses financial assets and liabilities at the end of the reporting period by remaining period to maturity.

	On demand or less than three months	Within one year but over three months	Within five year but over one year	More than five years	Total
	€	€	€	€	€
As at 31 December 2018					
Financial assets					
Balances with Central Bank of Malta	42,919,223	-	-	-	**42,919,223**
Loans and advances to banks	4,558,166	-	-	-	**4,558,166**
Loans and advances to customers	-	1,757,511	-	-	**1,757,511**
Financial investments	-	57,536	1,080,618	5,634,468	**6,772,622**
Other assets	181,489	-	-	-	**181,489**
	47,658,878	**1,815,047**	**1,080,618**	**5,634,468**	**56,189,011**
Financial liabilities					
Amounts owed to customers	24,845,913	7,347,598	13,263,367	-	**45,456,878**
Other liabilities	578,669	-	-	-	**578,669**
	25,424,582	**7,347,598**	**13,263,367**	**-**	**46,035,547**
Maturity gap	**22,234,296**	**(5,532,551)**	**(12,182,749)**	**5,634,468**	
Cumulative gap	**22,234,296**	**16,701,745**	**4,518,996**	**10,153,464**	

5. Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour.

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

5. Operational risk - continued

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management. This responsibility is supported by the development of overall standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorisation of transactions;
- requirements for the reconciliation and monitoring of transactions;
- compliance with regulatory and other legal requirements;
- documentation of controls and procedures;
- requirements for the periodic assessment of operational risks faced and the adequacy of controls and procedures to address the risks identified;
- requirements for the reporting of operational losses and proposed remedial action;
- development of contingency plans;
- training and professional development;
- ethical and business standards; and
- risk mitigation, including insurance where this is effective.

6. Capital management

6.1 Capital adequacy

The Bank is subject to externally imposed capital requirements only in respect of the Bank's activities as a credit institution.

On 1 January 2014 the Capital Requirements Directive (CRD) and the Capital Requirements Regulations (CRR) came into effect, constituting the European implementation of the Basel capital and liquidity agreement of 2010. The Bank has made necessary changes in order to ensure that it is compliant with Pillar I capital requirements set by the CRR. Other material risks are also allocated capital as part of the Internal Capital Adequacy Process (ICAAP) embedded in the Pillar II process. This process helps to measure with greater risk sensitivity the amount of regulatory capital which the Bank requires to cover risks assumed in the course of its business, including risks not covered in Pillar I.

The following is an analysis of the Bank's capital base in accordance with the CRD's requirements:

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 items in relation to credit risk together with notional risk-weighted assets in respect of operational risk and market risk.

6. Capital management - continued

6.1 Capital adequacy - continued

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 exposures, 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 items according to their asset class and credit assessment. 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 per cent) and adding the resulting figures to the sum of risk-weighted assets for credit risk.

	Carrying Amount	**Risk Weighted Amount**	**Capital Requirement**
	€	**€**	**€**
Central governments	49,692,134	-	-
Institutions	4,558,166	911,633	72,931
Corporates	1,757,511	1,557,511	124,601
Other items	1,416,213	381,983	30,558
Total credit risk	57,424,024	2,851,127	228,090
Foreign exchange risk		-	-
Operational risk		634,776	50,782
Total		**3,485,903**	**278,872**
Own funds		**10,010,614**	
Capital adequacy ratio		**287%**	

6. Capital management - continued

6.2 Internal capital adequacy assessment process (ICAAP)

The Bank developed a comprehensive Internal Capital Adequacy Assessment Process ("ICAAP"), as part of its 2012 plan to enhance its risk management process, in accordance with Banking Rule 12 'The Supervisory Review Process' (BR12). As part of this process, the Bank is required to assess its overall capital adequacy in relation to risk profile and a strategy for maintaining capital levels.

The purpose of the ICAAP is to formalise the process by which the Bank performs ongoing assessment of its risks, mitigates those risks and determines how much current and future capital is necessary having considered other mitigating factors.

The ICAAP has therefore been adopted by both the Board of Directors and the Bank's senior management to ensure that there is adequate identification, measurement and monitoring of the Bank's risks and that adequate internal capital is held by the Bank in relation to its risk profile. Furthermore, the Bank has utilised this ICAAP to assess its current risk management practices and to determine those practices which need to be developed further.

For this ICAAP, the Bank adopted a minimum capital requirement approach, using the audited figures as at 31 December 2018 as the benchmark year, which is based on Pillar I capital requirements together with the assessment of extra capital proportionate to Pillar II risks and supplementary stress testing to assess the impact of a possible prolonged economic recession on the Bank.

The ICAAP process was led by the Bank's Risk Department, and was challenged by the bank's independent external consultant. The final document was approved by the Bank's Board of Directors in April 2019 and presented to the MFSA.

The results show the Bank comfortably meeting its capital and liquidity targets over the regulatory minimum even in times of stress.

7 Remuneration Policy

The Bank's Remuneration Policy is based on the following principles:

- Clarity and transparency for all stakeholders;
- Adherence to the Bank's long-term objectives with reference to the relevant level of risk involved in attaining these goals;
- Maintaining a reasonable proportion between the fixed and variable part of remuneration package;
- The review of the annual staff remuneration considers the Bank's results, performance, as well as local market trends in the financial sector and individual performance in view of the risk level involved in the long term;
- Market data is considered and target remuneration brackets per job position are set in view to level of expertise, years in the position, attraction of talent and high performers.
- European Banking Authority Guidelines on sound remuneration policies under Articles 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013.

7 **Remuneration Policy** - continued

Total remuneration payable to senior management, which includes the CEO and two other beneficiaries, in 2018 was €235,868 all of which was fixed.

The Bank has appointed a Remuneration Committee whose objective is to ensure that all remuneration, including benefits and variable remuneration, follows legal requirements and market rates. All members appointed on the Remuneration Committee are not management members except for the CEO, whose membership is ex-officio. The Remuneration Committee meets at least twice a year and minutes are formally kept by the Company Secretary. The Remuneration Committee undertakes periodic studies into compensation market rates, including variable rates, and other benefits. All variable compensation for senior management is submitted to be authorised by the Remuneration Committee. The Remuneration Policy is subject to the Remuneration Committee's scrutiny and authorisation.

The Bank will determine the employee's remuneration and benefits by reference to market rates for specific roles and the Bank's own needs at a particular time. Remuneration for senior management staff is recommended to the Remuneration Committee for authorisation. The Bank incentive schemes are tied to the performance evaluation system and will always be subject to the Remuneration Committee's approval on the basis of a structured and measured approach, which must be tied to the adoption of sound operating procedures and risk practices. The Bank will not implement incentive schemes which will encourage its management and employees to commit the Bank to take on risks which in the view of the Board of Directors are not in line with the risk profile of the Bank. The Bank will also not implement incentive schemes which will constrain or endanger its financial position or capital base.

- Variable remuneration will not encourage excessive risk-taking beyond the tolerated risk level of the Bank;
- Variable remuneration will be in line with business strategy, long-term bank objectives and the avoidance of conflicts of interest.
- The implementation of basic remuneration policy (salaries) is subject to the Remuneration Committee's authorisation both at contracting stage and at periodic increase stage. The implementation of the variable remuneration policy is subject to the Remuneration Committee's scrutiny and authorisation both at initial stages, when drawing up performance targets and measures, and at recommendation stage, prior to decisions made on variable remuneration levels.
- Staff in control functions are independent from the business units they oversee and are remunerated according to independent market rates and according to the targets and measures included in their performance evaluation forms.

7 Remuneration Policy - continued

Variable remuneration shall be subject to the Bank's overall performance, to the achievement of targets previously established, which targets include behavioural objectives and to the following considerations:

- The Bank does not offer guaranteed variable remuneration unless the latter is part of the initial contracting process, which would only happen as a one-off factor during the first year of employment.
- The total variable remuneration value shall not in any manner constrain the Bank's capital base.
- The total level of variable remuneration shall not exceed 25% of the level of basic salary, unless specifically authorised by the Board of Directors in exceptional circumstances. In the case of the latter, such a decision would not constrain the Bank's capital base and would not be higher than 50% of basic salary.
- Variable remuneration of the most senior Bank officers may be set in a multi-year framework which will take into consideration the Bank's longer-term performance and its underlying business cycle. This may include variable remuneration being settled over a period of years corresponding to the Bank's business cycle.

8 Recruitment policy

The Bank is an equal opportunity employer and will not discriminate between candidates on grounds of race, religion, sex, status and disability. The Bank will strive to identify candidates who are best suited to the post on the basis of their academic achievements, work experience and career history.

9 Internal audit

The Bank outsources its Internal Audit function to an independent professional services firm. The Internal Auditors support the Board of Directors by independently assessing the effectiveness of the Bank's system of internal controls and compliance of the Bank with statutory, legal and regulatory requirements. All key issues raised by Internal Audit are communicated to the management responsible via formal audit reports. The Audit Committee and Board of Directors are informed of findings and actions being taken to implement improvements.

The Internal Auditors have unrestricted access to all accounts, books and records and are provided with all information and data needed to fulfil their duties. Coordination and close cooperation with the external auditors plays an important role to enhance the efficiency of Internal Audit's work.

10 Encumbered and unencumbered assets

As at 31 December 2018	Carrying amount of encumbered assets €	Fair value of encumbered assets €	Carrying amount of unencumbered assets €	Fair value of unencumbered assets €
Assets	**492,236**	**492,236**	**56,931,788**	**56,931,788**

11 Return on assets

The return on assets as at 31 December 2018 is -6.3%. This is calculated as loss after tax divided by total assets.

12 Leverage

	€
Total Assets	57,424,024
Leverage ratio exposure	57,424,024
Tier 1 Capital	9,813,019
Total on-balance sheet exposures	57,424,024
Total Exposures	57,424,024
Leverage ratio	17.08%

Five-year Summary

Statement of comprehensive income

	Year ended 31 December 2018 €	Year ended 31 December 2017 €	Year ended 31 December 2016 €	Year ended 31 December 2015 €	Year ended 31 December 2014 €
Interest income	131,526	768,389	1,614,165	2,085,709	1,429,583
Dividend income	-	851,555	128,730	-	-
Interest expense	(1,608,632)	(1,815,000)	(1,738,855)	(1,620,346)	(1,174,149)
Net interest income	(1,477,106)	(195,056)	4,040	465,363	255,434
Fee income	3,025	-	50	100	-
Fee expense	(72,703)	(70,779)	(74,053)	(24,067)	(17,696)
Net fee expense	(69,678)	(70,779)	(74,003)	(23,967)	(17,696)
Net trading income	3,971	11,746	32,213	(32,174)	21,698
Realised gain on disposal of financial investments	-	633,569	334,731	-	-
Dividend income	-	851,555	128,730	-	-
Operating income	(1,542,813)	379,480	296,981	409,222	259,436
Change in expected credit losses	(75,219)	-	-	(182,587)	-
Employee compensation and benefits	(838,803)	(509,032)	(576,430)	(672,960)	(594,881)
Administrative expense	(1,178,043)	(845,923)	(919,162)	(1,009,832)	(1,041,563)
Loss before income tax	(3,634,878)	(975,476)	(1,198,611)	(1,456,157)	(1,377,008)
Income tax credit	-	-	-	64,747	471,338
Loss for the year	(3,634,878)	(975,476)	(1,198,611)	(1,391,410)	(905,670)
Other comprehensive income					
Items that may be reclassified subsequently to profit or loss:					
Available-for-sale investments:					
- change in fair value	-	(113,705)	468,625	(319,150)	(250,477)
-impairment of available for sale investments	-	-	-	182,587	-
- deferred tax thereon	-	37,908	(163,071)	47,797	87,667
Other comprehensive (loss)/ income for the year net of tax	-	(75,797)	305,554	(88,766)	(162,810)
Total comprehensive loss for the year	(3,634,878)	(1,051,273)	(893,057)	(1,480,176)	(1,068,480)

Five-year Summary

Statement of financial position

	2018	2017	2016	2015	2014
	€	€	€	€	€
Assets					
Balances with Central Bank of Malta	**42,921,209**	57,023,963	3,597,402	15,167,026	18
Loans and advances to banks	**4,374,130**	9,320,142	5,905,440	3,531,786	9,270,474
Loans and advances to customers	**1,751,827**	-	-	-	-
Financial investments	**6,774,605**	2,272,941	54,640,925	36,084,468	38,479,954
Property, plant and equipment	**21,739**	11,258	15,385	35,169	57,842
Intangible assets	**130,456**	196,812	191,995	217,768	203,564
Deferred tax assets	**903,774**	877,882	839,974	1,003,045	888,177
Prepayment and other assets	**360,243**	159,806	561,053	764,667	735,040
Total assets	57,237,983	69,862,802	65,752,174	56,803,929	49,635,069
Equity					
Share capital	**20,250,000**	13,250,000	12,250,000	10,350,000	9,500,000
Investment revaluation reserve	**-**	48,082	123,879	(181,675)	(92,909)
Accumulated losses	**(8,904,099)**	(5,168,426)	(4,192,950)	(2,994,339)	(1,602,929)
Total equity	11,345,901	8,129,656	8,180,929	7,173,986	7,804,162
Liabilities					
Amounts owed to customers	**45,274,146**	60,955,858	56,849,001	48,906,650	38,430,577
Other liabilities	**617,936**	777,288	722,244	723,293	3,400,330
Total liabilities	45,892,082	61,733,146	57,571,245	49,629,943	41,830,907
Total liabilities and equity	57,237,983	69,862,802	65,752,174	56,803,929	49,635,069