FCM Bank Limited

Annual Report and Financial Statements
31 December 2021

Company Registration Number: C 50343

CONTENTS

Directors' report

The directors present their report and the audited financial statements of FCM Bank Limited ('the Bank') for the year ended 31 December 2021.

Principal activities

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

Performance Review

The Bank recognised a profit of €1,985,906 for the year under review (2020: €404,925) whilst operating income for the year stood at €4,303,993 (2020: €2,693,069). The improvement in the overall performance of the Bank was largely driven by an increase in interest income as a result of growth of its corporate lending business. The Bank remained highly liquid and very well capitalised as it focussed its efforts on developing its business.

During the year, the Bank continued to focus its efforts on its corporate lending business and its investment portfolio of fixed income securities. During 2021, loans and advances to customers increased by €93,835,076 (2020: €26,353,885), bringing the total loans and advances to customers as at the financial year end to €137,753,511 (2020: €43,918,435). The Bank's customer deposits increased by €57,902,625 during the year (2020: €49,408,674), bringing total deposits up to €141,449,401 (2020: €83,546,776).

The Bank evaluates the achievement of its objectives through the use of financial and non-financial measures. The Bank measures its Liquidity Risk against 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 against a minimum of 100%. In both cases, the Bank's ratios were significantly higher by a very large margin.

Since January 2020, the risk of the coronavirus pandemic (COVID-19) spreading rapidly has created a global panic. The global response to the pandemic continued to evolve in 2021. This had a significant impact on global financial markets, and it negatively affected many industries around the world. The Bank has reacted to the pandemic and taken all the necessary measures. The Bank has activated its Business Continuity Plan (BCP) and implemented remote working functionality for its employees with management maintaining complete oversight and control over activities. Client performance was continuously monitored and assessed, and notwithstanding the pandemic, the quality of the loan book remained intact.

With regard to corporate lending, the Bank experienced a substantial demand for credit with drawdowns heavily exceeding the year's budget. Similarly, customer deposits continued to rise. These mainly emanated from the on-line deposit platform and Maltese depositors.

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').

High level KPIs as at year end:

	2021	2020
	€	€
Profit for the year	**1,985,906**	404,925
Total own funds	**44,591,420**	19,245,160
Capital adequacy ratio	**19%**	22%
Leverage ratio	**19%**	17%

Directors' report - continued

Principal risks and uncertainties

The Board has designed a solid risk management framework and set a 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 its 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:

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. The Bank mitigates the risk of single dependency through ensuring continuity in the absence of any individual. During the year the number of staff has doubled with a consequent strengthening of each team to be in line with business, regulatory, and operational requirements.

Strategy risk

During 2021 and 2020, the Bank registered a significant growth in its corporate lending business. This increase exceeded the expected yearly target and has put the Bank in a strong position for further growth. Taking cognisance of the size of the Bank, the Bank is well capitalised and has a clearly defined strategy in place. There were several capital injections during the year that were recognised in the form of AT1 instruments and CET1 capital. During the year, the Bank injected €15,500,000 AT1 perpetual capital notes and also increased its share capital by €8,500,000.

Reputational risk

The Bank's reputation is, of course, of vital importance to its continued progress and is essential in attracting business, since any damage to its good standing would negatively impact the trust that customers expect when doing business with a banking 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. The Risk Committee meet on a regular basis and each potential risk is assessed and evaluated.

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.

Directors' report - continued

Result and dividends

The results for the year ended 31 December 2021 are shown in the statement of profit or loss and other comprehensive income on pages 20 and 21. The profit for the year was €1,985,906 (2020: €404,925). As at 31 December 2021, the retained earnings of the Bank amounted to €2,338,850 (2020: €479,302).

On 27 July 2020, the European Central Bank (ECB) issued a Recommendation on dividend distributions during the COVID-19 pandemic (ECB/2020/35), whereby it was recommended that until 1 January 2021, no dividends are paid out and no irrevocable commitment to pay out dividends is undertaken by credit institutions for the financial years 2019 and 2020. This Recommendation was repealed on 15 December 2020 through ECB/2020/62, which encourages banks to use prudence when deciding on dividend distributions. On 23 July 2021, another recommendation was issued by the ECB repeating recommendation ECB/2020/62 (ECB/2021/31) with effect from 30 September 2021.

Subsequent to the end of the reporting period, a net dividend of €0.04869565217 per nominal share of €1, for a total amount of €1,400,000 is being proposed by the Bank to be distributed to the shareholders for the twelve months ended 31 December 2021. The directors propose that the balance of retained earnings amounting to €2,338,850 (2020: 479,302) be carried forward to the next financial year. After the reporting date, a dividend of €1,400,000 is being proposed by the Board of Directors. A resolution to this effect will be proposed at the Annual General Meeting, subject to regulatory approval.

Shareholder's contribution

During 2021, the Bank, by virtue of a resolution dated 22 July 2021, increased its authorised share capital by €25,000,000 divided into 25,000,000 ordinary shares of a nominal value of €1.00 each from €25,000,000 (divided into 25,000,000 ordinary shares of a nominal value of €1.00 each) to €50,000,000 (divided into 50,000,000 ordinary shares of a nominal value of €1.00 each).

During 2021, the Bank, by virtue of a resolution dated and effective 25 August 2021, increased further its issued share capital by €8,500,000 divided into 8,500,000 ordinary shares of a nominal value of €1.00 each from €20,250,000 (divided into 20,250,000 ordinary shares of a nominal value of €1.00 each) to €28,750,000 (divided into 28,750,000 ordinary shares of a nominal value of €1.00 each).

During 2020, by virtue of resolutions dated 29 May 2020, 28 September 2020 and 16 November 2020, the Bank accepted capital contributions from SAB Europe Holding Ltd amounting to €1 million, €5.1 million and €2.8 million respectively. These contributions are free from all claims, charges, liens, equities and encumbrances and are irrevocable and unconditional. These are considered to form part of the CET1 capital of the Bank. During 2020, the capital contribution reserve was set-off against accumulated losses and as a result.

Perpetual capital notes

During 2021, by virtue of resolutions dated 5 January 2021, 27 July 2021, 18 August 2021 and 6 December 2021, the Bank issued fixed rate perpetual capital notes amounting to €2 million, €8 million, €3.5 million and €2 million, respectively. These notes are subject to fixed interest rates of 3.78% per annum, which amounted to €126,358 during 2021.

All interest payments on perpetual capital notes are cancellable at the discretion of the Bank.

These capital instruments qualify as Additional Tier 1 instruments in accordance with the requirements of Articles 51 to 54 of the Regulation (EU) No. 575/2013 and are categorised as equity within the Bank's Statement of Financial Position under the requirements of IFRSs as adopted by the EU.

During the year, the Bank has met all externally imposed capital requirements.

Directors' report – continued

Future business developments

The Bank will continue to focus on the development of its product portfolio in line with its strategy and business plan, and intends to continue growing its corporate lending business. The directors believe that the present outlook is positive and strongly believe that for the foreseeable future this main income stream should be pursued further.

Directors

The directors who served throughout the year were:

John Soler
Peter Cumba
Ondrej Korecky
Martin Farsky
Michael Borg Costanzi
Lino Casapinta
Dusan Benda (appointed with effect from 24 December 2021)

Directors' report - continued

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 the financial year and of the profit or loss of the Bank for that year in accordance with the requirements of International Financial Reporting Standards, as adopted by the European Union.

In preparing such 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 2021 are included in the Annual Report 2021, 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.

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 28 April 2022 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:

- The financial statements give a true and fair view of the financial position of FCM Bank Limited (the Bank) as at 31 December 2021, 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 19 to 88, comprise:

- the statement of financial position as at 31 December 2021;
- 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 significant accounting policies and other explanatory information.

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.

Independent auditor's report - *continued*

To the Shareholders of FCM Bank Limited

Independence

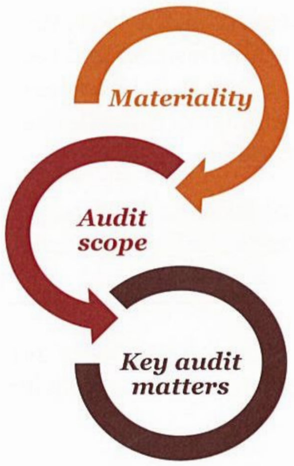
We are independent of the Bank in accordance with the International Code of Ethics for Professional Accountants (including International Independence Standards) issued by the International Ethics Standards Board for Accountants (IESBA Code) together with the ethical requirements of the Accountancy Profession (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.

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 2021 to 31 December 2021, are disclosed in Note 27 to the financial statements.

Our audit approach

Overview



- Overall materiality: €2,412,000 which represents 1% of total assets

- Credit loss allowances in respect of loans and advances to customers

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.

Independent auditor's report - continued

To the Shareholders of FCM Bank Limited

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	€2,412,000
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 and is a generally accepted benchmark. We chose 1% which is within the range of quantitative materiality thresholds that we consider acceptable.

We have applied a specific materiality of €82,000 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 €72,000 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Independent auditor's report - continued

To the Shareholders of FCM Bank Limited

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	How our audit addressed the Key audit matter
Credit loss allowances in respect of loans and advances to customers Credit loss allowances in respect of loans and advances to customers represent management's best estimate of expected credit losses ('ECLs') within the loan portfolios at the balance sheet date. The development of the models designed to estimate ECLs on the Bank's loans to customers, measured at amortised cost in accordance with the requirements of IFRS 9, requires a considerable level of judgement since the determination of ECLs is subject to a high degree of estimation uncertainty. The outbreak of the COVID-19 pandemic in the previous year has increased the level of uncertainty around the calculation of ECLs, giving rise to heightened subjectivity in the determination of model assumptions used to estimate key model risk parameters and hence necessitating a higher level of expert judgement. Credit loss allowances relating to all non-defaulted loans and advances to customers are determined at portfolio level through the use of an ECL model. Through its ECL model, the Bank calculates ECLs by multiplying three main components: probability of default (PD), loss given default (LGD) and exposure at default (EAD). i. Probability of default ("PD"): the likelihood of a borrower defaulting on its financial obligation either over the next 12 months or over the remaining lifetime of the obligation. ii. Loss given default ("LGD"): the expected losses taking into account, among other attributes, the mitigating effect of collateral value (if any) at the time it is expected to be realised and the time value of money.	During our audit of the financial statements for the year ended 31 December 2021, we continued to focus on the key drivers of the estimation of ECLs, also in view of the outbreak of the COVID-19 pandemic. We understood and critically assessed the model used for ECL estimation by reference to the requirements of IFRS 9. Since modelling assumptions and parameters are based on peer data, we independently assessed the reasonableness of the PDs and LGDs generated by the model and the appropriateness of management's judgements in respect of the calibration of PDs and LGDs as well as the application of multiple scenarios in the context of the uncertainty of the potential future impacts of the COVID-19 pandemic. The appropriateness of the modelling methodology and the key parameters used within the ECL calculations were discussed extensively with management. Our audit procedures in respect of credit loss allowances attributable to loans and advances to customers of the Bank included: • Ensuring that the granting of facilities was performed in accordance with the approval criteria of the Bank; testing of controls implemented by management over the monitoring of arrears, and of controls ensuring the necessary follow up actions on past due loans are satisfactorily resolved. We tested the design and operating effectiveness of these controls and determined that we could rely on these controls for the purposes of our audit.

Key audit matter	How our audit addressed the Key audit matter
iii. Exposure at default ("EAD"): the expected exposure in the event of a default (including any expected drawdowns of committed facilities). Within the ECL model for non-defaulted (Stages 1 and 2) exposures, in the absence of sufficient internal historical default data, the Bank's starting point PDs are derived by reference to published peer data for similar portfolios. For exposures secured by immovable properties, LGDs are driven by the loan-to-value ratio of the individual facilities taking into account other assumptions including market value haircut (which includes costs to sell), time to sell and the impact of discounting the collateral from the date of realisation back to the date of default. The maximum period considered when measuring ECLs is the maximum contractual period over which the Bank is exposed to credit risk. The use of published peer data to determine starting point PDs as well as the LGD modelling methodology might result in limitations in reliability to appropriately estimate ECLs. Under IFRS 9, the Bank is also required to formulate and incorporate multiple forward-looking economic conditions, reflecting management's view of potential future economic variables and environments, into the ECL estimates. The complexity attributable to this factor requires management to develop multiple macro-economic scenarios involving the use of significant judgements. In this context, the outbreak of COVID-19 and the government support and relief measures adopted to mitigate the impact of the pandemic have increased the uncertainty around judgements made in determining forward looking macro-economic scenarios and factors used in ECL model as well as the severity and probability attributable to such scenarios.	• Testing of a sample of exposures to independently review the borrower's financial performance and ability to meet loan repayments and assess the appropriateness of the stage classification assigned by management, taking into consideration the impact of COVID-19 on the repayment capabilities of the sampled borrowers and the potential postponement in timing of defaults due to payment deferrals and government support programmes and measures. Based on the evidence obtained we found the stage allocation of the Bank's loan portfolio to be appropriate. We also critically assessed the model used to determine the ECL in respect of the Bank's loans and advances to customers as at the financial reporting date. Our audit procedures included: • Testing the completeness and accuracy of the critical data utilised within the models for the year-end ECL calculations, including agreeing the terms of the exposures to supporting documentation. • Reviewing, on a sample basis, property collateral valuations utilised to determine LGDs applied by the Bank within ECL calculations, using our valuation experts; challenging the application of certain parameters considered in the LGD estimations such as the time to realise the collateral and costs associated with such process, taking into consideration the adequacy of modelled LGDs in light of the potential impact of the pandemic on local property prices. • Reviewing the PDs and the use of multiple scenarios to assess their reasonableness; assessing whether the severity in respect of modelled scenarios was appropriate in view of the pandemic and the high level of uncertainty surrounding the economic conditions. • Testing independently the model calculations.

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Key audit matter	How our audit addressed the Key audit matter
Data used in the impairment calculation is manually compiled. The ECL model is based on a general-purpose application which requires extensive manual handling of data. This increases risk around the accuracy and completeness of data used to determine assumptions and to operate the ECL model. In some cases, data is unavailable and reasonable alternatives have been applied to allow calculations to be performed. Judgement is also required to determine when an increase in credit risk or a default has occurred and as a result, allocate the appropriate stage classification. Staging is determined based on a combination of criteria including days past due criteria, the regular monitoring of the performance of borrowers against forecasts, as well as strategic developments affecting the borrowers' future payment capabilities. The local impact of the pandemic has been mitigated by a number of government programmes and measures, including general payment moratoria which have given rise to the deferral of payments of capital and/or interest over time periods that potentially extend until the end of the current financial reporting period. This factor has increased the level of uncertainty around judgements made in determining the timing of defaults and in respect of staging. For the purposes of avoiding the cliff edge effect on ECLs upon expiry of the moratoria, the Bank reassessed the credit risk ratings of exposures with approved moratoria on the basis of quantitative and qualitative characteristics to enable the identification of Significant Increase in Credit Risk ('SICR') or Unlikeliness-to-Pay (UTP) events as early as possible.	Based on the evidence obtained, we found the model assumptions, data used within the models and model calculations to be reasonable. In the case of some ECL allowances, we formed a different view from that of management, but in our view the differences were within a reasonable range of outcomes.

Key audit matter	How our audit addressed the Key audit matter
As part of these credit assessments, judgement is exercised in evaluating all relevant information on indicators of impairment, particularly where factors indicate deterioration in the financial condition and outlook of borrowers affecting their ability to pay. As part of the ongoing credit review process, the Bank also assessed whether potential heightened credit risk factors exist (SICR or UTP) from exposures not subject to a moratorium. As at 31 December 2021, none of the Bank's loans and advances to customers were classified as defaulted (Stage 3) exposures. Since the estimation of ECLs is subjective in nature and inherently judgemental, the Bank's application of the IFRS 9 impairment requirements is deemed to be an area of focus. We focused on credit loss allowances due to the subjective nature of specific data inputs into the calculation and the subjective judgements involved in both timing of recognition of impairment and the estimation of the size of any such impairment. Relevant references in the Annual Report and Financial Statements: - Accounting policy: Note 1.3; - Credit risk management: Note 2.1.1; - Critical accounting estimates, and judgements in applying accounting policies: Note 3; - Note on Changes in expected credit losses: Note 25; and - Note on Loans and advances to customers: Note 6.	

Independent auditor's report - *continued*

To the Shareholders of FCM Bank Limited

Other information

The directors are responsible for the other information. The other information comprises the Directors' report, the Additional Regulatory Disclosures and the 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 and we do not express any form of assurance conclusion thereon except as explicitly stated within the *Report on other legal and regulatory requirements*.

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.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the directors 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.

Independent auditor's report - *continued*

To the Shareholders of FCM Bank Limited

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, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Bank's ability to continue as a going concern. In particular, it is difficult to evaluate all of the potential implications that COVID-19 will have on the Bank's assets and liabilities, and the disruption to its business and the overall economy.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Independent auditor's report - *continued*

To the Shareholders of FCM Bank Limited

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, actions taken to eliminate threats or safeguards applied.

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

The *Annual Report and Financial Statements 2021* contains other areas required by legislation or regulation on which we are required to report. The Directors are responsible for these other areas.

The table below sets out these areas presented within the Annual Report, our related responsibilities and reporting, in addition to our responsibilities and reporting reflected in the *Other information* section of our report. Except as outlined in the table, we have not provided an audit opinion or any form of assurance.

Area of the *Annual Report and Financial Statements 2021* and the related Directors' responsibilities	Our responsibilities	Our reporting
Directors' report (on pages 1 to 5) The Maltese Companies Act (Cap. 386) requires the directors to prepare a Directors' report, which includes the contents required by Article 177 of the Act and the Sixth Schedule to the Act.	We are required to consider whether the information given in the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements. We are also required to express an opinion as to whether the Directors' report has been prepared in accordance with the applicable legal requirements. In addition, we are required to state whether, in the light of the knowledge and understanding of the Bank and its environment obtained in the course of our audit, we have identified any material misstatements in the Directors' report, and if so to give an indication of the nature of any such misstatements.	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). We have nothing to report to you in respect of the other responsibilities, as explicitly stated within the *Other information* section.

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Independent auditor's report - *continued*

To the Shareholders of FCM Bank Limited

Area of the *Annual Report and Financial Statements 2021* and the related Directors' responsibilities	Our responsibilities	Our reporting
	Other matters prescribed by the Maltese Banking Act (Cap. 371) In terms of the requirements of the Maltese Banking Act (Cap. 371), we are also required to report whether: • 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; • in our opinion, 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 which may from time to time be in force in the manner so required.	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 adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us.	We have nothing to report to you in respect of these responsibilities.

Independent auditor's report - continued

To the Shareholders of FCM Bank Limited

Other matter – use of this report

Our report, including the opinions, has been prepared for and only for the Bank's shareholders as a body in accordance with Article 179 of the Maltese Companies Act (Cap. 386) and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior written consent.

Appointment

We were first appointed as auditors of the Bank on 29 May 2018. Our appointment has been renewed annually by shareholder resolution representing a total period of uninterrupted engagement appointment of 4 years.

PricewaterhouseCoopers
78, Mill Street
Zone 5, Central Business District
Qormi
Malta

F Axis.

Fabio Axisa
Partner

28 April 2022

Statement of financial position

	Notes	As at 31 December 2021 €	2020 €
ASSETS			
Cash and balances with Central Bank of Malta	4	**5,120,404**	19,378,296
Loans and advances to banks	5	**3,362,185**	3,106,276
Loans and advances to customers	6	**137,753,511**	43,918,435
Financial investments	7	**84,855,487**	43,766,208
Derivative financial instruments	8	**2,171,859**	756,057
Property and equipment	9	**518,379**	63,547
Intangible assets	10	**1,309,073**	190,285
Deferred tax assets	11	**3,267,001**	1,538,249
Prepayments and other assets	12	**2,813,886**	2,311,802
Total assets		**241,171,785**	115,029,155
EQUITY			
Share capital	13	**28,750,000**	20,250,000
Perpetual capital notes	14	**15,500,000**	-
Fair value reserve	15	**36,286**	275,402
Retained earnings		**2,338,850**	479,302
Total equity		**46,625,136**	21,004,704
LIABILITIES			
Amounts owed to customers	16	**141,449,401**	83,546,776
Amounts owed to banks and other institutions	17	**52,633,639**	10,000,000
Derivative financial instruments	8	**11,793**	-
Other liabilities	18	**451,816**	477,675
Total liabilities		**194,546,649**	94,024,451
Total equity and liabilities		**241,171,785**	115,029,155
MEMORANDUM ITEMS			
Commitments	19	**63,821,336**	20,660,364

The notes on pages 24 to 88 are an integral part of these financial statements.

The financial statements on pages 19 to 88 were authorised for issue by the board on 28 April 2022 and were signed on its behalf by:

John Soler
Director

Michael Borg Costanzi
Director

Income statement

	Notes	Year ended 31 December 2021 €	2020 €
Interest income	20	**5,020,464**	1,487,441
Interest expense	21	**(1,475,125)**	(779,199)
Net interest income		**3,545,339**	708,242
Fee income	22	**113,936**	47,569
Fee expense	22	**(105,802)**	(76,234)
Net fee income/(expense)		**8,134**	(28,665)
Other income	23	**12,762**	1,855,550
Net trading income	24	**68,843**	77,302
Realised gains on disposal of debt instruments measured at FVOCI		**668,915**	80,640
Operating income		**4,303,993**	2,693,069
Changes in expected credit losses	25	**(142,712)**	(174,670)
Employee compensation and benefits	26	**(1,888,614)**	(1,198,088)
Administrative expenses	27	**(1,886,758)**	(1,315,615)
Profit before tax		**385,909**	4,696
Tax income	28	**1,599,997**	400,229
Profit for the year		**1,985,906**	404,925

The notes on pages 24 to 88 are an integral part of these financial statements.

Statement of comprehensive income

	Note	Year ended 31 December 2021 €	Year ended 31 December 2020 €
Profit for the year		**1,985,906**	404,925
Other comprehensive income			
Items that may be subsequently reclassified to profit or loss			
Fair valuation of debt instruments measured at FVOCI:			
- Net changes in fair value arising during the year, before tax	15	**301,044**	381,395
- Reclassification adjustments: net amounts reclassified to profit or loss, before tax		**(668,915)**	(80,640)
- Income tax relating to components of other comprehensive income		**128,755**	(105,264)
Other comprehensive income for the year, net of tax		**(239,116)**	195,491
Total comprehensive income for the year, net of tax		**1,746,790**	600,416

The notes on pages 24 to 88 are an integral part of these financial statements.

Statement of changes in equity

	Notes	Share capital €	Perpetual capital notes €	Capital contribution reserve €	Fair value reserve €	Retained earnings €	Total equity €
Balance at 1 January 2020		20,250,000	-	-	79,911	(8,825,623)	11,504,288
Comprehensive income							
Profit for the year		-	-	-	-	404,925	404,925
Other comprehensive income							
Fair valuation of financial investments measured at FVOCI:							
- net changes in fair value arising during the year, net of tax	15	-	-	-	247,907	-	247,907
- reclassification adjustments: net amounts reclassified to profit or loss upon disposal, net of tax	15	-	-	-	(52,416)	-	(52,416)
Total comprehensive income		-	-	-	195,491	404,925	600,415
Transactions with owners							
Capital contribution from shareholders	13	-	-	8,900,000	-	-	8,900,000
Transfer of capital contribution to retained earnings	13	-	-	(8,900,000)	-	8,900,000	-
Total transactions with owners		-	-	-	-	8,900,000	8,900,000
Balance at 31 December 2020		20,250,000	-	-	275,402	479,302	21,004,704
Balance at 1 January 2021		20,250,000	-	-	275,402	479,302	21,004,704
Comprehensive income							
Profit for the year		-	-	-	-	1,985,906	1,985,906
Other comprehensive income							
Fair valuation of financial investments measured at FVOCI:							
- net changes in fair value arising during the year, net of tax	16	-	-	-	195,679	-	195,679
- reclassification adjustments: net amounts reclassified profit or loss upon disposal, net of tax	16	-	-	-	(434,795)	-	(434,795)
Total comprehensive income		-	-	-	(239,116)	1,985,906	1,746,790
Transactions with owners							
Contributions by owners							
Issue of share capital	13	8,500,000	-	-	-	-	8,500,000
Issue of perpetual capital notes	14	-	15,500,000	-	-	-	15,500,000
Distributions to owners							
Interest paid on perpetual capital note	14	-	-	-	-	(126,358)	(126,358)
Total transactions with owners		8,500,000	15,500,000	-	-	(126,358)	23,873,642
Balance at 31 December 2021		28,750,000	15,500,000	-	36,286	2,338,850	46,625,136

The notes on pages 24 to 88 are an integral part of these financial statements.

Statement of cash flows

	Notes	2021 €	2020 €
		As at 31 December	
Cash flows from operating activities			
Interest and fee income received		**4,699,425**	1,218,733
Other income		**81,605**	975,036
Interest and fee expense paid		**(1,574,882)**	(779,043)
Cash payments to employees and suppliers		**(3,756,080)**	(2,465185)
Cash flows used in operating activities before changes in operating assets and liabilities		**(549,932)**	(1,050,459)
Changes in operating assets and liabilities			
Net (increase)/decrease in cash and balances with Central Bank of Malta		**(814,792)**	113,246
Net increase in loans and advances to customers		**(95,242,500)**	(26,503,885)
Net increase in other assets		**(1,372,152)**	(826,735)
Net increase in amounts owed to customers		**57,902,625**	49,408,674
Net increase in amounts owed to banks and other institutions		**42,633,639**	10,000,000
Net cash generated from operating activities		**2,556,888**	31,140,841
Cash flows from investing activities			
Purchase of property and equipment	9	**(514,446)**	(25,355)
Purchase of intangible assets	10	**(1,209,336)**	(22,945)
Purchase of financial investments	7	**(53,477,537)**	(41,842,659)
Proceeds from sale of financial investments	7	**13,954,014**	3,026,558
Net cash used in investing activities		**(41,247,305)**	(38,864,401)
Cash flows from financing activities			
Proceeds from issue of share capital	13	**8,500,000**	-
Capital contribution from shareholders	13	**-**	8,900,000
Proceeds from issue of perpetual capital notes	14	**15,500,000**	-
Interest paid on perpetual capital notes	14	**(126,358)**	-
Net cash generated from financing activities		**23,873,642**	8,900,000
Net movement in cash and cash equivalents		**(14,816,775)**	1,176,440
Cash and cash equivalents at beginning of year		**22,231,392**	21,054,952
Cash and cash equivalents at end of year	29	**7,414,617**	22,231,392

The notes on pages 24 to 88 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 certain financial assets and financial liabilities measured at fair value through profit or loss, including derivative financial instruments, and financial assets measured at fair value through other comprehensive income.

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 2021

In 2021, the Bank adopted new standards, amendments and interpretations to existing standards that are mandatory for the Bank's accounting period beginning on 1 January 2021. With exception to the interest rate benchmark reform as disclosed below, the adoption of these revisions to the requirements of IFRSs as adopted by the EU did not result in substantial changes to the Bank's accounting policies.

The IASB published 'Interest Rate Benchmark Reform – Phase 2: Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16' in August 2020, which became effective from 1 January 2021. These amendments represent the second phase of the IASB's project on the effects of interest rate benchmark reform, addressing issues affecting financial statements when changes are made to contractual cash flows as a result of the reform.

Under these amendments, changes to the basis for determining the contractual cash flows required by the interest rate benchmark reform are reflected by adjusting the effective interest rate for financial instruments measured using the amortised cost measurement and debt financing assets measured at FVOCI. No immediate gain or loss is recognised. These expedients are only applicable to changes that are required by the interest rate benchmark reform, which is the case if, and only if, the change is necessary as a direct consequences of the interest rate benchmark reform and the new basis for determining the contractual cash flows is economically equivalent to the previous basis.

The Bank has accordingly evaluated the extent of the impact of the discontinuation of the LIBOR rates on the Bank's financial statements. In this respect, the Bank's financial instruments were not impacted by the interest rate benchmark reform since the Bank's variable interest rate financial instruments re-price either to PRIBOR rates or EURIBOR rates, both of which are considered representative benchmark.

The transition is not expected to have a material impact on the Bank's operations and financial position. The Bank will continue to monitor the regulatory developments in this respect.

1. Summary of significant accounting policies - continued

1.1 Basis of preparation - continued

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

Certain new standards, amendments and interpretations to existing standards which are mandatory for accounting periods beginning on or after 1 January 2022 have been published by the date of authorisation for issue of these financial statements. The Bank has not early adopted these requirements of IFRSs as adopted by the EU and the Bank's directors are of the opinion that, there are no requirements that will have a possible significant impact on the Bank's financial statements in the period of initial application.

1.2 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 Bank 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

i. Initial recognition and measurement

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.

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

At initial recognition, an expected credit loss (ECL) allowance is recognised for financial assets measured at amortised cost and investments in debt instruments measured at fair value through other comprehensive income (FVOCI), which results in an accounting loss being recognised in profit or loss when an asset is newly originated.

1. Summary of significant accounting policies - continued

1.3 Financial assets - continued

i. Initial recognition and measurement - continued

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

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

ii. Classification and subsequent measurement

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

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

The classification requirements for debt and equity investments are described below.

Debt instruments

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

Classification and subsequent measurement of debt instruments depend on:

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

1. Summary of significant accounting policies - continued

1.3 Financial assets - continued

Debt instruments - continued

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

- Amortised cost: Assets that are held for the collection of contractual cash flows where those cash flows represent solely payments of principal and interest ('SPPI'), and that are not designated at FVTPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any ECL allowance recognised and measured as described in Note 2.1.1.1. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

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

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

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

The 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

Business Model Assessment

Key management personnel determine the Bank's business model by considering the way financial instruments are managed in order to generate cash flows i.e. whether the Bank's objective is solely to collect the contractual cash flows from the assets or 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 and measured at FVTPL. Such assessment is performed at a 'portfolio level' as it best reflects the way the business is managed, and information is provided to management.

The information that will be considered in such assessment includes:

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

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

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

Cash flows that represent solely payments of principal and interest

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

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

1.3 Financial assets - continued

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

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

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

Equity instruments

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

As at 31 December 2021 and 2020, the Bank had no investments in equity instruments.

Modification of loans and advances to customers

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

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

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

1.3 Financial assets - continued

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

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

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

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

The new gross carrying amount is recalculated by discounting the modified cash flows at the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets).

Impairment of financial assets

The Bank assesses on a forward-looking basis the ECLs associated with its debt instruments carried at amortised cost and FVOCI and with the exposure arising from loan commitments and financial guarantee contracts. The Bank recognises a loss allowance for such losses at each reporting date.

The measurement of ECLs reflects:

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

Note 2.1.1.1 provides more detail of how the expected credit loss allowance is measured.

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

1.3 Financial assets - continued

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

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

Derecognition of financial assets

Financial assets, or a portion thereof, are derecognised when the contractual rights to receive the cash flows from the assets have expired, or when they have been transferred and either (i) the Bank transfers substantially all the risks and rewards of ownership, or (ii) the Bank neither transfers nor retains substantially all the risks and rewards of ownership and the Bank has not retained control.

Write-off

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

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 Derivative financial instruments

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

The Bank principally uses currency swaps as a hedge of foreign exchange risk, and interest rate swaps as a hedge of interest rate risk, thereby entering into commitments to exchange one set of cash flows for another. All the Bank's derivative transactions provide effective economic hedges under the Bank's risk management policies. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in profit or loss.

The Bank deploys no hedging strategies that achieve hedge accounting in terms of IFRS 9.

1. Summary of significant accounting policies - continued

1.6 Property and equipment

All property 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:

Motor vehicles, Furniture and fittings	5 years
Computer hardware	3 years

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 1.9).

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

1.7 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 to ten 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 1.9).

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

1.8 Leases

At the inception of a contract, the Bank assesses if the contract is or contains lease components that conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

Lease liabilities arising from such contracts are measured at the present value of the remaining lease payments, discounted using the Bank's incremental borrowing rate, which is the rate that the Bank would have to pay to borrow the funds necessary to obtain an asset of a similar value in a similar economic environment with similar terms and conditions. Lease payments to be made under reasonably certain extension options are also included in the measurement of the liability. Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease term so as to produce a constant period rate of interest on the remaining balance of the liability.

The Bank measures the associated right-of-use assets at an amount equal to the lease liability at the date at which the leased asset is made available for use. The right-of-use assets are subsequently depreciated using the straight-line method from the commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term.

The Bank elects not to recognise a right-of-use asset and a lease liability for short-term leases. Short-term leases are leases with a lease term of 12 months or less from the commencement date. Instead, payments associated with these short-term leases, are recognised as an expense in profit or loss on a straight-line basis over the term of the lease. If a lease for which the short-term lease exemption has been applied is subsequently modified or the lease term is changed, it is accounted for as a new lease.

The Bank leases property used as office space and car spaces. In accordance with the practical expedients permitted by the standard, the Bank has elected not to separate lease and any associated non-lease components in respect of property leases, and instead accounts for these as a single lease component. As of 31 December 2021, all of the Bank's leases were considered to be short-term leases.

1.9 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. Summary of significant accounting policies - continued

1.10 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. Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities.

1.11 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.

1.12 Perpetual capital notes

Perpetual capital notes qualify as Additional Tier 1 capital instruments, are undated and subordinated obligations. Coupon payments on perpetual capital notes may be cancellable at the Bank's discretion and are accounted for through equity in the Statement of Financial Position.

1.13 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. 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.

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.

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

1.14 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 Bank; 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.

1.15 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.

However, for financial assets that are classified as credit-impaired after initial recognition, interest income is calculated by applying the effective interest rate to the amortised cost / net carrying amount of the financial asset. If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis.

For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying the credit-adjusted effective interest rate to the amortised cost of the asset. The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset improves.

1.16 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 is 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. **Summary of significant accounting policies** - continued

1.17 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.

1.18 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

Preamble

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 Bank's financial performance.

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The risk function of the Bank, which is headed by the Chief Risk Officer, is responsible for the monitoring of risk. The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Bank is exposed to financial risks, categorised as follows:

- Credit risk: Credit risk stems from the possible untimely or non-repayment of existing and contingent obligations by the Bank's counterparties, resulting in the loss of equity and profit. It is the risk that deterioration in the financial condition of a borrower would 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: The risk of losses arising from unfavourable changes in the level and volatility of interest rates, foreign exchange rates or investment prices.

- Liquidity risk: Liquidity risk arises from:
  - Market (product) liquidity risk: risk of losses arising from the inability to easily offset or eliminate a position without significantly affecting the market price because of inadequate market depth or market disruption; and
  - 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.

2. Financial risk management - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations in a timely manner and arises principally from the Bank's loans and advances to banks and customers.

Credit risk management

The measurement of credit exposure for risk management purposes considers that an exposure varies with changes in market conditions, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties.

(a) Loans and advances to customers

The Bank's principal credit risk arises on loans and advances to customers. To manage this risk, the Bank compiles and updates due diligence reports through which the Bank primarily evaluates the capacity of customers to repay loans from sources other than collateral. The evaluation includes a review of the client's borrowings and repayments history and a financial analysis to assess profitability, liquidity, and debt capacity using both historical and projected financial information where necessary. The value of the collateral in place is also evaluated.

The Bank's approach when granting credit facilities is based on the customer's capacity to repay rather than placing primary reliance on credit risk mitigants. Notwithstanding, as part of the Bank's credit risk mitigation techniques, the Bank holds collateral against loans and advances to customers, which nature and level generally depends on the amount of the exposure, the type of facility provided, the term of the facility and the level of credit risk involved. Loans and advances to customers are typically fully collateralised (see Note 2.1.1.8).

In addition, loan approval limits are in place to effectively manage credit risk. These are currently allocated between the Bank's Management Credit Committee (comprising of the CEO, CCO, CRO, and the Head of Credit Risk), and the Board of Directors. The Credit Committee is responsible for approving facilities which fall within defined limits. The approval of credit facilities exceeding such limits are evaluated by the Credit Committee and recommended to either the Chairman of the Board and the Chairman of the Audit Committee depending on the exposure limit. Furthermore, approval is also reserved to the Board in respect of participation or syndicate lending provided in the Czech Republic as well as in approving related party lending.

Exposure to credit risk is managed through regular analysis of the ability of counterparties and potential counterparties to meet interest and capital repayment obligations. The frequency at which credit review procedures are performed typically depend on the performance of the counterparty.

The current financial year continued to be characterised by the economic impacts that have resulted from the COVID-19 pandemic, which has continued to impact a proportion of the Bank's customers' business models, income levels or cash flow generation. In this respect, the Bank continued to support its customers and has accordingly granted moratoria on capital and/or interest payments and originated new loans to provide relief to customers experiencing liquidity pressures.

2. Financial risk management - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk - continued

As referred to previously, the COVID-19 pandemic continued to impact a number of the Bank's customers. During 2021, more information became available in respect of the impact of COVID-19 on specific borrowers and industry sectors, enabling management to assess in an enhanced manner borrower-specific credit risk levels and identify SICR or unlikeliness to pay ('UTP') events. The Bank continued to monitor closely exposures to update credit risk assessments by reference to actual financial performance and, where available, financial forecasts. Exposures deemed mostly impacted and in respect of which a SICR has been observed triggered more frequent monitoring.

Where appropriate, the Bank also enhanced its credit risk mitigation techniques in order to manage the heightened level of credit risk by requesting additional collateral in respect of specific exposures.

(b) Other financial assets

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, quantitative and qualitative characteristics, as well as the industry sector in which the counterparty operates are considered.

In addition, in respect of unrated debt securities, the Bank compiles and updates due diligence reports through which the Bank primarily evaluates the capacity of the counterparty to repay the debt. The evaluation includes a financial analysis to assess the counterparty's profitability, liquidity, and debt capacity.

2.1.1.1 Expected credit losses

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'. An allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL').

A pervasive concept in measuring ECL in accordance with IFRS 9 is that ECL should consider forward looking information as described further below.

2. Financial risk management - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.1 Expected credit losses – continued

The following diagram summarises the impairment requirements under IFRS 9:

Change in credit quality since initial recognition

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

Significant increase in credit risk

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

The Bank primarily identifies whether a SICR has occurred based on a variety of data that is determined to be predictive of the risk of default and applying experienced credit judgement. These factors vary depending on the nature of the exposure and the type of borrower. Exposures are subject to ongoing monitoring.

Monitoring typically involves use of the following data:

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

2. Financial risk management - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.1 Expected credit losses - continued

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

In the case of financial assets other than loans and advances to customers, which primarily include balances with the Central Bank of Malta, loans and advances to banks and externally rated investments in debt securities, the Bank applies the low credit risk simplification to all its exposures considered 'investment-grade', as rated by external rating agencies such as Standard & Poor's and Moody's. 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. Moving from 'investment-grade' to 'non-investment grade' does not automatically mean that there has been a SICR. If, on the other hand, these financial assets suffer a significant increase in credit risk, 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.

In respect of unrated debt securities, to determine whether credit risk has increased significantly since initial recognition, the Bank considers reasonable and supportable information that is relevant and available without undue cause or effect including both quantitative and qualitative information, and by applying experience credit judgement.

Definition of default and credit impaired

The Bank determines that a financial instrument is credit-impaired (or in default and accordingly stage 3 for IFRS 9 purposes) when:

- Contractual payments of either principal or interest are past due by more than 90 days for any material credit obligation to the Bank.
- The counterparty is unlikely to pay its credit obligations to the Bank in full, without recourse by the Bank to actions such as the realisation of collateral.

If unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure exceeds 90 days past due.

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

- qualitative – such as non-adherence to the terms and conditions of sanction and/or other breaches of covenants, overdue status and non-payment of another obligation of the same obligor to the Bank;
- quantitative – such as changes in probabilities of default; and
- based on data developed internally and other data obtained from external sources.

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

2. **Financial risk management** - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.1 Expected credit losses - continued

The Bank also assessed whether potential heightened credit risk factors exist (SICR or UTP) from exposures not subject to a moratorium as part of its ongoing credit review process.

As part of these credit assessments, judgement is exercised in evaluating all relevant information on indicators of impairment, particularly where factors indicate deterioration in the financial condition and outlook of borrowers affecting their ability to pay.

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 an asset is considered to be credit-impaired.

(a) Loans and advances to customers

The ECL from loans and advances to customers is determined by projecting the PD, LGD and EAD for each individual exposure. These three components are multiplied together to calculate the ECL.

The PD represents the likelihood of a borrower defaulting on its financial obligation (as per "Definition of default and credit-impaired assets" above), either over the next 12 months, or over the remaining lifetime of the obligation. The 12M PD is developed by utilising publicly available peer data for portfolios similar to those of the Bank as a starting point, and is scaled to a Lifetime PD by applying marginal rates determined on the basis of default curves published by the recognised credit rating agencies for exposures of similar credit quality. These PDs are further adjusted to reflect probability weighted forward looking macroeconomic information as explained in further detail below.

LGD represents the Bank's expectation of the extent of loss on a defaulted exposure. LGD varies by type of counterparty, type and seniority of claim and availability of collateral or other credit support. It is expressed as a percentage loss per unit of exposure at the time of default. The LGD is determined based on factors which impact the recoveries made post default. This is primarily based on projected collateral values, discounts to values, time to repossession and recovery costs observed. The Bank also considers forward looking macroeconomic information to estimate the extent of loss on a defaulted exposure under different forward looking scenarios.

The EAD is based on the amounts the Bank expects to be owed at the time of default. For example, for a real estate finance loan, the Bank includes the current drawn balance plus any further amount that is expected to be drawn up to the current contractual limit by the time of default, should it occur.

The 12-month ECL is calculated by multiplying the 12-month PD, LGD and EAD. Lifetime ECL is calculated on a similar basis for the residual life of the exposure. The ECL is then discounted back to the reporting date. The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

2. Financial risk management - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.1 Expected credit losses - continued

The Bank considers forward-looking macroeconomic information into the calculation of ECL by incorporating the effects of two scenarios, representative of forecast economic conditions, sufficient to calculate unbiased expected losses. They represent a 'most likely outcome' (the 'Baseline' scenario), and a less likely 'outer' scenario, referred to as the 'Downside' scenario, weighted by an appropriate probability of occurrence, determined on the basis of scenarios and respective probability weights sourced from macroeconomic research representing information published both by banking authorities and reputable credit rating agencies. Specifically, the Bank assigns a probability of occurrence of 70% (2020: 61%) to the 'Baseline' scenario and a probability of occurrence of 30% (2020: 39%) to the 'Downside' scenario.

In order to model the impact of economic scenarios on the 12M PD and Lifetime PD, the Bank applies a scaling factor based on default rate forecasts under both the 'Baseline' and 'Downside' scenarios. With respect to the LGD, the Bank considered the impact of worsening property values under the 'Downside' scenarios.

The Bank considers a 'Baseline' scenario which assumes that containment measures related to COVID-19 mitigate the emergence of the highly contagious Omicron variant. In addition, progress with vaccination ensures that hospital admissions and patients in intensive care remain low. The Bank also assumes that absences caused by the rapid spread of Omicron amplify global supply disruptions and international price pressures. The Bank expects the pandemic situation to adversely affect Malta's travel industry during the start of 2022. However, the Bank assumes that investment and private consumption growth pick up in 2022. On the other hand, the Bank expects price pressures to intensify and hence, inflation is projected to increase significantly in 2022.

For the 'Downside' scenario, the Bank assumes that both the Maltese and Czech economies are impacted by a market deterioration in the inflation outlook. This scenario contemplates that consumer prices surge on the back of higher commodity prices and consumers struggle to maintain real income in the face of higher prices. The Bank assumes a longer period of suppressed economic activity and weaker market conditions than in the baseline scenario resulting in a continuous rise in default rates over the next 12 months. The Bank also assumes that lower disposable income makes it challenging for homeowners to service their mortgages. This results in significantly higher mortgage defaults, which exerts downward pressure on residential real estate prices. The Bank also assumes an unparalleled decline in demand for property from certain industries as a result of significant changes in spending habits and business organisation, marked by an increase in remote working and a shift to e-commerce that leads to an abrupt and sustained drop in commercial real estate market activity and strong price corrections over the scenario horizon. Accordingly, under the Downside scenario, the Bank assumes that the real estate market experiences substantial repricing, which leads to a decline in the next three years.

The macroeconomic scenarios and likelihoods of occurrence are subject to a high degree of uncertainty and therefore, the actual outcomes may be significantly different to those projected. As a result, management assessed and considered the sensitivity of the ECL outcome against the forward-looking economic conditions as part of the ECL governance process.

In this respect, as at 31 December 2021, the sensitivity of the ECL outcome to the economic forecasts was assessed by recalculating the ECL under the Downside scenario described above for the loan portfolio, applying a 100% weighting. If the ECL outcome was estimated solely on the basis of the Downside scenario, the credit loss allowances in respect of the loan portfolio would increase by €202,000 (2020: €81,000).

2. **Financial risk management** - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.1 Expected credit losses - continued

Accordingly, the directors deem that ECLs in respect of the loan portfolio amounting to €349,707 (2020: €238,252) are reasonable.

(b) Balances with Central Bank of Malta, loans and advances to banks and financial investments

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 external credit rating of the counterparty or issuer, by reference to S&P default rates.

If a counterparty or exposure migrates between external credit ratings, then this will lead to a change in the associated PD. In the case of unrated loans and advances to banks and unrated debt securities, 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.

The Bank applies forward economic scenarios into the calculation of ECL by incorporating the effect of macroeconomic scenarios, sourced from external reputable agencies, into the estimation of the term structure of the PD under multiple scenarios which are weighted by an appropriate probability of occurrence.

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 by rating group, including sovereigns, financial institutions and corporates published by Moody's.

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

2. **Financial risk management** - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.2 Maximum exposure to credit risk

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

	2021 Gross carrying amount/ Fair value €	**2021** ECL allowance €	2020 Gross carrying amount/ Fair value €	2020 ECL allowance €
Credit risk exposure relating to on-balance sheet assets				
Subject to IFRS 9 impairment allowance				
Financial assets measured at FVOCI				
Debt securities	15,476,833	(2,155)	23,581,825	(14,535)
Financial assets measured at amortised cost:				
Balances with the Central Bank of Malta	5,122,958	(2,554)	19,380,332	(2,554)
Loans and advances to banks	3,362,407	(222)	3,106,498	(222)
Loans and advances to customers	138,103,218	(349,707)	44,156,687	(238,252)
Debt securities	69,434,739	(56,085)	20,196,831	(12,448)
Accrued interest receivable	600,216	-	115,041	-
Not subject to IFRS 9 impairment allowance				
Financial assets measured at FVTPL				
Derivative financial instruments	2,171,859	-	756,057	-
Credit risk exposure	**234,272,230**	**(410,723)**	111,293,271	(268,011)
Credit risk exposure relating to off-balance sheet instruments				
Undrawn commitments to lend	63,821,336	-	20,660,364	-
Credit risk exposure	**63,821,336**	-	20,660,364	-

Financial assets in the form of derivative financial instruments are subject to credit risk, but not subject to impairment rules in accordance with IFRS 9. These instruments are held at fair value through profit or loss and therefore any movements in the fair value of these assets are immediately recorded in profit or loss.

Accrued income substantially arises from loans and advances to customers. Expected credit losses in respect of accrued income, which are not deemed material, have been allocated to loans and advances to customers. Similarly, ECL arising on undrawn commitments to lend have been allocated to loans and advances to customers.

2. Financial risk management - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.3 Credit concentration risk

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

Credit concentration risk by industry sector

The following table analysis the Bank's financial investments, at their gross carrying amount or fair value, by industry sector:

	2021	2020
	€	€
Governments	**5,196,944**	3,397,506
Corporate		
Financial services	**9,117,771**	6,249,037
Gaming	**4,291,425**	3,194,259
Industrial	**6,731,447**	9,925,698
Transportation and automobile	**15,894,265**	6,919,952
Construction and real estate	**9,499,867**	6,857,350
Engineering	**10,386,364**	3,061,756
Retail trade	**5,980,326**	2,120,384
Manufacturing	**7,177,695**	-
Telecommunications	**3,288,547**	2,052,714
Other sectors	**7,346,921**	-
	84,911,572	43,778,656

The industry sector analysis of the Bank's loans and advances to customers, at their gross carrying amount, is described in the following table:

	2021	2020
	€	€
Financial services	**23,117,419**	9,695,605
Households and individuals	**8,037,793**	1,832,585
Construction and real estate	**75,296,608**	21,985,192
Wholesale and retail	**7,170,446**	1,799,499
Hotels and accommodation	**8,484,155**	3,610,267
Other sectors	**15,996,797**	5,233,539
	138,103,218	44,156,687

2. **Financial risk management** - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.3 Credit concentration risk - continued

The Bank's undrawn commitments to lend in respect of loans and advances to customers are analysed in the table below by industry.

	2021	2020
	€	€
Financial services	**654**	3,000,000
Households and individuals	**988,007**	877,100
Construction and real estate	**39,207,547**	8,908,680
Wholesale and retail	**4,451,444**	862,799
Hotels and accommodation	**3,756,060**	1,249,510
Other sectors	**13,657,384**	5,762,275
	62,061,096	20,660,364

Credit concentration risk by name

A significant concentration of credit risk arises due to the limited number of customers to which the Bank has extended lending. As at 31 December 2021, 7 (2020: 6) customers, with a total value of €46,306,031 (2020: €19,694,636) were deemed to be large exposures as defined in the Capital Requirements Regulations (CRR). The allowance for ECL in respect of such large exposures amounted to €99,416 (2020: €82,565). As at 31 December 2021 and 2020, no loans and advances to customers were deemed to be prohibited large exposures in terms of the CRR.

Credit concentration risk by geographical region

As illustrated in the table below, the majority of the Bank's exposures are in Malta in view of the Bank's operations being conducted in Malta, followed by the Czech Republic attributable to the fact that the Bank forms part of a group that operates in the Czech Republic.

2. Financial risk management - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.3 Credit concentration risk - continued

Credit concentration risk by geographical region - continued

The tables below describe the Bank's exposure to credit concentration by geographical region, gross of ECL, or fair value:

	2021	2020
	€	€
Financial investments		
Malta	**1,800,606**	1,882,127
Germany	**12,313,586**	6,374,459
Czech Republic	**39,496,643**	9,859,443
Netherlands	**8,428,103**	7,356,063
France	**7,360,175**	3,272,382
Austria	**4,596,649**	4,400,705
Romania	**7,365,773**	5,541,166
Poland	**3,286,720**	3,338,214
Other	**263,317**	1,754,097
	84,911,572	43,778,656

	2021	2020
	€	€
Loans and advances to banks		
Malta	**674,050**	993,952
Netherlands	**1,166,638**	1,200,230
Czech Republic	**451,332**	523,443
Other	**1,070,387**	388,873
	3,362,407	3,106,498

2. Financial risk management - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.3 Credit concentration risk - continued

	2021 €	2020 €
Loans and advances to customers		
Malta	**98,342,614**	37,152,151
Czech Republic	**39,760,604**	7,004,536
	138,103,218	44,156,687

	2021 €	2020 €
Undrawn commitments to lend		
Malta	**62,060,442**	20,582,434
Czech Republic	**654**	77,930
	62,061,096	20,660,364

	2021 €	2020 €
Derivative financial instruments		
Czech Republic	**2,171,859**	756,057

2. Financial risk management - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.4 Information on credit quality of balances with banks and debt securities

The Bank uses external ratings to highlight exposures which require closer management attention.

The following table presents an analysis of the Bank's financial investments, which comprise of debt securities, by rating agency based on Standard and Poor's ratings.

	2021 €	2020 €
AA	**307,807**	269,037
A	**1,254,480**	1,037,702
A-	**633,050**	733,977
BBB+	**6,458,917**	5,270,050
BBB	**6,327,913**	4,629,335
BBB-	**11,785,773**	9,958,753
BB-	**3,915,448**	-
BB+	**17,119,638**	11,732,854
B+	**4,291,425**	3,194,259
Unrated	**32,817,121**	6,952,689
	84,911,572	43,778,656

As at 31 December 2021 and 2020, the Republic of Malta and accordingly the Central Bank of Malta had a credit rating of A-, A2 and A+ from the three international credit rating agencies, S&P, Moody's and Fitch respectively.

Meanwhile, as at 31 December 2021 and 2020 credit ratings in respect of placements with counterparty banks range between BBB and A+.

As at 31 December 2021 and 2020, all balances with banks were classified as Stage 1.

In respect of unrated debt securities, the Bank compiles and updates due diligence reports through which the Bank primarily evaluates the capacity of the counterparty to repay the debt. The evaluation includes a financial analysis to assess the counterparty's profitability, liquidity, and debt capacity. To determine whether credit risk has increased significantly since initial recognition, the Bank considers reasonable and supportable information that is relevant and available without undue cause or effect including both quantitative and qualitative information, and by applying experience credit judgement. The Bank calibrates unrated counterparties to S&P default rates by reference to external ratings of comparable financial assets.

The following tables set out information on the credit quality of financial investments measured at amortised cost and financial investments measured at FVOCI. The credit quality of the financial assets is determined by credit ratings applicable to issuers or counterparties. In respect of debt securities which are not externally rated, the Bank calibrates unrated counterparties to S&P default rates by reference to external ratings of comparable financial assets. Explanation of the terms 12-month ECL, lifetime ECL and credit impaired are included in Note 2.1.1.1.

2. Financial risk management - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.4 Information on credit quality of balances with banks and debt securities - continued

	2021		
	Stage 1 12-month €	**Stage 2 Lifetime ECL €**	**Total €**
Financial investments measured at FVOCI			
Gross carrying amount – fair value	**15,476,833**	-	**15,476,833**
Financial investments measured at amortised cost:			
Gross carrying amount	67,507,518	1,927,221	69,434,739
Loss allowance	(40,908)	(15,177)	(56,085)
	67,466,610	**1,912,044**	**69,378,654**

	2020		
	Stage 1 12-month ECL	Stage 2 Lifetime ECL €	Total €
Financial investments measured at FVOCI			
Gross carrying amount – fair value	23,581,825	-	23,581,825
Financial investments measured at amortised cost:			
Gross carrying amount	20,196,831	-	20,196,831
Loss allowance	(12,448)	-	(12,448)
	20,184,383	-	20,184,383

As at 31 December 2021, the expected credit loss allowances in respect of financial investments measured at FVOCI classified as Stage 1 amounted to €2,155 (2020: €14,535).

2. Financial risk management - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.5 Information on credit quality of loans and advances to customers

The following table presents the distribution, by stage, of the gross carrying amount of loans and advances to customers to which the impairment requirements in IFRS 9 are applied, and the associated ECL as at 31 December 2021 and as at 31 December 2020. Explanation of the terms 12-month ECL, lifetime ECL and credit-impaired are included in Note 2.1.1.1.

	2021		
	Stage 1 12-month	**Stage 2 Lifetime ECL**	**Total**
	€	**€**	**€**
Gross carrying amount	134,511,323	3,591,895	138,103,218
Loss allowance	(256,640)	(93,067)	(349,707)
	134,254,683	**3,498,828**	**137,753,511**

	2020		
	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Total
	€	€	€
Gross carrying amount	41,587,062	2,569,625	44,156,687
Loss allowance	(203,980)	(34,272)	(238,252)
	41,383,082	2,535,353	43,918,435

The Bank assesses and individually rates those borrowers that requested moratoria or emergency funding to support their short-term liquidity constraints which are deemed mostly impacted by the pandemic. These exposures are assessed periodically for SICR and UTP events through individual credit risk assessments, on the basis of recently obtained management information, including forecasts. Exposures in respect of which SICR has been observed are attributed higher ECL, requiring closer and more frequent monitoring on a monthly or quarterly basis (depending on the extent of credit risk deterioration) to facilitate timely identification of further deterioration in financial condition.

As referred to earlier, during 2021, more information became available in respect of the impact of COVID-19 on specific borrowers and industry sectors, both in terms of actual financial performance and revised forecasts reflecting more accurate impacts of the pandemic when compared to prior year estimates. Credit risk assessments in respect of individually significant loans were updated during the financial year ended 31 December 2021 based on updated financial information, enabling management to better identify SICR or UTP events. These have resulted in further migrations from stage 1 to stage 2.

As at 31 December 2021, two of the Bank's loans and advances to customers were past due by less than 30 days. The gross carrying amount of these loans amounted to €2,241,000 (2020: nil).

2. Financial risk management - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.5 Information on credit quality of loans and advances to customers - continued

At the 31 December 2021 and 2020, none of the Bank's loans and advances to customers were credit-impaired.

2.1.1.6 Modification of financial assets

The contractual terms of a loan may be revised for a number of reasons, including changes in market conditions, customer retention and other factors that are not related to the credit quality of a customer. Forbearance measures comprise concessions made on the contractual terms of a loan in response to a customer's financial difficulties.

During the year, total loans with an aggregate gross carrying amount of €979,000 (2020: nil) were subject to forbearance measures, which were classified as Stage 2 as at 31 December 2021. The total ECL in respect of these loans amounted to €35,000 as at 31 December 2021. The Bank's forborne loans operate within the 'Construction and real estate' industry. These represent 0.7% of total gross loans and advances to customers. The total interest income recognised in 2021 in respect of forborne loans amounted to €131,634.

In April 2020, the Central Bank of Malta issued Directive 18, 'On Moratoria on Credit Facilities in Exceptional Circumstances ('Directive No. 18') in order to provide guidance on the treatment of moratoria in the current environment, in line with European Banking Authority ('EBA') Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis (the 'EBA Guidelines'). These are referred to as general payment moratoria. This treatment was extended to 31 March 2021. Exposures subject to general payment moratoria are not considered forborne loans, unless the borrower was already experiencing financial difficulties prior to the pandemic. As a consequence of the protracted impact of the Covid-19 pandemic, on 14 January 2021 the Central Bank of Malta reactivated Directive 18 by reopening the application period for moratoria until 31 March 2021. Under the amendments introduced during 2021, first time applicants were eligible for moratoria of maximum duration of up to nine months from the application date, whereas existing moratoria were allowed to be extended for a further six months as long as the total moratorium period would not exceed nine months.

During 2020, the Bank granted moratoria to 7 obligors on loans and advances amounting to €4,940,595, all of which moratoria met the criteria for a general payment moratorium as established within Directive No. 18 and the EBA guidelines.

During 2021, the Bank did not grant general payment moratoria on loans and advances to customers which met the criteria as established within Directive No. 18 and the EBA guidelines. Albeit, during 2021, extensions to general payment moratoria granted in 2020 were granted to 1 obligor with a gross exposure of €978,879, which extension met the criteria established within Directive No. 18 and the EBA guidelines.

The regulatory relief measure afforded to exposures benefiting from a general payment moratorium does not automatically lead to a Stage 1 classification, nor does the granting of the general payment moratorium automatically trigger the assumption that credit deterioration has occurred, requiring a downgrade in classification to Stage 2.

2. Financial risk management - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.6 Modification of financial assets - continued

As a result, the Bank performed an assessment in respect of such exposures in order to determine whether the effects of the pandemic may transform into long-term financial difficulties for such borrowers, thereby potentially requiring a downgrade to Stage 2 or Stage 3 to reflect the level of credit risk as appropriate. This assessment was performed at borrower level.

As at 31 December 2021, there were no loans and advances to customers subject to general payment moratoria given that in terms of the directive application for such moratoria ended on 31 March 2021 and could only be granted for a maximum period of 9 months (2020: €1.3 million). The total allowance for ECL in respect of loans and advances subject to general payment moratoria amounted to €35,386, the large majority of which is attributable to Stage 2 exposures.

During 2020, the Bank also confirmed its participation in the Malta Development Bank COVID-19 Guarantee Scheme, whereby the risk of newly originated loans under the scheme to viable businesses experiencing liquidity pressures resulting from the effects of the pandemic are mitigated by a government guarantee.

In this respect, as at 31 December 2021, gross loans subject to the Malta Development Bank COVID-19 Guarantee Scheme amounted to €19.14 million (2020: €10.50 million), of which a maximum amount of €9.55 (2020: €5.25 million) is considered guaranteed by the Government of Malta. As at 31 December 2021 and 2020, loans subject to the Malta Development Bank COVID-19 Guarantee Scheme were all classified as Stage 1 and the total ECL allowance in respect of these loans stood at €72,487 (2020: €56,000).

2.1.1.7 Loss allowances

Reconciliation of the gross carrying amount analysed by 12-month and lifetime ECL provisions

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

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

2. Financial risk management - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.7 Loss allowances - continued

The following table explains the changes in the gross carrying amount and loss allowances in respect of loans and advances to customers between the beginning and the end of the annual period. The increase in ECL during the year is primarily attributable to the growth in the loan book.

	2021					
	Stage 1		Stage 2		Total	
	Gross carrying amount €000	Expected credit losses €000	Gross carrying amount €000	Expected credit losses €000	Gross carrying amount €000	Expected credit losses €000
Loans and advances to customers at amortised cost						
At 1 January 2021	41,587	(204)	2,570	(34)	44,157	(238)
New and further lending	96,111	(227)	-	-	96,111	(227)
Repayments	(1,998)	81	(167)	7	(2,165)	88
Transfers of financial instruments						
Stage 1 to Stage 2	(1,189)	52	1,189	(52)	-	-
Net remeasurement of ECL arising from stage transfers and changes in risk parameters	-	41	-	(14)	-	27
At 31 December 2021	**134,511**	**(257)**	**3,592**	**(93)**	**138,103**	**(350)**
Total net income statement charge for the year						**111**

2. Financial risk management - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.7 Loss allowances – continued

	2020					
	Stage 1		Stage 2		Total	
	Gross carrying amount €000	Expected credit losses €000	Gross carrying amount €000	Expected credit losses €000	Gross carrying amount €000	Expected credit losses €000
Loans and advances to customers at amortised cost						
At 1 January 2020	17,653	(88)	-	-	17,653	(88)
New and further lending	27,577	(114)	-	-	27,577	(114)
Repayments	(1,073)	19	-	-	(1,073)	19
Transfers of financial instruments						
Stage 1 to Stage 2	(2,570)	11	2,570	(11)	-	-
Net remeasurement of ECL arising from stage transfers and changes in risk parameters		(32)		(23)		(55)
At 31 December 2020	**41,587**	**(204)**	**2,570**	**(34)**	**44,157**	**(238)**
Total net income statement charge for the year						**150**

	2021					
	Stage 1		Stage 2		Total	
	Gross carrying amount €000	Expected credit losses €000	Gross carrying amount €000	Expected credit losses €000	Gross carrying amount €000	Expected credit losses €000
Loans and advances to customers at amortised cost and undrawn commitments to lend						
At 1 January 2021	62,247	(204)	2,570	(34)	64,817	(238)
New and further lending	140,054	(227)	-	-	140,054	(227)
Repayments	(4,540)	81	(167)	7	(4,707)	88
Transfers of financial instruments						
Stage 1 to Stage 2	(1,189)	52	1,189	(52)	-	-
Net remeasurement of ECL arising from stage transfers and changes in risk parameters	-	41	-	(14)	-	27
At 31 December 2021	**196,572**	**(257)**	**3,592**	**(93)**	**200,164**	**(350)**
Total net income statement charge for the year						**111**

2. Financial risk management - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.7 Loss allowances – continued

	2020					
	Stage 1		Stage 2		Total	
	Gross carrying amount €000	Expected credit losses €000	Gross carrying amount €000	Expected credit losses €000	Gross carrying amount €000	Expected credit losses €000
Loans and advances to customers at amortised cost and undrawn commitments to lend						
At 1 January 2021	31,067	(88)	-	-	31,067	(88)
New and further lending	34,823	(114)	-	-	34,823	(114)
Repayments	(1,073)	19	-	-	(1,073)	19
Transfers of financial instruments						
Stage 1 to Stage 2	(2,570)	11	2,570	(11)	-	-
Net remeasurement of ECL arising from stage transfers and changes in risk parameters		(32)		(23)	-	(55)
At 31 December 2021	**62,247**	**(204)**	**2,570**	**(34)**	**64,817**	**(238)**
Total net income statement charge for the year						**150**

Changes in loss allowances on balances with Central Bank of Malta, loans and advances to banks and debt instruments arising during the year were not significant.

2.1.1.8 Collateral

The amount and type of collateral required depends on the amount of the exposure, the type of facility provided, the term of the facility and the level of credit risk involved. The main types of collateral obtained include charges over real estate properties, mortgages over residential properties and cash.

Management assesses the market value of collateral as part of the loan origination process. This assessment is reviewed periodically through ongoing credit file reviews, and in the case of real estate financing, upon the completion of agreed upon stages. The Bank requests additional collateral in accordance with the underlying agreement when necessary.

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

Loans granted as part of the Malta Development Bank COVID-19 Guarantee Scheme (Note 2.1.1.6) are secured by a Government guarantee which guarantees up to 90% of each individual exposure, subject to a 50% portfolio capping. These guarantees are included within 'Other collateral' in the tables below.

2. Financial risk management - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.8 Collateral - continued

The 'extendible value' of the collateral is the lower of the fair value of a pledged asset for lending purposes and the gross carrying amount of the secured loans. Since, in the table below, collateral is capped at the gross carrying amount, the 'residual exposure' represents the unsecured portion of the Bank's loans and advances to customers.

The following is an analysis of the extendible value of the collateral and other credit enhancements held by the Bank against exposures of loans and advances to customers.

	2021 €000
Performing – Stage 1	
Total maximum exposure	**134,512**
Extendible value of collateral	
Secured by cash	994
Residential and commercial property	100,989
Other collateral	4,500
Total extendible value of collateral	106,483
Residual exposure	28,029
Loss allowance	**(257)**
Underperforming – Stage 2	
Total maximum exposure	**3,591**
Extendible value of collateral	
Commercial immovable property	2,992
Total extendible value of collateral	2,992
Residual exposure	599
Loss allowance	**(93)**

2. **Financial risk management** - continued

2.1 Financial risk factors - continued

2.1.1 Credit risk – continued

2.1.1.8 Collateral - continued

	2020
	€000
Performing – Stage 1	
Total maximum exposure	**41,587**
Extendible value of collateral	
Secured by cash	528
Residential and commercial property	23,786
Other collateral	13,523
Total extendible value of collateral	37,837
Residual exposure	3,750
Loss allowance	**(204)**
Underperforming – Stage 2	
Total maximum exposure	**2,570**
Extendible value of collateral	
Commercial immovable property	2,570
Total extendible value of collateral	2,570
Residual exposure	-
Loss allowance	**(34)**

As at 31 December 2021, loans with a value of €126,453,511 (2020:15,802,802) were fully collateralised and a loan with a value of €11,300,000 (2020:1,850,000) was uncollateralised.

2. Financial risk management - continued

2.1 Financial risk factors - continued

2.1.2 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.

The Bank is primarily exposed to foreign exchange risk and interest rate risk.

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 manages its currency risk on an ongoing basis by ensuring that foreign currency liabilities are utilised to fund assets denominated in the same foreign currency thereby matching asset and liability positions as much as is practicable. When it is not possible to match the asset and liability currency positions, the Bank hedges its open foreign exchange exposures by entering into forward foreign exchange contracts or currency swaps.

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

	EUR currency €	CZK currency €	GBP currency €	Total €
As at 31 December 2021				
Financial assets				
Balances with Central Bank of Malta	5,122,958	-	-	5,122,958
Loans and advances to banks	2,591,132	369,851	401,424	3,362,407
Loans and advances to customers	110,505,223	27,597,995	-	138,103,218
Financial investments	50,717,907	33,885,858	307,807	84,911,572
Accrued interest receivable	386,077	213,311	828	600,216
	169,323,297	**62,067,015**	**710,059**	**232,100,371**
Financial liabilities				
Amounts owed to customers	139,908,255	884,659	656,487	141,449,401
Amounts owed to banks and other institutions	20,650,190	31,983,449	-	52,633,639
Accrued interest payable	227,544	52,661	5,541	285,746
	160,785,989	**32,920,769**	**662,028**	**194,368,786**
Net on-balance sheet financial position		**29,146,246**	**48,031**	
Notional of derivative financial instruments		**(28,858,298)**	**-**	
Residual exposure		**287,948**	**48,031**	

2. Financial risk management - continued

2.1 Financial risk factors - continued

2.1.2 Market risk - continued

	EUR currency €	CZK currency €	GBP currency €	Total €
As at 31 December 2020				
Financial assets				
Balances with Central Bank of Malta	19,380,850	-	-	19,380,850
Loans and advances to banks	1,465,413	522,650	1,118,435	3,106,498
Loans and advances to customers	43,644,509	512,178	-	44,156,687
Financial investments	36,853,825	6,655,794	269,037	43,778,656
Accrued interest receivable	105,651	9,390	-	115,041
	101,450,248	7,700,012	1,387,472	110,537,732
Financial liabilities				
Amounts owed to customers	140,021,608	-	1,427,794	141,449,401
Amounts owed to institutions	10,000,000	-	-	10,000,000
Accrued interest payable	267,598	-	10,470	278,068
	150,289,205	-	1,438,264	151,727,469
Net on-balance sheet financial position		7,700,012	(50,792)	
Notional of derivative financial instruments		(6,348,904)	-	
Residual exposure		1,351,108	(50,792)	

Accordingly, as at 31 December 2021, under the scenario that the euro appreciates by 20% against all currencies, the effect would be a loss of €67,000 (2020: loss €280,000) in the carrying amount of the financial instruments. Should the euro depreciate against all currencies by 20%, the effect would be a gain of €67,000 (2020: gain €280,000) in the carrying amount of the financial instruments. The impact would be recognised in profit or loss.

2. Financial risk management - continued

2.1 Financial risk factors – continued

2.1.2 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 principally managed through monitoring, on a continuous basis, the level of mismatch of interest rate repricing, taking cognisance of the terms of the Bank's principal assets, loans and advances to customers, of which the majority are repriceable at the Bank's discretion and by hedging any undesired unmatched interest rate risk arising in the balance sheet by entering into interest rate swap with a related party bank. The Bank also invests in highly liquid quality assets, namely listed government and corporate debt securities, for the purpose of mitigating exposures to fluctuations in interest rates.

The following tables summarise the Bank's exposures to interest rate risk. These analyse the Bank's interest-bearing financial instruments at their gross carrying amounts or fair value, categorised by the earlier of contractual repricing or maturity dates.

	Less than three months	Within one year but over three months	Within five years but over one year	More than five years	Gross carrying amount/ Fair value
	€	€	€	€	€
As at 31 December 2021					
Financial assets					
Balances with Central Bank of Malta	5,122,958	-	-	-	5,122,958
Loans and advances to banks	3,362,407	-	-	-	3,362,407
Loans and advances to customers	98,342,614	12,588,740	27,171,864	-	138,103,218
Financial investments	27,186,174	-	21,636,755	36,088,643	84,911,572
Derivative financial instruments	-	2,171,859	-	-	2,171,859
	134,014,153	**14,760,599**	**48,808,618**	**36,088,643**	**233,672,014**
Financial liabilities					
Amounts owed to customers	89,695,522	50,433,304	1,320,575	-	141,449,401
Amounts owed to banks and other institutions	20,400,000	32,233,639	-	-	52,633,639
	110,095,522	**82,666,943**	**1,320,575**	**-**	**194,083,040**
Interest repricing gap	**23,918,631**	**(67,906,344)**	**47,488,044**	**36,088,643**	
Impact of interest rate derivatives	**(10,000,000)**	**-**	**-**	**10,000,000**	
Net interest rate repricing gap	**13,918,631**	**(67,906,344)**	**47,488,044**	**46,088,643**	

2. Financial risk management - continued

2.1 Financial risk factors – continued

2.1.2 Market risk - continued

	Less than three months €	Within one year but over three months €	Within five years but over one year €	More than five years €	Gross carrying amount/ Fair value €
As at 31 December 2020					
Financial assets					
Balances with Central Bank of Malta	19,380,332	-	-	-	19,380,332
Loans and advances to banks	3,106,498	-	-	-	3,106,498
Loans and advances to customers	37,152,151	3,250,000	3,754,536	-	44,156,687
Financial investments	2,202,164	-	12,263,655	29,312,837	43,778,656
Derivative financial instruments	-	756,057	-	-	756,057
	61,841,145	**4,006,057**	**16,018,191**	**29,312,837**	**111,178,230**
Financial liabilities					
Amounts owed to customers	63,238,139	16,424,523	3,884,114	-	83,546,776
Amounts owed to institutions	10,000,000	-	-	-	10,000,000
	73,238,139	**16,424,523**	**3,884,114**	**-**	**93,546,776**
Interest repricing gap	**(11,396,994)**	**(12,418,466)**	**12,134,077**	**29,312,837**	
Cumulative gap	**(11,396,994)**	**(23,815,460)**	**(11,681,383)**	**17,631,454**	

The table below analyses interest-bearing assets and liabilities at their gross carrying amounts or fair value, into those that have a fixed rate and a variable rate.

	2021 Variable €	Fixed €	2020 Variable €	Fixed €
Financial assets				
Balances with Central Bank of Malta	5,122,958	-	19,380,332	-
Loans and advances to banks	3,362,407	-	3,106,498	-
Loans and advances to customers	98,582,301	39,520,917	37,152,151	7,004,536
Financial investments	22,416,695	62,494,877	2,202,164	41,576,492
Derivative financial instruments	-	2,171,859	-	756,057
	129,484,361	**104,187,653**	61,841,145	49,337,085
Financial liabilities				
Amounts owed to customers	22,046,959	119,402,442	9,273,702	74,273,074
Amounts owed to banks and other institutions	20,400,000	32,233,639	10,000,000	-
	42,446,959	**151,636,081**	19,273,702	74,273,074
Exposure	**87,037,402**	**(47,448,428)**	42,567,443	(24,935,989)
Impact of interest rate derivatives	**(10,000,000)**	**10,000,000**	-	-
Net exposure	**77,037,402**	**(37,448,428)**	42,567,443	(24,935,989)

2. Financial risk management - continued

2.1 Financial risk factors – continued

2.1.2 Market risk - continued

Fair value sensitivity for fixed rate instruments

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 institutions and customers are measured at amortised cost and are therefore not subject to fair value interest rate risk.

As at 31 December 2021, the Bank's instruments that are fair valued and which are subject to fair value interest rate risk comprise the Bank's investments in debt securities measured at FVOCI. These investments are subject to fixed interest rates. The estimated impact of an immediate 100 basis point increase in yields as at 31 December 2021 amounts to a loss of €272,948 (2020: loss of €1,419,000).

Cash flow sensitivity for variable rate instruments

The Bank is also exposed to cash flow interest rate risk principally in respect of financial assets and liabilities which are subject to floating interest rates.

Taking cognisance of the nature of the Bank's financial assets and liabilities as described above, under the requirements of IFRS 7, a sensitivity analysis in respect of interest rate changes is required in relation to the Bank's net floating rate assets.

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 €501,000 (2020: increase of €277,000). Taking cognisance of the current low interest rate environment, the Bank does not expect interest rates 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.

2.1.3 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 stage 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 maintains 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, from contractual commitments arising on loans and advances to customers, and other cash outflows. 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.

2. **Financial risk management** - continued

2.1 Financial risk factors – continued

2.1.3 Liquidity risk - continued

The Bank uses 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.

(i) Liquidity Coverage Ratio

The LCR metric is designed to promote the short-term resilience of a bank's liquidity profile, and became a minimum regulatory standard from 1 October 2015, under European Commission ('EC') Delegated Regulation 2015/61. It aims to ensure that a bank has sufficient unencumbered high-quality liquid assets ('HQLA') to meet its liquidity needs in a 30-calendar-day liquidity stress scenario. HQLA consist of cash or assets that can be converted into cash at little or no loss of value in markets.

The LCR as at 31 December 2021 was 963% (2020: 718%).

During the years ended 31 December 2021 and 2020 the LCR was above the regulatory minimum requirement.

(ii) Net stable funding ratio

The NSFR requires institutions to maintain sufficient stable funding relative to required stable funding, and reflects a bank's long-term funding profile (funding with a term of more than a year). It is designed to complement the LCR.

During 2020, the Bank calculated the NSFR in line with Basel Committee on Banking Supervision publication 295. During 2021, the NSFR methodology was updated in line with the amendments of the Capital Requirements Regulation (EU) No 575/2013 (CRR II) with effect from 28 June 2021.

The NSFR ratio as at 31 December 2021 was 114% (2020: 145%).

During the years ended 31 December 2021 and 2020 the NSFR was above the regulatory minimum requirement.

2. Financial risk management - continued

2.1 Financial risk factors – continued

2.1.3 Liquidity risk - continued

The following table discloses the gross carrying amount or fair value of financial assets and liabilities at the end of the reporting period by the remaining period to maturity.

	On demand or less than three months €	Within one year but over three months €	Within five years but over one year €	More than five years €	No maturity €	Gross carrying amount/ Fair value €
As at 31 December 2021						
Financial assets						
Balances with Central Bank of Malta	3,521,164	-	-	-	1,601,794	5,122,958
Loans and advances to banks	3,362,407	-	-	-	-	3,362,407
Loans and advances to customers	1,641,763	16,504,082	65,151,992	54,805,381	-	138,103,218
Financial investments	4,769,479	-	40,717,720	39,424,373	-	84,911,572
Derivative financial instruments	-	2,171,859	-	-	-	2,171,859
Other assets	2,570,984	-	-	-	-	2,570,984
	15,865,797	**18,675,941**	**105,869,712**	**94,229,754**	**1,601,794**	**236,242,998**
Financial liabilities						
Amounts owed to customers	89,695,522	50,433,304	1,320,575	-	-	141,449,401
Amounts owed to institutions	-	52,633,639	-	-	-	52,633,639
Other liabilities	451,816	-	-	-	-	451,816
	90,147,338	103,066,943	1,320,575	-	-	194,534,856
Maturity gap	**(74,281,541)**	**(84,391,002)**	**104,549,137**	**94,229,754**		
Cumulative gap	**(74,281,541)**	**(158,672,543)**	**(54,123,406)**	**40,106,348**		

As of 31 December 2021, unencumbered financial investments measured at FVOCI with a carrying amount of €6 million (2020: €8 million) and financial investments measured at amortised cost with a carrying amount of €26 million (2020: €23 million) form part of the Bank's high-quality liquid assets portfolio for LCR purposes and may accordingly be liquidated within one month.

2. Financial risk management - continued

2.1 Financial risk factors – continued

2.1.3 Liquidity risk - continued

Meanwhile, amounts owed to customers amounting to €89,695,522 (2020: €63,238,139), that are repayable on call and at short notice are disclosed within the 'On demand or less than three months' maturity bucket. However, this does not reflect their behaviour in practice, which shows that these deposits are maintained with the Bank for longer periods than three months.

Balances held with Central Bank of Malta include reserve deposits relating to the Minimum Reserve Requirement and balances pledged in favour of the Depositor Compensation Scheme amounting to €1,070,748 (2020: €255,956) and €531,046 (2020: €228,608) respectively which have no maturity.

	On demand or less than three months €	Within one year but over three months €	Within five years but over one year €	More than five years €	No maturity €	Gross carrying amount/ Fair value €
As at 31 December 2020						
Financial assets						
Balances with Central Bank of Malta	18,895,768	-	-	-	484,564	19,380,332
Loans and advances to banks	3,106,498	-	-	-	-	3,106,498
Loans and advances to customers	661,574	3,653,337	12,883,347	26,958,429	-	44,156,687
Financial investments	-	-	14,465,818	29,312,838	-	43,778,656
Derivative financial instruments	-	756,057	-	-	-	756,057
Other assets	2,311,802	-	-	-	-	2,311,802
	24,975,642	**4,409,394**	**27,349,165**	**56,271,267**	**484,564**	**113,490,032**
Financial liabilities						
Amounts owed to customers	63,238,139	16,424,523	3,884,114	-	-	83,546,776
Amounts owed to institutions	-	10,000,000	-	-	-	10,000,000
Other liabilities	477,675	-	-	-	-	477,675
	63,715,814	**26,424,523**	**3,884,114**	**-**	**-**	**94,024,451**
Maturity gap	**(38,740,172)**	**(22,015,129)**	**23,465,051**	**56,271,267**		
Cumulative gap	**(38,740,172)**	**(60,755,301)**	**(37,290,250)**	**18,981,017**		

2. Financial risk management - continued

2.1 Financial risk factors – continued

2.1.3 Liquidity risk - continued

The following table analyses the Bank's principal undiscounted cash flows payable under non-derivative financial liabilities into relevant maturity groupings based on the remaining period at the end of the reporting period to the contractual maturity date.

	On demand or less than three months €	Within one year but over three months €	Within five years but over one year €	More than five years €	Total €
As at 31 December 2021					
Financial liabilities					
Amounts owed to customers	89,716,194	50,460,202	1,332,991	-	141,509,387
Amounts owed to institutions	133,768	52,650,927	104,600	-	52,889,295
Other liabilities	451,816	-	-	-	451,816
	90,301,778	**103,111,129**	**1,437,591**	**-**	**194,850,498**
As at 31 December 2020					
Financial liabilities					
Amounts owed to customers	63,268,845	16,478,808	3,906,696	-	83,654,349
Amounts owed to institutions	-	10,025,000	-	-	10,025,000
Other liabilities	477,675	-	-	-	477,675
	63,746,520	26,503,808	3,906,696	-	94,157,024

As at 31 December 2021, the contractual undiscounted cash inflows and outflows attributable to the Bank's derivative transactions, which are all due within one to five years, amounted to €41,114,713 and €38,893,639 (2020: €6,932,665 and €6,335,601) respectively, and which resulted in a net inflow of €2,221,074 (2020: €597,064).

2.2 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.

2. Financial risk management - continued

2.1 Financial risk factors – continued

2.2 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.

2.3 Capital risk management

The Bank's objectives when managing capital, which is a broader concept than '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 subject to maintain a ratio of total regulatory capital to risk-weighted assets ('Capital adequacy ratio') of 15.5% which constitutes the following: (a) a minimum own funds requirement of 8% (6% of which needs to be composed of T1 capital), (b) an additional P2R of 4% (c) combined buffer requirements of 2.5%, and (d) a P2G of 1% which is entirely made up of CET1 capital. The Bank has processes to ensure that the minimum regulatory requirements in relation to own funds are met at all times.

During the financial years ended 31 December 2021 and 31 December 2020, the Bank has met all external capital requirements at all times.

2. Financial risk management - continued

2.3 Capital risk management - continued

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.

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

	2021	2020
	€	€
Common Equity Tier 1 (CET1) capital		
Share capital	**28,750,000**	20,250,000
Retained earnings	**2,338,850**	479,302
Fair value reserve	**36,286**	275,402
Less:		
Intangible assets	**(1,309,073)**	(190,285)
Deferred tax assets that rely on future profitability	**(325,327)**	(1,538,249)
Depositor compensation scheme	**(531,046)**	(228,608)
Other transitional adjustments	**131,730**	131,730
Common Equity Tier 1 (CET1) capital	**29,091,420**	19,179,292
Additional Tier 1 (AT1) capital	**15,500,000**	-
Tier 1 capital – Total own funds	**44,591,420**	19,179,292

2. Financial risk management - continued

2.4 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.

The following table analysis financial instruments recorded at fair value by level of the fair value hierarchy:

	Level 1	**Level 2**	**Total**
	€	**€**	**€**
At 31 December 2021			
Financial assets			
Financial investments measured at FVOCI			
Debt securities	15,476,833	-	15,476,833
Derivative financial instruments	-	2,171,859	2,171,859
Total financial assets	**15,476,833**	**2,171,859**	**17,648,692**
Financial liabilities			
Derivative financial instruments	-	11,793	11,793
Total financial liabilities	**-**	**11,793**	**11,793**
At 31 December 2020			
Financial assets			
Financial investments measured at FVOCI			
Debt securities	23,581,825	-	23,581,825
Derivative financial instruments	-	756,057	756,057
Total financial assets	23,581,825	756,057	24,337,882

As at 31 December 2021 and 2020 the Bank's financial investments measured at FVOCI were all deemed to be categorised as Level 1 assets. 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.

2. Financial risk management - continued

2.4 Fair value of financial instruments – continued

Level 2 instruments comprise derivatives held for risk management that are fair valued based on valuation models with the key methodology utilised comprising the calculation of the net present value of a series of expected cash flows, taking into account the different terms of each specific contract/instrument (discounted cash flow approach). These models use as their basis independently sourced market parameters including, for example, interest rate yield curves. Market parameters are either directly observable or are implied from observable instrument prices.

Financial instruments not measured at fair value

As at 31 December 2021, financial investments measured at amortised cost carried in the statement of financial position at €69,378,654 (2020: €20,184,383) have a fair value of €66,636,341 (2020: €19,982,940). The fair value of such instruments reflects the closing bid price quoted in an active market.

Loans and advances to banks and customers and amounts owed to banks, other institutions and customers are carried at amortised cost in the statement of financial position. The directors consider the carrying amounts of loans and advances to banks and customers 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.

3. Critical accounting estimates, and judgments in applying accounting policies

Critical accounting estimates and judgements in applying the Bank's accounting policies

Estimates and judgements are continually evaluated and based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances.

The Bank makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. These estimates and assumptions present a risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. The Bank's management also makes judgements, apart from those involving estimations, in the process of applying the entity's accounting policies that may have a significant effect on the amounts recognised in the financial statements.

In the opinion of the directors, other than for estimates relating to expected credit losses in respect of the Bank's loans and advances to customers, 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.

Accordingly, the directors believe there are no areas involving a higher degree of judgement that would have a significant effect on the amounts recognised in the financial statements, and there are no key assumptions and other key sources of estimation uncertainty relating to estimates that require subjective or complex judgments, other than for estimates relating to expected credit losses in respect of the Bank's loans and advances to customers.

The measurement of the expected credit loss allowance for loans and advances to customers is an area that requires the use of complex models and significant assumptions about future economic conditions and credit behaviour. In this respect, a number of significant judgements are made by management. These include (i) determining whether a SICR or UTP event has occurred; (ii) choosing appropriate assumptions at borrower level for the measurement of ECLs; and (iii) determining appropriate forward-looking macroeconomic variables under different scenarios and prescribing an associated probability weighting for each scenario.

3. Critical accounting estimates, and judgments in applying accounting policies - continued

The level of expert judgement required is currently exacerbated by the heightened level of estimation uncertainty around predictions in respect of forward looking scenarios, particularly in the aftermath of the COVID-19 pandemic and, as a result on forward-looking PDs and LGDs used within the Bank's ECL model.

In view of the level of estimation uncertainty involved, the directors considered the sensitivity of the ECL outcome to the macro-economic forecasts by recalculating the ECL under the different scenarios, applying a 100% weighting to each scenario, the effect of which is disclosed in Note 2.1.1.1.

4. Cash and balances with Central Bank of Malta

	2021	2020
	€	€
Cash in hand	**-**	518
Balances with Central Bank of Malta	**5,122,958**	19,380,332
Gross carrying amount	**5,122,958**	19,380,850
Less: Expected credit loss allowances on balances with Central Bank of Malta	**(2,554)**	(2,554)
Net carrying amount	**5,120,404**	19,378,296

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 €1,070,748 (2020: €255,956), which are subject to an interest rate of 0%. Other balances with the Central Bank of Malta are charged interest at the deposit facility rate set by the European Central Bank ('ECB'), which is set at a negative interest rate of 0.50% (2020: 0.50%).

Balances with Central Bank of Malta also include a balance of €531,046 (2020: €228,608) that has been 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

	2021	2020
	€	€
Repayable on call and at short notice	**3,362,407**	3,106,498
Less: Expected credit loss allowances	**(222)**	(222)
Net carrying amount	**3,362,185**	3,106,276

Loans and advances to bank as at 31 December 2021 include €500,984 (2020: €573,095) receivable from a related party as disclosed in Note 30.

Loans and advances to banks repayable on call and at short notice are included in cash and cash equivalents for the purposes of the statement of cash flows (Note 29).

6. Loans and advances to customers

	2021 €	2020 €
Term loans and advances	**138,103,218**	44,156,687
Less: Expected credit loss allowances	**(349,707)**	(238,252)
Net carrying amount	**137,753,511**	43,918,435

Loans and advances to customers at 31 December 2021 include a credit exposure to the ultimate parent company amounting to a gross exposure of €9,200,000 (2020: €3,250,000), subject to an interest rate of 3.2% (2020: 3.2%) per annum, unsecured and due on 30 November 2022, and a credit exposure to a related party amounting to a gross exposure of €4,375,000 (2020: €4,375,000), subject to an interest rate of 4.79% (2020: 4.79%) per annum, secured and due on 19 December 2029.

7. Financial investments

The Bank's debt and other fixed income securities consist entirely of listed securities and are analysed as follows:

	2021 €	2020 €
Debt instruments measured at FVOCI issued by:		
Local government	**633,050**	733,977
Local entities	**1,167,556**	1,148,150
Foreign governments	**307,807**	269,037
Foreign entities	**13,368,420**	21,430,661
	15,476,833	23,581,825
Debt instruments measured at amortised cost issued by:		
Foreign governments	**4,256,088**	2,394,492
Foreign entities	**65,178,651**	17,802,339
Less: Expected credit loss allowances	**(56,085)**	(12,448)
	69,378,654	20,184,383
Total debt instruments	**84,855,487**	43,766,208

7. Financial investments - continued

The movement in the carrying amount of financial investments is summarised as follows:

	2021	2020
	€	€
Debt instruments measured at FVOCI		
At 1 January	**23,581,825**	4,471,393
Additions	**5,531,560**	21,727,972
Disposals	**(13,954,014)**	(3,026,558)
Amortisation of premium/discount	**556,578**	213,527
Changes in fair value	**(239,116)**	195,491
At 31 December	**15,476,833**	23,581,825
Debt instruments measured at amortised cost		
At 1 January	**20,184,383**	-
Additions	**47,945,977**	**20,114,687**
Amortisation of premium/discount	**1,291,931**	**82,144**
Movement in credit loss allowances	**(43,637)**	**(12,448)**
At 31 December	**69,378,654**	**20,184,383**

As at 31 December 2021, the expected credit loss allowances in respect of financial investments measured at FVOCI amounted to €2,155 (2020: €14,535).

Investment securities with a nominal value of €22.9 million (2020: €12.3 million) and carrying amount of €20.7 million (2020: €11.9 million) have been pledged in favour of the Central Bank of Malta for the purpose of accessing the European Central Bank's open market operations and against which the Bank has drawn €20.4 million (2020: €10.0 million).

In addition, investment securities with a nominal value of €31.7 million (2020: nil) and carrying amount of €32.3 million (2020: nil) have been pledged as financial collateral for amounts owed to a related party bank amounting to €32.2 million (2020: nil).

8. Derivative financial instruments

	2021	2020
	€	€
Derivative assets		
Cross currency interest rate swaps	**2,171,859**	756,057
Derivative liabilities		
Interest rate swap	**11,793**	-

During 2021, the Bank entered into cross currency interest rate swaps to hedge the foreign currency exposures arising out of loans and advances to customers whereby the Bank borrowed CZK 665,000,000 (2020: CZK 200,000,000) from a related party bank in exchange for EUR, at an average contractual rate of 23.1153 (2020: 24.1079) maturing within one year from the end of the reporting period. The contractual rates at which the swaps were entered into factor in collateral pledged in favour of the related party bank at the rate of 10% and accordingly represents a multiplier of 1.1 to the average market exchange rate of 25.4268 (2020: 26.7866). The CZK borrowing was collateralised in this manner in view of the higher counterparty credit risk that the Bank is deemed to have as compared to the related party bank.

8. Derivative financial instruments - continued

During 2021, the Bank also entered into an interest rate swap whereby the Bank borrowed €10,000,000 from a related party bank subject to floating interest rates set and payable every six months. This loan is unsecured and due on 30 March 2026. The Bank in turn funded €10,000,000 to the same related party subject to fixed interest rates of -0.107% per annum from 30 March 2021 to 30 June 2021, at -0.007% per annum from 30 June 2021 to 30 September 2021 and at 0.0043% per annum from 30 September 2021 to 30 March 2026.

The Bank uses interest rate swaps to hedge its exposure to changes in the fair values of specific fixed rate securities attributable to changes in market interest rates. Interest rate swaps are matched to fixed rate securities in designated fair value hedging transactions.

While these derivative transactions provide effective economic hedges, hedge accounting under the requirements of IFRS 9 has not been adopted in this respect. Accordingly, these derivative contracts held for risk management purposes have been classified as held-for-trading in these financial statements in accordance with the requirements of IFRS 9.

9. Property and equipment

	Motor vehicles €	Furniture & fittings €	Computer hardware €	Total €
At 1 January 2020				
Cost	-	129,403	91,137	220,540
Accumulated depreciation	-	(95,661)	(56,430)	(152,091)
Net book amount	-	33,742	34,707	68,449
Year ended 31 December 2020				
Opening net book amount	-	33,742	34,707	68,449
Additions	-	4,321	21,034	25,355
Depreciation charge	-	(8,186)	(22,071)	(30,257)
Closing net book amount	**-**	**29,877**	**33,670**	**63,547**
At 31 December 2020				
Cost	-	133,724	112,171	245,895
Accumulated depreciation	-	(103,847)	(78,501)	(182,348)
Net book amount	**-**	**29,877**	**33,670**	**63,547**
Year ended 31 December				
Opening net book amount	-	29,877	33,670	63,547
Additions	125,100	79,095	310,251	514,446
Depreciation charge	(15,476)	(9,881)	(34,257)	(59,614)
Closing net book amount	**109,624**	**99,091**	**309,664**	**518,379**
At 31 December 2021				
Cost	125,100	212,819	422,422	760,341
Accumulated depreciation	(15,476)	(113,728)	(112,758)	(241,962)
Net book amount	**109,624**	**99,091**	**309,664**	**518,379**

9. Property and equipment - continued

During 2021, the Bank purchased three motor vehicles for use of its employees amounting to €125,100.

10. Intangible assets

	Computer software €
At 1 January 2020	
Cost	655,019
Accumulated amortisation	(404,858)
Net book amount	250,161
Year ended 31 December 2020	
Opening net book amount	250,161
Additions	22,945
Amortisation charge	(82,821)
Closing net book amount	**190,285**
At 31 December 2020	
Cost	677,964
Accumulated amortisation	(487,679)
Net book amount	**190,285**
Year ended 31 December 2021	
Opening net book amount	190,285
Additions	1,209,336
Amortisation charge	(90,548)
Closing net book amount	**1,309,073**
At 31 December 2021	
Cost	1,887,300
Accumulated amortisation	(578,227)
Net book amount	**1,309,073**

During 2021, the Bank entered into agreements with a related party and third parties for the licensing and implementation of a new core banking system amounting to €1,134,623 which was still not put into use at year end. As at 31 December 2021, the Bank had capital commitments for an amount of €1,760,240 which had been contracted but not provided for in the financial statements (Note 19).

11. Deferred tax assets

The movements in deferred tax assets during the year were as follows:

	2021 €	2020 €
At beginning of year	**1,538,249**	1,243,284
Recognised in profit or loss		
- Unabsorbed tax losses	**1,599,997**	400,229
Recognised in other comprehensive income		
- Net changes in fair value arising during the year	**(105,365)**	(133,488)
- Reclassification adjustments: net amounts reclassified to profit or loss	**234,120**	28,224
At end of year	**3,267,001**	1,538,249

The year-end balance represents temporary differences attributable to:

	2021 €	2020 €
Assets		
Unabsorbed tax losses	**3,285,055**	1,685,058
Liabilities		
Fair valuation of financial investments measured at FVOCI	**(18,054)**	(146,809)
	3,267,001	1,538,249

The major part of 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 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 shareholder. The directors will continue to monitor the position on an ongoing basis.

As at 31 December 2020, the Bank had unabsorbed tax losses of €4,534,975 for which no deferred tax asset was recognised in the statement of financial position.

12. Prepayments and other assets

	2021	2020
	€	€
Amounts due from immediate parent company	**584,749**	572,199
Amounts due from ultimate parent company	**568,120**	996,920
Amounts due from group undertakings	**669,963**	282,072
Accrued interest income	**600,216**	115,041
Other assets	**147,936**	188,764
Prepayments	**242,902**	156,806
	2,813,886	2,311,802

Amounts due from immediate parent company, ultimate parent company and group undertakings are unsecured, non-interest bearing and repayable on demand. The directors deem that ECLs in respect of these balances are immaterial on the basis of their short-term nature and the low credit risk that the counterparties present.

13. Share capital

	2021		2020	
	No. of shares	**€**	No. of shares	€
Authorised				
Ordinary shares at €1 each	**50,000,000**	**50,000,000**	25,000,000	25,000,000
Issued and fully paid up				
Ordinary shares at €1 each	**28,750,000**	**28,750,000**	20,250,000	20,250,000

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 regards to the Bank's residual assets.

During 2021, the Bank, by virtue of a resolution dated and effective 22 July 2021, increased its authorised share capital by €25,000,000 divided into 25,000,000 ordinary shares of a nominal value of €1.00 each from €25,000,000 (divided into 25,000,000 ordinary shares of a nominal value of €1.00 each) to €50,000,000 (divided into 50,000,000 ordinary shares of a nominal value of €1.00 each).

During 2021, the Bank, by virtue of a resolution dated and effective 25 August 2021, increased further its issued share capital by €8,500,000 divided into 8,500,000 ordinary shares of a nominal value of €1.00 each from €20,250,000 (divided into 20,250,000 ordinary shares of a nominal value of €1.00 each) to €28,750,000 (divided into 28,750,000 ordinary shares of a nominal value of €1.00 each).

Shareholder's contribution

During 2020, by virtue of resolutions dated 29 May 2020, 28 September 2020 and 16 November 2020, the Bank accepted capital contributions from SAB Europe Holding Ltd amounting to €1 million, €5.1 million and €2.8 million respectively. These contributions are free from all claims, charges, liens, equities and encumbrances and are irrevocable and unconditional. These are considered to form part of the CET1 capital of the Bank. During 2020, the capital contribution reserve was set-off against accumulated losses.

14. Perpetual capital notes

During 2021, by virtue of resolutions dated 5 January 2021, 27 July 2021, 18 August 2021 and 6 December 2021, the Bank issued fixed rate perpetual capital notes amounting to €2 million, €8 million, €3.5 million and €2 million, respectively. These notes are subject to fixed interest rates of 3.78% per annum, which amounted to €126,358 during 2021.

All interest payments on perpetual capital notes are cancellable at the discretion of the Bank.

These capital instruments qualify as Additional Tier 1 instruments in accordance with the requirements of Articles 51 to 54 of the Regulation (EU) No. 575/2013 and are categorised as equity within the Bank's Statement of Financial Position under the requirements of IFRSs as adopted by the EU.

15. Fair value reserve

The fair value reserve reflects the effects of the fair value measurement of financial instruments classified as at fair value through other comprehensive income, net of deferred taxes. In respect of debt securities measured at FVOCI, any gains or losses are not recognised in profit or loss until the debt security has been disposed of.

16. Amounts owed to customers

	2021 €	2020 €
Term deposits	**66,702,013**	45,156,450
Repayable on call and at short notice	**74,747,388**	38,390,326
	141,449,401	83,546,776

17. Amounts owed to banks and other institutions

	2021 €	2020 €
Amounts owed to banks	**32,233,639**	-
Amounts owed to other institutions	**20,400,000**	10,000,000
	52,633,639	10,000,000

During the height of the COVID-19 pandemic in 2020, the Governing Council of the European Central Bank (ECB) decided to conduct a series of longer-term refinancing operations, called pandemic emergency longer-term refinancing operations ('PELTROs'). The Bank participated in such funding and as at 31 December 2021, the Bank had borrowed a total of €20.4 million (2020: €10.0 million) at an interest rate of 25 basis points below the average rate applied in the Eurosystem's main refinancing operations which mature within one year from the end of the reporting period.

As at 31 December 2021, amounts owed to banks relate to fixed short term deposits placed by the Bank and repurchase agreements entered into with a related party bank which are secured by a pledge over the Bank's investments (Note 7).

18. Other liabilities

	2021 €	2020 €
Accrued interest expense	**285,746**	278,068
Other accrued expenses	**133,253**	189,785
Other liabilities	**32,817**	9,822
	451,816	477,675

19. Commitments

	2021 €	2020 €
Undrawn credit facilities	**62,061,096**	20,660,364
Capital commitments	**1,760,240**	-
	63,821,336	20,660,364

As part of its business activities, the Bank enters into various contractual commitments to extend credit. Commitments generally have fixed expiry dates, or other termination clauses. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements. The potential credit loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers meeting specific conditions. At the end of the reporting period, total outstanding commitments represent undrawn credit facilities amounting to €62,061,096 (2020: €20,660,364).

As at 31 December 2021, an amount of €1,760,240 (2020: nil) had been contracted with a related party for future services to be received in relation to the implementation of the new core banking system.

20. Interest income

	2021 €	2020 €
Negative interest on amounts owed to other institutions	**16,530**	6,886
On derivative financial instruments	**46,681**	11,003
On financial investments measured at FVOCI	**272,948**	378,677
On financial investments measured at amortised cost	**1,597,922**	66,375
On loans and advances to customers	**3,086,383**	1,024,500
	5,020,464	1,487,441

21. Interest expense

	2021	2020
	€	€
Negative interest on balances with Central Bank of Malta	**62,976**	53,993
On derivative financial instruments	**215,912**	23,876
On amounts owed to customers	**975,817**	701,330
On amounts owed to banks	**220,420**	-
	1,475,125	779,199

Interest expense on derivative financial instruments and amounts owed to banks arise in respect of transactions with related parties as disclosed in Notes 8 and 17.

22. Fee income and expense

	2021	2020
	€	€
Fee income		
Credit related fees	**107,290**	43,810
Other fees	**6,646**	3,759
	113,936	47,569
Fee expense		
Credit related fees	**32,549**	-
Correspondent bank charges	**58,205**	57,561
Other fees	**15,048**	18,673
	105,802	76,234
Net fee income/(expense)	**8,134**	(28,665)

23. Other income

	2021	2020
	€	€
Other income	**12,762**	1,855,550

During 2020, the Bank entered into an option agreement which gave the Bank the right to buy the ordinary shares of a related party from a related party bank. In December 2020, the Bank assigned the right to its ultimate parent company (Note 30) for a fee of €1.86 million.

24. Net trading income

	2021	2020
	€	€
Net income from foreign exchange activities	**68,843**	77,302

25. Changes in expected credit losses

	2021	2020
	€	€
Changes in expected credit losses on:		
- Loans and advances to customers	**111,455**	150,000
- Balances with Central Bank of Malta	**-**	799
- Loans and advances to banks	**-**	(356)
- Financial investments measured at amortised cost	**43,637**	12,448
- Financial investments measured at FVOCI	**(12,380)**	11,779
	142,712	174,670

26. Employee compensation and benefits

	2021	2020
	€	€
Wages and salaries	**1,821,307**	1,142,554
Social security costs	**67,307**	55,534
	1,888,614	1,198,088

The average number of persons employed by the Bank throughout the financial years 2021 and 2020 was as follows:

	2021	2020
Managerial	**14**	6
Other	**35**	20
	49	26

27. Administrative expenses

	2021	2020
	€	€
IT support	**524,387**	503,649
Regulatory expenses	**414,599**	34,089
Short-term lease payments	**258,389**	143,821
Legal fees and professional fees	**108,962**	143,509
Depreciation of property and equipment (Note 9)	**59,614**	30,257
Amortisation of intangible assets (Note 10)	**90,548**	82,821
Directors' fees	**133,222**	139,741
Other administrative expenses	**297,037**	237,728
	1,886,758	1,315,615

Other administrative expenses mainly comprise of marketing costs, telecommunication costs, and other services or expense items that are incurred in the course of the Bank's operations.

The Bank has a lease agreement in place with a related party to lease property used as office space and car spaces. The lease contract is a perpetual contract made for fixed periods of 1 year such that it is automatically renewable annually but has a termination option. The termination option held is exercisable by both the Bank and by the respective lessor without permission from the other party by giving 6 months' notice in writing. The lease term is therefore deemed to be the earliest point in time at which both parties can exit the contract and the related contractual obligations, being 6 months.

During 2021, the Bank entered into lease agreements with third parties to lease apartments for its employees' use with terms of less than one year. Accordingly, these leases qualify and are accounted for as a short-term lease. The lease payments are recognised on a straight-line basis as an expense in profit or loss over the term of the lease.

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

	2021	2020
	€	€
Annual statutory audit	**59,000**	47,500
Other non-audit assurance services	**7,000**	6,200
Tax compliance and advisory services	**6,000**	8,000
Other non-audit services	**20,000**	40,000
	92,000	101,700

28. Tax income

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

	2021 €	2020 €
Profit before tax	**385,909**	4,696
Tax at the applicable rate of 35%	**135,068**	1,644
Tax effect of:		
Expenses not deductible for tax purposes	**109,833**	41,004
Utilisation of capital allowances in respect of which no deferred tax was recognised	**(244,901)**	(42,648)
Recognition of previously unrecognised deferred tax assets attributable to unabsorbed tax losses	**1,599,997**	400,229
	1,599,997	400,229

29. Cash and cash equivalents

Cash and cash equivalents comprise balances with contractual maturities of not more than three months for the purposes of the Statement of Cash Flows and which form an integral part of the Bank's cash management.

	2021 €	2020 €
Statement of Cash Flows		
Cash and balances with Central Bank of Malta	**4,052,210**	19,124,894
Loans and advances to banks	**3,362,407**	3,106,498
Cash and cash equivalents	**7,414,617**	22,231,392
Statement of Financial Position		
Cash and balances with Central Bank of Malta (excluding reserve deposit requirement)	**5,120,404**	19,378,296
Loans and advances to banks	**3,362,185**	3,106,276
Adjustments for:		
Balances with a contractual maturity of more than three months	**(1,070,748)**	(255,956)
Expected credit loss allowances	**2,776**	2,776
Cash and cash equivalents	**7,414,617**	22,231,392

30. Related parties

Identification of related parties

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 Suite 3, Tower Business Centre, Tower Street, Swatar, Malta, while the ultimate parent company of the Bank is SAB Financial Group a.s., headquartered in Czech Republic. The ultimate controlling party of the Bank is Mr Radomir Lapcik, being the sole shareholder of the SAB Financial Group a.s. All entities which are ultimately controlled or significantly influenced by SAB Financial Group a.s. or Mr Radomir Lapcik are considered to be related parties.

Key management personnel of the Bank, being the Bank's directors, who have the authority and responsibility for planning, directing and controlling the activities of the Bank, close family members of key management personnel and entities which are controlled or jointly controlled by key management personnel or their close family members are also considered to be related parties.

The following tables show the total amount of transactions entered into with related parties during the year and balances held with related parties as at the end of the financial year.

Transactions and balances with the Bank's immediate parent company

	2021	2020
	€	€
Assets		
Prepayments and other assets	**584,749**	572,199

Transactions with the Bank's immediate parent company in respect of issued share capital during 2021 are explained in Note 13.

Transactions and balances with the Bank's ultimate parent company

	2021	2020
	€	€
Assets		
Loans and advances to customers	**9,200,000**	3,250,000
Prepayments and other assets	**568,120**	996,920
Income statement		
Other income	**-**	1,855,550
Interest income	**122,415**	108,044

During 2020, the Bank entered into an option agreement which gave the Bank the right to buy the ordinary shares of a related party from a related party bank. In December 2020, the Bank assigned the right to its ultimate parent company for a fee of €1.86 million.

30. Related parties - continued

Transactions and balances with other related parties ultimately controlled or significantly influenced by SAB Financial Group a.s. or Mr. Radomir Lapcik.

	2021	2020
	€	€
Assets		
Loans and advances to banks	**500,984**	573,095
Loans and advances to customers	**4,375,000**	4,375,000
Derivative financial instruments	**2,171,859**	756,057
Prepayments and other assets	**669,963**	282,072
Liabilities		
Amounts owed to banks and other institutions	**32,233,639**	-
Derivative financial instruments	**11,793**	-
Income statement		
Interest income	**259,155**	224,058
Interest expense	**436,332**	23,876
Administrative expenses	**141,115**	143,821

Transactions with other related parties in respect of perpetual capital notes issued by the Bank during 2021 are explained in Note 14.

Details on derivative financial instruments entered into with other related parties are further explained in Note 8.

During 2021, the Bank entered into agreements with a related party for the licensing and implementation of a new core banking system giving rise to expenditure amounting to €190,092. An amount of €1,760,240 had been contracted at 31 December 2021 but not provided for in the financial statements.

Transactions with the Bank's key management personnel

	2021	2020
	€	€
Income statement		
Directors' fees	**133,222**	139,741

31. Contingent liabilities

On 18 June 2020, the Malta Financial Services Authority ('MFSA') communicated to the Bank the feedback following the onsite visit carried out during 2019 in terms of Regulation 2(1) of the Prevention of Money Laundering and Funding of Terrorism Regulations ("PMLFTR"). In the letter received by the Bank, the MFSA referred to a number of findings which the MFSA raised as a result of the onsite visit and stated that the said findings may be indicative of potential breaches under the PMLFTR and FIAU's Implementing Procedures. The Bank submitted responses and respective evidence to the MFSA providing explanations in respect of the findings raised by the MFSA for which the Bank has not received any further feedback from the MFSA to date.

This process may lead to the imposition of administrative penalties in accordance with the relevant legislation. Quantifying the estimated impact of this matter on the Bank's financial statements, reflecting the likely incidence and level of administrative fines, if any, appears to be premature in the circumstances. In addition, Management has evaluated the severity of the MFSA's findings and are of the view that in connection with the MFSA's onsite inspection, material outflows are not probable.

32. Dividends

On 27 July 2020, the European Central Bank (ECB) issued a Recommendation on dividend distributions during the COVID-19 pandemic (ECB/2020/35), whereby it was recommended that until 1 January 2021, no dividends are paid out and no irrevocable commitment to pay out dividends is undertaken by credit institutions for the financial years 2019 and 2020. This Recommendation was repealed on 15 December 2020 through ECB/2020/62, which encourages banks to use prudence when deciding on dividend distributions. On 23 July 2021, another recommendation was issued by the ECB repeating recommendation ECB/2020/62 (ECB/2021/31) with effect from 30 September 2021.

Subsequent to the end of the reporting period, a net dividend of €0.04869565217 per nominal share of €1, for a total amount of €1,400,000 is being proposed by the Bank to be distributed to the shareholders for the twelve months ended 31 December 2021. The directors propose that the balance of retained earnings amounting to €2,338,850 (2020: 479,302) be carried forward to the next financial year. After the reporting date, a dividend of €1,400,000 is being proposed by the Board of Directors. A resolution to this effect will be proposed at the Annual General Meeting, subject to regulatory approval.

33. 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 Suite 3, Tower Business Centre, Tower Street, Swatar, Malta.

The ultimate parent company of the Bank is SAB Financial Group a.s. which is incorporated and registered in Czech Republic, the registered address of which is Senovážné náměstí 1375/19 110 00 Praha 1, Czech Republic.

34. Events after the reporting date

Subsequent to the reporting date, an armed conflict between Russia and Ukraine commenced as a result of which economic sanctions were imposed by the EU, the US and other countries on Russia and Belarus as well as a number of Russian and Belarussian individuals. The conflict and related sanctions are expected to contribute to global economic dislocation, including potentially, disruption of energy supplies, higher inflation and additional credit and market risks.

Upon the emergence of this conflict, the Bank performed an initial assessment of the effects the current situation may have on its financial position and ongoing financial performance, and as of the date that these financial statements were authorised for issue, the directors have not identified a material uncertainty that may cast significant doubt on the Bank's ability to continue as a going concern.

The assessment considered the impact that the conflict could have on the valuation of the Bank's investments as a result of credit and market risks, the effect of the conflict on the Bank's processes as well as the effect on borrowers' business environment and supply chains, and as a result on the creditworthiness of its borrowers.

34. Events after the reporting date - continued

Following an in-depth analysis of its lending customers, the Bank is not expecting delays in repayments from increased credit risk. Similarly, no material movements on the valuation of financial debt securities are expected, other than in the case of one debt security measured at amortised cost of €3.2 million which is currently trading at 60%, in view of the fact that the issuer has been directly affected by the current situation. Albeit, the Bank deems the impact to be immaterial in the context of the Bank's ability to continue as a going concern.

From an operational perspective, the Bank ensures compliance with any applicable sanctions. Management continues to monitor the situation and any potential effects on its business, customers and operations very closely.

Based on this assessment and the likely future impact of the conflict on the Bank, as of the date that these financial statements were authorised for issue, the directors have not identified a material uncertainty that may cast significant doubt on the Bank's ability to continue as a going concern as outlined previously. As a result, the Bank continues to adopt the going concern basis in preparing its Financial Statements.

Additional Regulatory Disclosures
31 December 2021

1. Risk management

1.1 Overview of risk disclosures

These Additional Regulatory Disclosures ('ARDs') have been prepared by the Bank 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 are published by the Bank on an annual basis as part of the Annual Report.

As per banking regulations, these disclosure are not subject to an external audit, except to the extent that any disclosures are equivalent to those made in the Financial Statements, which have been prepared in accordance with the requirements of International Financial Reporting Standards ('IFRS') as adopted by the EU. The Bank is satisfied that internal verification procedures ensure that these ARDs are presented fairly.

These ARDs should be read in conjunction with the Financial Statements and Notes to the Financial Statements.

1.2 Risk management framework

The Board of Directors has the 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.

2. **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 the risk that deterioration in the financial condition of a borrower will cause the asset value to decrease or be extinguished. Country risk and settlement risk are included in this category. Country risk refers to the risk of losses arising from economic or political changes that affect the country from which the asset originates. Settlement risk refers to the risk of losses through failure of the counterparty to settle outstanding dues on the settlement date owing to bankruptcy or other causes.

Market risk: 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.

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 EUR	Total EUR
Central Government	**9,855,289**	**9,855,289**
Institutions	**4,265,039**	**4,265,039**
Corporates	**216,618,546**	**216,618,546**
Other assets	**5,504,124**	**5,504,124**
	236,242,998	**236,242,998**

Exposures analysed by residual maturity

	On demand or less than three months €	Within one year but over three months €	Within five years but over one year €	More than five years €	No maturity €	Gross carrying amount/ Fair value €
As at 31 December 2021						
Financial assets						
Balances with Central Bank of Malta	3,521,164	-	-	-	1,601,794	5,122,958
Loans and advances to banks	3,362,407	-	-	-	-	3,362,407
Loans and advances to customers	1,641,763	16,504,082	65,151,992	54,805,381	-	138,103,218
Financial investments	4,769,479	-	40,717,720	39,424,373	-	84,911,572
Derivative financial instruments	-	2,171,859	-	-	-	2,171,859
Other assets	2,570,984	-	-	-	-	2,570,984
	15,865,797	**18,675,941**	**105,869,712**	**94,229,754**	**1,601,794**	**236,242,998**

	On demand or less than three months €	Within one year but over three months €	Within five years but over one year €	More than five years €	No maturity €	Gross carrying amount/ Fair value €
As at 31 December 2020						
Financial assets						
Balances with Central Bank of Malta	18,895,768	-	-	-	484,564	19,380,332
Loans and advances to banks	3,106,498	-	-	-	-	3,106,498
Loans and advances to customers	661,574	3,653,337	12,883,347	26,958,429	-	44,156,687
Financial investments	-	-	14,465,818	29,312,838	-	43,778,656
Derivative financial instruments	-	756,057	-	-	-	756,057
Other assets	2,311,802	-	-	-	-	2,311,802
	24,975,642	**4,409,394**	**27,349,165**	**56,271,267**	**484,564**	**113,490,032**

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:

	2021	2020
	€	€
AA	**307,807**	269,037
A	**1,254,480**	1,037,702
A-	**633,050**	733,977
BBB+	**6,458,917**	5,270,050
BBB	**6,327,913**	4,629,335
BBB-	**11,785,773**	9,958,753
BB-	**3,915,448**	-
BB+	**17,119,638**	11,732,854
B+	**4,291,425**	3,194,259
Unrated	**32,817,121**	6,952,689
	84,911,572	43,778,656

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:

	2021		2020	
	Variable	**Fixed**	Variable	Fixed
	€	**€**	€	€
As at 31 December 2021				
Financial assets				
Balances with Central Bank of Malta	5,122,958	-	19,380,332	-
Loans and advances to banks	3,362,407	-	3,106,498	-
Loans and advances to customers	98,582,301	39,520,917	37,152,151	7,004,536
Financial investments	22,416,695	62,494,877	2,202,164	41,576,492
Derivative financial instruments	-	2,171,859	-	756,057
	129,484,361	**104,187,653**	61,841,145	49,337,085
Financial liabilities				
Amounts owed to customers	22,046,959	119,402,442	9,273,702	74,273,074
Amounts owed to banks and other institutions	20,400,000	32,233,639	10,000,000	-
	42,446,959	**151,636,081**	19,273,702	74,273,074
exposure	**87,037,402**	**(47,448,428)**	42,567,443	(24,935,989)
Impact of interest rate derivatives	**(10,000,000)**	**10,000,000**	-	-
Net exposure	**77,037,402**	**(37,448,428)**	42,567,443	(24,935,989)

3. Market risk - continued

3.1 Interest rate risk - continued

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

	Less than three months €	Within one year but over three months €	Within five years but over one year €	More than five years €	Gross carrying amount/ Fair value €
As at 31 December 2021					
Financial assets					
Balances with Central Bank of Malta	5,122,958	-	-	-	5,122,958
Loans and advances to banks	3,362,407	-	-	-	3,362,407
Loans and advances to customers	98,342,614	12,588,740	27,171,864	-	138,103,218
Financial investments	27,186,174	-	21,636,755	36,088,643	84,911,572
Derivative financial instruments	-	2,171,859	-	-	2,171,859
	134,014,153	**14,760,599**	**48,808,618**	**36,088,643**	**233,672,014**
Financial liabilities					
Amounts owed to customers	89,695,522	50,433,304	1,320,575	-	141,449,401
Amounts owed to banks and other institutions	20,400,000	32,233,639	-	-	52,633,639
	110,095,522	**82,666,943**	**1,320,575**	**-**	**194,083,040**
Interest repricing gap	**23,918,631**	**(67,906,344)**	**47,488,044**	**36,088,643**	
Impact of interest rate derivatives	**(10,000,000)**	**-**	**-**	**10,000,000**	
Net interest rate repricing gap	**13,918,631**	**(67,906,344)**	**47,488,044**	**46,088,643**	

3. Market risk - continued

3.1 Interest rate risk - continued

	On demand or less than three months €	Within one year but over three months €	Within five years but over one year €	More than five years €	Gross carrying amount/ Fair value €
As at 31 December 2020					
Financial assets					
Balances with Central Bank of Malta	19,380,332	-	-	-	19,380,332
Loans and advances to banks	3,106,498	-	-	-	3,106,498
Loans and advances to customers	37,152,151	3,250,000	3,754,536	-	44,156,687
Financial investments	2,202,164	-	12,263,655	29,312,837	43,778,656
Derivative financial instruments	-	756,057	-	-	756,057
	61,841,145	**4,006,057**	**16,018,191**	**29,312,837**	**111,178,230**
Financial liabilities					
Amounts owed to customers	63,238,139	16,424,523	3,884,114	-	83,546,776
Amounts owed to institutions	10,000,000	-	-	-	10,000,000
	73,238,139	**16,424,523**	**3,884,114**	**-**	**93,546,776**
Interest repricing gap	**(11,396,994)**	**(12,418,466)**	**12,134,077**	**29,312,837**	
Cumulative gap	**(11,396,994)**	**(23,815,460)**	**(11,681,383)**	**17,631,454**	

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 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 manages its currency risk on an ongoing basis by ensuring that foreign currency liabilities are utilised to fund assets denominated in the same foreign currency thereby matching asset and liability positions as much as is practicable. When it is not possible to match the asset and liability currency positions, the Bank hedges its open foreign exchange exposures by entering into forward foreign exchange contracts or currency swaps.

3. **Market risk** - continued

3.1 **Market risk** - continued

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

	EUR currency €	CZK currency €	GBP currency €	Total €
As at 31 December 2021				
Financial assets				
Balances with Central Bank of Malta	5,122,958	-	-	5,122,958
Loans and advances to banks	2,591,132	369,851	401,424	3,362,407
Loans and advances to customers	110,505,223	27,597,995	-	138,103,218
Financial investments	50,717,907	33,885,858	307,807	84,911,572
Accrued interest receivable	386,077	213,311	828	600,216
	169,323,297	**62,067,015**	**710,059**	**232,100,371**
Financial liabilities				
Amounts owed to customers	139,908,255	884,659	656,487	141,449,401
Amounts owed to institutions	20,650,190	31,983,449	-	52,633,639
Accrued interest payable	227,544	52,661	5,541	285,746
	160,785,989	**32,920,769**	**662,028**	**194,368,786**
Net on-balance sheet financial position		**29,146,246**	**48,031**	
Notional of derivative financial instruments		**(28,858,298)**	-	
Residual exposure		**287,948**	**48,031**	

3. Market risk - continued

3.1 Market risk - continued

	EUR currency €	CZK currency €	GBP currency €	Total €
As at 31 December 2020				
Financial assets				
Balances with Central Bank of Malta	19,380,850	-	-	19,380,850
Loans and advances to banks	1,465,413	522,650	1,118,435	3,106,498
Loans and advances to customers	43,644,509	512,178	-	44,156,687
Financial investments	36,853,825	6,655,794	269,037	43,778,656
Accrued interest receivable	105,651	9,390	-	115,041
	101,450,248	7,700,012	1,387,472	110,537,732
Financial liabilities				
Amounts owed to customers	140,021,608	-	1,427,794	141,449,401
Amounts owed to institutions	10,000,000	-	-	10,000,000
Accrued interest payable	267,598	-	10,470	278,068
	150,289,205	-	1,438,264	151,727,469
Net on-balance sheet financial position		7,700,012	(50,792)	
Notional of derivative financial instruments		(6,348,904)	-	
Residual exposure		1,351,108	(50,792)	

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.

4. Liquidity risk - continued

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

The Bank uses a number of 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 a CALL report which is a six monthly forecast based on projections and contains information on the Bank's financial health.

As at 31 December 2020, 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 years but over one year	More than five years	No maturity	Gross carrying amount/ Fair value
	€	€	€	€	€	€
As at 31 December 2021						
Financial assets						
Balances with Central Bank of Malta	3,521,164	-	-	-	1,601,794	5,122,958
Loans and advances to banks	3,362,407	-	-	-	-	3,362,407
Loans and advances to customers	1,641,763	16,504,082	65,151,992	54,805,381	-	138,103,218
Financial investments	4,769,479	-	40,717,720	39,424,373	-	84,911,572
Derivative financial instruments	-	2,171,859	-	-	-	2,171,859
Other assets	2,570,984	-	-	-	-	2,570,984
	15,865,797	**18,675,941**	**105,869,712**	**94,229,754**	**1,601,794**	**236,242,998**
Financial liabilities						
Amounts owed to customers	89,695,522	50,433,304	1,320,575	-	-	141,449,401
Amounts owed to institutions	-	52,633,639	-	-	-	52,633,639
Other liabilities	451,816	-	-	-	-	451,816
	90,147,338	103,066,943	1,320,575	-	-	194,534,856
Maturity gap	**(74,281,541)**	**(84,391,002)**	**104,549,137**	**94,229,754**		
Cumulative gap	**(74,281,541)**	**(158,672,533)**	**(54,123,406)**	**40,106,348**		

4. Liquidity risk - continued

	On demand or less than three months €	Within one year but over three months €	Within five years but over one year €	More than five years €	No maturity €	Gross carrying amount/ Fair value €
As at 31 December 2020						
Financial assets						
Balances with Central Bank of Malta	18,895,768	-	-	-	484,564	19,380,332
Loans and advances to banks	3,106,498	-	-	-	-	3,106,498
Loans and advances to customers	661,574	3,653,337	12,883,347	26,958,429	-	44,156,687
Financial investments	-	-	14,465,818	29,312,838	-	43,778,656
Derivative financial instruments	-	756,057	-	-	-	756,057
Other assets	2,311,802	-	-	-	-	2,311,802
	24,975,642	**4,409,394**	**27,349,165**	**56,271,267**	**484,564**	**113,490,032**
Financial liabilities						
Amounts owed to customers	63,238,139	16,424,523	3,884,114	-	-	83,546,776
Amounts owed to institutions	-	10,000,000	-	-	-	10,000,000
Other liabilities	477,675	-	-	-	-	477,675
	63,715,814	**26,424,523**	**3,884,114**	**-**	**-**	**94,024,451**
Maturity gap	**(38,740,172)**	**(22,015,129)**	**23,465,051**	**56,271,267**		
Cumulative gap	**(38,740,172)**	**(60,755,301)**	**(37,290,250)**	**18,981,017**		

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.

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 the 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.

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.

6. **Capital management** - continued

6.1 **Capital adequacy** - continued

	Carrying amount €	Risk weighted amount €	Capital requirement €
Central governments	5,120,404	-	-
Institutions	3,362,185	672,437	53,795
Corporates	222,608,998	201,359,411	16,108,753
Other items	8,445,799	12,858,311	1,028,665
	239,537,386	214,890,159	17,191,213
Off-balance sheet	62,852,010	15,721,278	1,257,702
Total credit risk	302,389,396	230,611,437	18,448,915
Operational risk		5,594,169	447,534
Total		**236,205,606**	**18,896,449**
Own funds			**44,591,420**
Capital adequacy ratio			**18.9%**

6.2 **Internal capital adequacy assessment process (ICAAP)**

The Bank developed a comprehensive Internal Capital Adequacy Assessment Process ("ICAAP"), as part of its 2021 plan to enhance its risk management process, in accordance with Banking Rule 12 'The Supervisory Review Process' (BR12) and the recommendations proposed by the MFSA in the results of the Supervisory and Review Process (SREP). 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 2020 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 Board of Directors to ensure that the proposed strategy is in line with the Bank's risk profile. The final document was approved by the Bank's Board of Directors in June 2020 and presented to the MFSA. The results show that the Bank is 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.

Total remuneration payable to senior management, composed of the CEO and five other beneficiaries, in 2020 was €434,970, 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 the 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 play an important role to enhance the efficiency of Internal Audit's work.

10 Encumbered and unencumbered assets

	Carrying amount of encumbered assets €	**Fair value of encumbered assets €**	**Carrying amount of unencumbered assets €**	**Fair value of unencumbered assets €**
As at 31 December 2021				
Assets	53,072,758	53,072,758	31,726,643	31,726,643

	Carrying amount of encumbered assets €	**Fair value of encumbered assets €**	**Carrying amount of unencumbered assets €**	**Fair value of unencumbered assets €**
As at 31 December 2020				
Assets	12,083,268	12,083,268	102,945,887	102,945,887

11 Return on assets

The return on assets as at 31 December 2021 is 1.3% (2020: 0.89%). This is calculated as loss after tax divided by total assets.

12 Leverage

	€
Total Assets	241,171,785
Leverage ratio exposure	241,171,785
Tier 1 Capital	44,591,420
Total on-balance sheet exposures	241,171,785
Total Exposures	241,171,785
Leverage ratio	18.5%

Five-year summary

Statement of comprehensive income

	Year ended 31 December 2021 €	Year ended 31 December 2020 €	Year ended 31 December 2019 €	Year ended 31 December 2018 €	Year ended 31 December 2017 €
Interest income	**5,020,464**	1,487,441	497,027	131,526	768,389
Interest expense	**(1,475,125)**	(779,199)	(934,511)	(1,608,632)	(1,815,000)
Net interest income/(expense)	**3,545,339**	708,242	(437,484)	(1,477,106)	(1,046,611)
Fee income	**113,936**	47,569	175,764	3,025	-
Fee expense	**(105,802)**	(76,234)	(134,013)	(72,703)	(70,779)
Net fee (expense)/income	**8,134**	(28,665)	41,751	(69,678)	(70,779)
Other income	**81,605**	1,932,852	903,840	3,971	11,746
Realised gain on disposal of financial investments at FVOCI	**668,915**	80,640	1,445,501	-	633,569
Dividend income	**-**	-	-	-	851,555
Operating income	**4,303,993**	2,693,069	1,953,608	(1,542,813)	379,479
Changes in expected credit losses	**(142,712)**	(174,670)	(85,915)	(78,550)	-
Employee compensation and benefits	**(1,888,614)**	(1,198,088)	(827,011)	(780,475)	(453,365)
Administrative expenses	**(1,886,758)**	(1,315,615)	(1,336,845)	(1,236,371)	(901,590)
Profit/(loss) before tax	**385,909**	4,696	(296,163)	(3,638,209)	(975,476)
Tax income	**1,599,997**	400,229	381,055	-	-
Profit/(loss) for the year	**1,985,906**	404,925	84,892	(3,638,209)	(975,476)
Other comprehensive income					
Fair valuation of financial investments measured at FVOCI					
- net changes in fair value during the year, before tax	**301,044**	381,395	121,456	-	(113,705)
- Net amounts reclassified to profit or loss upon disposal, before tax	**(668,915)**	(80,640)	-	-	-
- Income tax relating to components of other comprehensive income	**128,755**	(105,264)	(41,545)	-	37,908
Other comprehensive income/ (loss) for the year, net of tax	**(239,116)**	195,491	79,911	(3,638,209)	(75,797)
Total comprehensive income/ (loss) for the year, net of tax	**1,746,790**	600,416	164,803	(3,638,209)	(1,051,273)

Five-year summary - continued

Statement of financial position

	2021	2020	2019	2018	2017
	€	€	€	€	€
Assets					
Cash and balances with Central Bank of Malta	**5,120,404**	19,378,296	13,317,530	42,919,512	57,023,963
Loans and advances to banks	**3,362,185**	3,106,276	8,104,291	4,558,166	9,320,142
Loans and advances to customers	**137,753,511**	43,918,435	17,564,550	1,757,511	-
Financial investments	**84,855,487**	43,766,208	4,471,393	6,772,622	2,272,941
Derivative financial instruments	**2,171,859**	756,057	124,328		-
Property and equipment	**518,379**	63,547	68,449	21,739	11,258
Intangible assets	**1,309,073**	190,285	250,161	130,456	196,811
Deferred tax assets	**3,267,001**	1,538,249	1,243,284	903,774	877,882
Prepayment and other assets	**2,813,886**	2,311,802	911,730	360,244	159,805
Total assets	**241,171,785**	115,029,155	46,055,716	57,424,024	69,862,802
Equity					
Share capital	**28,750,000**	20,250,000	20,250,000	20,250,000	13,250,000
Perpetual Capital Notes	**15,500,000**	-	-	-	-
Fair value reserve	**36,286**	275,402	79,911	-	48,082
Retained earnings/(Accumulated losses)	**2,338,850**	479,302	(8,825,623)	(8,910,515)	(5,168,426)
Total equity	**46,625,136**	21,004,704	11,504,288	11,339,485	8,129,656
Liabilities					
Amounts owed to customers	**141,449,401**	83,546,776	34,138,102	45,456,878	60,955,858
Amounts owed to banks and other institutions	**52,633,639**	10,000,000	-	-	-
Derivate Financial Instruments	**11,793**	-	-	-	-
Other liabilities	**451,816**	477,675	413,326	627,661	777,288
Total liabilities	**194,546,649**	94,024,451	34,551,428	46,084,539	61,733,146
Total liabilities and equity	**241,171,785**	115,029,155	46,055,716	57,424,024	69,862,802