Bank of Valletta p.l.c.

Annual Report & Financial Statements

2017

BOV
Bank of Valletta

Contents and General Information

BOARD OF DIRECTORS

Taddeo Scerri (Chairman)
John Cassar White (up to 16 December 2016)
Stephen Agius
Alan Attard
Paul V Azzopardi
Miguel Borg
James Grech
Alfred Lupi
Mario Mallia
Anita Mangion
Antonio Piras
Joseph M Zrinzo
Barbara Helga Ellul (up to 16 December 2016)
Mario Grima (up to 16 December 2016)
Gabriele Simonetti (up to 16 December 2016)

COMPANY SECRETARY

Ruth Spiteri Longhurst

MANAGEMENT BOARD

Mario Mallia (Chief Executive Officer)
Ernest John Agius (Chief Operations Officer)
Joseph Agius (Chief Technology Officer)
Miguel Borg (Chief Risk Officer)
Kenneth Farrugia (Chief Business Development Officer – Investments)
Albert Frendo (Chief Business Development Officer – Credit)
Elvia George (Chief Finance Officer)

Rudolph Gatt (Secretary)

AUDITORS

KPMG

LEGAL ADVISORS

Camilleri Preziosi

NOTICE OF MEETING

The Annual General Meeting of the Bank will be held at the Grand Master Suite, Hilton Malta, St Julians, on Thursday 10 May 2018 at 10.00 a.m.

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Bank of Valletta p.l.c.
BOV Centre
Triq il-Kanun
Santa Venera SVR 9030
Malta

Tel: (+356) 2275 3000
Fax: (+356) 2275 3711
www.bov.com
E-mail: customercare@bov.com

Bank of Valletta p.l.c.
Registered Office:
58, Triq San Żakkarija
Il-Belt Valletta VLT 1130
Malta
Registration Number C 2833

Bank of Valletta p.l.c. is a public limited company licensed to conduct Investment Services business by the Malta Financial Services Authority.

Bank of Valletta p.l.c. is authorised to act as a trustee by the Malta Financial Services Authority.

Bank of Valletta p.l.c. is an enrolled tied insurance intermediary of MAPFRE MSV Life p.l.c. (MMSV). MMSV is authorised and regulated by the Malta Financial Services Authority to carry on long term business under the Insurance Business Act 1998.

Board of Directors and Group Company Secretary

Taddeo Scerri

Chairman

C NGC R NED *

Taddeo Scerri was appointed Chairman of the Bank in December 2016. Previously, he was a director of the Bank following his appointment in April 2013. Mr Scerri currently chairs the Board's Nominations and Governance Committee, the Remuneration Committee and the Credit Committee. He is a qualified accountant. Mr Scerri was the managing partner of RSM Malta until his retirement in 2015. He was the Chairman of the local UEFA Clubs Licencing Board and was also a member of the Malta Football Association's Finance Committee.

Stephen Agius

Director

A NGC NED *

Appointed to the Board in December 2016. Stephen Agius is currently a member of the Nominations and Governance Committee and recently he was appointed also as a member of the Audit Committee. Formerly he was a member of the Risk Management Committee. Mr Agius works as a Chief of Information and Development with the national telecom regulatory authority. For five years, Mr Agius served as member of the Board of Directors of Enemalta p.l.c. and Engineering Resources Limited. Prior to his current role, Mr Agius occupied various positions where he was responsible for a number of large scale projects, both locally and abroad, in areas related to enterprise resource planning, billing, integration, business intelligence and data warehousing, and process modelling. Mr Agius is also a visiting senior lecturer at the University of Malta where he lectures 'Big Data Analytics for Marketing Professionals' and 'Digital Marketing Strategy'. He studied computer science and information systems and gained an honours Bachelor degree from the University of Greenwich UK, followed by an MBA in e-Business from the University of Malta.

Alan Attard

Director

C&CP RM NED

Appointed to the Board in December 2016. Mr Attard is currently a member of the Compliance and Crime Prevention Committee and he was recently also appointed as a member of the Risk Management Committee. He was previously a member of the Bank's Anti-Financial Crime Committee. He joined the Bank in 1987. For the past thirteen years, he has held various managerial positions including serving as branch manager of several branches. At present, Mr Attard is the branch manager of BOV's Floriana branch which is classified as one of the Bank's premier branches. In July 2015, he was elected as trustee on the Board of Trustees of the BOV Employees' Foundation and has since served as secretary to said Board. He is also a member of the Board of Directors of the Malta Ten Pin Bowling Association.

Paul V Azzopardi

Director

C&CP RM NED *

Appointed to the Board in December 2016. Mr Azzopardi is currently the Chairman of the Compliance and Crime Prevention Committee, and Deputy Chairman of the Risk Management Committee. He set up and managed Azzopardi Financial Services between 1989 and 2006 and subsequently worked in investments in Ontario, Canada, as director and portfolio manager, managing private clients' portfolios and investment funds. Mr Azzopardi was sponsoring and corporate stockbroker of the Bank from its initial listing on the Malta Stock Exchange in 1992 until 2006, and also served in the same roles for the funds of BOV Asset Management Limited and several other companies. Mr Azzopardi is the author of "Behavioural Technical Analysis" and two other books on investments, and contributes regularly to the press. He lectured at the University of Malta and the School of Continuing Studies, University of Toronto. Mr Azzopardi holds a first degree in accountancy from the University of Malta, an MBA from the University of British Columbia, is a Fellow of the Malta Institute of Accountants and a Certified Public Accountant. Mr Azzopardi is also Director of BOV Asset Management Limited (BOVAM) and BOV Fund Services Limited (BOVFS).

Miguel Borg

Director

ED

Appointed to the Board in July 2017. Miguel Borg joined the Bank in November 2007. Mr Borg was appointed Chief Risk Officer of the Group in November 2014 and is a member of the Management Board. In his role as Chief Risk Officer, he is responsible for overseeing the measurement and management of the Group's financial and non-financial risk. He is responsible for maintaining the Bank's relationship with regulators and supervisors. Risk management, compliance, anti-financial crime, legal services and credit risk sanctioning departments report to the Chief Risk Officer. Mr Borg is a Director of BOVAM and chairs the Risk and Regulatory Committee of BOVAM. He is a member of the Bank's Asset and Liability Committee and the Risk Committee of MAPFRE MSV Life p.l.c. Mr Borg is also Chairman of the Central Co-Operative Fund. Mr Borg holds a Masters in Economics from the University of Malta and lectures at the University of Malta.

James Grech

Director

C RM NED

Mr Grech was appointed to the Board in December 2014. He is the Executive Head of the Foreign Bank Relationships department and a member of the Bank's Asset and Liability Committee. Recently, he was appointed as member of the Credit Committee and of the Risk Management Committee. He was formerly a member of the Audit Committee and the Compliance and Crime Prevention Committee. He also serves as a member on the European's Banking Federation Correspondent banking taskforce and also as Chairman of the Board of Trustees of the BOV Employees' Foundation. Professionally, Mr Grech's career commenced as a management accountant with a local accounting firm. He then joined the Bank in 1998 and occupied senior managerial positions at various branches and departments within the Bank. He was a BOV Board Director between 2004 till 2008. Mr Grech is a director of other local companies and a recognised member of the Institute of Directors – UK. Mr Grech holds an Honours degree in Management and a Masters in Business Administration from Henley Management College, UK. His dissertation focused on the effectiveness of Board performance and Corporate Governance. He has lectured on Financial Services at the Malta College of Arts, Science and Technology, and on Corporate Governance at the University of Malta.

Alfred Lupi

Director

A C C&CP NED *

Appointed to the Board in December 2015. Mr Lupi currently chairs the Audit Committee and the Ethics Committee. He is also a member of the Credit Committee, and the Compliance and Crime Prevention Committee. He is a professional accountant with an economics degree and currently engaged in management consultancy. Mr Lupi was Chief Financial Officer in two major companies and the Executive Chairman of Pavi Shopping Complex p.l.c. He was a Director of the Central Bank of Malta and served as Acting Governor. Mr Lupi chaired the Accountancy Board and was a member of its Quality Assurance Oversight Committee. Mr Lupi has held a number of board appointments mainly in the financial sector.

Mario Mallia

Director

C ED

Appointed to the Board in July 2017. Mr Mallia joined the Bank in September 1979. He was appointed as the Bank's Chief Executive Officer in January 2016. In October 2014, he had been appointed as the Bank's first Chief Operations Officer. He carried out various other roles at the Bank, the most recent being those of Chief Finance Officer and Chief Risk Officer. Mr Mallia is Chairman of the Asset and Liability Committee and of the Management Board, and a member of the Credit Committee. Mr Mallia is also Director on the boards of MAPFRE MSV Life p.l.c. and BOVFS. He chairs the MAPFRE MSV Life Risk Committee and is currently chairman of the Malta Bankers Association. Mr Mallia graduated in accountancy from the University of Malta, holds the Certified Public Accountant warrant and is a Fellow of the Malta Institute of Accountants.

Anita Mangion

Director

C&CP R NED *

Appointed to the Board in December 2016. Anita Mangion is a member of the Remuneration Committee and was recently appointed Deputy Chairperson of the Compliance and Crime Prevention Committee. She was previously a member of the Audit Committee. Ms Mangion is an experienced Business and IT Consultant. Her area of specialisation is Technology Intrapreneurship wherein she utilises innovative ways to restructure existing processes and create new business within organisations. During the last sixteen years, she consulted to such effect different local and international entities in various sectors, where she successfully drove critical projects to completion and implemented sustainable profitable frameworks. Ms Mangion graduated in Executive MBA (eBusiness); B.Com. Management Hons, and B.Sc. Business and Computing from the University of Malta. Additionally she studied Business and IT at Indiana University (USA), and Technology Entrepreneurship and New Business Operations at the University of Malta in joint collaboration with Oxford University (UK). For four years, Ms Mangion served as Board Director at Malta Industrial Parks Limited (MIP). At MIP she was also entrusted to oversee the Tenders Committee, was a member of the Audit Committee and chaired the ICT Steering Committee.

Antonio Piras

Director

A R NED *

Appointed to the Board in December 2016. Mr Antonio Piras is currently the Deputy Chairman of the Remuneration Committee and he was recently appointed as a member of the Audit Committee. He was previously a member of the Risk Management Committee. Mr Piras occupies the role of Director of the Board of Lacobucci Aerospace HF SpA and until recently was Vice Chairman of Eurofidi Soc. Consortile Garanzia Fidi s.c.a.r.l. (Turin). Until 2014, Antonio used to be the CEO of Equitalia Centro S.p.A (Florence) and Chairman and CEO of other companies of Equitalia Group. In 1971 he started his career at UniCredit Group, former Credito Italiano, holding various key roles in the Italian commercial network until 1997. In 1998 he was appointed as CEO of UniCredit Factoring (Milan), Deputy General Manager of Banca dell'Umbria, Chairman and CEO of Pekao Leasing Sp.z.o.o (Warsaw) and Leasing Fabryczny Sp.z.o.o (Lublin), CEO of UniRiscossioni S.p.A. (Turin), all companies held by UniCredit, and from where he ended his career as Senior Executive Vice President in 2009.

Joseph M Zrinzo

Director

A NGC RM NED *

Appointed to the Board in December 2013. Mr Zrinzo currently chairs the Board's Risk Management Committee and the Bank's Property Committee. Mr Zrinzo is a member of the Audit Committee and the Deputy Chairman of the Nominations and Governance Committee. Until recently he was a member of the Credit Committee. Mr Zrinzo currently serves as managing director of a group of family companies, as board director of other local companies, committee member of the Cultural Heritage Advisory Committee and as an active member of philanthropic associations. Over the years, Mr Zrinzo served as director on boards of various local and international companies, as BOV Board Director between 1996 and 1998, as member of Audit, Remuneration and Compliance Committees and was founder member of the Malta Shareholders Association. Mr Zrinzo has a vast experience of international trade having operated businesses with European, North African and Middle-Eastern companies.

Ruth Spiteri Longhurst

Group Company Secretary

Appointed Group Company Secretary in April 2016. Previously she occupied the post of Executive Head of the Compliance Unit within the Bank. Dr Spiteri Longhurst is also the Company Secretary of MAPFRE MSV Life p.l.c., BOVAM and BOVFS. Dr Spiteri Longhurst graduated Doctor of Laws from the University of Malta in 2001 and obtained Master of Arts in Financial Services in 2004. Dr Ruth Spiteri Longhurst has been employed with the Bank for the past sixteen years.

A	Audit Committee
C&CP	Compliance and Crime Prevention Committee
C	Credit Committee
NGC	Nominations and Governance Committee
R	Remuneration Committee
RM	Risk Management Committee
ED	Executive Director
NED	Non-executive Director
*	Independent

Chairman's Statement

Taddeo Scerri

On the first anniversary of my appointment as Chairman of the Bank of Valletta Group I have the privilege to present to you the Group's annual report for the fifteen months ending 31 December 2017. The period has now been changed to cover a calendar year ending on the 31 December.

During the period under review, the Board of Directors have also seen material changes in its composition with five new non-executive directors assuming the responsibility and two new executive directors joining the Board in line with the amendments in the Memorandum and Articles of Association as approved in the Extraordinary General Meeting held last July. While welcoming the new directors, I thank the departing ones and my predecessor John Cassar White for their legacy.

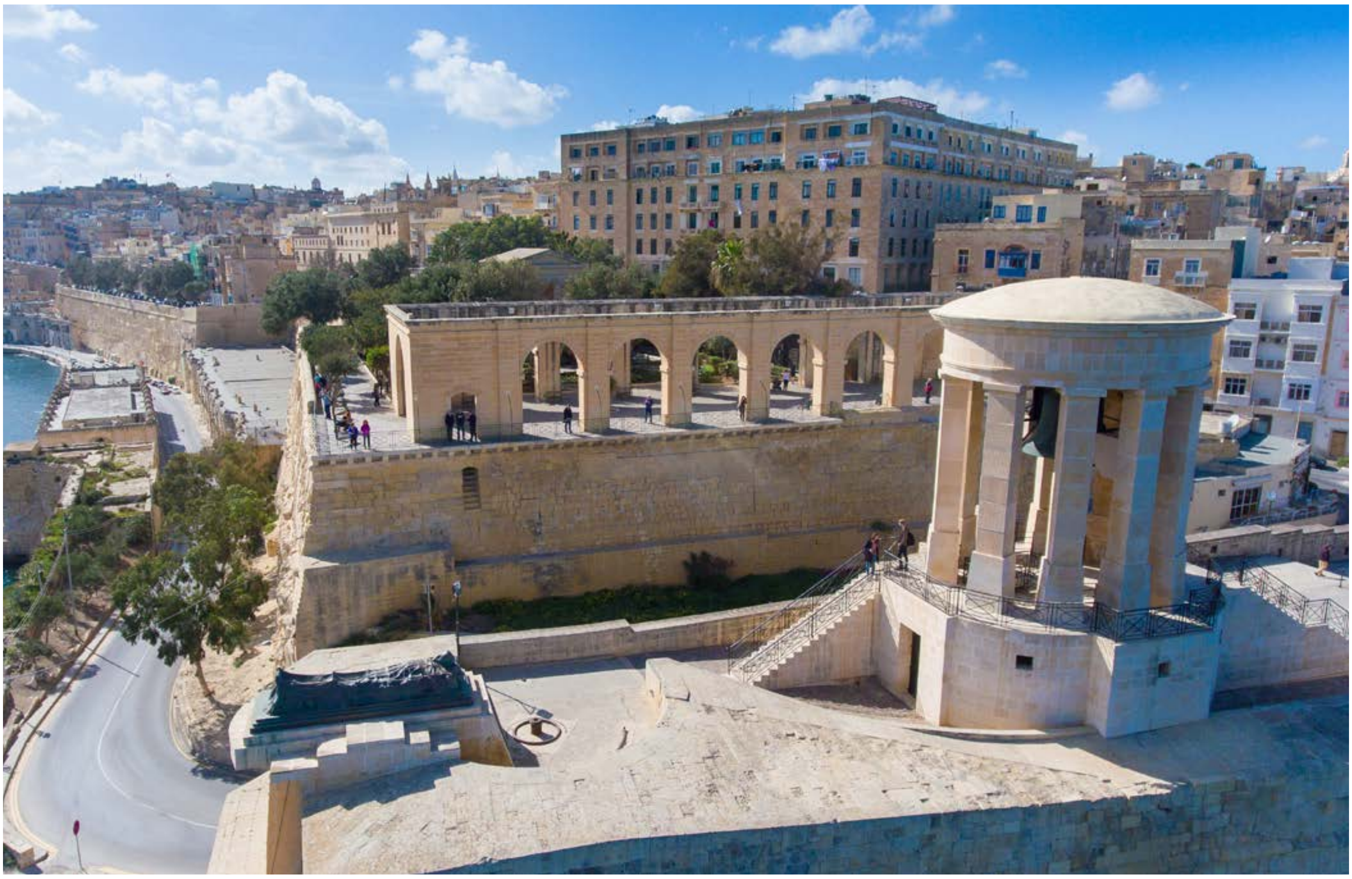
FINANCIAL PERFORMANCE

2017 was a year of change with multiple initiatives taking place across the Bank. While the Maltese economy continued to grow at consistent pace, uncertainties driven by restrained economic growth on the Continent, Brexit and a low interest rate scenario provided a challenging environment. Our financial performance was strong with non-interest income taking a centre stage in the implementation of our Vision 2020 strategy.

The BOV Group recorded a profit before tax of €174.7 million for the 15 month period to 31 December 2017. Core profit excluding fair value movements and the share of profits from associates reached €149.9 million. The results demonstrate the financial strength and strong market position of the Bank.

The increase in profitability was also driven by an increase in non-interest income as the Bank's strategy to tap diverse income sources continued to bear fruit. The increase in commissions (4.5% annualised) balanced the impact of narrower interest margins, high levels of liquidity and negative interest rates on deposits held with the ECB. Operating expenses also increased. Major increases were in the cost of IT, heavy investment in HR and the strengthening of the Bank's control functions. The results translate into a Return on Equity (ROE) ratio of 16.5% (December '17), slightly down from 16.9% (September 16) last year, as adjusted for the one off gain on the VISA transaction.

The annualised growth in Customer deposits was 8%. Deposits amounted to €10.1 billion at the reporting date, mainly driven by an increase in short-term retail deposits. This was the principal driver behind an increase in total assets reaching the figure of €11.8 billion. The loan book grew by €160 million propelled by a 4% annualised increase in home loans. Total loans as at December 2017 stood at €4.5 billion. Loan to deposit ratio continued to decrease, at 44.3% reflecting the Bank's highly liquid position.



2017 was a year of change with multiple initiatives taking place across the Bank

SOLID CAPITAL BASE

In November 2014 Bank of Valletta became a systemically important bank falling under the direct supervision of the Joint Supervisory Team made up of representatives from the European Central Bank as well as from the Malta Financial Services Authority. This has had a substantial impact on the Bank, its conduct, operations and ultimately its capital base.

During the last quarter of 2016 we had acknowledged that in order to sustain a growth strategy and harness market potential we had to strengthen the Bank's capital base. With this in mind, we launched a rights issue that increased capital by €150 million. While fully cognisant that this may result in value dilution for our shareholders, the Board was of the solid conviction that the strengthening of the capital base was in the long-term interest of shareholders and other stakeholders as it would sustain further business growth. The Issue's resounding success with an over subscription of nearly €50 million, was a clear sign of support from existing and new shareholders. As a result the Group's core capital position improved materially. The Common Equity Tier 1 (CET 1) capital ratio has gone up from 12.8% (2016) to 16.1% as at December 2017, providing substantial capital buffers to sustain business growth in line with the Bank's strategy.

STRATEGIC FOCUS

Our Vision 2020 strategy ensures that we maintain long-term stability and business sustainability for the generations to come. Solid Corporate Governance, an evolving Business Model and Operational Transformation through substantial investment in Human Resources, IT and process reviews remain at the core of our strategy.

MEASURED BUSINESS GROWTH

As I highlighted in last year's Extraordinary General Meeting, the Bank has to be on a constant lookout to engage in business and generate sustainable profits to support growth in the loan book as well as non-interest income. As interest income continues to dwindle we must explore new sources of income in the form of fees and commissions.

To this end four Strategic Teams were set-up to define the Bank's medium to long-term strategy with respect to Capital Management, Asset and Wealth Management, Consumer Finance and Digitalisation. The input of external specialists complimented the contribution of internal expertise within the teams. The Board of Directors approved these plans as part of the Group's Vision 2020. Subsequently, the CEO and Management Board drafted the operational plans.

Over the period under review we have embarked on different initiatives to enhance our investment services across the whole customer spectrum. Our strategy to develop Investment Centres of excellence has continued to produce encouraging results. We have also upgraded Gzira Investment Centre which is now housed in our new Gzira Banking Centre. Developments in this area continue and Q2 2018 will also see the opening of our new Premium Centre in Santa Venera which will service wealth management and corporate finance customers. This new venue will enable us to deliver a whole new experience for our high-end customers seeking personal investment advice or finance for their businesses.

As the Maltese social and economic realities continue to evolve at a quick pace, we see that the demand for personal finance is growing, so is competition, with retailers making quick inroads in this market.

Bank of Valletta is today the largest bank in Malta

Our Consumer Finance Division has embarked on various initiatives to be in a better position to service customer needs as market for motor loans, pleasure crafts and home improvements continues to grow. We aim to continue to deliver further innovation in the field of personal lending, increase market share and consequently increase interest and fee income from this sector.

Today's financial services environment can be described as highly competitive, complex and dominated by customer expectations and demand. The digital revolution is leading to the disruption and eventual transformation of the industry with new entrants challenging the norm and leading with customer-centric innovation. Following closely on the work of the respective Strategic Teams, the Board has identified the need to rapidly embrace the disruptive nature of Fintechs by seeking ways to forge partnerships that will enable it to provide innovative services by sharpening operational efficiency and focus on customer centricity. A Fintech Initiation Plan has been put into action with two operational streams. The first stream will tie up with the Core Banking Transformation plans currently in place to ensure that Bank of Valletta has the right resources in place to meet the evolving needs of customers in a digitised world. The second stream will be scanning the market with the assistance of industry experts with the ultimate aim of identifying Fintech start-ups that can provide synergies and potential for partnerships or buy-outs.

RISK AND REGULATION

The Bank continued with the consolidation of its business model in order to ensure that all business lines are aligned with our revised risk appetite. This will create a safer and stronger Bank. During this period we continued with winding down of the trust business. We undertook a programme where we rationalised our international corporate customer base, while strengthening our controls in a number of areas including the custody business. In the process we also revisited our fee structure to ensure an adequate risk-adjusted return.

Bank of Valletta is today the largest bank in Malta. The Bank is classified as a systemically important institution and together with another 117 banks falls within the regulatory framework of the Single Supervisory Mechanism (SSM). Notwithstanding its small size when compared to its European counterparts, BOV has to abide by the same harmonised regulations as other larger EU banks. This has provided us with a greater impetus to strengthen our Corporate Governance framework. This period has seen an extensive review of the terms of reference of the Board Committees, the amended Memorandum and Articles of Association, the introduction of various policies, and a more robust internal controls mechanism within the revised Risk Appetite Framework. We enhanced the Group's compliance, risk management and anti-financial crime capabilities. These departments are now housed under one roof in the recently inaugurated Risk Management Centre in Santa Venera. Substantial human and IT resources are also being directed in this area including enterprise-wide risk training.

DIVIDEND POLICY

The Board is committed to maintain a strong capital base that meets current regulatory requirements and supports the Group's strategic and operational goals. The Group registered a Common Equity Tier 1 CET1 capital ratio of 16.1% as at December 2017, an increase of 330 bps when compared to September 2016. This significant increase was the result of the successful rights issue and the retained profit for this financial period. BOV aims to maintain a Group CET1 capital ratio that satisfies the fully-loaded minimum requirement plus a comfortable management buffer.

In recommending the dividend distribution to the Annual General Meeting, the Board was guided by the recently approved Dividend Policy. This policy aims to achieve a balance between the long-term sustainability of the Group, the regulatory requirements and the interest of the shareholders.

The Board of Directors is recommending a gross final dividend of 8 cents per share resulting in a gross total dividend of 11.6 cents per share (as adjusted for Rights Issue) as compared to the adjusted gross total dividend of 9.2 cents per share declared for the last financial year (as adjusted for the bonus issue and Rights Issue).

The Board is also recommending an optional scrip dividend programme. Shareholders have the option to receive new ordinary shares instead of cash dividends. This provides our existing shareholders the opportunity to increase their shareholding without incurring trading costs. The decision was taken following the oversubscription by our shareholders of the rights issue. We want to give an opportunity to our shareholders to subscribe to more shares at a preferential price without incurring trading costs. This is an optional programme. Shareholders will receive their dividend in cash unless they opt for the scrip dividend programme.

CORPORATE SOCIAL RESPONSIBILITY (CSR)

In line with our obligations as the largest company listed on the Malta Stock Exchange we continue to invest substantial resources to ensure a fair balance between economic performance, environmental responsibility and a social conscience as a corporate citizen. This is done both directly as a Bank and indirectly through our two foundations the Marigold Foundation and the Joseph Calleja Foundation.

The social pillar of BOV's CSR programme is largely entrusted to the Marigold Foundation. This NGO provides assistance to a number of both large and small entities which operate in multiple spheres including special needs, mental health, rare diseases, drug rehabilitation and cancer support.

Education is another of our CSR pillars. Our Education Programme is very well received by the general public and has surpassed its tenth year since it was first launched. We continue to support high-performing University of Malta students with various awards throughout the year. The Joseph Calleja Foundation also provides scholarships for talented students with innovative, distinctive or unique artistic or musical talents who are in any way unable to develop or enhance their talents on their own. The Foundation currently has some twenty students under its stewardship.

Sports remain close at heart and BOV is proud to continue with the sponsorship of the major football, water polo and basketball leagues.

While the 2017 BOV Retrospective Arts Exhibition has commemorated its twenty fifth anniversary with a number of student workshops run by the artist Anthony Calleja himself, the Bank continues to support the local art scene. The Malta Philharmonic Orchestra and the Joseph Calleja Concert remain high on our agenda. We are also proud to have partnered the Valletta 2018 Foundation as a Preferred Partner and being named the Bank of the European Capital of Culture.

THE FUTURE

The progress we made over the past years has been remarkable. Faced by the challenges of a more demanding and sophisticated customer base, tighter regulation and controls, plus stiffer competition coming from both traditional and non-conventional players, we continue to strive towards the goal of building a better and more accessible Bank that is both agile and resilient at the same time. A Bank that actively participates in the economic development of the country, that is socially conscious in serving society, caring towards its employees and customers and ultimately delivering sustainable shareholder value for the years to come.

Taddeo Scerri
Chairman
23 March 2018

Chief Executive Officer's Review

Mario Mallia

FINANCIAL YEAR 2017 – A PERIOD OF TRANSFORMATION

The financial period which we have just concluded was a period of transformation in many ways. Perhaps the most evident change occurred in the Group's reporting date, which was switched from 30 September to 31 December, in order to achieve alignment with the vast majority of banks across Europe. This will facilitate more meaningful benchmarking of the Group's performance and financial situation with that of its peers, both local and international. As a result of the change, the financial statements for the financial period 2017 exceptionally cover a period of fifteen months, from October 2016 to December 2017.

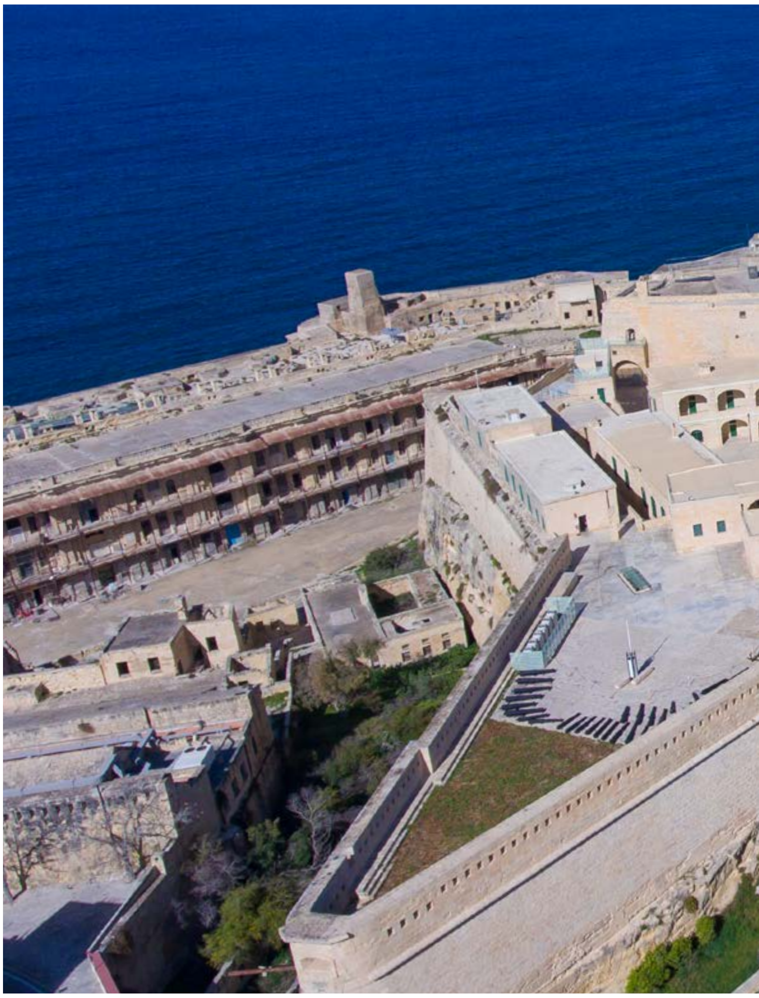
There were, however, a number of more significant changes which were executed during this period, all of which were in furtherance of the Group's strategic vision.

My brief for the financial period '17 remained the same as the one I had received from the Board of Directors on my appointment in January 2016, namely to implement the Bank's strategic plan in accordance with approved budgets and timelines. The Bank's strategy has one overarching vision – to ensure the stability and sustainability of BOV in the long term, while protecting depositors and ensuring a fair and equitable return to shareholders. This vision, internally branded as VISION 2020, is in turn articulated in four strategic goals: the long-term financial sustainability of the Group; the strengthening of the governance framework; the revision of the business model; and the implementation of the Core Banking Transformation (CBT) programme which comprises the change of the core IT system and the re-engineering of associated processes.

I am pleased to report that progress was achieved in all four areas over the period.

The first objective – long-term financial sustainability – was partly addressed through a rights issue of €150 million, which occurred between November and December. This was by far the largest public offering ever launched in Malta, and it was oversubscribed by almost €50 million. It was, however, only one of the building blocks of our capital management plan – over the coming years the Bank will continue to build up strong capital buffers through other initiatives.

The economic environment which characterised the financial period '17 was benign but challenging



Major steps were taken towards achieving the second objective, being the strengthening of corporate governance. The shareholders met in an Extraordinary General Meeting in July 2017 and approved changes to the Articles of Association aimed at enhancing the effectiveness and accountability of the Board of Directors. Concurrently, the Group focused on strengthening its Anti-Money Laundering and Countering of Financing of Terrorism defences, as well as the implementation of a Risk Appetite Framework and a complementary Risk Register.

The Group business model was kept under constant review during the period, with steps being taken to de-risk certain business lines and to diversify the Group's revenue sources. We are now in the final stages of exiting from the Trusts business, and have re-dimensioned other business areas, including international corporate and personal accounts, custody and safekeeping services, where the risk to the Bank is perceived to be high and not adequately compensated by return. The model applied to international accounts and custody services is one of controlled growth, whereby new business will continue to be accepted under more stringent criteria and subject to limits on volumes. Concurrently the Group is taking steps to diversify its income streams, by upgrading its product offering in the areas of wealth management, investment services, savings plans and consumer finance.

Work also continued on the fourth area of strategic focus – the CBT programme. The scope of the original programme has been widened to embrace further IT and process changes, and has now been structured as a holistic Transformation Programme, branded as "Changing BOV Together". This programme, which will extend up to the end of 2019, is centred around the implementation of an Oracle Flexcube core banking system which will take BOV into the 2020s and beyond. The system will also provide the technological foundations for the Bank's future digital channels and products.

THE ECONOMIC CONTEXT

The economic environment which characterised the financial period '17 was benign but challenging. The state of the Maltese economy, which continued to grow at a rate well above the average for the Euro area, offered quite a few opportunities for growth in both the business and the personal sectors. The demand for home loans continued to increase, as did the demand for wealth management, savings plans and investment services. The situation of a vibrant economy with practically full employment was also reflected in the improving quality of the loan book; non-performing exposures decreased, both in absolute terms and as a proportion of total lending.

A booming economy has its opportunities, but also its perils. It is the role of the banking sector to provide credit in a responsible and sustainable manner, and to avoid channelling capital to projects that are overly speculative, which are under-capitalised, or which are based more on market exuberance than on solid economic grounds. While we do not see signs of any developing "asset bubbles", we will continue to exercise all professional diligence in the provision of credit, to ensure that we will always have a well-diversified and good quality loan book at the heart of our balance sheet.

The state of the economy, and of the financial environment around us, has also brought its fair share of challenges. We are facing two main challenges, which, although distinct, are closely related. The first is the "low-for-long" interest rate situation, where benchmark rates continue to hover close to zero or have entered negative territory. Low rates put pressure on banks' profitability, particularly on banks which are very reliant on net interest income. The second challenge is the high level of liquidity in the economy, which, in the current interest rate scenario, places a burden on the banking sector. The strategic revision of the Group's business model, whereby the focus is being shifted towards the generation of non-interest income, is a direct response to these twin challenges.

A third challenge comes from the internationalisation of the local economy, which has led to demographic changes arising from the presence of a growing international workforce. This has necessitated the change and upgrading of KYC (Know Your Customer) and due diligence systems and procedures. The Group is committed to ensuring that all customers onboarded are reputable and bona fide persons, and that only legitimate business enters the banking system.

PERFORMANCE FOR THE FINANCIAL PERIOD 2017[1]

Despite the strain on resources which a transformation programme inevitably entails, the Group turned in a strong performance for the financial period 2017, reporting a pre-tax profit of €174.7 million, compared to €145.9 million for FY 16 or €118.4 million as adjusted for the one-off gain on the VISA transaction. Users of these financial statements are here reminded that the financial period 2017 consisted of fifteen months, while FY 16 comprised twelve months. These results represent an annualised return on equity (ROE) of 16.5% pre-tax (FY 16: 16.9%) or 11.3% p.a. post-tax (FY 16: 13.6% inclusive of the one-off VISA gain). Such a performance compares very well with ROE ratios of banks across the European Union. Data released by the European Banking Federation shows an average post-tax ROE of 3.5% across EU banks for 2016.[2]

The Group recorded an operating income of €300.5 million for the financial period 2017, compared to a total of €278.1 million for FY16 (which, however, included a windfall gain of €27.5 million). Operating income comprises interest margin of €183 million, fee income of €86 million, trading income of €22 million and other income of €9 million.

Interest rates receivable on treasury and liquid assets continued to fall throughout the financial period 2017, while those on loans and advances remained stable. The overall euro-denominated marginal interest rate dropped, but the impact on profit was offset by higher asset volumes.

Fee income amounted to €86.3 million, up from €66.1 million in 2016, with most of the increase arising on investment services and credit card fees. These results were in accordance with expectations, and are the result of the strategic shift towards diversified non-interest earnings. Income from the Group's insurance companies increased quite significantly, with profit recognised for 2017 amounting to €19.3 million, compared to €3.7 million for 2016. This sharp improvement arose on a number of factors, including a stronger performance in both life and non-life business, as well as the consolidation of eighteen months' profit (instead of the usual twelve) in order to align the reporting dates of the various companies.

The results for 2017 include a net impairment reversal of €6.2 million, compared to a charge of €23.1 million for 2016. This reversal reflects the ongoing focus on debt recovery and the management of non-performing loans (NPL), which remain central to Group strategy. In fact, the stock of NPLs continued to decrease throughout the period. For the first time, the Group has adopted an NPL strategy with the aim of articulating a clear and detailed long-term plan of action in this regard.

Overhead costs rose to €151.3 million, compared to €112.8 million for the prior year. The main increases were registered on HR costs, IT maintenance and regulatory expenditures. The main cost drivers were the Group's strategy to strengthen its anti-money laundering and anti-financial crime defences, and the Core Banking Transformation programme. Both entailed considerable recruitment of personnel and the procurement of consultancy services. The Group's Change Programme is, as

[1] All percentages quoted in this review are on an annualised basis so as to facilitate comparability.
[2] European Banking Federation, Banking Sector Performance (https://www.ebf.eu/banking-sector-performance/), accessed 1 March 2018.

The SME segment remains a main pillar of the Bank's customer base

anticipated, impacting costs significantly in the short term, with the relative benefits expected to materialise in the medium-to-longer term.

Customer deposits increased by €916 million over September 2016 to reach €10.1 billion, and now finance 85% of the balance sheet. Concurrently, net lending rose by €160 million to €4.2 billion, representing 36% of Group assets. Securities and equity holdings decreased by €428 million and stand at €3.7 billion, while short term funds increased by €1.3 billion to reach €3.6 billion.

The shift towards bank balances led to a higher mismatch between assets and liabilities with a remaining maturity of one month or less. This would make margin income more sensitive to interest rate changes in the short term. However, we do not, at the moment, foresee any significant change in benchmark euro rates over the coming year.

Shareholders' funds have increased by €233 million over the financial period, and now amount to €962 million.

BUSINESS REVIEW

Gross Loans and Advances to customers increased by nearly 4% during the financial period 2017 to reach €4.47 billion. This affirms the Bank's ongoing commitment to sustain the country's economic development through the supply of good quality credit for both business and consumer finance segments, in a backdrop of a highly regulated environment and competitive market pressures. During the period under consideration both segments of the Bank performed satisfactorily with net growth in balances of circa 2.7% and 5.1% respectively.

The net increase of €60 million registered in the business segment is primarily the result of high sanctioning activity, where more than €550 million were advanced to around 1,200 customers, spread along a number of different business lines. The Bank continued with its strategy of diversifying into new emerging sectors in line with the macro economic trends whilst renewing its support to the traditional industries.

The SME segment remains a main pillar of the Bank's customer base. The support to this segment is reflected in the flow of initiatives and products that the Bank continued to offer during the financial period under review. The BOV JAIME (Joint Assistance Initiative for Maltese Enterprises) instrument proved to be another success story with nearly all the pot of €50 million being allocated within the initial months of the scheme's operations. Through this scheme, SMEs were provided with enhanced access to finance opportunities through low pricing and collateral requirements. As at the end of the financial period 2017 more than €43 million worth of funds were distributed among 400 customers, which represents around 86% of the total pot. Micro entities and start-up companies operating in a variety of sectors including the technological and services industries were key beneficiaries of such funds ensuring the best possible outreach and optimal allocation. A sub-segment where the Bank placed specific focus during the period was family run businesses. A number of information sessions were held with a view to support and provide customised financing solutions for their specific needs.

The consumer finance arm also produced positive results with a net growth exceeding the €100 million mark. The Bank advanced around €440 million over a 12-month period. Despite the highly

competitive landscape, the Bank was in a position to retain its leading market share position in the Home Loans market. This was possible by keeping abreast of market realities and by launching a set of innovative and attractive products tailor-made for different segments of society. The Bank was also very much active on the personal financing side where different products were launched to address different customer needs in line with the country's demographic changes.

Asset quality on the credit portfolio remained of good standard with no major deteriorations being registered during the period. It is the Bank's strategy to continue to solidify its market positioning and to keep credit flowing in the coming years in a sustainable and managed manner to support added value propositions, economic growth and the evolving consumers' requirements and demand.

INVESTMENT SERVICES AND eBANKING

During the course of this financial period, the Bank embarked on a number of initiatives to further strengthen its touchpoints ensuring that these meet the exigencies of its client base.

Insofar as its servicing channels are concerned, the Bank has three key physical service touchpoints. The Bank's international corporate clients that are based in Malta and conducting international business are today serviced through a dedicated centre in Valletta – the International Corporate Centre. This Centre was reorganised in the process to ensure it meets the growing exigencies of this particular market segment. In the process of conducting its review to this Centre, the Bank held discussions with the various corporate service providers in Malta where the account opening process was reviewed to ensure a much more streamlined account opening service. On the other hand, all non-EU/EEA clients were centralised at the Bank's International Personal Banking Centre, which has been resourced with the relevant professional and skilled resources to service the requirements of this market segment. The remaining customers are serviced through the Bank's strong branch network in Malta and Gozo.

On the digital front, the Bank took forward a number of changes to its Internet Banking platform which will extend significant user experience improvements to its strong internet banking customer base. The new platform is planned to be launched during quarter two next year.

On the international front, the Bank also initiated the process to strengthen its network of international representative offices. In fact, following careful strategic evaluation in this regard, the Bank decided to proceed with the necessary requirements to open a Representative Office in the City of London, United Kingdom. The office is planned to be operational by the end of March 2018.

A number of initiatives were also undertaken on the product development side to ensure that the Bank's product suite

continues to meet the exigencies of its clients in a sustained manner. In fact, over the course of this period, the Bank, through its asset management subsidiary BOV Asset Management, introduced three innovative, risk budget driven contractual investment funds which were well received by the Bank's clients and attracted just under €40 million. The Bank also submitted its applications with the Malta Financial Services Authority to upgrade the regulatory license of BOV Asset Management to be able to provide institutional portfolio management as well as pension management. On the latter front, the Bank also took forward initiatives related to the eventual introduction of pension funds on the market during FY 2018.

The Bank also set in motion the process to upgrade its suite of debit and credit cards to contactless. In fact, the Bank has already started rolling out its contactless cards to its clients where the project covering all credit cards will be finalised by mid next year. The introduction of contactless cards ushers in a new era of digital banking in Malta. These cards combine the same security afforded by traditional chip-and-pin cards, with the convenience afforded by wireless payments. In this manner the Bank is making it easier for its clients to pay for low-value items by card rather than paying in cash. Now cardholders can simply tap their card on the EPOS machine at the retailer and the transaction is processed in seconds. There is no need to enter a PIN or sign on any slips as long as the transaction's value is below €20. Moreover, the bank organised various initiatives aimed at supporting its existing suite of products and services with its clients.

Over the course of this period, the Bank also entered into various support agreements with business-led organisations with the view to strengthen its presence and visibility within carefully selected sectors of the economy.

Apart from extending its support to these industry sectors, the Bank, in collaboration with these organisations, held a number of initiatives where it presented its various product and service solutions to their members covering amongst others, banking, investments and payment services, pensions and trade finance solutions.

CONCLUSION

The coming two years will see the realisation of VISION 2020, which will see BOV entering the 2020s as a digitalised and customer-centric bank. In the meantime, management will remain focused on the implementation of the underlying strategic plan. Our aim is to build a low-risk and sustainable but profitable business model which will ensure the long-term stability and viability of the institution.

I would like to conclude by thanking the executive team and all staff for their unwavering commitment to the Bank; our Board of Directors for their oversight and support; our supervisors for the guidance that they provide; and all our valued customers, without whom all our efforts would be in vain.

Mario Mallia
Chief Executive Officer
23 March 2018

Corporate Social Responsibility (CSR)

As a concept, Corporate Social Responsibility (CSR) has been developing since the early 1970s. There are various definitions and interpretations of this concept. For us at Bank of Valletta, CSR is the yardstick against which we measure our policies and practices, and the manner we interact with the different stakeholder groups.

The impact of an organisation's operations on society is generally proportional to its footprint. BOV boasts a history that goes back 200 years and is inextricably linked to the Maltese islands. We are one of the largest employers, striving to be the employer of choice and serving over 300,000 personal customers. With a retail network spanning 36 branches, five Business Centres and six Investment Centres across Malta and Gozo, in addition to a full-fledged Wealth Management arm and Corporate Centre, our footprint is significant.

Nonetheless, CSR does not present an easy 'plug-in' formula. For a financial services provider like BOV, where its people constitute the backbone of the organisation, whether they deal directly with the external customer or not, embracing CSR means building an internal culture of commitment to customers and society. An intimate knowledge of the environment in which the Bank operates and customers' specific needs is indispensable to provide customers with reliable service and added value. It is only by achieving internal excellence in this regard that valid society results can be achieved.

For BOV, CSR has become congruent to the manner in which we manage our business. To a great extent, the measure of our success is the difficulty experienced in trying to extract CSR-driven action from the day-to-day management of the business.

Here we outline the highlights of our journey during 2017:

CUSTOMERS

Inauguration of Gżira Premises

The new premises in Gżira represent a direct investment in the Bank's employees and an indirect one in its customers. In addition to the Branch and Investment Centre, these premises house the Bank's Training Centre and its Ethic and Employee Development function.

Dedicated Risk Management Unit

2017 also saw BOV inaugurating new premises for its Risk Management functions including a dedicated Anti-Financial Crime Unit. This is evidence of the Bank's enhanced efforts to ensure an adequate balance is reached between its dual goal of business growth and risk monitoring.

HERITAGE

Gran Salon

Bank of Valletta is supporting the conservation of the 'Gran Salon', one of the most captivating features of the Auberge de Provence in Valletta, boasting richly painted walls and wooden beamed ceiling.

Ta' Ġieżu Church

BOV Executives were among the first to visit the Ta' Ġieżu Church following the collapse of the ceiling, and pledging the Bank's support.

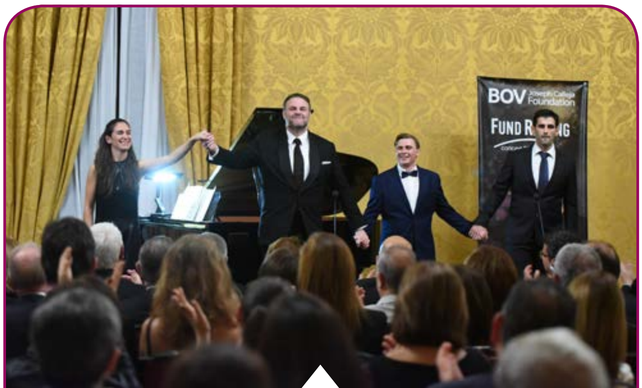
Martyrdom of St Lawrence – Mattia Preti

'The Martyrdom of St Lawrence', probably the largest painting by Italian Master Mattia Preti in Malta, found at the Church of St Lawrence in Vittoriosa dates back to 1689. It is currently undergoing extensive conservation through the support of Bank of Valletta.

Fondazzjoni Wirt Artna

Throughout the years during which BOV has collaborated with Fondazzjoni Wirt Artna, this NGO has remained true to its mission; managing several historical sites and buildings around Malta and Gozo, and bringing history to life through well-researched re-enactments.

BOV Joseph Calleja Foundation



This year, the BOV Joseph Calleja Foundation Concert provided a showcase for the young talented performers that the Foundation has taken under its wings. The Foundation runs another programme *Vulnerable Child* through which it uses music as therapy to help children overcome challenging circumstances.

Marigold Foundation – BOV in the Community

The Marigold Foundation – BOV in the Community organises various initiatives to raise awareness about philanthropic causes and NGOs. BOV employees dedicated a Dress Down Day in October 2017 towards the Pink October Campaign coordinated by the Marigold Foundation.

ENVIRONMENT

Killifish Conservation Project

The Killifish Conservation Project saw the Bank collaborating with Nature Trust Malta and the Aquaculture Directorate to conserve this small fish endemic to the Mediterranean. This project was a success so much so that Environment Minister José Herrera has recently declared this fish a national specie.

Dinja Waħda – Birdlife (Malta)

2017 saw BOV resuming its role as the Educational Partner of BirdLife Malta in relation to its programme *Dinja Waħda* which is targeted at Primary School children. This programme provides teachers with a valuable resource kit.

EDUCATION

Read with Me Programme

BOV has been collaborating with the National Literacy Agency since it was set up. The *Read with Me* programme is designed to make reading a fun activity for children aged zero to three years, and their parents/carers.

Discover Valletta

Discover Valletta is a series of brief narratives about locations in the capital city Valletta, available in audio format through MP3, a pack of flash cards and a map. With BOV's support, the packs are distributed to Form 1 students attending state, church and independent schools around Malta and Gozo.

SPORTS

Tazza l-Kbira

Bank of Valletta supported 'It-Tazza l-Kbira' – the Malta Racing Club's biggest annual event for horse racing.

Football

Bank of Valletta supports all senior football competitions organised by the Malta Football Association, both male and female.

Water polo

BOV's collaboration with the Aquatic Sports Association of Malta has seen the quality of the water polo game improving year on year.

Basketball

Through its support of the Malta Basketball Association, the Bank promotes excellence through individual awards in a team game. The BOV Basketball Player of the Month rewards the hardest working player and the best performers.

ARTS AND CULTURE

BOV Retrospective Art Exhibition

Renowned contemporary artist Anthony Calleja was the protagonist of the 25th BOV Retrospective Exhibition. Sculptures and paintings from the 1980s to his more recent work gave a unique insight into Anthony's search for his artistic soul over the years.

Joseph Calleja Summer Concert

The big voices of the young members of the BOV Joseph Calleja Choir were yet again one of the protagonists of the Maltese Tenor's annual summer concert, which this year marked his 20th anniversary. This choir effectively nurtures a love for music among the very young and their immediate families.

Teatru Manoel

BOV deepened its commitment towards Teatru Manoel, not only towards Mozart –Da Ponte's opera *Le Nozze di Figaro*, but also vis-à-vis the Theatre's much-loved education programme *Toi Toi*.

Malta Philarmonic Orchestra

The Bank is committed towards supporting the Malta Philarmonic Orchestra, and by extension its sister-ensemble the Malta Youth Orchestra, which serves as a launching pad for young musicians, providing them with more opportunities to fine-tune their skills whilst concurrently expanding their horizons.

CONCLUSION

For Bank of Valletta, Corporate Social Responsibility is an ongoing journey. Further details about the Bank's Corporate Social Responsibility may be found under Principle 12 on page 40.

Directors' report as at 31 December 2017

The Directors present their 44th Annual Report, together with the audited financial statements of the Bank of Valletta Group (the Group) and the Bank for the Financial Period ended 31 December 2017.

Principal Activities

The Bank of Valletta Group comprises Bank of Valletta p.l.c. (the Bank) and two subsidiary companies namely BOV Asset Management Limited (BOV AM) and BOV Fund Services Limited (BOV FS). Both subsidiaries changed their company name during financial period 2017. Valletta Fund Services Limited's name was changed to BOV Fund Services Limited and Valletta Fund Management Limited's name was changed to BOV Asset Management Limited. The Group also has two equity-accounted investee companies, MAPFRE Middlesea p.l.c. and MAPFRE MSV Life p.l.c. The Group's principal activities are set out below.

The Group offers banking, financial and investment services and connected activities within the domestic Maltese market. The principal activities of the Bank comprise the following:

1) The receipt and acceptance of customers' monies for deposit in current, savings and term accounts which may be denominated in Euro and other major currencies.

2) The provision of loans and advances to a wide array of customers.

3) The provision of investment services, covering a comprehensive suite of investment products and services that meet the customers' needs throughout their lifecycle, including stockbroking, advisory and discretionary portfolio management services.

The Group also provides a number of other services, including, bancassurance, corporate advisory, custody, fund management and fund administration, and other services, such as 24-hour internet banking service, issuance of major credit cards, night safe facilities, automated teller machines, foreign exchange transactions, outward and inward payment transfers.

The Bank has a well-developed worldwide network of correspondent banks that provide it with the necessary backbone to service its customers in international banking and trade transactions.

In most part, the activities of the Bank are licensable activities regulated under the domestic and EU financial regulatory framework.

Pursuant to Article 177 of the Companies Act, 1995 (Chapter 386, Laws of Malta), the Directors declare that there were no significant changes in the activities of the Bank during Financial Period 2017.

Information on the performance of the Bank is found under the CEO's Review.

The Parent Company

Bank of Valletta p.l.c. is licensed to carry out the business of banking and investment services in terms of the Banking Act,1994 (Chapter 371, Laws of Malta) and the Investment Services Act,1994 (Chapter 370, Laws of Malta). The Bank is an enrolled tied insurance intermediary of MAPFRE MSV Life p.l.c. under the Insurance Intermediaries Act, 2006 (Chapter 487, Laws of Malta).

The Bank offers the entire range of retail banking services as well as the sale of financial products such as units in collective investment schemes. The Bank also offers investment banking services, including underwriting and management of Initial Public Offerings (IPOs) as well as custody services.

The Subsidiaries

BOV AM provides management services for collective investment schemes and is a fully owned subsidiary of the Bank. On 17 March 2017, BOV AM had its licence extended to offer asset management services beyond collective investment schemes, in order to tap into the growing demand for bespoke portfolio management services to professional institutional clients. BOV AM has three regulatory functions: Asset Management, Risk Management and Compliance.

BOV FS is also a fully owned subsidiary of the Bank and is a recognised fund administrator by the Malta Financial Services Authority. BOV FS provides a comprehensive suite of services to fund managers and fund promoters, as well as a full suite of fund administration including fund accounting, shareholder registry services, regulatory reporting and corporate services.

The Associates

MAPFRE MSV Life p.l.c. operates as a life assurance company licensed under the Insurance Business Act, 1998 (Chapter 403, Laws of Malta). MAPFRE Middlesea p.l.c. is engaged in the business of insurance, including group life assurance.

Directors' report as at 31 December 2017 (continued)

Strategic Initiatives of the Bank

The Board of Directors has articulated clear corporate goals for the Bank and has set Strategic Initiatives for the years 2018 to 2020. These goals, which describe what the Bank aims to achieve in the long term, are as follows:

1) Financial stability and sustainability;
2) Protection of the interests of depositors; and
3) Provision of a sustainable and equitable return to Shareholders.

The Board has further identified a number of corporate strategies, which define the ways in which the Bank plans to achieve its goals. The principal strategies are:

1) Consolidation of long term financial sustainability;
2) Strengthening corporate governance;
3) The adoption of IFRS 9;
4) Revision of the business model; and
5) Reinforcement of HR and IT resourcing.

Principal Risks and Uncertainties pursuant to Article 177 of the Companies Act, 1995 (Chapter 386, Laws of Malta)

The Directors are aware of the various risks faced by the Group as a result of its involvement in different business lines and operations.

A number of measures are in place to ensure that such risks and uncertainties are maintained at acceptable levels and are in line with the Group's risk appetite and strategy of sustainable, long term growth and profitability. In March 2017, a revised Risk Appetite Statement and Framework was approved by the Board for the BOV Group. The document lays out the responsibilities of various stakeholders, including the Board of Directors and Senior Management, and establishes a number of qualitative and quantitative parameters for acceptable risk taking.

In line with the provisions of the Risk Appetite Statement and Framework, Senior Management is responsible for the day to day monitoring and control of risk taking, subject to the regular oversight of the Board through the Risk Management Committee. The overall structure is aimed at ensuring a sound risk culture supported by a performance management system that discourages excessive risk taking.

The key risks faced by the Group include credit risk, market risk, operational risk and liquidity risk. These, and other risks and uncertainties inherent in the business, require sound capital management to ensure adequacy against regulatory requirements and adverse events. With this in mind, the Group regularly sets out and reviews capital targets in line with actual and forecast business levels and monitors performance against such targets on a regular basis. A more detailed explanation of key risks and capital management is included within the *Capital and Risk Management Report*.

The Directors also recognize the fact that the Group may be subject to reputation and litigation risk as a result of its actions and operations. Conscious of the serious repercussions such risks may have on the Group's and the various stakeholders' wellbeing, both the Board of Directors and Senior Management exercise zero tolerance to conduct risk and aim to instill the highest levels of ethical behaviour through a number of appropriate policies, procedures and controls.

Operational Overview

A review of the business of the Group for the period ended 31 December 2017 and an indication of future developments are provided in the Chairman's Statement and the Chief Executive Officer's Review, which can be found in the front section of this Annual Report.

Dividends

A gross interim dividend of €0.0450 per share was paid on 26 May 2017. The Directors propose a final gross dividend of €0.0800 per share, resulting in a total gross dividend for the period of €0.116 per share (as adjusted for Rights Issue). The aggregate net dividend for the period is €0.075 per share (as adjusted for Rights Issue) amounting to €39.59 million (2016: €0.06 net per share as adjusted for bonus issue and Rights Issue, resulting in a net payout of €31.51 million). The total dividend is analysed as follows:

	The Bank	
	2017	2016
	€	€
Gross	60,900,000	48,477,000
Tax at source	(21,315,000)	(16,966,950)
Net	39,585,000	31,510,050

The Directors propose that shareholders are offered the right to elect to receive the dividend either in cash or by the issue of new shares.

Directors' report as at 31 December 2017 (continued)

Board of Directors

The following Directors served on the Board during the period from 1 October 2016:

Taddeo Scerri (appointed Chairman 16 December 2016)
John Cassar White (resigned 16 December 2016)
Stephen Agius (appointed 16 December 2016)
Alan Attard (appointed 16 December 2016)
Paul V Azzopardi (appointed 16 December 2016)
Miguel Borg (appointed 27 July 2017)
Barbara Helga Ellul (resigned 16 December 2016)
James Grech
Mario Grima (resigned 16 December 2016)
Alfred Lupi
Mario Mallia (appointed 27 July 2017)
Anita Mangion (appointed 16 December 2016)
Antonio Piras (appointed 16 December 2016)
Gabriele Simonetti (resigned 16 December 2016)
Joseph M Zrinzo

Directors' Responsibilities

The Directors are required by the Companies Act, 1995 (Chapter 386, Laws of Malta) to prepare financial statements in accordance with International Financial Reporting Standards as adopted by the EU which give a true and fair view of the state of affairs of the Group and the Bank as at the end of the financial period and of the profit or loss of the Group and the Bank for the period then ended. In preparing the financial statements, the Directors should:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable; and
- prepare the financial statements on a going concern basis unless it is inappropriate to presume that the Group and the Bank will continue in business as a going concern.

The Directors are responsible for ensuring that proper accounting records are kept which disclose with reasonable accuracy at any time the financial position of the Group and the Bank, and which enable the Directors to ensure that the financial statements comply with the Banking Act, 1994 (Chapter 371, Laws of Malta) and the Companies Act, 1995 (Chapter 386, Laws of Malta) and with the requirements of Article 4 of the Regulation on the application of IFRS as adopted by the EU. This responsibility includes designing, implementing and maintaining such internal controls as the Directors determine necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error. The Directors are also responsible for safeguarding the assets of the Group and the Bank, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

After reviewing the Group's plans for the coming financial years, the Directors are satisfied that at the time of approving these financial statements, it is appropriate to continue adopting the going concern basis in preparing these financial statements.

During financial period 2017, the Board of Directors resolved to change the financial reporting date of the Bank from 30 September to 31 December. The objective was to align the Bank's financial year-end with that of the vast majority of its European counterparts. The financial period which started on 1 October 2016 had a duration of 15 months and ended on 31 December 2017. Thereafter, each financial year will commence on 1 January and will end on 31 December.

Auditors

A resolution to re-appoint KPMG Malta jointly with KPMG LLP (United Kingdom) as auditors of the Bank will be proposed at the forthcoming Annual General Meeting (AGM). KPMG Malta and KPMG LLP (United Kingdom) have expressed their willingness to remain in office.

Information pursuant to Listing Rule 5.64

Following the approval of the Shareholders of the Bank, during an Extraordinary General Meeting held on 27 July 2017, the Bank's authorised share capital increased from €500 million to €1,000 million divided into 1,000 million ordinary shares with a nominal value of €1.00 each.

The issued shares of the Bank consist of one class of ordinary shares with equal voting rights attached.

Following the approval of the shareholders of the Bank during the 43rd AGM held on 16 December 2016, on the 16 January 2017, the amount of €30,000,000 from the Bank's reserves was capitalised for the purpose of a bonus issue of 30,000,000 ordinary shares of a nominal value of €1.00 each fully paid up. Following this allotment, the issued share capital of the Bank increased from €390,000,000 to €420,000,000 divided into 420,000,000 ordinary shares with a nominal value of €1.00 each fully paid up.

Directors' report as at 31 December 2017 (continued)

During the period under review the Bank went through a Rights Issue of €150 million worth of new ordinary shares. Following the listing of the new Ordinary Shares on 22 December 2017, the issued and paid up capital of the Bank increased from €420,000,000 to €525,000,000 divided into 525,000,000 ordinary shares with a nominal value of €1.00 each. Since an increase in the issued share capital requires a change in the Memorandum and Articles of Association, which in turn requires shareholders' approval, a specific resolution to this effect will be presented for the shareholders' approval at the forthcoming AGM.

Clause 4.3 of the Bank's Memorandum of Association provides that, with the exception of existing large shareholders, presently the Government of Malta and UniCredit S.p.A., no person may at any time, whether directly or indirectly and in any manner whatsoever acquire such number of shares in the Bank as would in aggregate be in excess of 5% of the issued share capital of the Bank. This threshold was previously 3% but was revised to 5% and approved during the Extraordinary General Meeting held on 27 July 2017. As at 31 December 2017, Malta Government Investments Limited had a shareholding in the Bank of 0.48% and National Development and Social Fund (NDSF) had a shareholding in the Bank of 2.91%. Both entities are fully owned by the Government.

Any shareholder holding in excess of 50% of the issued share capital of the Bank or if no such shareholder exists, the shareholder holding the highest number of shares not being less than 25% of the issued share capital, may appoint the Chairman. As also explained in more detail below, Qualifying Shareholders with 10% or more of the shares in issue are entitled to recommend one Director for every 10% holding.

The Directors confirm that as at 31 December 2017, shareholding in excess of 5% of the issued share capital of the Bank was held directly by:

Government of Malta	25.23%
UniCredit S.p.A.	11.64%

There were no changes in shareholders holding 5% or more of the issued share capital up to 23 March 2018 except that on 22 March 2018 UniCredit S.p.A. sold 7,670,250 shares by means of an off-exchange transaction. Following said transaction, the percentage holding by UniCredit S.p.A. in the Bank reduced to 10.0001%.

Memorandum and Articles of Association of the Bank

The Bank's Memorandum and Articles of Association was revised during the period under review and approved by the Shareholders during an Extraordinary General Meeting held on 27 July 2017.

One of the main changes therein, related to the introduction of the distinction between Executive and Non-Executive Directors. This with a view to enable Non-Executive Directors to exercise their monitoring function over management and the executive arm of the Board.

Another change related to the increase of the total number of Directors, from a maximum of eleven Directors to a maximum of twelve Directors, out of which, nine shall be Non-Executive Directors and a maximum of three shall be Executive Directors. The CEO is the first Executive Director, who is appointed by virtue of his office as Chief Executive Officer. Upon appointment as CEO, the CEO assumes the role of Executive Director ex officio and shall remain in office until his/her post as CEO terminates. With respect to the appointment of any other Executive Directors, the Non-Executive Directors are bound to appoint at least one such Director and may, if they consider it appropriate to do so on the basis of the skill, competence and experience required at the Board, appoint the third Executive Director. In either case any person so appointed shall be a senior executive officer of the Bank answerable directly to the CEO or the Board of Directors.

The new Articles of Association also introduced the set up of the Nominations and Governance Committee (NGC), which is responsible to ensure that the composition of the Board of Directors provides the appropriate level and mix of experience, skills, and competence required and ensure that persons occupying the post of Non-Executive Directors meet the legal requirements.

The Articles of Association also clarified the appointment of Non-Executive Directors by Qualifying Shareholders and Non-Qualifying Shareholders. Shareholders with 10% or more of the issued share capital were previously entitled to appoint one Director for every 10% holding. Whilst in essence this practice was retained, the Qualifying Shareholder shall now make a recommendation to the NGC, and only if in line with the scrutiny and assessment of that Committee, the recommended person is considered fit and proper, may that person take up office as Director. The NGC has the power to refuse a recommendation by a Qualifying Shareholder if the candidate does not meet the attributes required by the Board. In such cases the Qualifying Shareholder will be entitled to make other recommendations. The threshold applicable for Non-Qualifying Shareholders to nominate Non-Executive Directors was increased from 5,000 shares to €50,000 in nominal value. The threshold is no longer the number of shares but rather the nominal value. Non-Qualifying Shareholders will be entitled to make recommendations to the NGC of candidates who meet the criteria set by the same Committee. Only candidates whose nomination has been approved by the NGC shall be presented to the shareholders in general meeting for an election. The appointment of all Directors (Executive and Non-Executive) is subject to regulatory approval.

The rules governing the appointment and replacement of the Bank's Directors are contained in Articles 24 to 31 of the Bank's Articles of Association.

An extraordinary resolution approved by the shareholders in general meeting is required to amend the Memorandum and Articles of Association.

Directors' report as at 31 December 2017 (continued)

The Board of Directors has the power to transact all business of whatever nature, not expressly reserved by the Memorandum and Articles of Association of the Bank, to be exercised by the Bank in general meeting or by any provision contained in any applicable laws.

The shareholders in general meeting authorised the Board to exercise during the Prescribed Period all the powers of the Bank to issue and allot shares up to an aggregate nominal amount equal to the Prescribed Amount. The Prescribed Period refers to a term of five years approved during an Extraordinary General Meeting held on 27 July 2017 and which term expires on the 26 July 2022. This authority is renewable for further periods of five years each.

The Directors have service contracts with the Bank. More information on the Directors' service contracts can be found under the Remuneration Report.

The relative Collective Agreements regulate the compensation payable to employees in case of resignation, redundancy or termination of employment for other reasons.

It is hereby declared that as at 31 December 2017, information required under Listing Rules 5.64.5, 5.64.7 and 5.64.10 is not applicable to the Bank.

Information pursuant to Listing Rule 5.70.1

There were no material contracts to which the Bank, or any one of its subsidiaries was a party and in which anyone of the Bank's Directors was directly or indirectly interested.

Going concern – Listing Rule 5.62

The financial statements are prepared on a going concern basis. The Directors regard that pursuant to Listing Rule 5.62, this is appropriate, after due consideration of the Bank's profitability, liquidity, the statement of financial position, capital adequacy and solvency. Specifically, the Directors have prepared financial and capital plans for the next five years which shows that the Bank is in a position to continue operating as a going concern for the foreseeable future. These plans take into account risks facing the Bank, including but not limited to, the potential crystallisation of known contingent liabilities.

Shareholder Register Information pursuant to Banking Rule 7/2014

Directors' interests in the share capital of the Bank or in related companies as at 31 December 2017 are contained in the Corporate Governance Statement.

Number of shareholders analysed by range:

	23 March 2018	
Range of shareholding	**Total Shareholders**	**Shares**
1 – 500	928	249,554
501 – 1,000	1,837	1,425,908
1,001 – 5,000	7,681	21,999,586
5,001 and over	10,233	501,324,952
Total shareholding	**20,679**	**525,000,000**

Declaration pursuant to Investment Services Rule R4-4.3.4

Pursuant to Investment Services Rule R4-4.3.4, it is hereby declared that during the reporting period, there were no breaches of Standard Licence Conditions or other regulatory requirements.

Information pursuant to the Sixth Schedule of the Companies Act, 1995 (Chapter 386, Laws of Malta)

Branches, Agencies and Centres

The Bank has the following Branches, Agencies and Centres around Malta and Gozo:

- 36 Branches offering both deposit taking and lending services
- 5 Business Centres
- 6 Investment Centres
- 4 Agencies offering deposit services only
- 1 Sub-Agency/Satellite Branch offering both deposit and lending services which reports to the "parent" branch

Directors' report as at 31 December 2017 (continued)

Besides the above local Branches, the Bank has four Representative Offices, one in Milan which was opened in 1996, one in Libya which was opened in 2002, one in Brussels, opened in 2012 and another one in London which was opened in March 2018.

Research and Development

In light of the business sector in which it operates, the Bank does not consider research and development as a main area of activity.

Events occurring after the end of the accounting period

On the 15 and 16 January 2018, UniCredit S.p.A. disposed of 946,185 shares in the Bank, which amount of shares represents 0.18% of UniCredit S.p.A.'s shareholding in the Bank. These shares were traded on the market. As at 16 January 2018, UniCredit S.p.A. held 11.46% shareholding in the Bank. Furthermore on the 22 March 2018, UniCredit S.p.A. disposed of 7,670,250 shares in the Bank by means of an off-exchange transaction. This amount of shares represents 1.461% of UniCredit S.p.A.'s shareholding in the Bank. Therefore, as at 23 March 2018, UniCredit S.p.A. held 10.0001% shareholding in the Bank.

Non-Financial Disclosures

Environmental Friendly Measures – The Bank's ongoing commitment to promote Green practices within the community and determination to decrease the carbon footprint led to various Green Initiatives that included installations of modern, energy efficient Heating Ventilation Air Conditioning (HVAC) systems, continuous disinfection and cleaning of ducting systems at various branches, replacement of lights to energy efficient Light Emitting Diodes (LED) light fittings and installations of PV Cells which generated electrical energy and which was sold to the Government. The Bank also participated in the annual global initiative Earth Hour by switching off the BOV Centre and Legal Office façade lights during the hour indicated, with the aim of reducing electricity consumption. The Bank also participated in the European Week for Waste Reduction. Waste Separation and Recycling of Electronic Waste was ongoing throughout the reporting period. Furthermore, twenty trees were planted during a tree planting activity in November 2017.

Human Resources Matters – The Bank is covered by a Collective Agreement which binds the relationship between the organisation and its employees. The prevailing Collective Agreement includes a number of Family Friendly measures ensuring employee matters are looked after, including but not limited to Flexible Work Arrangements, Adoption/Fostering Leave, Bereavement Leave, Community Work Leave, Employee Welfare and an Employee Wellness Allowance. Moreover, the Bank has in place a number of policies ensuring respect for human rights including a Bullying Policy, Health and Safety Policy, a Code of Ethics and an Equality Policy. Related to the latter, the Bank has been awarded the Equality Mark, in recognition of the Bank's non-discriminatory approach to its workforce. An Employee Assistance Programme is also in place to assist employees resolve personal or work related problems that critically hinder their ability to carry out responsibilities at work. The Bank, in conjunction with the Richmond Foundation, also offers its staff members free Mental Health Care related services. The Bank's Performance Management System is divided in four quadrants, namely Financial, Process, Customer and Employee, out of which 60% are non-financial key performance indicators.

Anti-Corruption and Bribery Matters – The Bank has a zero tolerance policy towards bribery and corruption and is committed to applying high standards of honesty and integrity. Recognising that bribery and corruption can have negative effect on its shareholders, its clients and the wider financial industry, the Bank is in the process of setting up a dedicated Unit as part of its Anti-Financial Crime Department. The Bank is also implementing initiatives to address key bribery and corruption risks including policies, procedures and training.

Other than as disclosed in note 33 to the financial statements, there were no subsequent events which would have otherwise warranted an adjustment to or disclosure in these financial statements.

Statement by the Directors pursuant to Listing Rule 5.68

We, the undersigned, declare that to the best of our knowledge, the financial statements prepared in accordance with the applicable accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Bank and its subsidiaries included in the consolidation taken as a whole, and that this report includes a fair review of the performance of the business and the position of the Bank and its subsidiaries included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

Approved by the Board of Directors and authorised for issue on 23 March 2018 and signed on its behalf by:

Taddeo Scerri Chairman	Joseph M Zrinzo Director

Capital & risk management report 31 December 2017

Pillar 3 Disclosures

Basis for preparation

The Basel III capital adequacy framework consists of three complementary pillars: Pillar 1 provides a framework for measuring minimum capital requirements for the credit, market and operational risks faced by banks; Pillar 2 addresses the principles of the supervisory review process, emphasizing the need for a qualitative approach to supervising banks; Pillar 3 requires banks to publish a range of disclosures aimed at providing further insight on the capital structure, adequacy and risk management practices.

This Capital and Risk Management Report provides Pillar 3 disclosures for BOV Group (hereinafter referred as 'the Group') in accordance with disclosure requirements under Part Eight of EU Regulation No. 575/2013 Capital Requirements Regulation (CRR). During 2017, the EBA released guidelines on disclosure requirements which aim to improve the comparability and consistency of institution's Pillar 3 disclosures. These guidelines, applicable as from December 2017, provide detailed disclosure requirements for credit risk, counterparty credit risk, market risk and capital requirements.

The Bank publishes these disclosures on an annual basis as part of the Annual Report and Financial Statements in accordance with Article 433 of the CRR. A reference has been added in cases where the information addressing Pillar 3 requirements is included in other parts of the Annual Report.

This Capital and Risk Management Report is not subject to external audit, except where a disclosure is equivalent to that made in the Financial Statements which adhere to International Financial Reporting Standards (IFRS) as adopted by the EU. Nonetheless, this Capital and Risk Management Report has been verified internally and was approved by the Bank's Audit Committee and the Board of Directors (BoD). The Bank is satisfied that internal verification procedures ensure that these Additional Regulatory Disclosures are presented fairly.

Section 1: BOV Risk Management

It is the core function of every bank to take risks consciously with the aim of managing them to achieve a return. The Group is consistently working towards achieving the required balance between profitability and growth against the appropriate risk levels.

The Group's Risk Appetite Framework (RAF) articulates the types and level of risk that the Group is willing to take in pursuit of the strategic objectives. The RAF ensures that all material risks are kept within appropriate limits, both to safeguard the financial sustainability of the Group, as well as to meet the needs of the stakeholders (including depositors, shareholders and regulators). Any breaches or early warning signs need to be immediately escalated to the CEO and/or CRO and further to the Risk Committee, the Compliance and Crime Prevention Committee or the BoD as applicable. To maintain an environment where staff are comfortable raising concerns, the Bank also has a whistleblowing policy and the respective procedures in place. During 2017, the Group's RAF was reviewed and approved by the BoD and communicated with management and all departments to ensure a robust risk culture throughout the organisation.

Within this context, the Bank's organisational structure is built upon a framework that promotes a transparent and efficient, enterprise-wide risk management culture wherein the behaviour, attitude and decisions reflect risk awareness and mitigation across the Group. Great importance is given to the risk governance structure, which includes corporate value statements, codes of conduct and ethics, policies, procedures and risk assessment. The Group strives to strengthen and build upon the existent risk values so as to minimise risk exposure to insignificant levels.

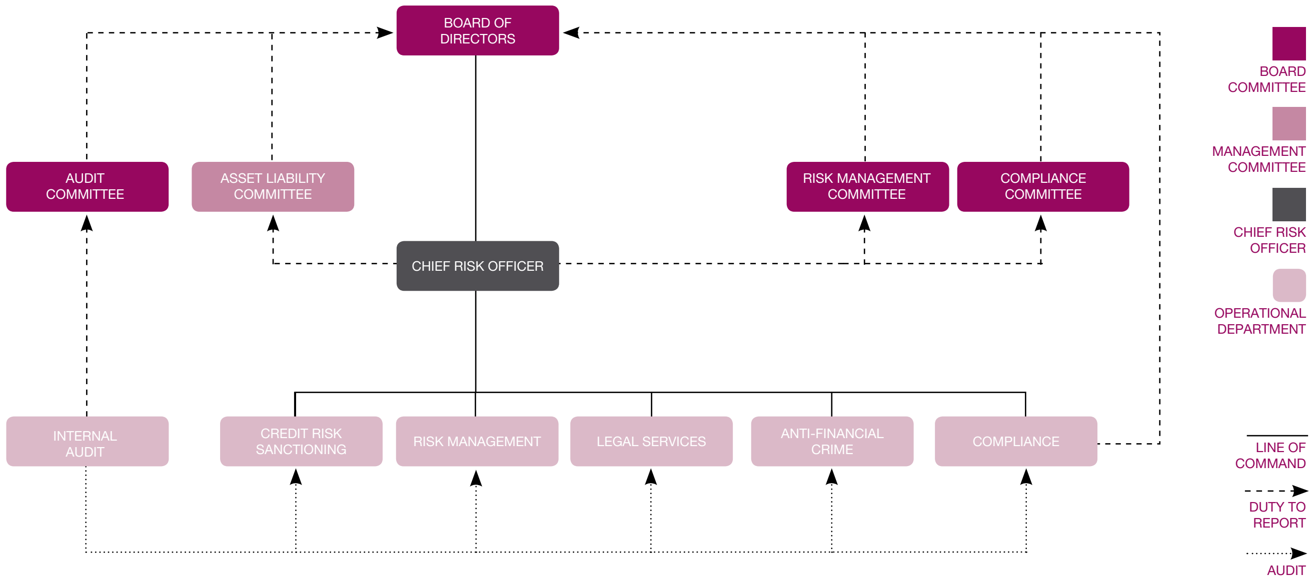
The Group's risk culture supports the core competency and business strategy. One of the high priority objectives of the second line of defence is to instil a cultural awareness which helps to establish a robust risk management and control process. This is done through training, workshops and continuous sharing of information between different departments and business lines. During this financial period, the Group engaged in a bank-wide risk register exercise which aids in the identification and management of risk across the Group and also serves to improve the level of risk awareness.

Risk Governance

The Bank adopts different layers of defence and segregates duties to reinforce the currently implemented risk control mechanisms. Such approach is embraced through the application of the three lines of defence model. The first line of defence is executed by the functions that own and manage risks, namely the business units. The second line is executed by the functions that oversee risks, namely Risk Management, Compliance and Anti-Financial Crime Departments; and the third line is executed by Group Internal Audit, which is the function that provides independent assurance to the Board. This means that responsibility for risk management resides at all levels within the Bank. The Group continues to adopt and strengthen the three lines of defence by ensuring effectiveness of the risk management framework which includes constant monitoring and assurance. The risk governance framework efficiently enhances the understanding of existing and emerging risks through cooperation between all three lines and effectively executing risk management controls. The collective effort across different lines of defence ensures that the Group's risk culture is recognised as an essential factor to achieve compliance and strategic objectives.

Capital & risk management report 31 December 2017 (continued)

The Bank's risk governance structure is represented below:



The following points give a brief description of the main functions of the second line of defence.

The Risk Management Department is responsible for the overall risk management of the Bank. In order to ensure integrity, the Risk Management Department operates independently of the Bank's business activities. This Department has a number of units including:

- *Credit Risk Management Unit (CRMU).* The Unit's objective is to safeguard the soundness of the loan portfolio, to ensure sustainable credit growth and to enable a diversified portfolio aligned with the Bank's risk appetite. CRMU is responsible for the development and maintenance of the Credit Policy, which sets out the Bank's core principles governing the provision of credit. The Unit is also responsible for measuring and managing asset quality in line with the prevailing banking rules.

- *Enterprise Risk Management Unit (ERMU)*. ERMU takes a holistic enterprise-wide view of the risks taken on by the Bank in carrying out its business and ensures that these are consistent with the overall risk appetite framework. It is a central unit which is responsible for the management of risk reporting, risk data governance and portfolio risk management. The Unit is responsible for internal stress tests and regulatory periodic stress tests conducted by the European Central Bank (ECB) and is also actively involved in the compilation and submission of the Internal Capital Adequacy Assessment Programme (ICAAP), Internal Liquidity Adequacy Assessment Programme (ILAAP) and the Recovery Plan.

- *Economics & Risk Research Unit.* The Unit brief includes the monitoring of the Bank's economic environment with special focus on the local and European economy. The Unit is responsible for conducting all mathematical, statistical and economic research that is required by the Bank.

- *Operational Risk Management Unit.* The core operational risk function is responsible to coordinate and oversee the identification, assessment, management and reporting of operational risks. It is also responsible for the implementation of the Operational Risk Management Framework (ORMF). The key elements of the ORMF are the risk register, risk identification, monitoring of risk indicators, loss database, business continuity and scenario analysis. The Unit is also responsible for the mitigation of operational risks events through the procurement of adequate and cost-effective insurance cover. In addition, the Unit has an information security function which analyses and communicates information security risks and evaluates their potential impact on the business processes.

- *Risk Coordination Unit.* The objective of this Unit is to be the direct link between the first and the second line of defence by increasing the awareness of risk responsibilities and cultivating a risk culture so that risk can be owned and managed within each business unit.

The Credit Risk Sanctioning Department is responsible for conducting independent financial and risk analysis of lending and investment proposals that fall under the dual-voting system and to ensure that these are within the risk appetite communicated by the BoD.

The Legal Services Department ensures that the Bank's interests are duly safeguarded and that the Bank is kept duly updated with all legislative developments. This enables the Bank to map the way forward and be legally prepared even in terms of the Bank's processes.

Anti-Financial Crime Department is responsible for the development and implementation of policies, procedures, systems and controls to counteract financial crime, money laundering, counter terrorism financing, bribery and corruption, and fraud. The Department also ensures that all applicable sanctions are implemented. The MLRO is the Bank's liaison with the FIAU.

Capital & risk management report 31 December 2017 (continued)

Compliance Department is responsible to ensure that the Bank and its subsidiaries operate in line with regulatory requirements. The Compliance Department monitors regulatory developments and assesses the impact and applicability of rules and regulations. It also carries out specific and thematic reviews on various functions, while ensuring that the Group has effective policies for mitigating reputational and conduct risk. It provides regular training on regulatory obligations and requirements emanating from internal policies and procedures.

Key Risks

The Group has specific risk appetite statements for all of its material risks which are reviewed on a regular basis. The main categories of risk related to the business model to which the Group is exposed are shown in the following table. Further details on how these risks are identified and managed at different levels of the organisation can be found in the relevant sections as highlighted below.

Capital Management	The ability to hold sufficient capital to meet both regulatory requirements and shareholder expectations. *[Notes to the Financial statement note 39.7; Pillar 3 disclosures Section 3, 4 and 5]*
Credit Risk	The risk of financial loss if a customer or counterparty fails to meet an obligation under a contract *[Notes to the Financial statement note 39.2; Pillar 3 disclosures Section 6]*
Market Risk	The risk that the fair value or future cash flows will fluctuate because of changes in market prices. Given that the Group does not operate a Trading book, market risk is limited to interest rate risk, currency risk and other price risk. *[Notes to the Financial statement note 39.4; Pillar 3 disclosures Section 7]*
Operational Risk	The risk of losses resulting from inadequate or failed processes, people and internal systems, or from external events. *[Pillar 3 disclosures Section 8]*
Liquidity Risk	It is the risk of incurring losses due to the inability of meeting obligations as they become due and can be categorised into two types: • Funding liquidity risk which results when the Group cannot fulfil its obligations due to being unable to obtain new funding. • Market liquidity risk which occurs when the Group is unable to sell or transform its liquidity buffers into cash without incurring significant losses. *[Notes to the Financial statement note 39.3; Pillar 3 disclosures Section 10]*

The Group's management body monitors the key indicators on a regular basis to ensure proper monitoring and adherence to risk appetite limits. In addition, early warning indicators embedded in the Group's recovery plan are monitored on a frequent basis. The BoD, Management Board (MB) and various committees are presented with risk reports on a regular basis to ensure adequate risk management, enabling them to take corrective action in a timely manner. These reports provide insight on particular risks, highlighting the current position, compliance with set limits and sensitivity analysis.

Section 2: Scope of application of the regulatory framework

The consolidation of the Group's financial statements is based on the IFRSs, whereas the prudential consolidation in the statement of capital is based on the CRR 575/2013. The following table gives an overview of the accounting and regulatory consolidation methods for each entity within the Group. Further information on the Group's associates and subsidiaries can be found in note 18 and 19 to the Financial Statements, respectively.

EU LI3 - Outline of the differences in the scopes of consolidation (entity by entity)

Name of the entity	Method of accounting consolidation	Method of regulatory consolidation		Description of the entity
		Full consolidation	Deducted	
Bank of Valletta plc	Full consolidation	x		Credit institution
BOV Fund Services Ltd	Full consolidation	x		Fund Administration
BOV Asset Management Ltd	Full consolidation	x		Fund Management
MAPFRE MSV Life plc	Equity method of accounting		x	Life Assurance
MAPFRE Middlesea plc	Equity method of accounting		x	Insurance

Capital & risk management report 31 December 2017 (continued)

Section 3: Own Funds

3.1 Capital Overview

The Group maintains its objective of actively managing capital in an integrated way, seeking to fulfil the regulatory requirements, guarantee solvency, and maximise profit. Through this holistic approach the Group is able to achieve long-term sustainability and identify growth opportunities that provide a sustainable risk-return performance. The Group's capital management approach aims to ensure a sufficient level of capitalisation to absorb unexpected losses from its risk exposures while supporting business growth and providing adequate return to shareholders.

Capital metrics and the successful implementation of the ICAAP framework are continuously monitored by the BoD, the Assets and Liabilities Committee (ALCO), and the MB. The BoD regularly receives information and reports from the lines of defence and all other functions and action is taken on emerging items of concern. They also ensure that the three lines are operating uniformly and according to best practice. The MB meets on a weekly basis to oversee the overall management of the Bank. The MB formulates risk strategies and risk profiles, including policies conducive to the achievement of organisational goals. ALCO meets on a monthly basis to analyse financial information and to assess the impact that the various types of risks arising from changes in interest rates, exchange rates and the market, have on the profitability and capital of the Bank. Through this structured monitoring, it is ensured that the Group is adequately capitalised to achieve the strategic objectives set by the BoD.

The Group has a comfortable solvency position which exceeds the minimum requirements of the European Central Bank (ECB) and other regulations. During the last quarter of the financial period, the Group increased its share capital through a successful rights issue. This led to a significant increase in the Group's Common Equity Tier 1 (CET1) ratio, reported at 16.13% as at end of December 2017. This improvement in the capital position enables the Bank to comply with increases in the regulatory capital requirements and to implement the Bank's strategic initiatives.

The Group adopts a prudent approach when determining dividend pay-outs, which aims to ensure that an adequate amount of earnings is retained to strengthen the Tier 1 capital base. The Group's approach is to determine a target CET1 ratio such that sufficient earnings are retained to enable the Bank to reach the aforementioned target ratio with the remaining profit then being deemed eligible for distribution.

3.2 Capital Instruments

The Group's capital base is composed of CET1 and Tier 2 capital, as defined in Part Two of the CRR. In line with new regulations, the Group is putting much of its emphasis and monitoring on CET1 capital which is the highest form of quality capital, thus providing the greatest level of protection against losses.

The Group's capital base is primarily composed of issued common shares and retained earnings, which are part of CET1 capital – the Group's core capital. In line with the CRR, the Group's capital is subject to relative deductions. The main deductions relate to intangible assets, unrealised gains and losses, reserve for possible litigation and the reserve held against depositor compensation scheme which is an added requirement in national legislation. In accordance with Section 3, Chapter 2, Title I, Part Two of CRR there were no other items requiring deductions from the Own Funds. As at the end of the financial period both the Group's significant investments and deferred taxation were below the 10% threshold as stipulated in Article 48(1) of the CRR.

The Group has four subordinated bonds in issue and these are included as part of Tier 2 Capital as they fully qualify for the provisions listed under CRR (575/2013) Part Two, Title 1, Chapter 4, Article 63. Specifically, these instruments rank after the claim of all other creditors and are not to be repaid until all other debts outstanding at the time have been settled. The 5.35% and the 4.80% Euro subordinated bonds are redeemable at par during the next five years (8 June 2019 and 15 March 2020 respectively) and thus the amortised amount is eligible for inclusion in Own Funds.

Capital & risk management report 31 December 2017 (continued)

In accordance with Article 492 of the CRR, the Group is required to complete a transitional disclosure template during the phasing in of regulatory adjustments from 1 January 2014 to 31 December 2017. The transitional disclosure template is set out below.

	CET1 CAPITAL	€'000s
	Common Equity Tier 1 capital: instruments and reserves	
1	Capital instruments and the related share premium accounts	570,427
2	Retained earnings	245,861
3	Accumulated other comprehensive income (and other reserves, to include unrealised gains and losses under the applicable accounting standards)	33,194
3a	Funds for general banking risk	4,713
6	**Common Equity Tier 1 capital before regulatory adjustments**	**854,195**
	Common Equity Tier 1 (CET1) capital : regulatory adjustments	
8	Intangible assets (net of related tax liability) (negative amount)	(28,453)
18	Direct and indirect holdings by an institution of CET1 instruments of financial sector entities where the institution has a significant investment in those entities	-
21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related liability where the conditions in 38 (3) are met, negative amount)	-
	Amount exceeding the 17.65% threshold (negative amount)	
23	*of which: Significant direct and indirect holdings by the institution of the CET1 instruments of financial sector entities*	-
25	*of which: Deferred tax assets arising from temporary differences*	-
26a	Regulatory adjustments relating to unrealised gains and losses	(6,639)
26b	Amount to be deducted from or added to CET1 capital with regard to additional filters and deductions required pre CRR	(44,634)
28	**Total regulatory adjustments to Common Equity Tier 1 (CET1)**	**(79,726)**
29	**Common Equity Tier 1 (CET1) Capital**	**774,469**
	TIER 2 CAPITAL	
46	Capital instruments and the related share premium accounts	157,016
51	**Tier 2 (T2) capital before regulatory adjustments**	157,016
57	Total regulatory adjustments to Tier 2	-
58	**Tier 2 (T2) Capital**	**157,016**
59	**TOTAL CAPITAL**	**931,485**
	TOTAL Risk Weighted Assets	
59a	Risk weighted assets in respect of amounts subject to pre-CRR treatment and transitional treatments	
	of which deferred tax assets not deducted from CET1 capital	144,808
	of which direct holdings by the institution of the CET1 instruments of financial sector entities not included in CET1 capital	127,140
60	**TOTAL Risk Weighted Assets**	**4,802,010**
	Capital Ratios and buffers	
62	Tier 1 capital	**16.13%**
63	Total capital	**19.40%**
64	Institution specific buffer requirement	6.81%
65	*of which: capital conservation buffer requirement*	1.25%
66	*of which: countercyclical buffer requirement*	0.06%
67	*of which: Other Systemically Important Institution (O-SII) buffer*	1.00%
68	Common Equity Tier 1 available to meet buffers	11.63%
	Amounts below the thresholds for deductions	
73	The part of the holdings of CET1 instruments of financial sector entities (as defined in Article 4(1)(27) of CRR) where the institution has a significant investment but which is below the 10 % threshold in Article 48(1) point (b) of CRR.	52,870
75	Deferred tax assets arising from temporary differences (amount below 10% threshold)	60,217

Capital & risk management report 31 December 2017 (continued)

In accordance with Part Eight Article 437 of the CRR the following table discloses the main features and the terms and conditions of Tier 1 and Tier 2 instruments.

Capital Instruments Main Features	BOV Ordinary Shares	5.35% BOV Subordinated Bonds 2019	4.8% BOV Subordinated Bonds 2020	3.5% BOV Subordinated Notes 2030 Series 1	3.5% BOV Subordinated Notes 2030 Series 2
1 Issuer	Bank of Valletta plc	Bank of Valletta plc	Bank of Valletta plc	Bank of Valletta plc	Bank of Valletta plc
2 Unique identifier	MT0000020116	MT0000021262	MT0000021270	MT0000021312	MT0000021320
3 Governing Law(s) of the instrument	Maltese Law	Maltese Law	Maltese Law	Maltese Law	Maltese Law
Regulatory Treatment					
4 Transitional CRR rules	Common Equity Tier 1	Tier 2	Tier 2	Tier 2	Tier 2
5 Post-transitional CRR rules	Common Equity Tier 1	Tier 2	Tier 2	Tier 2	Tier 2
6 Eligible at solo/(sub)consolidated / solo & (sub)consolidated	Solo & (Sub) consolidated	Solo & (Sub) consolidated	Solo & (Sub) consolidated	Solo & (Sub) consolidated	Solo & (Sub) consolidated
8 Amount recognised in regulatory capital	EUR 525 million	EUR 14.6 million	EUR 30.9 million	EUR 66.9 million	EUR 44.7 million
9 Nominal amount of instrument	EUR 525 million	EUR 50.0 million	EUR 70.0 million	EUR 66.9 million	EUR 44.7 million
9a Issue Price	N/A	At par (€100 per bond)	At par (€100 per bond)	At par (€100 per bond)	At par (€100 per bond)
9b Redemption Price	N/A	At €100	At €100	At €100	At €100
10 Accounting classification	Share Equity	Liability- amortised cost	Liability- amortised cost	Liability- amortised cost	Liability- amortised cost
11 Original date of issuance	26 August 1992	8 June 2009	15 March 2010	22 December 2015 and 6 April 2016 *	22 December 2015 and 6 April 2016 **
12 Perpetual or dated	N/A	Dated	Dated	Dated	Dated
13 Original maturity date	N/A	15 June 2019	15 March 2020	8 August 2030	8 August 2030
14 Issuer call subject to prior supervisory approval	No	No	No	No	No
Coupons/dividends					
17 Fixed or floating dividend coupon	Floating	Fixed	Fixed	Fixed	Fixed
18 Coupon rate and any related index	N/A	5.35%	4.80%	3.50%	3.50%
19 Existence of dividend stopper	No	No	No	No	No
20a Fully discretionary, partially discretionary or mandatory (in terms of timing)	Fully discretionary	Mandatory	Mandatory	Mandatory	Mandatory
20b Fully discretionary, partially discretionary or mandatory (in terms of amount)	Partially discretionary	Mandatory	Mandatory	Mandatory	Mandatory
21 Existence of step up or other incentive to redeem	N/A	No	No	No	No
22 Noncumulative or cumulative	Non-cumulative	Non-cumulative	Non-cumulative	Non-cumulative	Non-cumulative
23 Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible
30 Write-down features	No	No	No	No	No
35 Position in subordination hierarchy in liquidation	Subordinated to the Issuer's (BOV) subordinated bonds	Subordinated to other outstanding, unsubordinated and unsecured obligations of the Issuer (BOV), present and future.	Subordinated to other outstanding, unsubordinated and unsecured obligations of the Issuer (BOV), present and future.	Subordinated to other outstanding, unsubordinated and unsecured obligations of the Issuer (BOV), present and future.	Subordinated to other outstanding, unsubordinated and unsecured obligations of the Issuer (BOV), present and future.
Non-compliant transitional features	No	No	No	No	No

* €52,705,800 were issued on 22 December 2015 (Tranche 1 - MT0000021312) and €14,214,700 were issued on 6 April 2016 (Tranche II -MT 0000021338) These two tranches were subsequently merged on 8 August 2016 into ISIN MT0000021312

** €22,294,200 were issued on 22 December 2015(Tranche 1-MT0000021320) and €22,376,200 were issued on 6 April 2016 (Tranche II -MT 0000021346) These two tranches were subsequently merged on 8 August 2016 into ISIN MT0000021320

Capital & risk management report 31 December 2017 (continued)

3.3 Reconciliation of Own Funds to audited Financial Statements

The table below provides a full reconciliation of the Group's own funds to the statement of financial position within the audited financial statements for the period ended 31 December 2017.

Reconciliation between accounting and regulatory scope of consolidation

	Group 2017 € 000
Common Equity Tier 1	
As per Statement of Financial Position	
Called up share capital	525,000
Share premium account	45,427
Retained earnings	358,466
Revaluation reserves	33,194
Less: Own Funds adjustments	
Investments in Associates	(56,591)
Depositor Compensation Scheme reserve	(44,634)
Intangible assets	(28,453)
Final dividend	(27,300)
Non-distributable reserve for possible litigation	(24,000)
Transitional Adjustments	(6,639)
	774,469
Tier 2	
As per Statement of Financial Position	
Subordinated liabilities	231,591
Less: Amortisation of subordinated loan capital	(74,575)
	157,016
Total Own Funds	**931,485**

Section 4: Capital Requirements (CRR Article 438)

4.1 Overview of Pillar 1 capital requirements

The Group uses the following approaches to calculate the own funds requirements for Pillar I risks.

- The *Standardised Approach for credit risk.* Risk weights for the Treasury Portfolio are determined by taking the worst credit rating provided by eligible External Credit Assessment Institutions (ECAIs) – Fitch, Moody's and S&P. Regulatory risk weights are used for unrated exposures and the lending portfolio.
- The *Basic Indicator Approach for operational risk.* Under this approach the Group allocates capital by taking 15% of the average gross income of the preceding three years.
- The *Basic Method* with respect to the Group's foreign exchange risk. The capital charge for foreign exchange risk using the Basic Method is calculated at 8% of the higher of the sum of all the net short positions and the sum of all the net long positions in each foreign currency.
- A minimum capital requirement is also determined for non-credit obligation assets (i.e. 'other assets' on the balance sheet) in line with the CRD IV 575/2013.

In addition to the above, Banking Rule BR/15: Capital Buffers of Credit Institutions authorised under the Banking Act, 1994, requires additional buffers, viz. the Capital Conservation Buffer (CCB), Countercyclical Capital Buffer (CCyB), Other-Systemically Important Institutions (O-SII) buffer, and Systemic Risk Buffer. These buffers are aimed at strengthening the resilience of the Group and have entered into force as from January 2016, with full application as from January 2019. Automatic restrictions on capital distributions apply if the Group's CET1 capital falls below the level of its CRD IV combined buffer.

Capital & risk management report 31 December 2017 (continued)

The Group is also required to maintain an institution-specific CCyB. This is calculated on the basis of the geographical location of the relevant credit exposures for the CCyB. In line with Article 440 of the CRR the table below discloses the geographical distribution of the Group credit exposures relevant for the calculation of the institution-specific CCyB and the amount of the institution specific CCyB.

Countercyclical Capital Buffer

Country	General Credit	Total RWA	Own Funds	Share	CCyB Rate
	€000	€000	€000		
CZ	5,214	2,660	213	1.87%	0.50%
NO	113,044	50,226	4,018	35.36%	2.00%
SE	224,898	87,896	7,032	61.88%	2.00%
SK	6,315	1,263	101	0.89%	0.50%
	349,471	**142,046**	**11,364**	**100.00%**	**1.96%**

Total Capital Required (all portfolio) (in thousands):	384,161
Share of CCyB out of total capital required	2.96%
Institution specific CCyB:	0.06%
CCyB (in thousands):	223

In accordance with Article 438(c) to (f) of the CRR, the following table provides an overview of the total RWA and the capital requirement for credit risk split by the different exposure classes as well as capital for operational risk, foreign exchange risk, and credit valuation adjustment risk. No capital is allocated for market risk as the Bank does not operate a trading book. The Bank has no exposure in items representing securitisation positions. Moreover, the capital allocated to settlement risk and commodities risk is nought. The exposure value is equal to the total on-balance sheet and off-balance sheet net of value adjustments and provisions and post CCF.

EU OV1 – Overview of RWAs

€ thousands		December 2017		December 2016	December 2017
	Exposure Class	Exposure value	RWA	RWA	Capital required
1	**Credit risk (including CCR)**	**11,531,337**	**4,307,073**	**4,244,475**	**344,566**
2	of which the standardised approach	11,531,337	4,307,073	4,244,475	344,566
	Central government or central banks	3,765,764	8,154	9,435	652
	Regional government or local authorities	263,567	53,263	78,669	4,261
	Public sector entities	73,249	36,624	43,832	2,930
	Multilateral development banks	139,701	-	-	-
	International organisations	-	-	-	-
	Institutions	2,131,812	763,583	826,651	61,087
	Corporates	1,425,970	1,121,391	1,002,136	89,711
	Retail	394,709	288,232	371,720	23,059
	Secured by mortgages on immovable property	2,648,158	1,319,536	1,216,547	105,563
	Exposures in default	154,551	163,081	140,957	13,046
	Items associated with particular high risk	34,399	51,599	93,003	4,128
	Covered bonds	-	-	-	-
	Claims in the form of CIU	999	999	-	80
	Equity exposures	70,106	70,106	86,314	5,608
	Other items	428,352	430,505	375,211	34,440
6	**Credit valuation adjustment risk**		**5,679**	**10,660**	**454**
9	of which the standardised approach		5,679	10,660	454
13	**Settlement risk**		**-**	**-**	**-**
19	**Foreign exchange risk**		**2,435**	**768**	**195**
23	**Operational risk**		**486,823**	**433,191**	**38,946**
24	of which the basic indicator approach		486,823	433,191	38,946
27	**Amounts below the thresholds for deduction (subject to 250% risk weight)**		**271,948**	**224,881**	**21,756**
29	**TOTAL CAPITAL REQUIRED**		**4,802,010**	**4,689,095**	**384,161**

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4.2 Internal Capital Adequacy Assessment Process (ICAAP) and stress testing

The ICAAP document is prepared on an annual basis and includes an assessment of the current and future capital requirements given the Bank's strategy, risk profile and capital plan. Apart from encompassing the adequacy of capital requirements for Pillar 1 risks, the ICAAP includes other material residual risks which are not fully captured under Pillar 1. These include concentration, interest rate risk in the banking book, reputational risks and other material risks. The ICAAP also includes a number of stress tests which are applied to assess the resilience of the Bank's capital to severe but plausible events and identify any potential vulnerabilities. The BoD and senior management strongly believe that the ICAAP will continue to act as an important contribution to the strengthening of the risk management practices and capital adequacy of the Bank.

The Group's internal stress testing is based on various scenarios and sensitivity analysis. On a regular basis various sensitivity assessments are performed on credit risk, interest rate risk and liquidity risk. Stress tests are an important means of analysing the risk profile since they give management a better understanding of how the Group's revenue and capital are impacted by macroeconomic changes. The Bank also participates in the Supervisory Review and Evaluation Process (SREP) EU-wide external stress test conducted by the ECB. The purpose of the ECB stress tests is to assess the health of the Single Supervisory Mechanism (SSM) banks under stressed conditions and the ability of the individual banks to absorb losses in various economic scenarios.

Section 5: Leverage Ratio (CRR Article 451)

The Leverage Ratio was introduced into the Basel III framework as a non-risk-based backstop limit, to supplement risk-based capital requirements. Its purpose is to limit the leverage effects in the balance sheet as it is a volume-based measure calculated as Tier 1 capital divided by Total exposure. The latter is composed of on-balance sheet assets plus off-balance sheet exposures, such as undrawn commitments and derivatives potential future exposures, less amounts permitted to be deducted for Tier 1 capital.

As at December 2017, the transitional leverage ratio stood at 6.40% (Sep 2016: 5.34%) on a Tier 1 Capital of €774 million and a total exposure of €12,109 million. This lies well above the 3% minimum requirement and thus no additional capital is required. There were no material risks of excessive leverage during the period under review that had a significant negative impact on the reported ratio, with the increase from September 2016 to December 2017 being mainly due to the increase in Tier 1 capital.

Leverage Ratio	**Dec-17 € 000s**
On-balance sheet items (excluding derivatives and SFTs)	11,813,140
Asset amounts deducted in determining Tier 1 capital	(79,726)
Total on-balance sheet exposures (excluding derivatives and SFTs)	**11,733,414**
Replacement cost associated with all derivatives transactions	7,490
Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	546
Total derivatives exposures	**8,037**
Off-balance sheet exposures at gross nominal amount	2,084,928
Adjustments for conversion to credit equivalent amounts	(1,717,177)
Total Other off-balance sheet exposures	**367,751**
Leverage ratio total exposure measure	12,109,202
Tier 1 Capital	774,469
Actual Leverage Ratio (transitional)	**6.40%**
Statutory Minimum	*3.00%*

The following table provides a summarised reconciliation of accounting assets and leverage ratio exposures.

Summary reconciliation of accounting assets and leverage ratio exposures	**Dec-17 € 000s**
Total assets as per published financial statements	11,820,630
Adjustments for derivatives financial instruments	546
Adjustments for off-balance sheet items	367,751
Other adjustments	(79,726)
Leverage ratio total exposure measure	**12,109,202**

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The following table provides a split-up of the on-balance sheet exposures, excluding derivatives.

EU-1	**Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures)**	**Dec-17 € 000s**
EU-2	Trading book exposures	-
EU-3	Banking book exposures, of which:	11,813,140
EU-4	Covered Bonds	-
EU-5	Exposures treated as sovereign	3,765,059
EU-6	Exposures to regional government, MDB, international organisations and PSE not treated as sovereigns	476,517
EU-7	Institutions	2,126,512
EU-8	Secured by mortgages of immovable properties	2,648,760
EU-9	Retail exposures	420,595
EU-10	Corporate	1,676,651
EU-11	Exposures in default	164,017
EU-12	Other exposures	535,029

Section 6: Credit Risk

6.1 Management of Credit Risk

Credit risk is the risk of suffering financial loss should any of the Bank's counterparties fail to fulfil their contractual payment obligations. The Group's exposure to credit risk arises mainly through its lending and investment activities. Credit risk represents the Group's largest regulatory capital requirement and is subject to rigorous monitoring and control.

The credit risk management function is responsible for ensuring that the Bank's credit risk is properly managed. The main objectives of credit risk management are to (i) maintain a framework of controls to ensure that credit risk-taking is based on sound credit risk management principles; (ii) identify, assess and measure credit risk clearly, both on an individual level as well as on a portfolio basis, avoiding undesirable concentrations of exposure by counterparty, sector and geography; and (iii) monitor credit risk while ensuring that risk-reward objectives are met.

The Bank has in place a number of policies, tailored for each type of business, which articulate the Bank's appetite towards credit risk. These include (i) Business Lending; (ii) Home Loans; (iii) Personal Lending and Credit Cards (iv) E-Commerce; (v) Trade Finance; (vi) Property Lending; and (vii) Treasury management. These policies are underpinned by core principles related to compliance with the Group's ethical standards, clear definition of responsibilities, the existence and implementation of procedures, limits that ensure a high degree of diversification, and through analysis of risk. Procedures for the consideration and monitoring of exceptions to each policy are included in the respective policy document.

Policies are reviewed periodically to keep them aligned with the ever-changing market conditions, new regulations and the Bank's risk appetite, and are approved by the BoD. During this financial period, the focus was mainly on the fine tuning/review and updating of the Business Lending Policy, Property Lending Policy and the Write off policy.

6.2 Approval authorities

The Bank has in place a dual voting system with regards to business related transactions, governed by the Business Credit Policy. New lending facilities are sanctioned through a vote by Business Sanctioning Officers and a vote by Risk Sanctioning Officers, in accordance with the relative limits. For proposals above a certain limit, authorisation is sought from higher levels in the Bank hierarchy or from the Credit Committee appointed by the BoD. Lending officers are each allocated a voting limit based on their individual capabilities and experience, and the nature and scale of lending in the business unit where they are posted. Voting limits are approved by the MB on the recommendation of the Chief Risk Officer.

Other areas such as Trade Finance, E-Commerce, Debt Management and Consumer Lending exposures exceeding a threshold defined by the Bank are also within the dual voting system, and governed by their respective policies.

The dual voting system does not govern other Consumer Lending for which a separate discretionary lending limits system applies, in the majority of cases aided by the use of a credit scorecard. The latter analyses data and grades customers according to their creditworthiness. Borderline cases are referred and become subject to the normal approval process in line with the appropriate discretionary lending limits. The Bank has been using the credit scorecard for a number of years, and this has evolved from a generic to a bespoke application after an adequate history of defaults was accumulated.

The investment portfolio is managed by the Treasury Department and it is the Bank's strategy to buy and hold instruments till maturity rather than for trading purposes. Investment proposals are allocated limits according to the Treasury Management Policy

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(TMP) with a 'four-eye' approach applied when an investment proposal falls outside the criteria set out in the Bank's TMP. The Credit Risk Sanctioning Department undertakes an independent analysis of proposals which are then submitted to the Board for their consideration. The Board's approval is also required for exposures above TMP.

6.3 Quantitative information on credit risk exposures

The following table shows the net exposure values as at end December 2017 and end December 2016 by exposure classes and the average net exposure value of this financial period; based on the last 4 end of quarter observations. During the last quarters the term placements with the Central Bank have continued to increase leading to an increase in the exposure value to central banks.

	EU CRB-B: Total and average net amount of exposures € millions	**Net value of exposures at the end of Dec 2017**	**Average net exposures over the period**	**Net value of exposures as at December 2016**
16	Central governments or central banks	3,813	3,474	3,063
17	Regional governments or local authorities	264	327	370
18	Public sector entities	73	340	531
19	Multilateral development banks	140	158	168
20	International organisations	-	-	-
21	Institutions	2,127	2,199	2,294
22	Corporates	3,170	2,496	2,013
23	Of which: SMEs	1,982	1,456	1,096
24	Retail	948	1,040	1,214
25	Of which: SMEs	64	203	412
26	Secured by mortgages on immovable property	2,649	2,625	2,532
27	Of which: SMEs	761	743	689
28	Exposures in default	181	184	194
29	Items associated with particularly high risk	37	40	39
30	Covered bonds	-	-	-
31	Claims on institutions and corporates with a short-term credit assessment	-	-	-
32	Collective investments undertakings	-	-	-
33	Equity exposures	70	76	86
34	Other exposures	428	412	393
35	**Total Standardised Approach**	**13,899**	**13,371**	**12,897**

6.3.1 Concentration Risk

Concentration risk occurs when the Bank has significant exposures to one counterparty or to a group of connected counterparties, or to counterparties with similar characteristics within a given economic sector or to counterparties operating in the same geographical area. Due to the structure of the local economy and the size of the domestic financial sector, the Bank faces concentration risk in its lending and investment activities.

As part of the Group's credit risk management approach and in order to avoid undue concentrations, the Bank has systems to identify, measure and monitor Single Name, Sectoral and Geographical concentrations. The systems and controls allow the Bank to ensure adherence to prudential limits set by the BoD and/or the Regulatory Authority to single counterparty or groups of related counterparties; the Board and senior management being informed on a regular basis on the level of concentration in the Bank's portfolio.

The Bank analyses its concentration risk in the advances and investment portfolios. The Herfindahl-Hirschman Index (HHI) calculated using risk-weighted assets to better reflect the degree of risk sensitivity is used to assign a capital add-on (%) to credit risk. This results in an amount of capital allocated against concentration risk under Pillar2.

The following tables show the distribution of the exposures (net values of on-balance sheet and off balance sheet balances) by geographical distribution, industry and residual maturity broken down by exposure classes in line with CRR Article 442(d/e/f).

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EU CRB-C: Geographical breakdown of exposures € millions		Net value MALTA	UNITED STATES	FRANCE	GERMANY	SWEDEN	AUSTRALIA	UNITED KINGDOM	OTHER COUNTRIES	TOTAL
7	Central governments or central banks	3,655	-	-	53	-	-	-	105	3,813
8	Regional governments or local authorities	19	-	36	23	12	-	-	174	264
9	Public sector entities	73	-	-	-	-	-	-	-	73
10	Multilateral development banks	-	-	-	-	-	-	-	140	140
11	International organisations	-	-	-	-	-	-	-	-	-
12	Institutions	41	147	223	119	183	222	154	1,038	2,127
13	Corporates	2,493	196	82	112	49	13	59	166	3,170
14	Retail	943	0	0	0	0	0	0	3	948
15	Secured by mortgages on immovable property	2,620	1	1	0	0	1	8	18	2,649
16	Exposures in default	180	-	-	0	-	0	0	0	181
17	Items associated with particularly high risk	37	-	-	-	-	-	-	-	37
18	Covered bonds	-	-	-	-	-	-	-	-	-
19	Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-	-	-
20	Collective investments undertakings	-	-	-	-	-	-	-	-	-
21	Equity exposures	26	5	6	4	-	-	5	24	70
22	Other exposures	428	-	-	-	-	-	-	-	428
23	**Total standardised approach**	**10,515**	**350**	**348**	**312**	**245**	**236**	**226**	**1,668**	**13,899**

Note to EU CRB-C Table: Other countries account for circa 12% of the total net exposure value and comprises of 43 different countries. The main ones being Belgium, Canada, Luxembourg, Netherlands, Norway, and Japan.

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	EU CRB-D: Concentration of exposures by industry or counterparty types € millions	**Financial and Insurance Activities**	**Households and Individuals**	**Public administration and defence, compulsory social security**	**Wholesale and retail trade**	**Manufacturing**	**Transportation and storage**	**Others**	**Total**
7	Central governments or central banks	3,006	-	807	1	-	-	-	3,813
8	Regional governments or local authorities	46	0	215	-	-	-	2	264
9	Public sector entities	-	-	-	-	-	73	-	73
10	Multilateral development banks	-	-	140	-	-	-	-	140
11	International organisations	-	-	-	-	-	-	-	-
12	Institutions	2,127	-	-	-	-	-	-	2,127
13	Corporates	468	28	12	501	613	320	1,228	3,170
14	Retail	3	777	0	56	14	6	91	948
15	Secured by mortgages on immovable property	114	1,749	1	198	57	35	495	2,649
16	Exposures in default	4	31	-	25	11	19	92	181
17	Items associated with particularly high risk	-	-	-	-	-	-	37	37
18	Covered bonds	-	-	-	-	-	-	-	-
19	Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-	-
20	Collective investments undertakings	-	-	-	-	-	-	-	-
21	Equity exposures	31	-	15	1	6	1	15	70
22	Other exposures	-	-	-	-	-	-	428	428
23	**Total standardised approach**	**5,798**	**2,585**	**1,190**	**782**	**702**	**455**	**2,388**	**13,899**

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EU CRB-E: Maturity of Exposures € millions		Net Exposure Value On demand	<= 1 year	> 1 year <= 5 years	> 5 years	No stated maturity	Total
7	Central governments or central banks	3	3,207	471	132	1	3,813
8	Regional governments or local authorities	0	93	152	19	-	264
9	Public sector entities	-	-	-	73	-	73
10	Multilateral development banks	-	43	97	-	-	140
11	International organisations	-	-	-	-	-	-
12	Institutions	343	510	1,262	11	-	2,127
13	Corporates	553	521	616	947	533	3,170
14	Retail	91	455	84	303	14	948
15	Secured by mortgages on immovable property	200	8	141	2,301	-	2,649
16	Exposures in default	47	48	24	53	8	181
17	Items associated with particularly high risk	4	3	10	20	-	37
18	Covered bonds	-	-	-	-	-	-
19	Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-
20	Collective investments undertakings	-	-	-	-	-	0
21	Equity exposures	-	-	-	-	70	70
22	Other exposures	-	-	-	-	428	428
23	**Total standardised approach**	**1,242**	**4,888**	**2,856**	**3,858**	**1,054**	**13,899**

6.4 Credit Risk Adjustments

6.4.1 Past due and Impaired

In accordance with article 178 of the CRR, the Bank defines non-performing exposures (NPL) as those that satisfy either or both of the following criteria:

a) Material exposures which are more than 90 days past due;
b) The debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past due amount or of the number of days past due.

An exposure is deemed to be impaired when cash flows from operations plus the estimated realisable value of any collateral held are considered insufficient to recover the full exposure. In such cases a specific allowance is set aside to cover the unsecured portion.

The Bank has a comprehensive internal rating system designed to accurately reflect the risk inherent in each lending relationship, identify problematic loans in a timely and accurate manner and thereby assist in the creation of a quality loan book. The Bank's loan portfolio is analysed according to the twelve grading levels within the internal credit rating system. The relative rating is primarily determined by the operating performance of the account and by other qualitative criteria. Exposures are analysed on a regular basis to determine whether there is impairment in the customer's business which merits a change in rating. For business related facilities, these criteria (both financial and business related) are reviewed at least once a year. For regulatory and high level internal reporting, the twelve grading levels are regrouped in five categories: Regular, Watch, Substandard, Doubtful and Loss.

6.4.2 Impairment Allowances and Coverage

The Provisions Committee is responsible for developing and maintaining the Bank's provisioning methodology. It is composed of representatives from Finance, Risk and Credit with the latter attending as observers.

As defined in Regulation 183/2014 the following shall be classified as specific credit adjustments:

a) losses recognised in the profit or loss account for instruments measured at fair value that represent credit risk impairment under the applicable accounting framework;
b) losses as a result of current or past events affecting certain exposures;
c) losses for which historical experience, adjusted on the basis of current observable data, indicates that the loss has occurred but the institution is not yet aware which individual exposure has suffered these losses.

Accordingly, the Group's specific and general impairment allowances calculated under IAS 39 are classified as specific credit risk adjustments and in line with CRR article 111 are deducted from the accounting values in order to determine the exposure value of an asset for risk weighted assets calculations. (Further details related to impairment allowances can be found in the following notes to the Financial Statements – 17; 39.2)

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Specific Impairment allowances covers two types of exposures:

(i) Impaired exposures on which the Bank does not expect to recover its exposure in full, even after the realisation of collateral.
(ii) Exposures which are deemed to carry a specific risk. Specific risks may vary from time to time and are determined by taking into consideration external and internal factors. External factors include market forces, the performance of specific economic sectors in relation with the gross value added within a particular period of time, and geopolitical circumstances. Internal factors namely include individual significance of exposures and/or day delinquency equal to or greater than 60 days.

Collective impairment allowances cover performing exposures for losses which have already been incurred, but cannot yet be specifically identified, and that based on past trends have a high probability of occurring.

Probability of defaults (PDs) based on Moody's Global Average Cumulative Issuer-weighted Default rates 1983-2016 are used for the Bank's portfolio with an increased weighting in the PDs for the calculation of specific risks provisioning. The loss given default rates are consistent for all exposures. Different rates apply for secured and unsecured portions of exposures.

As from 1 January 2018, the Bank has implemented IFRS 9, further information can be found under Note 1.1.1 of the Financial Statement.

6.4.3 External Credit Assessment Institutions (ECAIs)

The Standardized Approach (SA) requires banks to use the risk assessments prepared by ECAIs to be able to determine the risk weights to be applied. For treasury investments the Bank uses three of the EBA recognized ECAIs – Fitch, Moody's and S&P - and takes the worst credit grading available. The Bank maps these external rating to the credit quality steps in line with EBA guidelines.

6.4.4 Credit quality of the Bank's exposures

The following tables provide a comprehensive picture of the credit quality of the Bank's assets by exposure class as at December 2017 in line with EBA guidelines on disclosures, by exposure class, industry and geography.

	EU CR1-A: Credit quality of exposures by exposure class and instrument € millions	Gross carrying values of Defaulted exposures	Non-defaulted exposures	Specific credit risk adjustment	Net values
16	Central governments or central banks	-	3,813	-	3,813
17	Regional governments or local authorities	-	264	0	264
18	Public sector entities	-	73	-	73
19	Multilateral development banks	-	140	-	140
20	International organisations	-	-	-	-
21	Institutions	-	2,127	-	2,127
22	Corporates	-	3,201	32	3,170
23	Of which: SMEs	-	1,995	13	1,982
24	Retail	-	955	7	948
25	Of which: SMEs	-	66	2	64
26	Secured by mortgages on immovable property	-	2,658	10	2,649
27	Of which: SMEs	-	766	5	761
28	Exposures in default	298	-	118	181
29	Items associated with particularly high risk	-	37	0	37
30	Covered bonds	-	-	-	-
31	Claims on institutions and corporates with a short-term credit assessment	-	-	-	-
32	Collective investments undertakings	-	-	-	-
33	Equity exposures	-	70	-	70
34	Other exposures	-	428	-	428
35	**Total standardised approach**	**298**	**13,767**	**166**	**13,899**
37	Of which: Loans and advances	282	7,720	166	7,835
38	Of which: Debt securities	-	3,485	-	3,485
39	Of which: Off-balance-sheet exposures	17	2,071	-	2,088

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EU CR1-B: Credit quality of exposures by industry or counterparty types € millions	**Gross carrying values of**			
	Defaulted exposures	**Non-defaulted exposures**	**Specific credit risk adjustment**	**Net values**
Financial and Insurance Activities	4	5,797	3	5,798
Households and Individuals	50	2,562	27	2,585
Manufacturing	24	694	16	702
Public administration and defence, compulsory social security	0	1,190	0	1,190
Transportation and storage	21	449	15	455
Wholesale and retail trade	38	764	21	782
Others	162	2,738	85	2,815
Total	**298**	**13,767**	**166**	**13,899**

Note - Net Values is equal to Gross carrying values less credit risk adjustments

EU CR1-C: Credit quality of exposures by geography € millions	**Gross carrying values of**			
	Defaulted exposures	**Non-defaulted exposures**	**Specific credit risk adjustment**	**Net values**
MALTA	298	10,383	166	10,515
UNITED STATES	-	350	0	350
FRANCE	-	348	0	348
GERMANY	0	312	0	312
SWEDEN	-	245	-	245
AUSTRALIA	-	236	0	236
UNITED KINGDOM	-	226	0	226
OTHERS	**0**	**1,667**	**0**	**1,667**
Total	**298**	**13,767**	**166**	**13,899**

The following table provides an ageing analysis of accounting on-balance sheet past due exposures regardless of their impairment status. All debt securities have no days past due as at end of the financial period 2017.

EU CR1-D: Ageing of past-due exposures € millions		**Gross carrying values**					
		≤ 30 days	**> 30 days ≤ 60 days**	**> 60 days ≤ 90 days**	**> 90 days ≤ 180 days**	**> 180 days ≤ 1 year**	**> 1 year**
1	Loans	97	21	6	19	15	156
2	Debt securities	-	-	-	-	-	-
3	**Total exposures**	**97**	**21**	**6**	**19**	**15**	**156**

The Bank has in place various units set up with the aim to support, prevent, reduce, remediate or recover non-performing loans. Each unit, depending on the stage, exposure and severity of the NPL, has its internal procedures in order to aim to achieve the desired results.

Fine tuning of the Bank's policies and procedures regarding the management of NPLs are underway. During this financial period, the Bank has carried out a write-off exercise on non-performing loans wherein these loans were transferred off-balance sheet. A Write-Offs Committee was set and entrusted with the sanctioning of definite write-offs as per limits defined by the BoD.

Forbearance measures represent concessions granted by the Bank to borrowers when they are considered to be unable to meet the original terms and conditions of the contract due to financial difficulties. Through forbearance measures, the Bank may modify the terms and conditions of the contract to allow the borrower sufficient ability to service the debt or refinance the contract. Rigorous assessment is undertaken to ensure that restructuring is only allowed in those cases where the underlying fundamentals are sound and where the customer is expected to meet the revised obligations. When the concession is due to financial difficulty the account is marked as forborne. As part of its asset quality measure, CRMU reviews the financial difficulty tests and take a final decision as to whether the facility is to be categorised as Forborne.

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The table below provides an overview of non-performing and forborne exposures as at 31 December 2017.

EU CR1-E: Non-performing and forborne exposures € millions		**Gross carrying values of performing and non-performing exposures**						
			Of which performing but past due > 30 days and < = 90 days	**Of which performing forborne**	**Of which non-performing**			
						Of which defaulted	**Of which impaired**	**Of which forborne**
010	Debt securities	3,485	-	-	-	-	-	-
020	Loans and advances	8,001	18	37	282	97	185	131
030	Off-balance sheet exposures	2,088	NA	1	17	-	NA	1

€ millions		**Accumulated impairment and provisions and negative fair value adjustments due to credit risk**				**Collaterals and financial guarantees received**	
		On performing exposures		**On non-performing exposures**		**On non-performing exposures**	**Of which forborne exposures**
			Of which forborne		**Of which forborne**		
010	Debt securities	-	-	-	-	-	-
020	Loans and advances	33	2	133	63	149	100
030	Off-balance sheet exposures	-	-	-	-	-	-

6.5 Credit Risk Analysis and Mitigation

An assessment of the borrower's ability to service and repay the proposed debt is undertaken for each credit request and is a key element when considering an application for credit. In particular, before making any commitments, the Bank carries out an in-depth review of the borrower and ensures that it has a thorough knowledge of all the structural aspects of the borrower's operations and that adequate monitoring will be possible. Consideration is also given to the sector in which the borrower operates in terms of economic prospects and potential growth along with the Bank's default history of the sector.

The credit process provides for at least an annual review of business facilities granted with the review being more frequent under certain circumstances, such as the emergence of adverse risk factors. All credit exposures are regularly reviewed for objective evidence of impairment, either individually or as part of a collective assessment, with a view to taking early recovery action. In addition, hindsight overviews are carried out on a sample basis by CRMU to strengthen the credit decision-making process, wherein the judgement of the initial decision-makers is reviewed to determine the extent to which such decision-makers were in compliance with Bank policies and procedures in approving the credit application concerned. This ensures that the quality of the lending portfolio is properly and regularly monitored by an independent authority, so that any necessary remedial action can be taken.

The granting of credit facilities is primarily based on the capacity to repay, rather than placing primary reliance on credit risk mitigants. The mitigation of credit risk is however a key aspect of effective risk management used to help mitigate the risk inherent in individual exposures. The nature and level of collateral required depends on a number of factors, including but not limited to, the amount of the exposure, the type of facility provided, the term of the facility, the amount of the counterparty's contribution and an evaluation of the level of the credit risk or probability of default involved. The main types of collateral accepted by the Bank are listed in the Credit Policy.

Collateral is taken into account at a margin which is applied to the market value and is only accepted as the main source of repayment in property development and other exceptional cases. Valuation strategies are established to monitor collateral mitigants to ensure that they continue to provide the anticipated secure secondary repayment source. Immovable properties held as collateral against material exposures are subject to regular revaluation in order to maintain a constant true picture of their values and to ensure that the value being relied on as collateral adequately reflects the current value of the property.

The Bank also mitigates credit risk through the adoption, on the sanctioning of facilities, of terms and provisions known as covenants, both financial and non-financial, which allow the Bank to take action when a borrower's default risk increases. A breach of these covenants is an event of default which may permit a reduction of the maximum amount of borrowing under the commitment, increases in collateral, repricing and, in a worst case scenario, a call-in of facilities.

Capital & risk management report 31 December 2017 (continued)

Investment exposures and limits are regularly reviewed upon changes in credit ratings or outlook so as to prompt any mitigating action if required. Credit risk in the investment portfolio is mitigated through limits set in the TMP. These limits are set on the level of credit risk undertaken in relation to any counterparty exposure in accordance with external ratings issued by major rating agencies. The TMP also sets limits in respect of settlements and derivatives.

Settlement risk is the risk of loss due to failure of a company to honour its obligations to deliver cash, securities or other assets as contractually agreed. This risk is mitigated through settlement limits assigned to counterparties based on external credit ratings or by effecting payment on a delivery versus payment (DVP) basis.

6.5.1 Quantitative information on credit risk mitigation

The following tables shows an analysis of the on balance sheet exposure value (carrying amount net of provisions) that is covered by eligible collateral in line with CRR requirements highlighting the amount of the exposure value which is unsecured and secured.

EU CR3: CRM techniques - Overview € millions		Exposures Total unsecured - Carrying amount	Exposures Total secured - Carrying amount	Exposures secured by Immovable Property collateral	Exposures secured by Other Eligible Collateral
1	Total Loans and Advances	4,408	3,427	2,821	606
2	Total Debt Securities	3,485	-	-	-
3	**Total exposures**	**7,894**	**3,427**	**2,821**	**606**
4	*of which Defaulted*	*0*	*149*	*145*	*4*

EU CR4 – Standardised approach – Credit risk exposure and CRM effects € millions		Exposures net of provisions before CCF and CRM		Exposures post CFF and CRM		RWA after SME factor and RWA density	
		On-Balance sheet amount	Off-Balance sheet amount	On-Balance sheet amount	Off-Balance sheet amount	RWAs	RWA density
1	Central governments or central banks	3,765	48	3,765	1	8	0.2%
2	Regional government or local authorities	264	-	264	-	53	20.2%
3	Public sector entities	73	-	73	-	37	50.0%
4	Multilateral development banks	140	-	140	-	-	0.0%
5	International organisations	-	-	-	-	-	0.0%
6	Institutions	2,127	-	2,127	-	761	35.8%
7	Corporates	1,677	1,493	1,200	225	1,120	78.6%
8	Retail	421	527	331	64	288	73.0%
9	Secured by mortgages on immovable property	2,649	-	2,648	-	1,320	49.8%
10	Exposures in default	164	17	152	3	163	105.5%
11	Exposures associated with particularly high risk	37	-	34	-	52	150.0%
15	Equity	70	-	70	-	70	100.0%
16	Other items	428	-	428	-	431	100.5%
17	**Total**	**11,814**	**2,085**	**11,232**	**292**	**4,302**	**37.3%**

Capital & risk management report 31 December 2017 (continued)

EU CR5: Standardised approach Exposure Value € millions	Risk Weight 0%	20%	35%	50%	75%	100%	150%	250%	Total
Central governments or central banks	3,746	5	-	14	-	-	-	-	3,766
Regional government or local authorities	19	230	-	14	-	-	-	-	264
Public sector entities	-	-	-	73	-	-	-	-	73
Multilateral development banks	140	-	-	-	-	-	-	-	140
International organisations	-	-	-	-	-	-	-	-	-
Institutions	-	1,027	-	1,092	-	3	4	-	2,127
Corporates	-	90	-	448	-	887	-	-	1,424
Retail	-	-	-	-	395	-	-	-	395
Secured by mortgages on immovable property	-	-	1,693	378	-	577	-	-	2,648
Exposures in default	-	-	-	-	-	137	17	-	155
Exposures associated with particularly high risk	-	-	-	-	-	-	34	-	34
Covered bonds	-	-	-	-	-	-	-	-	-
Institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-	-	-
Collective investment undertakings	-	-	-	-	-	-	-	-	-
Equity	-	-	-	-	-	70	-	-	70
Other items	157	6	-	-	-	157	-	109	428
Total	4,062	1,357	1,693	2,019	395	1,832	56	109	11,523

6.6 Counterparty Credit Risk

The CRR defines counterparty credit risk (CCR) as the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. The Group is exposed to CCR through its over the counter (OTC) derivative exposures which are used to hedge against adverse interest rate and currency movements. To calculate its CCR exposure value the Group uses the 'Mark-to-Market' approach (as defined in Article 274 of the CRR) where predefined add-on is added to the current positive fair value of the contract in order to account for potential future changes, taking into consideration the netting arrangements in place as per Article 298 of the CRR.

EU CCR1 - Analysis of CCR exposure by approach € millions		Replacement cost/current market value	Potential future credit exposure	EAD post CRM	RWAs
1	Mark to market	1.02	7.02	8.04	5.31

Wrong way risk arises when the probability of default of a particular counterparty is positively correlated to the exposure with the same counterparty, so that the mark-to-market exposure increases at the same time as the riskiness of the counterparty increases. This risk is addressed by the Bank through the setting up of internal limits and its collateral management procedure. The TMP, which sets the limits on the maximum exposures held in derivatives, assumes that the business relationship with most counterparties is an on-going one; therefore the limits are primarily based on the worst long-term credit rating of the counterparty. For requests falling outside the TMP, these are also reviewed by Credit Risk Sanctioning Department and approved by the Chief Risk Officer or the BoD according to the exposure. Limits are reviewed annually or more frequently in the event of a downgrade of the counterparty.

The Bank ensures that an ISDA agreement with the respective counterparties is in place prior to effecting a transaction and that the agreement covers the deal in question. Furthermore, in order to secure the collateral, the Bank enters into an agreement with the counterparties in accordance with the Credit Support Annex (CSA) under the ISDA agreement. The CSA is a schedule to the ISDA Master Agreement. By virtue of such CSAs, a party to a derivative that has an exposure to its counterpart will post collateral to its counterpart to cover such exposure by way of an outright title transfer of such collateral. All CSAs that the Bank has in place are of a two-way nature. Variation margin is exchanged on a daily basis.

The Credit Rating Downgrade Threshold clause in some CSA agreements is designed to trigger a series of events which may include the termination of transactions by the non-affected party if the credit rating of the affected party falls below a specified level.

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Nevertheless, the amount of collateral posted will not change in the event the Bank suffers a credit rating downgrade. The Bank does not have any credit derivative hedges in place.

'Credit Valuation Adjustment' (CVA) is defined by the CRR as an adjustment to the mid-market valuation of the portfolio of transactions with a counterparty. That adjustment reflects potential mark-to-market losses due to counterparty migration risk on bilateral OTC derivative contracts. The CVA charge is computed according to the Standardised Method as defined in Article 384 of the CRR.

EU CCR2 – CVA capital charge

€ millions		Exposure value	RWAs
4	All portfolios subject to the standardised method	8.04	5.68

Section 7: Market Risk

7.1 Nature of Market Risk

Market risk is the risk that the Bank's earnings or capital will be adversely affected by the volatility of market rates or prices such as interest rates, credit spreads and foreign exchange rates. The Group's exposure to market risk is limited given that it does not operate a trading book. Accordingly, the Group's exposure to market risk comprises three types of risk: (i) interest rate risk in the banking book (ii) currency risk; and (iii) equity price risk.

7.2 Interest Rate Risk

Interest rate risk is defined as the probability of incurring financial losses due to adverse movements in interest rates. The Bank is exposed to Interest Rate Risk in the Banking Book (IRRBB) from mismatches between interest rate sensitive assets and liabilities held in the banking book.

The Bank has an Interest Rate Risk Policy which clearly describes the approaches through which interest rate risk is identified, evaluated, monitored, managed, and reported to higher management. The policy also outlines the structure, responsibilities and controls that manage and oversee the interest rate positions of the Bank.

The BoD is ultimately responsible for the interest rate risk assumed by the Bank and the manner in which this risk is managed to ensure that it is aligned with the interest rate risk strategy and risk appetite.

The Bank's exposure to interest rate risk is monitored and evaluated on a monthly basis by the Asset Liability Management Committee (ALCO). The role of ALCO is that of managing the balance sheet to attain an optimal balance between risk and return. ALCO assesses the interest rate risk with the objective of limiting potential adverse effects of interest rate movements on net interest income and on equity.

7.2.1 The Measurement of Interest Rate Risk

Risk management processes are in place to control and limit the interest rate risk exposure without negatively affecting the profitability of the Bank. The Bank takes two different, yet complementary perspectives to the process of controlling and assessing IRRBB. These are the economic value of equity (EVE) and the earnings-based approach. The EVE approach measures the interest rate risk by observing the change in the theoretical value of the banking book. Meanwhile, the earnings-based approach focuses on the impact on the net interest income following changes in the interest rates.

Impact on the Net Interest Income

Changes in the interest rates effect the sensitivity of earnings in the short term by changing its net interest income and the level of other interest sensitive income and expenses. This approach provides information necessary to manage and optimize the risk-return position as well as the structure of the balance sheet from an earnings based point of view.

ALCO monitors on a regular basis the current rates being paid on liabilities and the rates earned on assets. This method allows management to effectively monitor the interest earning potential of the present balance sheet.

In order to remain within the Bank's guidelines, the Bank consciously chooses low risk/return treasury assets in order to retain the high quality of the portfolio. During the financial period under review, the ECB maintained the marginal lending facility at 0.25% and the deposit facility rate at -0.40%. These rates are expected to remain at present levels for an extended period of time.

On a regular basis the Bank also monitors the sensitivity of the financial assets and liabilities to parallel shifts in the yield curve of 200 basis points over a time horizon of one year. Interest rate risk arises from the different re-pricing characteristics of the Bank's interest-sensitive assets and liabilities and from the mismatch between interest rate-sensitive assets and liabilities.

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Impact on the Economic Value of Equity

As the interest rate increases/decreases, the monetary value of owning an instrument offering a fixed rate of interest decreases/increases. If this position is not perfectly offset by changes in the value of other instruments held by the Bank an economic loss materialises. Such open positions mostly result from differences in the nominal/principal values, varied residual terms to maturities and different interest rate reset dates.

The economic loss (or gain) is estimated through the interest rate term structure – commonly referred to as the yield curve – which measures the relationship between the discount rates and the time to maturity. Changes to the yield curve are a reflection of the anticipated future interest rates, inflation and economic growth. The discount rate provides the present value of the Bank's expected future cash flows. It is representative of a risk-free yield curve and this is generally a representation of either the secured interest rate swap curve or, in the absence of such, a high credit rating government yield curve.

In case of positions with no contractual maturity, the Bank regularly monitors the behaviour of non-maturity deposits (NMDs). Statistical evidence shows that even though NMDs do not have a specific contractual maturity, a significant share of the on-demand deposits is stable over time even when market rates change. The element of NMDs which is considered to be particularly stable – core deposits, is spread into different short-term and medium-term time buckets based on the customer. No assumptions are made with respect to prepayments of loans and advances.

Six prescribed interest rate shock scenarios are simulated to estimate the capital charged with respect to the IRRBB. Such scenarios capture the possible different shifts to yield curve. These simulations are generated every quarter and subsequently reported to ALCO. As at December 2017, the capital charge with respect to the IRRBB is €21.9 million and emanates from a downward parallel shock.

7.3 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 TMP sets limits on the level of net exposure by currency which are monitored on a daily basis. Further information related to currency risk can be found in the notes to the financial statements Note 39.4.2.

7.4 Exposures to equities not included in the trading book

The Group is exposed to equity price risks arising from the holding of equity instruments classified either as available for sale or at fair value through profit or loss. The overall strategy of the equity portfolio is to earn regular dividends and not invest in highly volatile equities. The investment portfolio has a relatively small allocation to equity investments which are not included in the trading book amounting to approximately €63.8 million as at 31 December 2017.

All equities are priced at mark-to-market and any price changes are passed through the income statement. The fair value of all equities corresponds to their market value. Cumulative realised gains / losses from sales & liquidations during the financial period amounted to €1.38 million which is equal to the total unrealised gains and losses. This is due to the fact that all equities are classified within the FVTPL portfolio, whereby all cumulative gains / losses are netted off with unrealised gains / losses made. Latent revaluation gains / losses included in Common Equity Tier 1 Capital for the financial period amount to €1.96 million.

Section 8: Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The Risk Appetite Framework states that the Bank has a goal of minimising operational risk whilst ensuring that its operations are regulatory compliant, efficient and cost-effective. This is achieved through early identification and measurement of risks, monitoring and mitigation by recommending changes to improve controls, performance and procedures, as well as by the procurement of appropriate insurance cover.

8.1 The Management of Operational Risk

In line with common industry practice, BOV applies the three lines of defence model for operational risk governance. The Operational Risk Management Unit (ORMU) is the second line of defence and acts independently from risk generating business lines. Although ownership and accountability for operational risk resides with the business level, the ORMU co-ordinates, supervises and drives forward the identification, assessment and monitoring of operational risks and controls. The unit is responsible for providing the framework, infrastructure, tools and methodology for rolling out operational risk management throughout the Group, ensuring that the overall risk portfolio is managed in line with the operational risk management policy. ORMU is also responsible to develop and review policies and procedures to ensure that operational risks are managed effectively.

ORMU supports the business units in identifying and assessing the operational risk exposure. Risk assessments involve risk identification, risk evaluation and recommendations for managing and mitigating the risks. For the risk identification process, some of the tools used include audit findings, internal loss data and scenario analysis. The Bank is also compiling a Group Risk Register and key risks from forty-seven process areas have been identified and assessed. A loss database has been created and maintained since 2009 and is updated regularly through risk event reporting on internal loss events and near misses. Key Risk Indicators

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and thresholds have been identified at generic enterprise-wide level and are reported regularly. Business Continuity supporting documentation at unit level is in place throughout the organisation. A BCM programme is maintained and the Group is implementing a robust enterprise-wide Business Continuity Plan (BCP). BCPs for critical activities and IT systems are regularly tested, thus ensuring timely response to disruptions and effective restoration. The Group's Incident Management Team works in liaison with the ORMU to effectively manage the organisation's efforts where widespread threats require a more co-ordinated approach.

The Group is exposed to claims and litigation arising from its business operations. On the basis of legal opinion the Board concluded that it has a strong legal position on the significant claims. Further information can be found under Note 33 of the Financial Statement.

The Group currently uses the Basic Indicator Approach to apportion capital for operational risk and accordingly allocates 15% of the average gross income over three years in line with Basel III guidelines.

The operational risk regulatory capital requirement for the Group as at December 2017 is €38.95 million (Notional Risk Weighted Assets €486.8 million).

8.2 Mitigation of Operational Risk

The Group addresses identified risks where these are not aligned with stated risk appetite by improving processes, investing in technology changes and where necessary tackling human resource vulnerabilities. As part of its BCP the Group maintains and periodically tests contingency facilities to validate the effectiveness of the plan in the event of a disaster. It also mitigates the possibility of higher impact risk events through comprehensive insurance coverage on selected business risks. Insurance cover is under on-going review by a specialised team within ORMU, which works in close liaison with the Group's Insurance Brokers and the Group's different business units.

8.3 Information Security Risk

Information security risk refers to the risk of loss caused by deliberate or accidental loss, alteration, falsification or leakage of information, or by destruction, disruption, errors or misuse of information systems. The Group applies various international standards in its integrated approach, which has the fundamental objective of ensuring the confidentiality, integrity and availability of its information assets.

In order to fulfil the proper handling of information and prevent loss or leakage of information, the Group has developed a number of qualitative measures to reduce such risks through its organisational structure, with officials having specific responsibilities for information security issues, the establishment of information security policies, procedures and standards, awareness training and the implementation of a security infrastructure and systems to ensure a stable information security environment. The approach to the management of information security risks is in line with global standards, in particular ISO/IEC 27001/2.

As part of our ongoing commitment towards ensuring the security of information systems throughout the Group, we will be increasing our focus and attention towards some of the prevalent Information Security risks within the industry; key amongst which are logical access controls specific to our various IT systems. A holistic approach will be applied, based on the analysis of both systems and operational procedures, setting up appropriate action plans to resolve any deviations from our established policy.

Section 9: Remuneration Policy

The Bank has a Remuneration Policy aimed at aligning individual rewards with the Bank's performance, business strategy, risk appetite, values and long-term interests. It also encourages a prudent approach to risk taking. The Policy deals with the remuneration of all staff members including members of the MB, in accordance with regulation incorporated in the Capital Requirements Directive. Additional disclosures on the governance process related to remuneration has been made under the Remuneration Report section in this annual report.

The target population defined as Identified Staff for the purposes of this Disclosure represents 3.5% of total number of employees in the Group. Identified staff is determined in line with recommended EBA Regulatory Technical Standards[1] and includes:

- senior executives responsible for material business units/business lines or internal control functions including Risk, Compliance and Audit;
- executives of Support Functions;
- other employees who are members of committees with collective authority to commit to risk exposures per transaction beyond 0.5% of CET1 Capital; and
- employees who, individually or as part of a committee take, approve or veto decisions on new products, material processes or material systems.

For the purposes of remuneration, Identified Staff have been aggregated and split into business areas according to EBA guidelines[2]. The table below includes the total fixed and variable remuneration and the number of beneficiaries for each business area. All fixed and variable remuneration were paid in cash. On average the ratio of variable to fixed remuneration for Identified Staff is 5.11%.

[1] EBA Final Draft Regulatory Technical Standards EBA/RTS/2015/09 dated 16 July 2015
[2] EBA Guidelines on the remuneration benchmarking exercise EBA/GL/2014/08 dated 16 July 2016

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9.1 Remuneration of Identified Staff

Remuneration of Identified staff	Supervisory Function^	Management Function^	Investment Banking^	Independent Control Functions^	Retail Banking^	Asset Management^	Corporate Functions^	All Other^
Management Body	**13**	**7**						
Number of identified staff			**2**	**5**	**19**	**2**	**14**	**1**
Total fixed remuneration	**€ 402,826**	**€ 924,405**	**€ 170,215**	**€ 465,599**	**€ 1,794,756**	**€ 188,676**	**€ 1,138,022**	**€ 83,518**
Total variable remuneration	**Nil**	**€ 91,400**	**€ 3,500**	**€ 30,317**	**€ 72,544**	**€ 7,550**	**€ 55,831**	**€ 2,900**

**variable remuneration for identified staff includes performance related bonuses and other discretionary benefits*
^as defined in EBA guidelines EBA/GL/2014/8. None of the employees individually earn over €500,000.

Link between Pay and Performance

The variable portion of remuneration is linked to the level of profit earned by the Bank during the relative financial period. The calculation of the bonus attributed to the staff in the clerical and managerial grades is determined in the Collective Agreement and is based on the profit achieved by the Bank. The bonus is distributed to employees in proportion to the performance achieved by the individual and in accordance with their respective grades.

Employees in the executive grade are also eligible for an annual bonus determined by the Bank's performance and their individual performance. Annual bonus entitlements are also applicable to the CEO and members of the MB as highlighted under the Remuneration Report.

Performance Management System

Key Performance Indicators (KPIs), by which employees' performance is measured, provide individual, unit and organisation level targets aligned with the strategic objectives of the Group.

In order to avoid rewarding individuals for taking excessive risks, KPIs have been designed to account for the Group's long-term interest and values, with quality and compliance measures receiving a strong weighting at target setting stage. Financial and non-financial performance indicators are based on a balanced scorecard approach and therefore, financial targets are counterbalanced by process, customer satisfaction and employee development measures.

Section 10: Liquidity Risk

During 2017, the EBA has issued a set of guidelines (EBA/GL/2017/01) which aim to harmonise the disclosures in line with CRR 575/2013 Article 435(1) in relation to liquidity risk. Additional disclosures on liquidity risk can be found under the note 39.3 to the financial statement.

Liquidity risk is the risk that a bank is unable to meet its current or future payment obligations when they fall due and to replace funds when they are withdrawn, even when this occurs unexpectedly. Funding risk arises when the liquidity needed to fund illiquid asset positions cannot be obtained on the expected terms and when required. The Bank has always recognised liquidity risk as an important risk, to this end, the objective of the Bank's liquidity risk management is to ensure that both foreseeable and unpredicted funding commitment can be met when due and at a reasonable cost.

The oversight of liquidity risk within the Bank is the responsibility of the ALCO committee. This Committee maintains an on-going oversight of assets and liability cash flows, their risk and the management of such integrated exposures at a consolidated level by monitoring the availability of funds to meet commitments. The Treasury Department addresses its available liquidity resources on a daily basis and compiles a forecast that serves as an early warning indicator in the identification of abnormal liquidity activity. The resilience of the Bank's liquidity buffers is evaluated on a frequent basis to ensure a constant state of readiness should an exceptionally high demand for liquidity arise at any time. The Bank maintains a portfolio of highly marketable assets that can easily be liquidated in times of need.

Diversification of the Bank's funding profile is also an important element of the liquidity risk management framework. The Bank maintains an ongoing presence in funding markets and taps into unsecured credit lines to maintain a strong inter-bank relationship with fund providers. This is mostly done within the European market. A number of Global Master Repurchase Agreement with foreign banks are also in place to provide access to repo borrowing.

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Section 10: Liquidity Risk (continued)

In line with the Bank's risk appetite and in order to mitigate liquidity risk, adequate measures are established in a number of policies as highlighted below:

- TMP sets out the limits and controls that ensure a highly liquid investment portfolio;
- Liquidity Risk Management Policy outlines the liquidity management framework of the Bank developed to identify, evaluate, monitor, manage and report the Bank's liquidity position. The policy also sets out the controls available to manage liquidity risk and oversee the liquidity position of the Bank;
- Internal Liquidity Adequacy Assessment Process (ILAAP) contains detailed qualitative and quantitative information of the Bank's processes and methodology used to measure and manage liquidity and funding risk. To better assist the liquidity management and to ensure the adequacy of the liquidity tolerance levels, the ILAAP document includes a set of sensitivity analyses and a liquidity stress test; and
- Contingency Funding Plan sets out the strategies that will be activated in case of excessive liquidity demand. It includes an outlined process and action plan for responding to severe disruptions to the Bank's ability to fund some or all of its activities. This will ensure sufficient liquidity resources for meeting all liabilities when they fall due.

The BoD is satisfied with the Bank's liquidity adequacy and mitigants in place. In fact, in the last ILAAP document (September 2016), the Bank did not allocate any Pillar II capital against liquidity risk. This has been driven by the high degree of confidence that the Bank is in a position to address daily liquidity obligations and withstand a period of liquidity stress.

ALCO continuously analyses the best way to utilise the excess liquidity and monitors the Bank's liquidity position by following the liquidity risk tolerance/limits set out in the Bank's Risk Appetite. The Bank kept its highly liquid position during this financial period, with its loan portfolio fully funded by deposits. The LtD ratio (net of interest in suspense) has been on the decline throughout this period, standing at 44.2% as at December 2017 (September 2016 46.3%). The decrease in the LtD ratio was the result of a significantly higher rise in customer deposits when compared to the increase in the lending portfolio. The Bank calculates and monitors on a frequent basis the LCR and the NSFR ratios. The LCR is designed to promote the short-term resilience of the Bank's liquidity profile, while the NSFR is used to monitor the structural long-term funding position of the Bank.

EU LIQ 1 - LCR Disclosure table

€ millions		Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
21	Liquidity Buffer	3,367	3,536	3,820	4,131	4,358
22	Total Net Cash Outflows	2,614	2,718	2,804	2,944	2,928
23	**Liquidity Coverage Ratios**	**129%**	**130%**	**136%**	**140%**	**149%**

Section 11: Risk Management in Subsidiary Companies

The Group has two fully owned subsidiaries: BOV Asset Management Limited ("BOVAM") and BOV Fund Services Limited ("BOVFS")

BOVAM, formerly known as Valletta Fund Management Limited, was registered as a limited liability company under the laws of Malta on the 6 June 1995. BOVAM is licensed by the Malta Financial Services Authority (MFSA), to provide investment management services to collective investment schemes and qualifies as a 'Maltese Management Company' in terms of the Investment Services Act (Marketing of UCITS) Regulations (Subsidiary Legislation 370.18), by virtue of a licence issued on 22 September 1995. On 17 March 2017, BOVAM extended its licence to offer services beyond collective investment schemes. Upon extension of the licence, BOVAM started offering portfolio management service to institutional clients.

BOVAM is the appointed manager of Vilhena Funds SICAV plc which is a company organised as a multi-fund investment company with variable share capital pursuant to the Companies Act, Cap 386 of the Laws of Malta, registered on 10 October 1997, bearing registration Number SV4 and licensed by the MFSA as a collective investment scheme pursuant to the Investment Services Act, Cap 370 of the Laws of Malta and the UCITS Directive.

BOVAM is also the appointed manager of the BOV Investment Funds which is a common contractual fund licenced by the MFSA as a collective investment scheme pursuant to the Investment Services Act and the UCITS Directive.

Collectively, the sub-funds of the Vilhena Funds SICAV plc and of the BOV Investment Funds as well as the institutional clients will be referred to as 'portfolios'.

BOVAM has three regulatory functions, Asset Management, Risk Management and Compliance Monitoring. Risk Management and Compliance Monitoring are core functions of the company's culture and operations. Both functions are interlinked and work together to:

a) Ensure compliance with limits laid out in the UCITS directive, MFSA rules, Vilhena Funds SICAV plc Prospectus and respective Fund Supplements;
b) Ensure that risk measurement arrangements, processes and techniques on the portfolios' positions are in place, and that their contribution to the overall risk profile of the portfolios are accurately measured and documented;
c) Conduct periodic stress tests and scenario analyses to address risks arising from potential changes in market conditions that might adversely impact the portfolios;

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Section 11: Risk Management in Subsidiary Companies (continued)

d) Establish, implement and maintain a documented system of internal limits concerning the measures used to manage and control the relevant risks of the portfolios;
e) Ensure that the current level of risk complies with the risk limits set; and
f) Establish, implement and maintain adequate procedures that, in the event of actual or anticipated breaches to the risk limits of the portfolios, result in timely remedial actions.

The risk management techniques applied are appropriate and proportionate to the nature, scale and complexity of the BOVAM's activities and of the UCITS it manages. From time to time, BOVAM reviews the measurement techniques to ensure that these remain appropriate and effective, depending on the investment strategies of the portfolios.

BOVAM has a robust governance structure. It has documented policies and procedures in place and a comprehensive risk register identifying primary and consequential risks. For all the risks outlined in the risk register, BOVAM has internal control principles that enable it to operate in an efficient and diligent way.

Moreover, the BoD has established a Risk and Regulatory Committee ("RRC"), whose terms of reference are laid out in an appropriate document. This Committee is, amongst others, responsible to ensure that BOVAM has an appropriate risk management process in place. The RRC is also responsible to monitor, on a regular basis, the effective implementation of the risk management process, such that BOVAM is able to monitor, measure and manage at any time the various risks of the positions and their contribution to the overall risk-profile of the portfolios.

On the other hand, BOVFS (formerly Valletta Fund Services) was set up in 2006 as a fully owned subsidiary of the Bank to provide asset managers with a comprehensive suite of administration services to investment funds. BOVFS is recognised to provide fund administration services by the MFSA. In providing its services, BOVFS is exposed to both operational and reputation risks, and to a lesser extent also market risks. To mitigate these risks, BOVFS has in place compliance and risk monitoring internal audit programs through the Company's Compliance and Risk Management Division, aimed at reviewing the processes and the corresponding control procedures. In addition, periodic audits of the Company's various operations are undertaken by the Group's Internal Audit department. BOVFS has also engaged an independent audit firm to perform a biennial ISAE 3402 examination of its processes and controls, which consists of an evaluation of the design and operating effectiveness of the controls of the Company. In relation to managing reputation risks, BOVFS carries out an extensive due diligence process on its potential clients and has in place the necessary procedures to ensure that the business is compliant with prevention of money laundering regulations.

Lastly, in view of the dependency of the Company on its various IT systems, BOVFS has in place a detailed business continuity plan in order to appropriately manage the incidence of business interruptions and disaster recovery.

CRR References

CRR Articles	Description	Reference
Article 435	Risk management objectives and policies	Section 1, 10 and 11
Article 436	Scope of application	Section 2
Article 437	Own funds	Section 3
Article 438	Capital requirements	Section 4
Article 439	Exposure to counterparty credit risk	Section 6.6
Article 440	Capital buffers	Section 4
Article 441	Indicators of global systemic importance	N/A
Article 442	Credit risk adjustments	Section 6
Article 443	Unencumbered assets	Note to the Financial Statement 39.3
Article 444	Use of ECAIs	Section 6.4.3
Article 445	Exposure to market risk	Section 7
Article 446	Operational risk	Section 8
Article 447	Exposures to equities not included in the trading book	Section 7.4
Article 448	Exposure to interest rate risk on positions not included in the trading book	Section 7.2
Article 449	Exposure to securitisation positions	N/A
Article 450	Remuneration policy	Section 9 and Remuneration Report
Article 451	Leverage	Section 5
Article 452	Use of IRB Approach to credit risk	N/A
Article 453	Use of credit risk mitigation techniques	Section 6.5
Article 454	Use of advances measurements approaches to operational risk	N/A
Article 455	Use of Internal Market Risk models	N/A

Corporate governance statement of compliance

A. INTRODUCTION

Pursuant to the Malta Financial Services Authority Listing Rules, Bank of Valletta p.l.c. (the Bank) as a company whose equity securities are listed on a regulated market, should endeavour to adopt the Code of Principles of Good Corporate Governance (the Code) contained in Appendix 5.1 to Chapter 5 of the Listing Rules. In terms of Listing Rule 5.94, the Bank is obliged to prepare a report explaining how it has complied with the Code. For the purposes of the Listing Rules, the Bank is hereby reporting on the extent of its adoption of the Code.

The Board of Directors (the Board) is committed to the values of truth, transparency, honesty and integrity in all its actions. The Board strongly believes that the Bank benefits from having in place more transparent governance structures and from improved relations with the market which enhance market integrity and confidence. The Board acknowledges that the Code recommends principles for the Board and the Bank's management to pursue objectives that are in the interest of the Bank and its shareholders.

Good corporate governance is the responsibility of the Board, and in this regard the Board has adopted a corporate decision-making and supervisory structure that is tailored to suit the requirements of the Bank's constitutional documents as well as its size, nature and operational needs. In addition, while the structure provides flexibility and an efficient decentralisation of selective decision-making, it concurrently provides a system of checks and balances. The Board believes that any structure which is adopted must be geared to meet the necessary standards of accountability and probity and considers that the structure which it has adopted does so.

As demonstrated by the information set out in this Statement, together with the information contained in the Remuneration Report and in the Nominations Report, the Bank believes that it has, save as indicated herein, in the section entitled Non-Compliance with the Code, throughout the accounting period under review, applied the principles and complied with the provisions of the Code. In the Non-Compliance section, the Board indicates and explains the instances where it has departed from or where it has not applied the Code.

B. COMPLIANCE WITH THE CODE

Principle 1: The Board

The Board's role and responsibility is to provide the necessary leadership, to set strategy and to exercise good oversight and stewardship. The Board is composed of a Chairman, two Executive Directors and eight Non-Executive Directors. This mix of Executive and Non-Executive Directors on the Board enables the Non-Executive Directors to exercise their monitoring function over the management and the executive arm of the Board at the level of the Board. Moreover, the fact that the Chief Executive Officer (CEO) is also an Executive Director on the Board, enables the Board to be in receipt of timely and appropriate information in relation to the business of the Bank and Management's performance. As a result, the Board can contribute effectively to the decision making process, whilst at the same time exercising prudent and effective controls.

The Board delegates specific responsibilities to a number of Committees, notably the Asset and Liability Committee, the Audit Committee, the Risk Management Committee, the Compliance and Crime Prevention Committee, the Remuneration Committee and the Nominations and Governance Committee, each of which operates under formal terms of reference approved by the Board.

Further details in relation to the Committees and the responsibilities of the Board is found under Principles 4 and 5 of this Statement.

Principle 2: Chairman and Chief Executive Officer (CEO)

The Bank's current organisational structure incorporates the position of a CEO. The position of the Chairman and that of the CEO are occupied by different individuals. Their respective positions have been defined with specific roles rendering these positions completely separate from one another. This separation of roles of the Chairman and the CEO avoids concentration of authority and power in one individual.

The Chairman is responsible to lead the Board and to set its agenda. The Chairman ensures that the Board's discussions on any issue put before it go into adequate depth, that the opinions of all the Directors are taken into account and that all the Board's decisions are supported by adequate and timely information. The Chairman ensures that the CEO develops a strategy which is agreed to by the Board.

On the other hand, the CEO, besides being an Executive Director, leads the Bank's Management Board, which is the highest decision-making body within the Bank.

More information on the Bank's Management Board can be found under the section entitled Management Committees, within this Statement.

Corporate governance statement of compliance (continued)

Principle 3: Composition of the Board

The Board considers that the size of the Board, whilst not being too large as to be unwieldy, is appropriate, taking into account the size of the Bank and its operations. The combined and varied knowledge, experience and skills of the Board members provide a balance of competences that are required and add value to the proper functioning of the Board.

Independence of Directors

During the period under review, the Board consisted of seven Independent Non-Executive Directors (including the Chairman) and two Non-Independent Non-Executive Directors (as indicated on pages (ii) and (iii) of the Annual Report). In determining the independence or otherwise of its Directors, the Board has considered, amongst others, the notion of independence as contained in the Code, the Bank's own practice as well as general good practice principles. The Board believes that, by definition, employment with the Bank renders Directors Alan Attard and James Grech as Non-Independent from the institution. However, this should not, in any manner, detract from the said Non-Independent Directors' ability to maintain independence of analysis, decision and action at all times.

Appointment of Non-Executive Directors

The Board of Directors consists of a minimum of seven and a maximum of twelve individuals. A maximum of three are to be appointed as Executive Directors whilst the remaining nine are to be Non-Executive Directors.

The appointment of the nine Non-Executive Directors is governed by article 25 of the Articles of Association and appointments may be made as follows:

(a) By Qualifying Shareholders – namely members holding at least 10% of the issued share capital of the Bank having voting rights, that are entitled to nominate, for the approval of the Nominations and Governance Committee, one person for each 10% voting shares held; and

(b) By Non-Qualifying Shareholders not having a Qualifying Shareholding, but who individually or in aggregate hold not less than €50,000 in nominal value of shares having voting rights in the Bank and who are entitled to make recommendations for the approval of the Nominations and Governance Committee; or

(c) By the Nominations and Governance Committee itself seeking the recruitment of fit and proper persons having the right attributes that can add value to the Board of Directors.

Appointment of Executive Directors

The appointment of Executive Directors is regulated by article 24 of the Articles. In accordance with the said article, the CEO of the Bank shall ex officio become an Executive Director by virtue of his office and shall remain in office until the tenure of office as CEO. The Non-Executive Directors shall appoint at least one other Executive Director on the Board from amongst the Senior Management and may also appoint a third Executive Director if the Non-Executive Directors consider it in the best interests of the collective knowledge and competence of the Board to do so. To date one additional Executive Director has been appointed and that position is held by the Chief Risk Officer, which is in line with the Bank's strategic initiatives to highlight risk management even at Board level.

Nominations and Governance Committee

All Directors, irrespective of the manner in which they are proposed, can only take office following the approval of their nomination by the Nominations and Governance Committee. In this context, the Nominations and Governance Committee is the organ that, after having scrutinised the list of candidates to ensure that the Board will have the appropriate collective knowledge, experience and competence, will then place the list of approved candidates for election at the Annual General Meeting. More information on the Nominations and Governance Committee is found under the Nominations Report.

The appointment of all Directors is subject to regulatory approval.

Rotation of Directors

Following the amendments approved by an Extraordinary General Meeting of Shareholders in July 2017, the Bank has adopted a system of rotation of Directors aimed at ensuring a certain level of continuity within the Board of Directors. The system of rotation of Directors contemplates the retirement of one-third of the Non-Executive Directors in each year, with the remaining two-thirds of the Board retaining office. This is aimed at providing stability of policy-making and implementation by retaining a majority of the Board in place for a period of at least three years at any time. Those Directors whose turn it is to retire from office, pursuant to the rotation system, will be eligible for reappointment, subject to approval by the Nominations and Governance Committee. The Directors to retire first shall be determined as follows:

a) Those Non-Executive Directors who wish to retire and who do not seek reappointment prior to the full term of their appointment;

b) To the extent that there are less than three Non-Executive Directors who intimate their willingness to retire and not seek reappointment, by agreement between the Non-Executive Directors;

Corporate governance statement of compliance (continued)

c) In the absence of agreement, those to retire first shall be the Non-Executive Directors who have been longest in office, including by virtue of re-election, since their first election, but as between persons who became Directors on the same day or in the event that the duration in office cannot be properly determined those to retire shall (unless they otherwise agree among themselves) be determined by lot.

A retiring Director shall only be eligible for re-election provided that such person did not occupy the office of Non-Executive Director for an aggregate period of more than 12 years in any period of 15 years.

The Directors currently in office were appointed in December 2016. They shall all retire at the forthcoming Annual General Meeting scheduled for 10 May 2018, but shall be subject to reappointment in accordance with the Articles, and subject to the rotation mechanism explained above. As from the forthcoming Annual General Meeting scheduled for 10 May 2018, all Directors will be appointed for a term of three years, subject to the rotation mechanism. During each of the annual general meetings of the year 2019, 2020 and 2021, three out of the nine Non-Executive Directors' terms of office, shall expire pursuant to the rotation mechanism in the Articles (set out above), provided that such persons may be reappointed if they are eligible for reappointment.

Number of directorships held by members of the Board of Directors including the appointment on the Board of Bank of Valletta p.l.c.

Name	Number of Directorships held – Executive Director (ED) and Non-Executive Director (NED)
Stephen Agius	1 NED
Alan Attard	1 NED
Paul V Azzopardi	3 NED + 1 ED
Miguel Borg	2 NED + 1 ED
James Grech	3 NED
Alfred Lupi	2 NED
Mario Mallia	3 NED + 1 ED
Antonio Piras	1 NED
Joseph M Zrinzo	2 NED

Taddeo Scerri and Anita Mangion are not subject to the provisions of Article 91 of the CRD IV and Article 14 of the Banking Act, 1994 (Chapter 371, Laws of Malta) as regards the number of directorships held by them in view of their appointment in a national representative capacity.

Principles 4 and 5: The Responsibilities of the Board and Board Meetings

The Board meets approximately twice a month, unless further meetings are required for the Board to discharge its duties effectively. The Board discusses and decides upon matters relating to the Bank's business. During the financial period under review, the Board met 36 times. As from this financial period, the Credit Committee was specifically set up to discuss and decide upon credit proposals. Thus credit proposals are no longer considered by the Board. More information on the Credit Committee can be found under the section entitled Board Committees.

The Board regularly reviews and evaluates corporate strategy, major operational and financial plans, risk policies, performance objectives and business alternatives. The Board also monitors implementation and corporate performance within the parameters of all relevant laws, regulations and codes of best business practice. The Board has a formal schedule of matters reserved for its decision and also delegates specific responsibilities to Board Committees.

The Board ensures that it has the appropriate policies and procedures in place which guarantee that the Bank and its employees maintain the highest standards of corporate conduct, including compliance with applicable laws, regulations, business and ethical standards.

After each Board meeting, minutes that faithfully record attendance, matters discussed and decisions taken, are prepared and circulated to all Directors as soon as practicable after the meeting.

Members of Senior Management attend Board Meetings by invitation on a regular basis.

Corporate governance statement of compliance (continued)

Members	Meetings Held: 36 Members Attended	
Taddeo Scerri (appointed Chairman 16 December 2016)	35	(out of 36)
John Cassar White (resigned 16 December 2016)	6	(out of 7)
Stephen Agius (appointed 16 December 2016)	27	(out of 29)
Alan Attard (appointed 16 December 2016)	28	(out of 29)
Paul V Azzopardi (appointed 16 December 2016)	29	(out of 29)
Miguel Borg (appointed 27 July 2017)	13	(out of 15)
Barbara Helga Ellul (resigned 16 December 2016)	4	(out of 7)
James Grech	33	(out of 36)
Mario Grima (resigned 16 December 2016)	7	(out of 7)
Alfred Lupi	35	(out of 36)
Mario Mallia (appointed 27 July 2017)	14	(out of 15)
Anita Mangion (appointed 16 December 2016)	26	(out of 29)
Antonio Piras (appointed 16 December 2016)	19	(out of 29)
Gabriele Simonetti (resigned 16 December 2016)	6	(out of 7)
Joseph M Zrinzo	36	(out of 36)

Board Committees

The Board also delegates specific responsibilities to Committees, which operate under their respective formal terms of reference. In this respect, the Board has established the following Committees:

Credit Committee

The Credit Committee was set up by the Board during the period under review, to discuss and decide upon credit proposals. The Committee also considers and decides upon investment limits and write-offs on loan bank balances which require a level of authority higher than that of the Bank's Executives. The Committee also considers credit related issues which the Bank's Executives may wish to escalate. The Credit Committee was originally set up as a Credit Board, however, in August 2017, the Terms of Reference of the Credit Board were revised and its name was accordingly changed to a Credit Committee. The Credit Committee is a Board Committee.

Members	Meetings Held: 21 Members Attended	
Taddeo Scerri (Chairman)	19	(out of 21)
Miguel Borg	5	(out of 5)
Alfred Lupi	19	(out of 21)
Mario Mallia	19	(out of 21)
Joseph M Zrinzo	21	(out of 21)

The Executive Chairman's Office, the Chief Risk Officer, the Executive Credit Risk Sanctioning Department, the Chief Business Development Officer – Credit and the Chief Officer Corporate Finance attend the Credit Committee by invitation.

During four Credit Committee Meetings, Mr Alfred Lupi declared a potential conflict of interest and was excused from the discussions held therein. Mr Taddeo Scerri declared a potential conflict of interest during one committee meeting and Mr Miguel Borg also declared a potential conflict of interest during one Committee Meeting. Both were excluded from the discussions accordingly.

The Audit Committee

The Audit Committee's terms of reference include the monitoring of the financial reporting process, the effectiveness of the Bank's internal control, internal audit and risk management systems and the audit of the Bank's annual and consolidated accounts. The Audit Committee has established internal procedures and monitors these on a regular basis. The Audit Committee also scrutinizes and approves related party transactions as per the Related Party Transaction Policy. The Audit Committee considers the materiality and the nature of the related party transactions carried out by the Bank to ensure that the arms' length principle is adhered to at all times. The Audit Committee is also responsible for managing the Board's relationships with internal and external auditors.

In terms of Listing Rules 5.117, 5.118 and 5.118A, the Audit Committee is composed of four Non-Executive Directors, three of whom are considered as independent of the Bank. The three Non-Executive Independent Directors are considered as independent as they are free from any business, family or other relationship with the Bank or its management that may create a conflict of interest such as to impair their judgement. The other Non-Executive Director is a Bank employee and by virtue of his employment with the Bank, such Director is considered as Non-Independent from the institution.

Corporate governance statement of compliance (continued)

Alfred Lupi FCCA, FIA, BSc Econ is a Non-Executive Director. He is a professional accountant with an economics degree and is currently engaged in consultancy services. He is the Director whom the Bank considers as competent in accounting. Alfred Lupi is independent of the Bank.

James Grech B.Com. (Hons.) Mangt., MBA (Henley) (UK) is a Non-Executive Non-Independent Director. He joined the Bank in 1998 and is currently the Executive Head Foreign Bank Relationships. During his career at the Bank he held various managerial positions at various branches and departments and is thus considered as a competent member of the Audit Committee.

Anita Mangion B.Sc. Business & Computing, B.Com. Management Hons, MBA eBusiness is a Non-Executive Director. Ms Mangion is an experienced business and IT consultant and during the last fifteen years has consulted different local and international entities in various sectors such as financial, ICT and banking. Ms Mangion is independent of the Bank and considered as a competent member of the Audit Committee.

Joseph M Zrinzo is a Non-Executive Director. Mr Zrinzo has various Board directorship experiences on a number of companies. He also served as a member of various committees. He is independent of the Bank and considered as competent to be a member of the Audit Committee.

The Bank considers the Audit Committee members as having the adequate competence and independence criteria as required by Listing Rule 5.118.

Members	Meetings Held: 22 Members Attended	
Alfred Lupi (Chairman appointed 20 December 2016)	16	(out of 16)
Barbara Helga Ellul (resigned 16 December 2016)	4	(out of 4)
James Grech (appointed 20 December 2016)	17	(out of 18)
Anita Mangion (appointed 20 December 2016)	15	(out of 16)
Taddeo Scerri (Chairman until 16 December 2016)	3	(out of 3)
Joseph M Zrinzo	21	(out of 22)

The CEO, the Chief Risk Officer, the Chief Finance Officer and a representative of the External Auditors attend the Audit Committee meetings by invitation. KPMG Malta are the Group's statutory auditors. The Chief Officer Group Internal Audit also attends the meetings of the Audit Committee. A designated person from the Office of the Company Secretary acts as Secretary to the Audit Committee.

During the period under review, the Audit Committee was chaired by Taddeo Scerri until his appointment as Chairman of the Bank on 16 December 2016. During this period and pursuant to the Bank's Related Party Transaction Policy, Alfred Lupi chaired one Audit Committee Meeting, which discussed related party transactions, concerning the Government of Malta or related parties as defined in the Bank's Related Party Transaction Policy.

Alfred Lupi was then appointed Chairman of the Audit Committee on 20 December 2016. Paul V Azzopardi chaired two Audit Committee Meetings which discussed related party transactions instead of Alfred Lupi who could not chair the meeting due to a potential conflict of interest.

The Remuneration Committee – This is considered under the Remuneration Report.

The CEO and the Chief Risk Officer attend the Remuneration Committee meetings by invitation. The Company Secretary acts as Secretary to the Remuneration Committee.

The Nominations and Governance Committee – This is considered under the Nominations Report.

The CEO and the Chief Risk Officer attend the Nominations and Governance Committee meetings by invitation. The Company Secretary acts as a Secretary to the Nominations and Governance Committee.

Corporate governance statement of compliance (continued)

The Risk Management Committee

The Risk Management Committee assists the Board in assessing the different types of risks to which the organisation is exposed. This Committee is responsible for the proper implementation and review of the Group's risk policies related mainly, but not restricted to, Credit, Market and Operational Risks. It reports to the Board on the adequacy, or otherwise, of such policies. The Committee is also responsible to review delegated limits, together with an oversight of the Group's monitoring and reporting systems, to ensure regular and appropriate monitoring and reporting on the Group's risk positions.

Members	Meetings Held: 7 Members Attended	
Joseph M Zrinzo (Chairman appointed 20 December 2016)	5	(out of 5)
Stephen Agius (appointed 20 December 2016)	4	(out of 5)
Paul V Azzopardi (appointed 20 December 2016)	5	(out of 5)
Mario Grima (Chairman until 16 December 2016)	2	(out of 2)
Antonio Piras (appointed 20 December 2016)	3	(out of 5)
James Grech (member until 16 December 2016)	2	(out of 2)
Alfred Lupi (member until 16 December 2016)	2	(out of 2)

The CEO, the Chief Finance Officer, the Chief Risk Officer, the Chief Officer Group Internal Audit, the Executive Risk Management and the Head Enterprise Risk Management attend the Risk Management Committee meetings by invitation. A designated person from the Office of the Company Secretary acts as Secretary to the Risk Management Committee.

The above information on the Risk Management Committee, together with the information contained in Section 1 of the Capital and Risk Management Report included in this Annual Report, is also to be considered as a disclosure for the purposes of Regulation 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms.

The Compliance and Crime Prevention Committee

The primary objective of the Compliance and Crime Prevention Committee is to assist and guide the Board of Directors in the discharge of their obligations imposed from time to time by regulation in the area of financial services and in light of the Bank acting as a credit and financial institution licensed to provide services under different laws and within the framework of the Compliance Function as defined in the Compliance Charter and as approved by the Board of Directors. The Committee is also responsible to assist the Bank in combatting financial crime and money laundering activities.

The CEO, the Chief Risk Officer, the Chief Business Development Officer – Investments, the Executive Legal Services, the Executive Group Compliance and the Money Laundering Reporting Officer attend the Compliance and Crime Prevention Committee meetings by invitation. A designated person from the Office of the Company Secretary acts as Secretary to the Compliance and Crime Prevention Committee.

Members	Meetings Held: 8 Members Attended	
Paul V Azzopardi (Chairman appointed 20 December 2016)	6	(out of 6)
Alan Attard (appointed 20 December 2016)	5	(out of 6)
James Grech (appointed 20 December 2016)	5	(out of 6)
Mario Grima (member until 16 December 2016)	2	(out of 2)
Alfred Lupi (appointed 20 December 2016)	6	(out of 6)
Joseph M Zrinzo (Chairman until 16 December 2016)	2	(out of 2)

Management Committees

The **Management Board** is primarily responsible for the management of the Bank and its strategy, financial performance, risk management, human resources, information technology and data management, setting up committees which may become necessary and escalation procedures. The Bank's Management Board meets on a regular basis. It is chaired by the CEO and is composed of the following members:

- The Chief Operations Officer
- The Chief Risk Officer
- The Chief Finance Officer
- The Chief Business Development Officer – Investments
- The Chief Business Development Officer – Credit
- The Chief Technology Officer

Corporate governance statement of compliance (continued)

The **Asset and Liability Committee (ALCO)** is an integral part of the BOV Group management. The Committee takes an integrated view in managing the Group's assets and liabilities to achieve an optimal balance between risk and return. ALCO evaluates the asset and liability cash flows, and the management of integrated exposures at a consolidated level, to enable it to give strategic direction to the business. Consideration is given, inter alia, to solvency, liquidity and interest rate risks. It also provides guidance in respect of risk and return to the business, and exercises executive authority in the area of interest rate management by setting the interest rates payable on retail deposit products. Additionally, the Committee monitors hedging strategies and hedge effectiveness in respect of the risks aforementioned, as well as asset mix, liabilities and balance sheet growth. ALCO also monitors the capital adequacy of the Group on a continuous basis, making use of capital forecasts to ensure that enough capital is readily available at all times to meet the demand arising from business growth and regulation. The Committee meets at least once a month to review the balance sheet risks and ensures its prudent management. ALCO is chaired by the CEO and has as members a Board Director and other members of Senior Management.

The **Provisions Committee** is responsible to develop and maintain a provisioning methodology in line with best practice and regulatory expectations. The Committee meets on a monthly basis unless further meetings are required. The Provisions Committee is chaired by the Chief Finance Officer and is composed of members of Senior Management.

The **IT Steering Committee** is responsible for the effective and cost-efficient application of information technologies, related personnel resources and funding in support of the objectives and needs of the Bank. The Committee meets every two months unless further meetings are required. The IT Steering Committee is chaired by the Chief Technology Officer and is composed of members of Senior Management.

The **Procurement Committee** is responsible for the approval of procurement of goods and services that exceed limits afforded to management and to make recommendations to the Management Board and to the Board of Directors on the award of contracts that exceed a defined value. The Committee meets at least once a month unless further meetings are required. The Committee is chaired by the Chief Operations Officer and is composed of members of Senior Management.

The **Core Banking Transformation Steering Committee** is responsible for overseeing the implementation of the new selected core banking solution, together with overseeing the transformation required in line with the Bank's operations. The Committee takes into consideration current banking practices that need to be transformed in order to adopt the solution selected. The Committee meets on a monthly basis and is chaired by the CEO and is composed of members of Senior Management.

The **Anti-Financial Crime Committee (AFCC)** is responsible to discuss and ensure that legal, regulatory and other developments related to money laundering, funding of terrorism and other financial crime matters, are implemented in the Bank's policies and procedures. This Committee is also tasked to set the risk appetite for financial crime for the Bank and to ensure that the Bank follows best practice in connection with anti-money laundering, combatting the funding of terrorism and other financial crime. The AFCC is chaired by the Chief Risk Officer and is composed of members of Senior Management.

The **New Product Approval Committee (NPAC)** ensures the enhancement of long term value creation for the benefit of all stakeholders. The aim is to ensure adequate due diligence before a new product or service is launched by understanding and vetting its features. The Committee aims to identify and mitigate potential risks which impact both the product or service and the Group. The NPAC makes the final decision to either approve, decline or recommend changes to the proposed product or service. The Committee also provides guidance and recommendations to the Board of Directors in case of a new business line. The NPAC is appointed by the Management Board and is chaired by the Chief Risk Officer to ensure a risk adequate approach and the necessary degree of intervention in relation to product development, hence also ensuring that the new proposed product or service falls within the Group's risk appetite.

Principle 6: Information and Professional Development

The CEO is appointed by the Board and is inter alia responsible for the recruitment and selection of Senior Management and consults with the Nominations and Governance Committee and with the Board on the appointment of Senior Management. Training of management and employees is a priority and internal and external training is provided by the Bank's Training Centre specifically set up for this purpose.

On joining the Board, a Non-Executive Director is provided with briefings by the CEO on the activities of the Bank. All Directors are provided with a dossier that, apart from incorporating the relevant legislation, rules and bye laws, and Memoranda and Articles of Group companies, also includes the Bank's Policy documents.

Directors may, where they judge it necessary to discharge their duties as Directors, take independent professional advice on any matter at the Bank's expense. Directors have access to the advice and services of the Company Secretary, who is responsible for ensuring adherence to Board procedures as well as good information flows within the Board and its Committees.

Informative sessions on risk management, corporate governance and training sessions on the Bank's business operations were organised during the period under review for the Board and for the members of the Management Board. In addition, the Company Secretary directs members of the Board to seminars or conferences which serve as professional development for Directors in the discharge of their functions on the Board and on the Committees.

Corporate governance statement of compliance (continued)

Principle 7: Evaluation of the Board's Performance

During the period under review, the Nominations and Governance Committee undertook an evaluation of the performance of the Board, the Chairman and the Board Committees. The evaluation exercise was conducted through a Board Effectiveness Questionnaire prepared by the Nominations and Governance Committee. The results of the Questionnaire were analysed by the Nominations and Governance Committee and discussed at Board level.

From the Board Effectiveness Questionnaire, the following points emerged:

- All Board Members support and debate the Company's strategy and values enabling them to set the tone from the top. The need for more focus on strategic issues and externalities, with more use of dashboards, particularly to monitor project progress, was also recommended.
- The Board has a clearer understanding of its responsibilities and promotes high-level discussions.
- The Board follows up on action points taken during previous meetings and ensures that it has a rigorous program of continuous professional education.
- The Directors present a good level of skills covering a wide range of experiences.
- The Board continually monitors and challenges management with the sole aim of ensuring its success in the interest of all stakeholders involved.
- Board Committees are properly constituted and their members have the necessary expertise and skills to perform their delegated roles and report back clearly and fully to the Board.

Principle 8: Committees

The Remuneration Committee is dealt with under the Remuneration Report, which also includes the Remuneration Statement of Compliance in terms of Code Provisions 8.A.3 and 8.A.4.

The Nominations and Governance Committee was set up by the Board during financial year 2016 as set out in the Code provisions. Further details on the Nominations and Governance Committee is found under the Nominations Report as per Listing Rule 8.B.7.

Principles 9 and 10: Relations with Shareholders and with the Market and Institutional Shareholders

The Bank recognises the importance of maintaining a dialogue with its shareholders and of keeping the market informed to ensure that its strategies and performance are well understood.

The Board is of the view that during the period under review the Bank has communicated effectively with the market through a number of company announcements and press releases.

The Bank also communicates with its shareholders through the Bank's Annual General Meeting (AGM) (further detail is provided under the section entitled General Meetings). All Directors attend the AGM and are available to answer questions, if necessary.

The Chairman and the CEO also ensure that sufficient contact is maintained with major shareholders to understand issues and concerns.

Apart from the AGM, the Bank communicates with its shareholders by way of the Annual Report and Financial Statements, by publishing and sending to the shareholders its results on a six-monthly basis and through a bi-annual newsletter to shareholders. Since financial period 2017 covered a period of fifteen months, two sets of interim financial statements were issued, on 27 April 2017 and 26 October 2017 respectively, accompanied with the issuance of three letters to shareholders. The Bank's website (www.bov.com) also contains information about the Bank and its business, including an Investor Relations Section.

In addition, the Bank holds a meeting for stockbrokers and financial intermediaries, usually twice a year, to coincide with the publication of its Financial Statements. Other meetings with stockbrokers and financial intermediaries are held as necessary.

The Bank's Investor Relations Officer at the Office of the Company Secretary maintains two-way communication between the Bank and its investors. Individual shareholders can raise matters relating to their shareholdings and the business of the Group at any time throughout the financial year and are given the opportunity to ask questions at the AGM or submit written questions in advance. In terms of Article 18.3 of the Articles of Association of the Bank and Article 129 of the Companies Act,1995 (Chapter 386, Laws of Malta), the Directors may call an extraordinary general meeting on the requisition of shareholders holding not less than one-tenth of the paid up share capital of the Company.

Corporate governance statement of compliance (continued)

Principle 11: Conflicts of Interest

The Directors are strongly aware of their responsibility to act at all times in the interest of the Bank and its shareholders as a whole and of their obligation to avoid conflicts of interest. The latter may, and do arise on specific matters. In such instances, the Bank ensures that such conflicts, actual or potential, are managed in the best interest of the Bank.

A Director is therefore required to make full and frank disclosure with respect to any matter where there is a potential or actual conflict, whether such conflict arises from personal interests or the interests of the companies in which such person is a Director or officer and the said Director is excused from the meeting and accordingly is not involved in the Bank's Board discussion on the matter and does not vote on any such matter.

On joining the Board, and regularly thereafter, the Directors are informed of their obligations on dealing in securities of the Bank within the parameters of the law, including the Listing Rules, as well as the Bank's Code of Conduct for Securities Transactions and Directors follow the required notification procedures.

Directors' interest in the share capital of the Bank as at 31 December 2017 was as follows:

	Beneficial Interest*
Alan Attard	14,782 shares
Paul V Azzopardi	9,153 shares
Miguel Borg	6,731 shares
Alfred Lupi	30,154 shares
Joseph M Zrinzo	193,266 shares

**Includes any shares held by spouses or partners*

Alan Attard held 15,749,945 shares by way of non-beneficial interest in his capacity as one of the five trustees of the BOV Employees' Foundation.

No Director has any other benefit or non-beneficial interest in the share capital of the Bank.

As at 31 December 2017, the Directors below also held the following:

	Beneficial interest**	
Alan Attard	6,500	BOV 5.35% Subordinated Bonds 2019
Joseph M Zrinzo	8,000	BOV 4.80% Medium Term Notes 2018
	11,700	BOV 5.35% Subordinated Bonds 2019
	31,500	BOV 4.80% Subordinated Bonds 2020
	35,000	BOV 3.50% Subordinated Notes 2030 Series 2

***Includes any holdings by spouses or partners*

Principle 12: Corporate Social Responsibility (CSR)

"We are committed to play a leading and effective role in the country's sustainable development, whilst tangibly proving ourselves to be responsible and caring citizens of the community in which we operate."

Bank of Valletta recognises it has an important role to play in being an active corporate citizen within the Maltese society in which it operates. It is committed to contribute to the cultural landscape and social fibre of the country, not only to its economic development, but also through the efficient management of resources for the benefit of all stakeholders involved.

BOV continuously strives to be the employer of choice for its people, whom it considers to be its primary asset. In a bid to promote a healthy lifestyle and well-being for its employees, the Bank has a number of programmes in place to help its people maintain a stress-free balance between their work and private life (i.e. health check-ups). Employees are also encouraged to fulfil their role in the community by participating in events like blood donation drives, dress down days in aid of NGOs and tree-planting activities organised throughout the year. Meanwhile, teams across the retail network come together to organise an initiative for the benefit of groups in their community, thereby reinforcing the link between the Bank and the community.

Corporate governance statement of compliance (continued)

The customer, be it personal or corporate, remains at the heart of the Bank's strategy and vision going forward. 2017 saw Bank of Valletta inaugurating new premises in Gzira and Centris Business Gateway in Mrieħel. In Gzira, the Bank's premises houses various customer-facing initiatives, as well as its Training Academy and the Bank's Ethics and Employee Development function. The latter represents a direct investment in the Bank's people and their future. The offices in Mrieħel are dedicated to areas that a few years ago were peripheral to the banking business but whose function became more critical as the Bank was recognised to be of systemic importance to the country. These units include the Bank's Risk Management Division, Compliance and Anti-Financial Crime Department and Debt Management Unit. Meanwhile, during the financial period under review, the Bank increased its ATM fleet to 95 across the Maltese Islands, and also introduced contactless cards thereby harnessing technology to provide other innovative solutions, offering added efficiency and convenience, without forfeiting security to its card base.

Shareholders are kept abreast of developments – beyond regulatory requirements – via the BOV Shareholders' Link, while the public is invited to participate in educational sessions to help them become more financially literate and in a better position to take informed decisions.

The Bank continues to work on its Green agenda, which has been featuring in its Mission Statement for several years now. As an organisation with roots running deep within the Maltese society, the Bank feels responsible not only to act ethically but also to actively promote conservation and safeguard the green stakeholder, in its bid to reduce its carbon footprint whilst instilling more environmentally-friendly practices. This philosophy is extended to the supply-chain by integrating environmental considerations into all stages of the purchasing process.

The Bank's roots run deep into the community in which it operates. The sound principles of Corporate Social Responsibility (CSR) are put into practice through its extensive Community Programme which is distilled into seven distinct pillars, representing diverse but equally important concerns for the Maltese society. These are:

Arts and Culture – BOV has taken onboard a number of artistic initiatives during the financial period under review. The span includes performances at the Manoel Theatre and the two theatres in Gozo – Astra and Aurora. BOV remains a leading sponsor of the Malta Philharmonic Orchestra. The Bank has continued to endorse the Maltese Tenor Joseph Calleja as well as the BOV Joseph Calleja Children's Choir. The BOV Retrospective Arts Exhibition, which this period featured works of art by renowned artist Anthony Calleja, has remained a much sought after annual appointment on the national cultural calendar.

Heritage – The conservation project at the vault of the Sanctuary in Mellieħa was brought to an end, but several other initiatives were undertaken. Meanwhile, the Bank stepped in to support the conservation of the 16th century baroque 'Grand Salon' at the Auberge de Provence in Valletta, one of the only five wooden trussed roofs still surviving from the period of the Knights of the St John. 2017 also saw Bank of Valletta lending its support when the ceiling of the Ta' Ġieżu Church in Rabat tragically collapsed. Meanwhile, the Bank continued to partner Fondazzjoni Wirt Artna, not only in relation to safeguarding historical gems but also vis-à-vis its Hands-On Heritage programme which focuses on educating the younger generation about our rich past by offering students the unique opportunity to handle period instruments and tools, and learn how they were used.

Natural Environment – After an absence of several years, 2017 saw Bank of Valletta renewing its backing to Dinja Waħda, a nationwide education and awareness program run across Primary Schools by the NGO BirdLife Malta. Targeting thousands of school children, this program aims to instil in them a deeper appreciation for Malta's fauna and flora. The Bank continued to support the BOV Adventure Park at Ta' Qali in a bid to ensure adequate green space for Maltese families to spend quality time together.

Education – The Bank renewed its collaboration with the National Literacy Agency towards the Read with Me programme which is run free of charge in various centres across Malta and Gozo, in a bid to help combat illiteracy by targeting children aged 0 to 4 years and their parents/guardians. This is done by providing the environment and the professionals who make reading time a fun experience for everyone involved. The Bank also organised dedicated sessions for its own employees and their children at BOV Centre. Excellence in education was promoted by sponsoring various educational awards. The BOV Investment Education Project – a project which gives University students reading for a degree in Economics, Management and Accountancy the opportunity to get first-hand experience in the world of financial trading – was once again successfully executed.

Philanthropy – Social causes have always featured strongly on the Bank's agenda. Since it was set up in 2014, the Marigold Foundation – BOV in the Community acts as a Trust that manages requests by NGOs and individuals with a philanthropic purpose. The BOV Joseph Calleja Foundation, on the other hand, is a partnership between the Bank and the internationally renowned Maltese tenor that raises funds to support talented youth in fulfilling their artistic dreams. Dress downs organised during the period under review, supported the Pink October effort, Dr Klown and Puttinu Cares. Meanwhile, the Bank dedicated its Cards for Charity campaign towards 'Service Dogs Foundation – Malta' and Puttinu Cares. This was indeed marked as a record period in terms of the Bank's contribution towards the Malta Community Chest Fund, with its donation towards L-Istrina BOV Piggy Bank campaign reaching €200,000.

Sport – Promoting a healthy lifestyle has remained a key pillar of the Bank's Community Relations programme. Witness to this is the support provided to various sporting associations in a bid to encourage the general public to make sports a more integral part of their lifestyle. In fact 2017 saw the Malta Basketball Association inaugurate their new pavilion, whilst Bank of Valletta and Sports Malta collaborated to extend the Youth Development Scheme to twenty Maltese athletes, who have not yet reached the age of 18. The scheme provides the nominated athletes financial assistance to participate in international competitions overseas.

Corporate governance statement of compliance (continued)

Strategic Alliances – The Bank continued to work closely with the main representative bodies and business associations, such as the Malta Chamber of Commerce, Enterprise and Industry and the Malta Hotels and Restaurants Association. 2017 saw Bank of Valletta support several business initiatives and conferences organised to open discussion about topical issues of interest to businesses in Malta.

There is no one formula for implementing Corporate Social Responsibility. For Bank of Valletta, being a responsible organisation means keeping the interests of the different stakeholders in mind in all its decisions, from strategic to the daily operational ones. The Community Programme gives the Bank a framework guiding its support towards the Community, in a fair and managed manner. By implementing a Programme that strategically directs the Bank's efforts into specific spheres, the Bank stirs away from adopting an excessively narrow approach that focuses solely on philanthropy and sponsorships. This also corroborates the Bank's belief that being a corporate citizen is really a frame of mind impacting its holistic approach to doing business.

C. NON-COMPLIANCE WITH THE CODE

Principle 4 (Code Provision 4.2.7)

The Code recommends "the development of a succession policy for the future composition of the Board of Directors and particularly the executive component thereof, for which the Chairman should hold key responsibility". Although the Bank does not have a Succession Policy *per se*, the concept of Rotation of Directors (as further explained under Principle 3 above) was introduced to ensure continuity at Board level and is embedded within the Bank's Memorandum and Articles of Association.

Principle 6 (Code Provision 6.4.4)

During the financial period under review there was not a system in place to establish a succession plan for senior management, however, the Bank has always been successful in appointing individuals internally.

Principle 9 (Code Provision 9.3)

Code Provision 9.3 requires the Bank to have in place a mechanism to resolve conflicts between minority shareholders and controlling shareholders. This Code Provision is not applicable to the Bank since the Bank has no controlling shareholders.

Listing Rules – Section 5.97.8 – Policy on Diversity

The Bank does not have a Policy on Diversity in place, however it ensures that the Bank is diverse in terms of skills, competency, gender and age. In the Maltese environment, it is difficult to ensure gender diversity at Board level, which is a nationwide problem.

The Bank is Equality Certified and has an Equality Policy. The Equality Mark is a certification awarded to companies that make gender equality one of their values and whose management is based on the recognition and promotion of the potential of all employees irrespective of their gender and caring responsibilities.

Furthermore, the Bank has policies in place which encourage and promote family-friendly measures such as child-care leave and child-care subsidies.

D. INTERNAL CONTROL

Authority to manage the activities of the Bank is delegated to the CEO within the limits set by the Board.

The Board is ultimately responsible for the Bank's systems of internal control and for reviewing their effectiveness. Such systems are designed to manage, rather than eliminate, the risk of failure to achieve business objectives, and can only provide reasonable as opposed to absolute assurance against material misstatement or loss. Through the Audit Committee, the Risk Management Committee and the Compliance and Crime Prevention Committee, the Board reviews the process and procedures to ensure the effectiveness of the Group's systems of internal control, which are monitored by the Group Internal Audit Department.

The key features of the Group's systems of internal control are as follows:

Organisation

The Group operates through the Board of Directors of subsidiary companies and equity-accounted investee companies with clear reporting lines and delegation of powers.

Control Environment

The Group is committed to the highest standards of business conduct and seeks to maintain these standards across all of its operations. Group policies and employee procedures are in place for the reporting and resolution of fraudulent activities. The Group has an appropriate organisational structure for planning, executing, controlling and monitoring business operations in order to achieve Group objectives.

Corporate governance statement of compliance (continued)

Risk Identification

The management of each of the Group members is responsible for the identification and evaluation of key risks applicable to their areas of business. The risk management model adopted by BOV is the classic "three lines of defence model" wherein the first line of defence is constituted by the functions that own and manage risks, namely the business units; the second line is constituted by the functions that oversee risks, namely Risk Management, Compliance and Anti-Financial Crime; and the third line is constituted by Internal Audit, which is the function that provides independent assurance. The Risk Management function, within the second line of defence, falls under the responsibility of the Chief Risk Officer, and operates within a wider Bank structure that reflects the risk appetite and risk management philosophy articulated by the Board of Directors.

Reporting

Functional, operating and financial reporting standards are applicable to all entities of the Group. These are supplemented by operating standards set, as required, by the Bank's Board and the Management Board. Systems and procedures are in place to identify, control and to report on the major risks including credit risk, changes in the market prices of financial instruments, liquidity, operational error and fraud. Exposure to these risks is monitored by ALCO and by the Risk Management Committee. The Board receives periodic management information giving comprehensive analysis of financial and business performance including variances against budgets.

E. LISTING RULE 5.97.5

The information required by this Listing Rule is found in the Directors' Report.

F. GENERAL MEETINGS

The general meeting is the highest decision making body of the Bank. A general meeting is called by twenty-one days' notice and it is conducted in accordance with the Articles of Association of the Bank.

The Annual General Meeting (AGM) deals with what is termed as "ordinary business", namely, the receiving or adoption of the annual financial statements, the declaration of a dividend, the appointment of the auditors, Board authorisation to fix the auditors' emoluments and the Election of Directors. Other business which may be transacted at a general meeting (including at the AGM) will be dealt with as Special Business.

All shareholders registered in the Shareholders' Register on the Record Date as defined in the Listing Rules, have the right to attend, participate and vote in the general meeting. A shareholder or shareholders holding not less than 5% in nominal value of all the shares entitled to vote at the general meeting may request the Bank to include items on the agenda of a general meeting and/or table draft resolutions for items included in the agenda of a general meeting. Such requests are to be received by the Bank at least forty six days before the date set for the relative general meeting.

A shareholder who cannot participate in the general meeting can appoint a proxy by written or electronic notification to the Bank. Every shareholder represented in person or by proxy is entitled to ask questions which are pertinent and related to items on the agenda of the general meeting and to have such questions answered by the Directors or by such persons as the Directors may delegate for that purpose.

Remuneration report as at 31 December 2017

1. Terms of Reference and Membership of the Remuneration Committee

The Remuneration Committee (the Committee) is charged with overseeing the development and implementation of the remuneration and related policies of the Group. Its primary purpose is to make recommendations to the Board on the remuneration policy of the Group, support the Board in overseeing the remuneration system's design and operation and ensure that remuneration is appropriate and consistent with the Bank's culture, long term business and risk appetite, performance and control environment as well as with any legal or regulatory requirements. The role of the Committee is to devise the appropriate remuneration packages needed to attract, retain and motivate Directors, as well as key function holders required for the proper governance of the Group.

The Committee is composed of Taddeo Scerri (Chairman), Anita Mangion and Antonio Piras as members, all of whom are Independent Non-Executive Directors. The Chief Executive Officer and the Chief Risk Officer attend meetings of the Committee. The Company Secretary acts as secretary to the Committee.

2. Meetings

The Committee held eight meetings during the period under review, which meetings were attended as follows:

Members	Attended	
Taddeo Scerri (Chairman appointed 20 December 2016)	8	(out of 8)
John Cassar White (resigned from the Bank 16 December 2016)	1	(out of 1)
Alfred Lupi (member until 16 December 2016)	1	(out of 1)
Anita Mangion (appointed 20 December 2016)	7	(out of 7)
Antonio Piras (appointed 20 December 2016)	7	(out of 7)

3. Remuneration Statement

3.1 Remuneration Policy – Executive Management

The Board determines the framework of the overall remuneration policy for Executive Management based on recommendations from the Committee. The Committee, on the recommendations of the Chief Executive Officer, then establishes the individual remuneration arrangements of the Group's Executive Management, namely the members of the Management Board and Heads of Departments.

The Committee is also charged with considering and determining requests for early retirement based on exceptional circumstances, which must be assessed by the Bank on a case by case basis.

The Remuneration Policy applies consistently to all employees within the Group. Its objective is to align individual rewards with the Group's performance, business strategy, risk appetite, values and long term interests. It also encourages a prudent approach to risk taking. The overriding principle of the Remuneration Policy is that individual performance is evaluated according to both quantitative/financial and qualitative/behavioural measures. Further details about the Bank's Remuneration Policy are found in the Capital and Risk Management Report.

The Committee considers that the current Executive Management remuneration packages are based upon the appropriate local market equivalents and are adequate for the responsibilities involved. The Committee is of the opinion that the remuneration packages are such, so as to enable the Bank to attract, retain and motivate executives having the appropriate skills and qualities, in order to ensure the proper management of the organisation. Such packages should therefore be kept under constant review.

Hereinafter, for the purposes of this Remuneration Statement, references to "Senior Executives" shall mean the Chief Executive Officer and the other six members of the Management Board.

Senior Executives are in full employment with the Bank on an indefinite contract but their appointment on the Management Board is on a definite contract. They enjoy the health insurance arrangements and death in service benefits as all Bank employees. Senior Executives are also entitled to the use of a company car. Certain members of the Management Board have a clause in their contract wherein should their contract be terminated without due reason, they may be eligible for monetary compensation. Share options and profit sharing are not part of the Group's Remuneration Policy.

The Chief Executive Officer's remuneration is reviewed and approved by the Committee. The Chief Executive Officer is eligible for an annual bonus entitlement by reference to the attainment of pre-established objectives and targets as approved by the Committee. The Members of the Management Board are also eligible for an annual bonus entitlement.

The Members of the Management Board are eligible for an annual salary increase within a maximum salary range approved by the Committee.

No supplementary pension or other pension benefits are payable to the Senior Executives. Insofar as early retirement schemes are concerned, the Senior Executives are subject to the schemes which are set out and defined in the Collective Agreement (for Managerial and Clerical Grades) as may be applicable to employees from time to time.

Remuneration report as at 31 December 2017 (continued)

The Committee is of the view that the amount of performance bonus paid out at all staff levels is not significant.

Total emoluments received by Senior Executives during financial period 2017 are reported below under section 3.3 in terms of Code Provisions 8.A.5.

Variable Remuneration of Senior Executives (Management Board)

The Variable Remuneration of Senior Executives is determined by the Remuneration Committee. During financial period 2017 Management Board members qualified for a collective performance-related pay system. The payment of bonuses payable to the Management Board members was linked to the performance and achievement of the objectives of the Management Board. The objectives of the Management Board were based partly on financial targets (financial ratios) and partly on qualitative targets (quality ratios).

3.2 Remuneration Policy – Directors

With effect from 27 July 2017, the Board is composed of Executive and Non-Executive Directors. Directors' remuneration is determined and regulated by service contracts for Directors as detailed below. The maximum annual aggregate emoluments that may be paid to the Directors is approved by the shareholders at the General Meeting in terms of Article 33.1 of the Bank's Articles of Association. The aggregate emoluments of all directors of €450,000 per annum was fixed at an Extraordinary General Meeting held on 27 July 2017. This amount excludes the salaries of Directors in the Bank's employment.

Service Contracts for Directors

The Directors have service contracts with the Bank, none of which provide for severance payments upon termination of their respective directorships. In terms of the said service contracts, the Directors are entitled to certain benefits after the termination of their directorship, including discounts on products and services offered by the Group. Service contracts regulate the term of office of Directors, referring specifically to the concept of Rotation of Directors provided within the Memorandum and Articles of Association (as further explained under Principle 3 of the Corporate Governance Statement of Compliance). Vacation of office of Director shall be served in writing. Service contracts also provide for the Directors' powers and duties vis-à-vis the Bank and their obligation to dedicate sufficient time to carry out their responsibilities. Directors are obliged to avoid conflicts of interest and shall take reasonable steps to keep the Bank's matters confidential. Directors' emoluments are designed to reflect the time committed by Directors to the Bank's affairs, including the different Board Committees of which Directors are members, and their responsibilities on such Committees. None of the Directors, in their capacity as a Director of the Bank, is entitled to profit sharing, share options or pension benefits. In terms of non-cash benefits, Directors are entitled to health insurance and to a refund of out-of-pocket expenses.

The Directors' fees as approved by the Board are as follows:

Directors' Fees	**€**
Chairman	80,000
All other Directors (both Executive and Non-Executive)	20,500
Board Committees Fees	
Chairman	5,000
Members	3,000

Two of the Non-Executive Directors, as well as both the Executive Directors, are employees of the Bank and therefore also receive remuneration by virtue of their employment.

Total fees received by Directors during financial period 2017 are reported below under section 3.3 in terms of Code Provisions 8.A.5.

Remuneration Policy Review

There were no changes to the Remuneration Policy for Directors and Executive Management during financial period 2017. However, the current Remuneration Policy will be revised during financial year 2018.

3.3 Code Provision 8.A.5

Senior Executives' Emoluments (Management Board)

Fixed Remuneration	Variable Remuneration	Share Options	Others
€924,404.86	€91,399.92	none	non-cash benefits: health insurance and refund of out-of-pocket expenses

Remuneration report as at 31 December 2017 (continued)

Directors' Fees

Fixed Remuneration	Variable Remuneration	Share Options	Others
€402,826	None	None	non-cash benefits: health insurance and refund of out-of-pocket expenses

For the Financial Period under review these were paid as follows:

Directors' fees including benefits – Financial Period 2017	**€**
Taddeo Scerri (appointed Chairman 16 December 2016)	103,270
John Cassar White (resigned 16 December 2016)	17,739
Stephen Agius (appointed 16 December 2016)	26,974
Alan Attard (appointed 16 December 2016)	27,658
Paul V Azzopardi (appointed 16 December 2016)	28,692
Miguel Borg (appointed 27 July 2017)	8,904
Barbara Helga Ellul (resigned 16 December 2016)	5,310
James Grech	35,638
Mario Grima (resigned 16 December 2016)	5,566
Alfred Lupi	38,520
Mario Mallia (appointed 27 July 2017)	12,185
Anita Mangion (appointed 16 December 2016)	27,231
Antonio Piras (appointed 16 December 2016)	26,500
Gabriele Simonetti (resigned 16 December 2016)	4,375
Joseph M Zrinzo	43,579
Total	412,141

Nominations report as at 31 December 2017

The Nominations and Governance Committee (NGC)

The Nominations Committee (the Committee) was set up by the Board during financial year 2016. Its name was changed to Nominations and Governance Committee (NGC) during financial period 2017 and it has been enshrined in the Memorandum and Articles of Association approved by the Shareholders during the Extraordinary General Meeting held on 27 July 2017. The Committee follows the Nominations Policy and works under the guidance of its Terms of Reference as approved by the Board.

The role of the NGC is twofold, namely (i) to ensure that the composition of the Board of Directors of the Bank has the appropriate level and mix of experience, skills, and competence that may be required for the operation of a credit institution and (ii) to ensure that persons occupying the post of Non-Executive Directors meet the requirements of prevailing legislation and regulation.

From time to time, the Board of Directors sets out the terms of reference of the NGC. However certain fundamentals are entrenched in the Memorandum and Articles of Association, that set out both the basic role of the NGC as well as the parameters within which the directors may provide the appropriate terms of reference, namely:

i) To recommend to the Board, candidates having the right attributes, including:
   - integrity, skill, competence and experience individually; and
   - contributes to the collective skills, experience and competence required at Board level.
ii) To make recommendations to the Board on persons considered as independent to occupy positions on the Board;
iii) To make recommendations on matters such as succession planning, establishment of policies and procedures related to the selection of senior management and the optimal size of the Board of Directors and the Management Board;
iv) To ensure that nominations to the Board are made on merit and in line with the overall requirements of the skills and competence required in the Board;
v) To evaluate and test each candidate against guidelines issued from time to time by the Regulators; and
vi) Periodically assess the skills, knowledge and experience that may be required within the Board and make recommendations to the Board.

With a view to avoid possible perceptions of conflicts of interest in the scrutiny and approval of candidates for appointment as Non-Executive Directors, the Articles of Association provide that no member of the NGC shall be present when his nomination as a director or a matter which concerns that member in question, is being evaluated by the NGC. In such instances such member shall be substituted by another director. In this same context, the proposals include a system of rotation that would, as far as practicably possible, ensure that members on the Committee will not have an interest in the scrutiny of other candidates for the same position.

The Committee is composed of three Non-Executive Directors and chaired by the Bank's Chairman. Two of the Non-Executive Directors appointed thereon are Independent Directors. During financial period 2017, the Committee was chaired by the Chairman of the Bank Taddeo Scerri, with Stephen Agius and Joseph M Zrinzo as members, all Independent and Non-Executive Directors. The Chief Executive Officer and the Chief Risk Officer attend meetings of the Committee. The Company Secretary acts as secretary to the Committee. The Committee held six meetings during the period under review and all members attended all six meetings.

During financial period 2017, the Committee focused on implementing a structured nominations process for the appointment of Executive Directors, changes in reporting lines, as well as, the composition of Board Committees for financial period 2018. The Committee was also responsible for the evaluation of the Board's performance, the Chairman's performance and the Board Committees' performance (as further explained under Principle 7 of the Corporate Governance Statement of Compliance).

Disclosures for the purposes of Regulation 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms:

While information about every member of the Board is found on pages (ii) and (iii) of the Annual Report, a detailed curriculum vitae of every member of the Board and of the nominees is available at the Office of the Company Secretary.

Independent Auditors' Report to the Shareholders of Bank of Valletta p.l.c.

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

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

Specifically, with respect to the following matters noted in Listing Rule 5.100, we report whether:

(a) we have identified material misstatements with respect to the disclosures referred to in Listing Rule 5.97.4 and Listing Rule 5.97.5. Where any material misstatements are identified, we are required to provide an indication of the nature of such misstatements; and

(b) the other disclosures required by Listing Rule 5.97 have been provided.

Responsibilities of the Directors

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

Auditors' Responsibilities

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

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

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

We are not required to, and we do not, consider whether the directors' statements on internal control and risk management systems cover all the risks and controls in relation to the financial reporting process or form an opinion on the effectiveness of the Bank's corporate governance procedures or its risks and control procedures, nor on the ability of the Bank to continue in operational existence. Our opinion in relation to the disclosures pursuant to Listing Rule 5.97.4 and Listing Rule 5.97.5 is based solely on our knowledge and understanding of the Bank and its environment obtained in forming our opinion on the audit of the financial statements. We have not performed any procedures by way of audit, verification or review on the underlying information from which the other disclosures required by Listing Rule 5.97 is derived.

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

Conclusion

Our conclusion has been formed on the basis of, and is subject to, the matters outlined in this report.
We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our conclusion.

In our opinion:

(a) in light of the knowledge and understanding of the Bank and its environment obtained during the course of our audit of the financial statements, we have not identified material misstatements with respect to the following disclosures:
   (i) the information referred to in Listing Rule 5.97.4, included in the directors' Corporate Governance Statement of Compliance, as this relates to the Bank's internal control and risk management systems in relation to the financial reporting process; and
   (ii) the information referred to in Listing Rule 5.97.5, included in the Directors' Report, insofar as it is applicable to the Bank;

(b) the other disclosures required by Listing Rule 5.97 have been included in the directors' Statement of Compliance on Corporate Governance, as these apply to the Bank.

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

KPMG
Registered Auditors

23 March 2018

Statements of profit or loss for the fifteen months ended 31 December 2017

	Note	The Group		The Bank	
		2017	2016	2017	2016
		15 months to Dec 2017	12 months to Sep 2016	15 months to Dec 2017	12 months to Sep 2016
		€000	€000	€000	€000
Interest and similar income					
- on loans and advances, balances with					
Central Bank of Malta and treasury bills	2	198,997	160,339	198,997	160,339
- on debt and other fixed income instruments	2	60,197	54,063	60,197	54,063
Interest expense	3	(76,247)	(65,573)	(76,247)	(65,573)
Net interest income		**182,947**	**148,829**	**182,947**	**148,829**
Fee and commission income		98,787	75,021	87,587	66,840
Fee and commission expense		(12,498)	(8,936)	(12,498)	(8,936)
Net fee and commission income	4	**86,289**	**66,085**	**75,089**	**57,904**
Dividend income		1,925	1,901	17,682	9,635
Trading profits	5	22,290	24,724	22,338	24,724
Net gain on investment securities and hedging instruments	6	7,022	9,046	7,022	9,046
Gain on Visa transaction	6	-	27,511	-	27,511
Operating income		**300,473**	**278,096**	**305,078**	**277,649**
Employee compensation and benefits	7	(79,750)	(64,168)	(76,507)	(62,036)
General administrative expenses		(59,463)	(40,103)	(57,806)	(39,085)
Amortisation of intangible assets	20	(4,933)	(3,539)	(4,933)	(3,539)
Depreciation	21	(7,105)	(4,968)	(7,035)	(4,899)
Net impairment reversals/(losses)	8	6,227	(23,142)	6,227	(23,147)
Operating profit		**155,449**	**142,176**	**165,024**	**144,943**
Share of results of equity-accounted investees, net of tax	18	19,287	3,730	-	-
Profit before tax	9	**174,736**	**145,906**	**165,024**	**144,943**
Income tax expense	10	(55,238)	(50,708)	(56,180)	(50,760)
Profit for the period		**119,498**	**95,198**	**108,844**	**94,183**
Attributable to:					
Equity holders of the Bank		119,498	94,742	108,844	94,183
Non-controlling interest		-	456	-	-
		119,498	95,198	108,844	94,183
Earnings per share	11	**27c1**	**21c6**	**24c7**	**21c5**

Statements of profit or loss and other comprehensive income

for the fifteen months ended 31 December 2017

	Note	The Group		The Bank	
		2017	2016	2017	2016
		15 months to Dec 2017	12 months to Sep 2016	15 months to Dec 2017	12 months to Sep 2016
		€000	€000	€000	€000
Profit for the period		119,498	95,198	108,844	94,183
Other comprehensive income					
Items that may be reclassified subsequently to profit or loss:					
Available-for-sale investments					
- change in fair value		1,379	33,777	1,379	33,777
deferred tax thereon		(483)	(11,822)	(483)	(11,822)
- change in fair value transferred to profit or loss		(7,443)	(34,876)	(7,443)	(34,876)
deferred tax thereon		2,605	12,206	2,605	12,206
Items that will not be reclassified to profit or loss:					
Property revaluation	21	2,005	960	2,005	960
deferred tax thereon and effect of changes in property tax rates		(201)	44	(201)	44
Remeasurement of actuarial losses on defined benefit plans	35	15	(1,448)	15	(1,448)
deferred tax thereon		(5)	508	(5)	508
Other comprehensive income for the period, net of tax		(2,128)	(651)	(2,128)	(651)
Total comprehensive income		117,370	94,547	106,716	93,532
Attributable to:					
Equity holders of the Bank		117,370	94,091	106,716	93,532
Non-controlling interest		-	456	-	-
		117,370	94,547	106,716	93,532

The notes are an integral part of these financial statements.

Statements of financial position

as at 31 December 2017

	Note	The Group 2017 €000	The Group 2016 €000	The Bank 2017 €000	The Bank 2016 €000
ASSETS					
Balances with Central Bank of Malta, treasury bills and cash	13	159,684	171,050	159,684	171,050
Financial assets at fair value through profit or loss	14	326,291	392,430	325,316	391,292
Investments	15	3,374,541	3,736,272	3,374,541	3,736,272
Loans and advances to banks	16	3,431,383	2,098,439	3,431,383	2,098,439
Loans and advances to customers at amortised cost	17	4,162,032	4,001,656	4,162,032	4,001,656
Investments in equity-accounted investees	18	109,461	97,041	52,870	52,870
Investments in subsidiary companies	19	-	-	6,230	6,230
Intangible assets	20	28,453	13,272	28,453	13,272
Property and equipment	21	105,222	89,574	105,048	89,452
Current tax		12,034	16,061	9,379	15,091
Deferred tax	22	60,217	67,188	60,217	67,188
Assets held for realisation	40	5,972	11,973	5,972	11,973
Other assets		5,955	4,818	5,872	4,809
Prepayments and accrued income	23	39,385	23,077	40,317	22,697
Total Assets		**11,820,630**	**10,722,851**	**11,767,314**	**10,682,291**
LIABILITIES					
Financial liabilities at fair value through profit or loss	14	11,957	20,327	11,957	20,327
Amounts owed to banks	24	192,196	250,155	192,196	250,155
Amounts owed to customers	25	10,100,625	9,184,517	10,102,164	9,187,940
Debt securities in issue	26	95,400	95,400	95,400	95,400
Deferred tax	22	4,519	4,318	4,519	4,318
Other liabilities	27	197,751	170,518	197,428	170,333
Accruals and deferred income	28	12,451	16,215	11,958	15,802
Derivatives designated for hedge accounting	29	12,053	20,649	12,053	20,649
Subordinated liabilities	30	231,591	231,591	231,591	231,591
Total Liabilities		**10,858,543**	**9,993,690**	**10,859,266**	**9,996,515**
EQUITY					
Called up share capital	31	525,000	390,000	525,000	390,000
Share premium account	31	45,427	988	45,427	988
Revaluation reserves	32	33,194	35,332	33,082	35,220
Retained earnings	32	358,466	302,841	304,539	259,568
Total Equity attributable to equity holders of the Bank		**962,087**	**729,161**	**908,048**	**685,776**
Total Equity		**962,087**	**729,161**	**908,048**	**685,776**
Total Liabilities and Equity		**11,820,630**	**10,722,851**	**11,767,314**	**10,682,291**
MEMORANDUM ITEMS					
Contingent liabilities	33	253,851	225,407	253,851	225,407
Commitments	34	1,858,191	1,590,156	1,858,191	1,590,156

The notes are an integral part of these financial statements. These financial statements were approved by the Board of Directors and authorised for issue on 23 March 2018 and signed on its behalf by:

Taddeo Scerri
Chairman

Joseph M Zrinzo
Director

Mario Mallia
Chief Executive Officer

Statements of changes in equity for the fifteen months ended 31 December 2017

	Attributable to Equity holders of the Bank						
	Share Capital	Share Premium Account	Revaluation Reserves	Retained Earnings	Total	Non-controlling Interest	Total Equity
	€000	€000	€000	€000	€000	€000	€000
The Group							
At 1 October 2015	**360,000**	**988**	**35,217**	**272,713**	**668,918**	**1,271**	**670,189**
Profit for the year	-	-	-	94,742	**94,742**	456	**95,198**
Other comprehensive income							
Available-for-sale investments							
- change in fair value, net of tax	-	-	21,955	-	**21,955**	-	**21,955**
- change in fair value transferred to profit or loss, net of tax	-	-	(22,670)	-	**(22,670)**	-	**(22,670)**
Property revaluation, net of tax	-	-	1,004	-	**1,004**	-	**1,004**
Release of surplus on sale of property, net of tax	-	-	(174)	174	**-**	-	**-**
Remeasurement of actuarial losses on defined benefit plans, net of tax	-	-	-	(940)	**(940)**	-	**(940)**
Total other comprehensive income/(loss)	-	-	115	(766)	**(651)**	-	**(651)**
Total comprehensive income for the year	-	-	115	93,976	**94,091**	456	**94,547**
Transactions with owners, recorded directly in equity:							
Acquisition of non-controlling interest	-	-	-	(4,046)	**(4,046)**	(954)	**(5,000)**
Bonus issue	30,000	-	-	(30,000)	**-**	-	**-**
Dividends to equity holders	-	-	-	(29,802)	**(29,802)**	(773)	**(30,575)**
	30,000	-	-	(63,848)	**(33,848)**	(1,727)	**(35,575)**
At 30 September 2016	**390,000**	**988**	**35,332**	**302,841**	**729,161**	**-**	**729,161**
Profit for the period	-	-	-	119,498	**119,498**	-	**119,498**
Other comprehensive income							
Available-for-sale investments							
- change in fair value, net of tax	-	-	896	-	**896**	-	**896**
- change in fair value transferred to profit or loss, net of tax	-	-	(4,838)	-	**(4,838)**	-	**(4,838)**
Property revaluation, net of tax	-	-	1,804	-	**1,804**	-	**1,804**
Remeasurement of actuarial losses on defined benefit plans, net of tax	-	-	-	10	**10**	-	**10**
Total other comprehensive income/(loss)	-	-	(2,138)	10	**(2,128)**	-	**(2,128)**
Total comprehensive income for the period	-	-	(2,138)	119,508	**117,370**	-	**117,370**
Transactions with owners, recorded directly in equity:							
Rights issue	105,000	44,439	-	-	**149,439**	-	**149,439**
Bonus issue	30,000	-	-	(30,000)	**-**	-	**-**
Dividends to equity holders	-	-	-	(33,883)	**(33,883)**	-	**(33,883)**
	135,000	44,439	-	(63,883)	**115,556**	-	**115,556**
At 31 December 2017	**525,000**	**45,427**	**33,194**	**358,466**	**962,087**	**-**	**962,087**

The notes are an integral part of these financial statements.

Statements of changes in equity

for the fifteen months ended 31 December 2017 (continued)

	Share Capital €000	Share Premium Account €000	Revaluation Reserves €000	Retained Earnings €000	Total €000
The Bank					
At 1 October 2015	**360,000**	**988**	**35,105**	**225,953**	**622,046**
Profit for the year	-	-	-	94,183	**94,183**
Other comprehensive income					
Available-for-sale investments					
- change in fair value, net of tax	-	-	21,955	-	**21,955**
- change in fair value transferred to profit or loss, net of tax	-	-	(22,670)	-	**(22,670)**
Property revaluation, net of tax	-	-	1,004	-	**1,004**
Release of surplus on sale of property, net of tax	-	-	(174)	174	**-**
Remeasurement of actuarial losses on defined benefit plans, net of tax	-	-	-	(940)	**(940)**
Total other comprehensive income/(loss)	-	-	115	(766)	**(651)**
Total comprehensive income for the year	-	-	115	93,417	**93,532**
Transactions with owners, recorded directly in equity:					
Bonus issue	30,000	-	-	(30,000)	**-**
Dividends to equity holders	-	-	-	(29,802)	**(29,802)**
	30,000	-	-	(59,802)	**(29,802)**
At 30 September 2016	**390,000**	**988**	**35,220**	**259,568**	**685,776**
Profit for the period	-	-	-	108,844	**108,844**
Other comprehensive income					
Available-for-sale investments					
- change in fair value, net of tax	-	-	896	-	**896**
- change in fair value transferred to profit or loss, net of tax	-	-	(4,838)	-	**(4,838)**
Property revaluation, net of tax	-	-	1,804	-	**1,804**
Remeasurement of actuarial losses on defined benefit plans, net of tax	-	-	-	10	**10**
Total other comprehensive income/(loss)	-	-	(2,138)	10	**(2,128)**
Total comprehensive income for the period	-	-	(2,138)	108,854	**106,716**
Transactions with owners, recorded directly in equity:					
Rights issue	105,000	44,439	-	-	**149,439**
Bonus issue	30,000	-	-	(30,000)	**-**
Dividends to equity holders	-	-	-	(33,883)	**(33,883)**
	135,000	44,439	-	(63,883)	**115,556**
At 31 December 2017	**525,000**	**45,427**	**33,082**	**304,539**	**908,048**

The notes are an integral part of these financial statements.

Statements of cash flows for the year ended 31 December 2017

	Note	The Group		The Bank	
		2017 15 months to Dec 2017	2016 12 months to Sep 2016	2017 15 months to Dec 2017	2016 12 months to Sep 2016
		€000	€000	€000	€000
Cash flows from operating activities					
Interest and commission receipts		301,893	237,321	290,744	229,154
Interest, commission and compensation payments		(91,668)	(77,205)	(91,748)	(77,026)
Payments to employees and suppliers		(137,262)	(103,563)	(133,675)	(99,601)
Operating profit before changes in operating assets and liabilities		72,963	56,553	65,321	52,527
(Increase)/decrease in operating assets:					
Loans and advances		16,706	(53,038)	16,706	(53,038)
Reserve deposit with Central Bank of Malta		(11,254)	(8,643)	(11,254)	(8,643)
Fair value through profit or loss financial assets		66,844	97,902	66,844	97,902
Fair value through profit or loss equity instruments		15,843	1,303	15,680	477
Treasury bills with original maturity of more than 3 months		(4,503)	-	(4,503)	-
Other assets		(2,638)	(311)	(2,564)	(302)
Increase in operating liabilities:					
Amounts owed to banks and to customers		872,724	752,337	870,840	752,384
Other liabilities		17,639	(33,187)	17,523	(33,120)
Net cash from operating activities before tax		1,044,324	812,916	1,034,593	808,187
Tax paid		(42,122)	(44,862)	(41,381)	(44,955)
Net cash from operating activities		1,002,202	768,054	993,212	763,232
Cash flows from investing activities					
Dividends received		8,794	5,628	17,682	9,636
Interest received from held-to-maturity debt and other fixed income instruments		74,725	59,783	74,725	59,783
Acquisition of non-controlling interest		-	(5,000)	-	(5,000)
Purchase of debt instruments		(897,650)	(1,257,546)	(897,650)	(1,257,546)
Proceeds from sale or maturity of debt instruments		1,155,933	869,184	1,155,933	869,184
Proceeds from sale of equity instruments		4,350	3,043	4,350	3,043
Proceeds from Visa transaction		-	22,042	-	22,042
Purchase of property and equipment and intangible assets		(33,341)	(8,111)	(33,239)	(8,070)
Proceeds from disposal of property and equipment		-	598	-	598
Net cash from/used in investing activities		312,811	(310,379)	321,801	(306,330)
Cash flows from financing activities					
Proceeds from rights issue		149,439	-	149,439	-
Proceeds from issue of subordinated bonds		-	111,591	-	111,591
Dividends paid to Bank's equity holders		(33,883)	(29,802)	(33,883)	(29,802)
Dividends paid to non-controlling interests		-	(773)	-	-
Net cash from financing activities		115,556	81,016	115,556	81,789
Net change in cash and cash equivalents		1,430,569	538,691	1,430,569	538,691
Effect of exchange rate changes on cash and cash equivalents		772	-	772	-
Net change in cash and cash equivalents after effect of exchange rate changes		1,429,797	538,691	1,429,797	538,691
Net change in cash and cash equivalents		1,430,569	538,691	1,430,569	538,691
Cash and cash equivalents at 1 October		1,848,038	1,309,347	1,848,038	1,309,347
Cash and cash equivalents at 31 December / 30 September	36	**3,278,607**	**1,848,038**	**3,278,607**	**1,848,038**

The notes are an integral part of these financial statements.

Notes to the financial statements for the fifteen months ended 31 December 2017

1. SIGNIFICANT ACCOUNTING POLICIES

1.1 Basis of preparation

Legal Notice 19 of 2009 as amended by Legal Notice 233 of 2016, Accountancy Profession (Accounting and Auditing Standards) (Amendments) Regulations, 2016, defines compliance with generally accepted accounting principles and practice as adherence to International Financial Reporting Standards (IFRS) as adopted by the EU for financial periods starting on or after 1 January 2008. These Regulations have come into force on 17 June 2016.

Article 4 of Regulation 1606/2002/EC requires that, for each financial period starting on or after 1 January 2005, companies governed by the law of an EU Member State shall prepare their consolidated financial statements in conformity with IFRS as adopted by the EU if, at their reporting date, their securities are admitted to trading on a regulated market of any EU Member State. This Regulation prevails over the provisions of the Companies Act, 1995, (Chapter 386, Laws of Malta) to the extent that the said provisions of the Companies Act, 1995, (Chapter 386, Laws of Malta) are incompatible with the provisions of the Regulation.

Consequently, the separate and the consolidated financial statements are prepared in conformity with IFRS as adopted by the EU.

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

The Group has changed its accounting reference date from 30 September to 31 December. This set of financial statements is the first one prepared under this new date and therefore covers a fifteen month period from 1 October 2016 to 31 December 2017. The comparative period is the twelve months from 1 October 2015 to 30 September 2016.

The financial statements have been prepared on the historical cost basis. Assets and liabilities are measured at historical cost except for the following that are measured at fair value: available-for-sale financial assets, financial instruments classified at fair value through profit or loss, derivatives and land and buildings. Additionally, assets held for realisation are measured at fair value less costs to sell.

The financial statements are prepared on a going concern basis. The Directors regard that this is appropriate, after due consideration of the Bank's profitability, liquidity, the statement of financial position, capital adequacy and solvency. Specifically, the directors have prepared financial and capital plans for the next five years which shows that the Bank is in a position to continue operating as a going concern for the foreseeable future. These plans take into account risks facing the Bank, including but not limited to, the potential crystallisation of known contingent liabilities.

A number of new standards and amendments were endorsed by the EU but effective for periods starting on or after 1 January 2017 as disclosed hereunder. The directors have assessed the impact of IFRS 9 Financial Instruments and IFRS15 Revenue from Contracts with Customers as disclosed in Note 1.1.1.2.2 and 1.1.2 respectively. The impact that the adoption of other International Financial Reporting Standards will have on the financial statements of the Group and the Bank in the period of initial application is currently being assessed by the directors. These standards and amendments include the following:

Standards:
- IFRS15 Revenue from Contracts with Customers (issued on 28 May 2014) and clarifications thereon (issued on 12 April 2016) - effective 1/1/2018
- IFRS9 Financial Instruments (issued on 24 July 2014) - effective 1/1/2018
- Annual Improvements to IFRSs 2014-2016 Cycle - various standards (issued on 8/12/2016) - effective 1/1/2018
- IFRS16 Leases (issued on 13 January 2016) - effective 1/1/2019.

Amendments:
- Amendments to IAS 7: Disclosure initiative *(issued on 29 January 2016)* - effective 1/1/2017
- Amendments to IAS12: Recognition of Deferred Tax Assets for Unrealised Losses *(issued on 19 January 2016)* - effective 1/1/2017.

In addition, the following new interpretations and amendments have not yet been endorsed by the EU:

- IFRIC 22 Foreign Currency Transactions and Advance Consideration (issued on 8 December 2016) and effective for periods starting on or after 1/1/2018
- IFRIC 23 Uncertainty over Income Tax Treatments (issued on 7 June 2017) and effective for periods starting on or after 1/1/2019
- Amendments to IFRS 9: Prepayment Features with Negative Compensation (issued on 12 October 2017) and effective for periods starting on or after 1/1/2019
- Amendments to IAS 28: Long-term Interests in Associates and Joint Ventures (issued on 12 October 2017) and effective for periods starting on or after 1/1/2019
- Annual Improvements to IFRS Standards 2015-2017 Cycle (issued on 12 December 2017) and effective for periods starting on or after 1/1/2019
- Amendments to IAS 19: Plan Amendment, Curtailment or Settlement (issued on 7 February 2018) and effective for periods starting on or after 1/1/2019.

Notes to the financial statements for the fifteen months ended 31 December 2017 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.1 Basis of preparation (continued)

Standards issued but not yet effective:

1.1.1 IFRS 9 Financial Instruments

In July 2014, the International Accounting Standards Board issued the final version of IFRS 9, Financial Instruments.

IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted. The Group will adopt IFRS initially on 1 January 2018.

The new standard requires the Group to revise its accounting processes and internal controls related to reporting financial instruments.

1.1.1.1 Implementation Strategy

The Group's IFRS 9 implementation process is governed by a Steering Committee whose members include representatives from risk, treasury, finance, credit, and IT functions. The Steering Committee set up an IFRS 9 working group as well as met regularly to challenge key assumptions, approve decisions and monitor the progress of the implementation work across the Group. The Board and Audit Committee were being updated on the project's progress on a regular basis and its approval for key decisions was sought and obtained.

1.1.1.2 Classification and measurement of financial assets

1.1.1.2.1 Classification of financial assets

From 1 January 2018, the Group will apply IFRS 9 and classify its financial assets in the following measurement categories:

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

The standard eliminates the existing IAS39 categories of held to maturity, loans and receivables and available for sale.

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.

Classification and subsequent measurement of debt instruments depend on:

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

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

- Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ('SPPI'), and that are not designated at FVTPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any expected credit loss allowance recognised and measured as described in note 1.1.1.2.3.1. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method.
- Fair value through other comprehensive income (FVOCI): Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent solely payments of principal and interest, and that are not designated at FVTPL, are measured at FVOCI. Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortised cost which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in 'Net gain on investment securities and hedging instruments'. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method.
- Fair value through profit or loss (FVTPL): Assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at FVTPL and is not part of a hedging relationship is recognised in profit or loss and presented in the profit or loss statement within 'Trading profits'. Interest income from these financial assets is included in 'Interest income'.

Also, IFRS 9 permits new elective designations at FVTPL or FVOCI to be made on the date of initial application and permits or requires revocation of previous FVTPL elections at the date of initial application depending on the facts and circumstances at that date.

Notes to the financial statements 31 December 2017 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.1 Basis of preparation (continued)

1.1.1.2.1 Classification of financial assets (continued)

Financial assets and liabilities are designated at fair value through profit or loss on initial recognition where such designation results in more relevant information because it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases.

Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never bifurcated. Instead, the hybrid financial instrument as a whole is assessed for classification.

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

On initial recognition of an equity investment that is not held for trading, the Group may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis and is irrevocable.

Gains and losses on such equity instruments are never reclassified to profit or loss and no impairment is recognised. Dividends are recognised in profit or loss unless they clearly represent a recovery of part of the cost of the investment, in which case they are recognised in OCI. Cumulative gains and losses recognised in OCI are transferred to retained earnings on disposal of an investment.

1.1.1.2.1.1 Business model assessment

The Group made an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered included:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, 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 the assets;
- how the performance of the portfolio is evaluated and reported to the Group's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Group's stated objective for managing the financial assets is achieved and how cash flows are realised.

Financial assets that are held for trading and 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.

1.1.1.2.1.2 Cash flows that represent solely payments of principal and interest

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Group will consider the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Group considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Group's claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
- features that modify consideration of the time value of money – e.g. periodical reset of interest rates.

Notes to the financial statements 31 December 2017 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.1 Basis of preparation (continued)

1.1.1.2.2 Impact assessment

Based on its assessment of changes to the classification and measurement of financial assets held as at 31 December 2017, the Group's expectation is that:

- trading assets and derivative assets held for risk management that are classified as held-for-trading and measured at FVTPL under IAS 39 would also be measured at FVTPL under IFRS 9;
- loans and advances to banks and to customers that are classified as loans and receivables and measured at amortised cost under IAS 39 would, in general, also be measured at amortised cost under IFRS 9 while those at FVTPL would also in general continue to be measured at fair value;
- held-to-maturity investment securities measured at amortised cost under IAS 39 would, in general, also be measured at amortised cost under IFRS 9;
- debt securities that are classified as available-for-sale under IAS 39 would, in general, be measured at FVOCI;
- equity securities that meet the definition of equity in their entirety and which are classified as fair value through profit or loss or as available-for-sale under IAS 39 would, generally, be measured at FVOCI under IFRS 9, with a minority of such securities classified and measured at FVTPL;
- investments in collective investment schemes that are classified as FVTPL under IAS 39 would continue to be classified and measured at FVTPL under IFRS 9.

1.1.1.2.3 Impairment of financial assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' (ECL) model. This will require considerable judgement over how changes in economic factors affect ECLs, which will be determined on a probability-weighted basis.

The new impairment model will apply to the following financial instruments that are not measured at FVTPL:

- financial assets that are debt instruments;
- financial guarantee contracts issued; and
- loan commitment issued.

No impairment loss will be recognised on equity investments.

Under IFRS 9, the Group will recognise a loss allowance at an amount equal to lifetime ECL, except in the following cases, where the amount recognised will be 12-month ECL:

- debt investment securities that are determined to have low credit risk at the reporting date; and
- other financial instruments on which credit risk has not increased significantly since their initial recognition.

1.1.1.2.3.1 Expected credit loss measurement

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

- A financial instrument that is not credit-impaired on initial recognition is classified in 'Stage 1' and has its credit risk continuously monitored by the Group.
- If a significant increase in credit risk ('SICR') since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired. The assessment of whether credit risk on a financial asset has increased significantly will be one of the critical judgements in implementing the impairment model of IFRS 9.
- If the financial instrument is deemed to be credit-impaired, the financial instrument is then moved to 'Stage 3'.
- Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in Stages 2 and 3 have their ECL measured based on expected losses on a lifetime basis.
- A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward-looking information.

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

Change in credit quality since initial recognition

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

Notes to the financial statements 31 December 2017 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.1 Basis of preparation (continued)

1.1.1.2.3.2 Significant increase in credit risk

The assessment of whether credit risk on a financial asset has increased significantly is one of the critical judgements in implementing the impairment model of IFRS 9.

With the exception of those instruments measured at FVTPL, exposures with low credit risk at the reporting date and any purchased or originated credit-impaired financial assets, the Group assesses whether debt instruments have experienced a significant increase in credit risk since initial recognition.

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Group would consider reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Group's historical experience and expert credit assessment and including forward-looking information.

In the case of the Group's loan portfolio, the objective of the assessment is to identify whether a significant increase in credit risk has occurred for an exposure by comparing:

- the remaining lifetime probability of default (PD) as at the reporting date; with
- the remaining lifetime PD for the point in time that was estimated at the time of initial recognition of the exposure (adjusted where relevant for changes in prepayment expectations).

The Group will apply the low credit risk simplification for all investments which are of an investment grade, which comprises the vast majority of its treasury portfolio. The Group will accordingly only assess SICR for investments in those debt securities which are rated as sub-investment grade. For sub-investment grade securities, the Group will consider a security to have experienced a significant increase in credit risk if the security has been the subject of a credit rating downgrade since initial recognition.

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

- qualitative – e.g. breaches of covenant;
- quantitative – e.g. overdue status and non-payment on another obligation of the same issuer to the Group; and
- based on data developed internally and obtained from external sources.

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances.

Financial assets that are credit-impaired are defined by IFRS 9 in a similar way to financial assets that are impaired under IAS 39, which is also in line with EBA's technical standard.

The Group considers a financial asset to be in default when:

- the borrower is unlikely to pay its credit obligations to the Group in full, without recourse by the Group to actions such as realising security (if any is held); or
- the borrower is past due more than 90 days on any material credit obligation to the Group. Overdrafts are considered as being past due once the customer has breached an advised limit or been advised of a limit smaller than the current amount outstanding.

This is in line with the non performing loan defintion given in the EBA guidelines.

The Group will assess on a forward-looking basis the expected credit losses ('ECL') associated with its debt instrument assets carried at amortised cost and FVOCI and with the exposure arising from loan commitments and financial guarantee contracts. The Group will recognise a loss allowance for such losses at each reporting date. The measurement of ECL will reflect:

- 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.

Notes to the financial statements 31 December 2017 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.1 Basis of preparation (continued)

1.1.1.2.3.4 Measuring 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. Expected credit losses are the discounted product of the Probability of Default (PD), Exposure at Default (EAD), and Loss Given Default (LGD), defined as follows:

- The PD represents the likelihood of a borrower defaulting on its financial obligation (as per "Definition of default and credit-impaired" above), either over the next 12 months (12M PD), or over the remaining lifetime (Lifetime PD) of the obligation.
- EAD is based on the amounts the Group expects to be owed at the time of default, over the next 12 months (12M EAD) or over the remaining lifetime (Lifetime EAD). For example, for a revolving commitment, the Group includes the current drawn balance plus any further amount that is expected to be drawn up to the current contractual limit by the time of default, should it occur.
- LGD represents the Group's expectation of the extent of loss on a defaulted exposure. LGD varies by type of counter party, type and seniority of claim and availability of collateral or other credit support. LGD is expressed as a percentage loss per unit of exposure at the time of default (EAD). LGD is calculated on a 12 month or Lifetime basis, where 12-month LGD is the percentage of loss expected to be made if the default occurs in the next 12 months and Lifetime LGD is the percentage of loss expected to be made if the default occurs over the remaining expected lifetime of the loan.

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

1.1.1.2.3.5 Forward-looking information

The assessment of SICR and the calculation of ECL both incorporate forward-looking information. The Group has performed historical analysis and identified the key economic variables impacting credit risk and expected credit losses for each portfolio.

These economic variables and their associated impact on the PD, EAD and LGD vary by financial instrument. Expert judgement will also be applied in this process. Forecasts of these economic variables (the "base economic scenario") which will be sourced externally and reviewed by the Group's economic team, provide the best estimate view of the economy over the next five years.

1.1.1.2.3.6 Presentation of allowance for ECL in the statement of financial position

Loss allowances for ECL will be 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;
- Where a financial instrument includes both a drawn and undrawn component, and the Group cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Group will present a combined loss allowance for both components. The combined amount will be presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component will be presented as a provision; and
- Debt instruments measured at FVOCI: no loss allowance will be recognised in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance will be disclosed and recognised in the fair value reserve.

1.1.1.2.3.7 Measurement of ECL

ECL are a probability-weighted estimate of credit losses. They will be measured as follows:

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Group expects to receive);
- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows;
- undrawn loan commitments: as the present value of the difference between the contractual cash flows that are due to the Group if the commitment is drawn down and the cash flows that the Group expects to receive; and
- financial guarantee contracts: the expected payments to reimburse the holder less any amounts that the Group expects to recover.

Notes to the financial statements 31 December 2017 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.1 Basis of preparation (continued)

1.1.1.3 Classification and measurement of financial liabilities

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities.

IFRS 9 also removes the volatility in profit or loss that was caused by changes in the credit risk of liabilities elected to be measured at fair value.

This amendment does not have an impact on the Bank or the Group.

1.1.1.4 Hedge Accounting

When initially applying IFRS 9, the Group will chose its accounting policy to continue to apply the hedge accounting requirements of IAS 39 instead of the requirements of IFRS 9. However, the Group will provide the expanded disclosures on hedge accounting introduced by IFRS 9 amendments of IFRS 7 because the accounting policy election does not provide an exemption from these new disclosure requirements.

1.1.1.4.1 Disclosures

IIFRS 9 will require extensive new disclosures, in particular about hedge accounting, credit risk and ECLs. The Group's preliminary assessment included an analysis to identify data gaps against current processes and the Group has implemented systems and controls changes that were necessary to capture the required data.

1.1.1.5 Transition

The Group has taken advantage of the exemption allowing it not to restate comparative information for prior periods with respect to classification and measurement and impairment changes. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 will generally be recognised in retained earnings and reserves as at 1 January 2018 as detailed below:

Estimated impact of adoption of IFRS 9

	As reported 31 December 2017	Classification and measurement adjustments	Impairment adjustments	Estimated adjustments due to adoption of IFRS9	Estimated adjusted opening balance at 1 January 2018
	€ million	€ million	€ million	€ million	€ million
Reserves	33.2	9.6	-	9.6	42.8
Retained Earnings	358.5	(12.7)	(5.0)	(17.7)	340.8
		(3.1)	(5.0)	(8.1)	

1.1.2 IFRS 15 Revenue from Contracts with Customers

IFRS 15 Revenue from Contracts with Customers establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including IAS 18 Revenue, IAS 11 Construction Contracts and IFRIC 13 Customer Loyalty Programmes. IFRS 15 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted.

On 1 January 2018, the Group will adopt IFRS 15 Revenue from Contracts with Customers issued by the IASB in May 2014. The Group has carried out an impact assessment and concluded that this standard will not have a material impact on the Group's retained earnings or opening balance at 1 January 2018. Most of the Group's revenue, including net interest income, is not impacted by the implementation of IFRS 15.

1.1.3 IFRS 16 Leases

IFRS 16 introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments. A lessee measures right-of-use assets similarly to other non-financial assets (such as property, plant and equipment) and lease liabilities similarly to other financial liabilities. As a consequence, a lessee recognises depreciation of the right-of-use asset and interest on the lease liability, and also classifies cash repayments of the lease liability into a principal portion and an interest portion and presents them in the statement of cash flows applying IAS 7 Statement of Cash Flows. Assets and liabilities arising from a lease are initially measured on a present value basis. The measurement includes non-cancellable lease payments (including inflation-linked payments), and also includes payments to be made in optional periods if the lessee is reasonably certain to exercise an option to extend the lease, or not to exercise an option to terminate the lease.

This new standard substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. Additionally, this standard requires (i) lessees to apply judgement in deciding upon the information to disclose to meet the objective of providing a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessee, and (ii) lessors to disclose enhanced information about lessor's risk exposure, particularly to residual value risk.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Earlier application is permitted for entities that apply IFRS 15 Revenue from Contracts with Customers at or before the date of initial application of IFRS 16. The Group is currently assessing the potential impact on its consolidated and separate financial statements resulting from the application of this standard.

Notes to the financial statements 31 December 2017 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.1 Basis of preparation (continued)

1.1.3 IFRS 16 Leases (continued)

Other than the Standards specifically mentioned above, the impact that the adoption of these other standards and amendments will have on the financial statements of the Group and the Bank is currently being assessed by the directors. The directors anticipate that the adoption of other International Financial Reporting Standards that were in issue at the date of authorisation of these financial statements, but not yet effective, as well as amendments to existing standards, will not have a material impact on the financial statements of the Group and the Bank in the period of initial application.

1.2 Basis of consolidation

The Group financial statements comprise the financial statements of Bank of Valletta p.l.c., (the Bank), a limited liability company domiciled and incorporated in Malta, and its subsidiaries. Subsidiaries are entities controlled by the Group. The Group 'controls' an entity if it is exposed to, or has rights to, variable returns from its involvement with the entity. The Group reassesses whether it has control if there are changes to one or more of the elements of control. This includes circumstances in which protective rights held (e.g. those resulting from a lending relationship) become substantive and lead to the Group having power over an investee. The results of subsidiaries are included in the Group financial statements from the date that control commences until the date that control ceases. Intragroup balances, transactions, income and expenses are eliminated on consolidation. Non-controlling interests that represent ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation may be initially measured either at their present ownership interests' proportionate share in the recognised amounts of the acquiree's identifiable net assets or at fair value. The choice of measurement basis is made on an acquisition-by-acquisition basis. After initial recognition, non-controlling interests in the net assets consist of the amount of those interests at the date of the original business combination and the non-controlling interests’ share of changes in equity since the date of the combination.

The excess of the cost of acquisition over the Group’s share of the net fair value of the identifiable assets and liabilities is recognised as goodwill and is included within the carrying amount of the investment and assessed for impairment as part of the investment. If the cost of acquisition is less than the Group’s share of the net fair value of the identifiable assets and liabilities, the difference is included as income in the determination of the Group's share of the profit or loss in the period in which the investment is acquired. Equity-accounted investees comprise interests in associates. The results and assets and liabilities of equity-accounted investees are incorporated in the Group financial statements using the equity method of accounting from the date that significant influence or joint control commences until the date that significant influence or joint control ceases. Equity-accounted investees are those entities in which the Group has significant influence, but not control or joint control over the financial and operating policies. A joint venture is an arrangement in which the Group has joint control, whereby the Group has rights to the net assets of the arrangement rather than rights to its assets and obligations for its liabilities. The significant accounting policies adopted are set out below.

1.3 Financial assets at fair value through profit or loss, investment securities and loans and receivables

The Group classifies its financial assets in the following categories: (i) financial assets at fair value through profit or loss; (ii) investment securities; and (iii) loans and receivables. The classification depends on the purpose for which the investments were acquired.

1.3.1 Financial assets at fair value through profit or loss

This classification includes financial assets classified as held for trading, and those designated at fair value through profit or loss upon initial recognition. Derivatives are categorised as held for trading unless they are designated and effective hedging instruments. Financial assets at fair value through profit or loss are initially recognised and are subsequently measured at fair value based on quoted bid prices in an active market. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. If the market for a financial asset is not active, the Group establishes fair value by using valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction. Interest receivable on financial assets at fair value through profit or loss is included with interest receivable and similar income. All related realised and unrealised gains and losses are included in trading profits in the year in which they arise.

Portfolios of over-the-counter derivatives that are exposed to credit risk and are managed by the Group on the basis of the net exposure to credit risk are measured on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure. Those portfolio-level adjustments are allocated to the individual assets and liabilities on the basis of the relative risk adjustment of each of the individual instruments in the portfolio.

1.3.2 Investment securities

Investment securities are classified into two sub-categories: held-to-maturity and available-for-sale financial assets. Non-derivative investment securities, with fixed or determinable payments and fixed maturity, where the Group has both the positive intent and the ability to hold them to maturity, other than those that upon initial recognition are designated as at fair value through profit or loss, those that are designated as available-for-sale financial assets and those that meet the definition of loans and receivables, are classified as held-to-maturity financial assets. Investment securities intended to be held for an indefinite period of time, but which may be sold in response

Notes to the financial statements 31 December 2017 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.3 Financial assets at fair value through profit or loss, investment securities and loans and receivables (continued)

1.3.2 Investment securities (continued)

to needs for liquidity or changes in interest rates, exchange rates or market prices are classified as available-for-sale financial assets. All investment securities are initially measured at fair value plus transaction costs, if any, that are directly attributable to their acquisition.

Those investment securities classified as available-for-sale financial assets are subsequently measured at fair value based on quoted bid prices in an active market, or by reference to a valuation technique if the market is not active, with the exception of equity instruments that do not have a quoted price in an active market for an identical instrument (ie. a Level 1 input) and whose fair value cannot be measured reliably which are measured at cost less any impairment losses. Gains and losses arising from changes in the fair value of securities classified as available-for-sale that are not designated as hedged items in a fair value hedge are recognised in other comprehensive income, except for impairment losses and foreign exchange gains and losses on monetary items, until the security is derecognised, at which time the related accumulated fair value adjustments previously recognised in other comprehensive income are included in profit or loss as a reclassification adjustment within net gains or losses on investment securities. With respect to available-for-sale securities that are designated as hedged items in a fair value hedge, gains and losses arising from changes in fair value attributable to the hedged risk are accounted for in profit or loss. Fair value movements attributable to other factors, such as changes in credit status, are recognised in other comprehensive income, except for impairment losses and foreign exchange gains and losses on monetary items. Interest calculated using the effective interest method is recognised in profit or loss.

Those investment securities classified as held-to-maturity financial assets are subsequently measured at amortised cost using the effective interest method, less any impairment losses. Interest calculated using the effective interest method and impairment losses are recognised in profit or loss.

The Bank, in line with IAS39, does not classify financial assets as held-to-maturity if it has during the current financial year or during the two preceding years, sold or reclassified more than an insignificant amount of the held-to-maturity portfolio other than sales or reclassifications that are specifically exempted for the purpose of this requirement. Significance is measured in relation to the total amount of held-to-maturity investments.

1.3.3 Loans and receivables

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

Loans and receivables are initially measured at fair value plus transaction costs, if any, that are directly attributable to their acquisition, and are subsequently measured at amortised cost using the effective interest method, less any impairment losses. Gains and losses are recognised in profit or loss when the financial asset is derecognised or impaired and through the amortisation process using the effective interest rate.

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

(i) Financial assets carried at amortised cost

The Group considers evidence of impairment for loans and advances at both a specific asset and a collective level. All individually significant loans and advances are assessed for specific impairment. Those found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and advances that are not individually significant are collectively assessed for impairment by grouping together loans and advances with similar risk characteristics.

For held-to-maturity securities carried at amortised cost and quoted in an active market, if there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset’s carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset’s original effective interest rate, by reference to the asset's quoted market price.

For individually significant loans and receivables, if there is objective evidence that an impairment loss has been incurred, the amount of loss is measured in line with Banking Rule 09 'Measures Addressing Credit Risks arising from the Assessment of the Quality of Asset Portfolios of Credit Institutions Authorised under the Banking Act 1994' (Chapter 371, Laws of Malta) which is

Notes to the financial statements 31 December 2017 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.3 Financial assets at fair value through profit or loss, investment securities and loans and receivables (continued)

1.3.3 Loans and receivables (continued)

in line with the IAS 39. The measurement of the loss amount takes account of the repayment history of the borrower and the value of collateral held against borrowings. Financial assets which do not attract a specific allowance are categorised according to credit risk characteristics and the amount of loss thereon is measured by taking account of the probability of default and loss given default for similar assets, after considering the level of collateral held.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss.

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

(ii) Impairment losses on restructured/refinanced corporate assets (forbearance)

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

In the case of loans and advances which encounter actual or apparent financial difficulties, the Group may grant a concession where a customer's financial difficulty indicates that with the original terms and conditions of the contract satisfactory repayment may not be possible.

A concession refers to either of the following:

- a modification of the previous terms and conditions of a contract the customer is considered unable to comply with due to its financial difficulties to allow for sufficient debt service ability, that would not have been granted had the customer not been in financial difficulties;
- a total or partial refinancing of a troubled debt contract, that would not have been granted had the customer not been in financial difficulties.

When accounts are classified as 'non-performing' assets, prior to the restructuring, they continue to be assessed for impairment individually taking into account the value of the collateral held as confirmed by professional valuations and the available cash flow to service debt over the period of the restructuring. If classified as 'performing' assets, restructured loans continue to be assessed for impairment collectively for inherent losses under the Group's normal collective assessment methodology.

(iii) Available-for-sale financial assets

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

Impairment losses recognised in profit or loss on equity instruments are not reversed through profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, then the impairment loss is reversed through profit or loss; otherwise, any increase in fair value is recognised through OCI. Any subsequent recovery in the fair value of an impaired available-for-sale equity security is always recognised in OCI. Changes in impairment attributable to application of the effective interest method are reflected as a component of interest income. The impairment loss on investments in equity instruments that do not have a quoted market price in an active market for an identical instrument (ie. a Level 1 input) and whose fair value cannot be reliably measured is recognised in profit or loss and is not reversed in a subsequent period.

The Group writes off a loan or an investment debt security, either partially or in full, and any related allowance for impairment losses, when Group Credit determines that there is no realistic prospect of recovery.

Notes to the financial statements 31 December 2017 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.4 Financial liabilities and equity instruments

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into, and the definitions of a financial liability and an equity instrument.

Financial liabilities are initially measured at fair value less, in the case of financial liabilities not at fair value through profit or loss, transaction costs that are directly attributable to their issue. Financial liabilities are subsequently measured at amortised cost using the effective interest method, except for financial liabilities at fair value through profit or loss, which are measured at fair value.

Financial liabilities at fair value through profit or loss include financial liabilities classified as held for trading and those designated at fair value through profit or loss upon initial recognition. During the current and the previous year, the Group did not designate any financial liabilities as at fair value through profit or loss upon initial recognition. Derivatives are categorised as held for trading, unless they are designated and effective hedging instruments.

Financial liabilities that are measured at amortised cost using the effective interest method include amounts owed to banks, amounts owed to customers, debt securities in issue, other liabilties and subordinated liabilities.

The gain or loss on financial liabilities at fair value through profit or loss is recognised in profit or loss. For financial liabilities carried at amortised cost, the gain or loss is recognised in profit or loss when the financial liability is derecognised and through the amortisation process whereby any difference between the proceeds net of transaction costs, and the settlement or redemption is recognised over the term of the financial liability.

Equity instruments are recorded at the proceeds received, net of direct issue costs.

1.5 Recognition, derecognition and offsetting of financial assets and financial liabilities

Financial assets and financial liabilities are recognised when a Group entity becomes a party to the contractual provisions of the instrument.

All loans and receivables are recognised when cash is advanced to borrowers.

All purchases and sales of securities are recognised and derecognised on settlement date, which is the date that an asset is delivered to or by the Group.

A financial asset is derecognised when the contractual rights to the cash flows from the financial asset expire, or when the Group transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Group neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset and the transfer qualifies for derecognition. A financial liability is derecognised when it is extinguished. This occurs when the obligation specified in the contract is discharged, cancelled or expires.

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when the Group currently has a legally enforceable right to set off the recognised amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

1.6 Classification of financial assets and financial liabilities at fair value through profit or loss upon initial recognition

Financial assets and liabilities are designated at fair value through profit or loss on initial recognition where such designation results in more relevant information because either:

- it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or

- a group of financial assets, financial liabilities or both, is managed and its performance is evaluated on a fair value basis, in accordance with the Group’s documented risk management and investment strategy, and information about the Group is provided internally on that basis to key management personnel, including the Board of Directors and Chief Executive Officer.

Notes to the financial statements 31 December 2017 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.7 Derivative financial instruments

Derivative financial instruments are initially recognised and subsequently measured at fair value. Fair values are obtained from quoted market prices in active markets and through the use of discounted cash flow models where an active market does not exist. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The method of recognising the fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged.

Certain derivative instruments are not designated in a hedge relationship for accounting purposes. The Group classifies forward exchange contracts, options and certain interest rate swaps as at fair value through profit or loss, and accordingly any changes in their fair value are included in trading profits.

The Group designates certain interest rate swaps as hedges of the exposure to variability in the fair value of certain available-for-sale financial assets, which arises from interest rate movements. Changes in the fair value of interest rate swaps that are designated and qualify as fair value hedging instruments, together with any changes in the fair value of the hedged items that are attributable to the hedged risk, are recognised in profit or loss.

1.8 Sale and repurchase agreements

Securities sold subject to a linked repurchase agreement ('repos') are retained in the financial statements at fair value through profit or loss or as investment securities as appropriate, and the counterparty liability is included in amounts owed to banks. Securities purchased under agreements to resell ('reverse repos') are not recognised but the amounts paid are recorded as loans and advances to banks. The difference between sale and repurchase price or purchase and subsequent sale price is recognised over the life of the repo/reverse repo agreements using the effective interest method and is treated as interest.

1.9 Investments in subsidiaries and equity-accounted investees

Investments in subsidiaries and equity-accounted investees are initially included in the Bank's statement of financial position at cost and subsequently at cost less any impairment loss which may have arisen. Interest in equity-accounted investees are accounted for using the equity method at Group level. They are initially recognised at cost, which includes transaction costs. Subsequently, the consolidated financial statements include the Group's share of profit or loss and other comprehensive income of equity-accounted investees, until the date on which significant influence ceases. Dividends from the investments are recognised in profit or loss when its right to receive dividend is established.

Impairment
At the end of each reporting period, the Bank reviews the carrying amount of its investments in subsidiaries and equity-accounted investees to determine whether there is any indication of impairment and if any such indication exists, the recoverable amount of the asset is estimated.

An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount. The recoverable amount is the higher of fair value less costs of disposal and value in use. An impairment loss recognised in a prior year is reversed if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, provided that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. Impairment losses and reversals are recognised immediately in profit or loss.

1.10 Property and equipment

Property and equipment are classified into the following classes – land and buildings, IT infrastructure and equipment and other (primarily furniture and fittings).

Property and equipment are initially measured at cost. Subsequent costs are included in the asset's carrying amount when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. Expenditure on repairs and maintenance of property and equipment is recognised as an expense when incurred.

Subsequent to initial recognition, freehold and long-term leasehold properties are stated in the statement of financial position at revalued amounts, being the fair value at the date of revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

Revaluations are performed by a professionally qualified architect on a regular basis such that the carrying amount does not differ materially from that which would be determined using fair values at the end of the reporting period. Any surpluses arising on such revaluation are recognised in other comprehensive income and accumulated in equity as a revaluation reserve unless they reverse a revaluation decrease for the same asset previously recognised in profit or loss, in which case the increase is credited to profit or loss to

Notes to the financial statements 31 December 2017 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.10 Property and equipment (continued)

the extent of the decrease previously charged. Any deficiencies resulting from decreases in value are deducted from this revaluation reserve to the extent that the balance held in this reserve relating to a previous revaluation of that asset is sufficient to absorb these, and charged to profit or loss thereafter.

Other tangible assets are stated at cost less any accumulated depreciation and any accumulated impairment losses.

Property and equipment are derecognised on disposal or when no future economic benefits are expected from their use or disposal. Gains or losses arising from derecognition represent the difference between the net disposal proceeds, if any, and the carrying amount, and are included in profit or loss in the period of derecognition.

1.11 Intangible assets

Intangible assets comprise computer software. In determining the classification of an asset that incorporates both intangible and tangible elements, judgement is used in assessing which element is more significant. Computer software which is an integral part of the related hardware is classified as property and equipment and accounted for in accordance with the Group's accounting policy on property and equipment. Where the software is not an integral part of the related hardware, this is classified as an intangible asset. Computer software is externally generated.

Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates.

Computer software is initially measured at cost. It is subsequently carried at cost less any accumulated amortisation and any accumulated impairment losses.

Computer software is derecognised on disposal or when no future economic benefits are expected from its use or disposal. Gains or losses arising from derecognition represent the difference between the net disposal proceeds, if any, and the carrying amount, and are included in profit or loss in the period of derecognition.

1.12 Depreciation and amortisation

Depreciation on property and equipment and amortisation on intangible assets commence when these assets are available for use and are charged to profit or loss so as to write off the cost or revalued amount of assets, other than land, less any estimated residual value, over their estimated useful life, using the straight line method, on the following bases:

Property and equipment		
Freehold and long-term leasehold buildings	2%	per annum
IT infrastructure and equipment	10% - 25%	per annum
Other (primarily furniture and fittings)	5% - 33%	per annum
Intangible assets		
Computer software	10% - 20%	per annum

The depreciation or amortisation method applied, the residual value and the useful life are reviewed at the end of each reporting period and adjusted if appropriate.

1.13 Impairment of property and equipment and intangible assets

At the end of each reporting period the Group reviews the carrying amount of its property and equipment and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If such indication exists the recoverable amount is estimated in order to determine the extent of the impairment loss and the carrying amount of the asset is reduced to its recoverable amount. The recoverable amount is the higher of fair value less costs of disposal and value in use.

An impairment loss is recognised immediately in profit or loss, unless the asset is carried at a revalued amount, in which case the loss is recognised in other comprehensive income to the extent that it does not exceed the amount in the revaluation surplus for that asset.

An impairment loss recognised in a prior year is reversed if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. When an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, to the extent that it does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. Impairment reversals are recognised immediately in profit or loss, unless the asset is carried at a revalued amount, in which case the impairment reversal is recognised in other comprehensive income, unless an impairment loss on the same asset was previously recognised in profit or loss.

Notes to the financial statements 31 December 2017 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.14 Provisions, contingent liabilities and contingent assets

Provisions are recognised when the Group 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. In such case, the unwinding of the discount is recognised as finance cost.

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

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. Contingent assets are not recognised. Contingent assets are disclosed where an inflow of economic benefits is probable.

'Financial guarantees' are contracts that require the Group to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when it is due in accordance with the terms of a debt instrument. 'Loan commitments' are firm commitments to provide credit under pre-specified terms and conditions.

1.15 Non-current assets and disposal groups held for sale

Non-current assets and disposal groups are classified as held for sale if it is highly probable that they will be recovered primarily through a sale transaction rather than through continuing use. Such assets, or disposal groups, are generally measured at the lower of their carrying amount and fair value less costs to sell and the asset or disposal group is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within a reasonable period from the date of classification. An impairment loss is recognised in profit or loss. Non-current assets are not depreciated (or amortised) while they are classified as held for sale or while they are part of a disposal group classified as held for sale.

1.16 Cash and cash equivalents

Cash and cash equivalents comprise cash in hand and deposits repayable on demand or with a contractual period to maturity of less than 3 months; advances to banks repayable within 90 days from the date of the advance; balances with the Central Bank of Malta, excluding reserve deposit requirements and treasury bills with an original maturity of less than 3 months. Amounts owed to banks that are repayable on demand or with a contractual period to maturity of less than 3 months and which form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statements of cash flow.

1.17 Dividends payable

Interim dividends are approved by the directors and recognised when paid. Final dividends are recognised as liability upon approval by the shareholders at the Annual General Meeting.

1.18 Operating segments

An operating segment is a component of an entity (a) that engages in business activities from which it may earn revenues and incur expenses, (b) whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and (c) for which discrete financial information is available. Unallocated items comprise mainly head office expenses and tax assets and liabilities.

1.19 Fair value

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

Fair value reflects conditions, including but not limited to liquidity in the market, at a specific date and may therefore differ significantly from the amounts which will actually be received on the maturity or settlement date. The Bank's portfolio remains deployed across a wide spread of holdings of moderate duration debt securities issued by quality, credit rated, sovereign, supranational, corporate and financial institutions, as further disclosed in notes 14 and 15 to the financial statements.

Notes to the financial statements 31 December 2017 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.19 Fair value (continued)

The best evidence of fair value of an instrument is a quoted price in an actively traded market for that instrument. The determination of what constitutes an active market is subjective and requires the collation of data and the exercise of judgement. A financial instrument is regarded as quoted in an active market 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 Bank determines whether active market conditions exist by taking into consideration various characteristics, including:

- a significant decline in volume and level of trading activity;
- significant variations in available prices either over time or among market participants;
- the absence of or stale prices;
- unusually wide bid/offer spreads; and
- exceptionally minimal transactions when compared with the quantum of the issue in question.

Where it is concluded that an active market does not exist a valuation technique is used. The latter gives consideration to transaction prices in inactive markets, however it makes use of other observable market data which include a combination of the following:

- the risk premium of more active instruments of the same issuer, the same type of debt, the same currency and with the same or similar maturity;
- the spreads payable on Credit Default Swaps of the issuer;
- the risk premium over and above the risk free bonds for similarly rated issuers in the same industry sector;
- yield curve or DCF calculations to maturity using appropriate interest rate/discount factors;
- liquidity adjustments to reflect ability to sell asset over a reasonable timeframe; and
- other overall reasonableness tests.

The main assumptions and estimates which management considers when using valuation techniques are the likelihood and expected timing of future cash flows on the instrument, selecting an appropriate discount rate for the instrument and a risk premium. The valuation techniques used by the Bank incorporate all factors that market participants would consider in setting a price and are consistent with accepted economic methodologies for pricing financial instruments.

1.20 Taxation

Income tax expense comprises current and deferred tax and is recognised in profit or loss, except when it relates to items recognised in other comprehensive income or directly in equity, in which case it is dealt with in other comprehensive income or in equity, as appropriate.

Current tax
Current tax is based on the taxable result for the period. The taxable result for the period differs from the result as reported in profit or loss because it excludes items which are non-assessable or disallowed and it further excludes items that are taxable or deductible in other periods. Current tax also includes any tax arising from dividends. It is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax
Deferred tax is determined under the liability method in respect of all temporary differences between the carrying amount of an asset or liability in the financial statements and its tax base. Deferred tax liabilities are generally recognised for all taxable temporary differences subject to certain exceptions and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled based on tax rates that have been enacted or substantively enacted by the end of the reporting period. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised. Deferred tax is not recognised for temporary differences related to investments in subsidiaries to the extent that it is probable that they will not reverse in the forseeable future.

1.21 Revenue recognition

Revenue is recognised to the extent that it is probable that future economic benefits will flow to the Group and these can be measured reliably. The following specific recognition criteria must also be met before revenue is recognised.

Dividend income from investments is recognised when the right to receive payment has been established.

Interest income and expense is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the instrument

Notes to the financial statements 31 December 2017 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.21 Revenue recognition (continued)

or, when appropriate, a shorter period to that instrument's net carrying amount. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the instrument but not future credit losses. The calculation includes payments and receipts that are an integral part of the effective interest rate, transaction costs and all other discounts or premiums.

Fees and commissions that are earned on the execution of a significant act (for example, fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as an arrangement for the acquisition of shares or other securities) are recognised as revenue when the significant act has been completed. Fees and commissions that are earned as services are provided to the customer are recognised as revenue as the services are provided. Where fees are charged to cover the cost of a continuing service, these are recognised in proportion to the costs required to render the services over the relevant period.

1.22 Foreign currency translation

For the purpose of the consolidated and separate financial statements, the presentation currency is the Euro. The functional currency of the Bank and of all its subsidiaries is the Euro.

In preparing the financial statements of the individual group entities, transactions denominated in currencies other than the functional currency are translated at the exchange rates ruling on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated to Euro at the rates of exchange ruling at the end of the reporting period. Gains and losses arising from such translation are dealt with in profit or loss and presented with trading income. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Euro at the exchange rate ruling on the date the fair value was measured. Non-monetary assets and liabilities denominated in foreign currencies that are measured in terms of historical cost are not retranslated.

1.23 Employee benefits

The Group and the Bank contribute towards the state pension in accordance with local legislation. The only obligation of the Group and the Bank is to make the required contribution. Costs are expensed in the period in which they are incurred in profit or loss.

For the Group's and the Bank's defined benefit plans, the cost of providing benefits is determined using the projected unit credit method, with estimations being carried out at each reporting date. Past service cost is recognised as an expense at the earlier of the following dates (a) when the plan amendment or curtailment occurs and (b) when the entity recognises related restructuring costs or termination benefits. The amount recognised in the Statement of Financial Position represents the present value of the expected future payments required to settle the obligation resulting from employee service in the current and prior periods. The service cost and the net interest on the net defined benefit liability are recognised in profit or loss. Remeasurements of the net defined benefit liability, comprising actuarial gains and losses are recognised in other comprehensive income and are not reclassified to profit or loss in a subsequent period. Such remeasurements are reflected immediately in retained earnings. Actuarial gains and losses are changes in the present value of the defined benefit obligation resulting from experience adjustments and the effects of changes in actuarial assumptions. Actuarial assumptions are an entity's best estimates of the variables that will determine the ultimate cost of providing post-employment benefits. Due to the nature of the actuarial assumptions, in accordance with the provisions of IAS 19, the Group and the Bank did not involve a qualified actuary in the measurement of their post-employment benefit obligations.

1.24 Judgements in applying accounting policies and key sources of estimation uncertainty

The amounts recognised in the financial statements are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of financial statements. The judgements made by management in applying the Group's and the Bank's accounting policies that have the most significant effect on the amounts recognised in the financial statements, together with information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are either disclosed below or in the remaining notes to the financial statements.

1.24.1 Impairment losses on loans and advances

The Group reviews its loan portfolio on an ongoing basis to assess whether there is any objective evidence of impairment. Objective evidence that individual loans and advances are impaired includes observable data that comes to the attention of the Group about loss events, such as repayments falling into arrears, a deterioration in the financial situation of the principal debtor or guarantor, economic conditions which may adversely affect the borrower's business activity or market, technological change and changes in the fair value of collateral. With respect to a group of loans and receivables, loss events include probabilities of default associated with the credit status of that group and measurable economic conditions which may influence future cash flows from the assessed loans. Management uses estimates based on historical loss experience for assets with credit risk characteristics similar to those of the assessed group when forecasting future cash flows. The exercise of judgement is an inherent aspect in assessing provisions required and is applied in determing the underlying value of collateral held and the period over which collateral or other projected cashflows are expected to be realised. For collective provisioning estimation uncertainty is mainly around the application of probability of default to loans with similar credit risk characteristics. The methodology and assumptions for estimating the amount and timing of future cash flows are reviewed regularly in the light of actual loss experience.

Notes to the financial statements 31 December 2017 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.24.2 Portfolio valuation

The Group measures portfolios of financial assets and financial liabilities on the basis of net exposures to market risks, then it applies judgement in determining appropriate portfolio-level adjustments such as bid-ask spreads. Such adjustments are derived from observable bid-ask spreads for similar instruments and adjusted for factors specific to the portfolio. Similarly, when the Group measures portfolios of financial assets and financial liabilities on the basis of net exposure to the credit risk of a particular counterparty, then it takes into account any existing arrangements that mitigate the credit risk exposure - e.g. master netting agreements with the counterparty.

1.24.3 Fair value of financial instruments not quoted in active markets

The fair value of financial instruments that are not quoted in active markets is determined by using valuation techniques. Periodically, the Group calibrates these valuation techniques and tests them for validity. Where possible the valuation techniques used by the Group make use of observable data and incorporate all factors that market participants would consider in setting a price and are consistent with accepted economic methodologies for pricing financial instruments. Management is required to make certain assumptions and estimates in arriving at an appropriate fair value, based on available observable market data. A change in assumptions could affect the reported fair value of these financial instruments. Further disclosures are provided in note 39.

1.24.4 Impairment losses on held-to-maturity investments and on available-for-sale investments

In the case of financial assets that are either classified as held-to-maturity investments or as available-for-sale investments, objective evidence of impairment includes observable data about the following loss events, as applicable – significant financial difficulty of the issuer (or counterparty), a breach of contract, it becoming probable that the borrower will enter bankruptcy or other financial reorganisation, the disappearance of an active market for that financial asset because of financial difficulties or observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets. In addition to the above loss events, objective evidence of impairment for an investment in an equity instrument includes information about significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates or a significant or prolonged decline in the fair value below its cost. The determination of these loss events is based on the analysis of the amortised cost amount against the fair value of the individual security to assess whether declines in value are indicative of impairment.

1.24.5 Fair value of land and buildings

The fair value of the Group's and the Bank's land and buildings is determined by using valuation techniques as further disclosed in Note 21. In arriving at an estimate of fair value at the end of the reporting period, the Group and the Bank make use of significant unobservable inputs. A change in such inputs could affect the reported fair value of these land and buildings.

1.24.6 Classification of facilities as forborne

Management follows the European Banking Authority technical standard in identifying performing/non-performing exposures and in determining forborne exposures. Judgement is exercised in determining whether the modification of the original terms of a facility are granted, because of financial difficulties, which would result in the exposure being classified as forborne.

1.24.7 Provisions and contingent liabilities

In the ordinary course of operations, the Group faces loss contingencies that may result in the recognition of a liability. Management periodically assesses these issues based on information available and assessments from internal and/or external legal counsel.

The Group is currently involved in various claims and legal proceedings arising out of its normal business operations. Periodically, the status of each significant loss contingency is reviewed to assess the potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount can be reasonably estimated, a liability for the estimated loss is provided for. Due to the uncertainties inherent in such matters, provisions are based on the best information available at the reporting date. As additional information becomes available, the potential liability related to pending claims and litigation is reassessed and, if required, estimates are revised. Such revisions in the estimates of the potential liabilities could have a material impact on results of operations and the financial position of the Group. Where an individual provision is material, the fact that a provision has been made would be stated and quantified, except to the extent that it would be seriously prejudicial if such disclosure is provided. Any provision recognised does not constitute any admission of wrongdoing or legal liability.

Notes to the financial statements 31 December 2017 (continued)

	The Group		The Bank	
	2017 15 months to Dec 2017 €000	2016 12 months to Sep 2016 €000	2017 15 months to Dec 2017 €000	2016 12 months to Sep 2016 €000
2. INTEREST AND SIMILAR INCOME				
On loans and advances to banks	1,892	2,128	1,892	2,128
On loans and advances to customers	197,105	158,211	197,105	158,211
	198,997	160,339	198,997	160,339
On debt and other fixed income instruments				
- available-for-sale	9,316	10,945	9,316	10,945
- held-to-maturity	61,966	48,016	61,966	48,016
- fair value through profit or loss	5,741	6,873	5,741	6,873
	77,023	65,834	77,023	65,834
Amortisation of discounts and premiums				
- available-for-sale	(2,481)	(2,463)	(2,481)	(2,463)
- held-to-maturity	(14,345)	(9,308)	(14,345)	(9,308)
	(16,826)	(11,771)	(16,826)	(11,771)
Net interest income on debt and other fixed income instruments	60,197	54,063	60,197	54,063
	259,194	214,402	259,194	214,402
3. INTEREST EXPENSE				
On amounts owed to banks	11,622	8,481	11,622	8,481
On interest rate swaps	7,510	7,372	7,510	7,372
On amounts owed to customers	26,625	30,984	26,625	30,984
On debt securities in issue	5,449	4,359	5,449	4,359
On subordinated liabilities	12,426	8,758	12,426	8,758
Negative interest on loans to banks, treasury bills and balances with Central Bank of Malta	12,615	5,619	12,615	5,619
	76,247	65,573	76,247	65,573
4. NET FEE AND COMMISSION INCOME				
On loans and advances, similar activities and local business	41,320	31,678	41,320	31,678
On life assurance, fund management and similar activities	27,682	21,641	16,482	13,460
On other activities	17,287	12,766	17,287	12,766
	86,289	66,085	75,089	57,904
5. TRADING PROFITS				
Net income on foreign exchange activities	23,752	20,327	23,803	20,341
Fair value movements and net gains on sale of financial instruments at fair value through profit or loss	(1,462)	4,397	(1,465)	4,383
	22,290	24,724	22,338	24,724

Notes to the financial statements 31 December 2017 (continued)

	The Group		The Bank	
	2017 15 months to Dec 2017	2016 12 months to Sep 2016	2017 15 months to Dec 2017	2016 12 months to Sep 2016
	€000	€000	€000	€000
6. NET GAIN ON INVESTMENTS AND HEDGING INSTRUMENTS				
Available-for-sale assets				
- net gain on disposal	7,443	9,263	7,443	9,263
- net revaluation (loss)/gain attributable to hedged risk	(8,432)	2,877	(8,432)	2,877
	(989)	12,140	(989)	12,140
Derivative financial instruments				
- net gain/(loss) on derivative financial instruments held for hedging	8,011	(3,094)	8,011	(3,094)
	7,022	9,046	7,022	9,046
Gain on Visa transaction	-	27,511	-	27,511

Gain on Visa transaction arose on the disposal of the Bank's membership interest in Visa Europe. In June 2016 Visa Inc. completed the acquisition of Visa Europe. This transaction resulted in a receipt of an upfront cash consideration, preference shares and a deferred cash payment. The total income on this transaction, recognised in profit for the year 2016, amounted to €27.5 million. The preference shares have been recognised at the value provided to all holders by Visa and adjusted by a haircut of 50%, to reflect litigation and liquidity risks.

	The Group		The Bank	
	2017 15 months to Dec 2017	2016 12 months to Sep 2016	2017 15 months to Dec 2017	2016 12 months to Sep 2016
	€000	€000	€000	€000
7. EMPLOYEE COMPENSATION AND BENEFITS				
Employee compensation and benefits				
- wages and salaries	66,130	53,435	62,986	51,402
- social security costs	4,121	3,218	4,022	3,119
- retirement benefits	3,663	3,397	3,663	3,397
- other staff costs	5,836	4,118	5,836	4,118
	79,750	64,168	76,507	62,036

	The Group		The Bank	
	2017 15 months to Dec 2017	2016 12 months to Sep 2016	2017 15 months to Dec 2017	2016 12 months to Sep 2016
	No. of persons	No. of persons	No. of persons	No. of persons
The average number of employees are analysed as follows:				
Managerial	515	521	493	501
Supervisory and clerical	1,055	949	1,006	906
Others	43	48	40	43
	1,613	1,518	1,539	1,450

Notes to the financial statements 31 December 2017 (continued)

	The Group		The Bank	
	2017 15 months to Dec 2017 €000	2016 12 months to Sep 2016 €000	2017 15 months to Dec 2017 €000	2016 12 months to Sep 2016 €000
8. NET IMPAIRMENT REVERSAL/(LOSSES)				
Loans and advances to customers				
- specific allowances	38,667	53,323	38,667	53,323
- collective allowances	3,251	1,579	3,251	1,579
- bad debts written off	13,311	52,581	13,311	52,581
	55,229	107,483	55,229	107,483
Reversals of write-downs:				
Investments and other assets				
- specific allowances	-	(107)	-	(102)
Loans and advances to customers				
- specific allowances	(51,861)	(77,629)	(51,861)	(77,629)
- collective allowances	(1,984)	(4,681)	(1,984)	(4,681)
- bad debts recovered	(7,611)	(1,924)	(7,611)	(1,924)
	(61,456)	(84,234)	(61,456)	(84,234)
Net impairment (reversals)/losses	(6,227)	23,142	(6,227)	23,147

During the financial year ended 30 September 2016 a number of long outstanding non-performance exposures, which were mostly provided for, were written off. As a result, the allowances held in respect of those exposures were duly reversed. The exercise continued during 2017.

	The Group		The Bank	
	2017 15 months to Dec 2017 €000	2016 12 months to Sep 2016 €000	2017 15 months to Dec 2017 €000	2016 12 months to Sep 2016 €000
9. PROFIT BEFORE TAX				
Profit before tax is stated after charging:				
Total remuneration payable to the external auditors of the parent company				
- the audit of financial statements	378	210	348	186
- other assurance services	115	143	111	138
- tax advisory services	5	15	3	9
- other non-audit services	70	48	70	48
	568	416	532	381
Directors' emoluments				
- fees	412	276	412	276
- directors' salaries as full-time bank employees	282	55	282	55
	694	331	694	331
Compensation to other key management personnel is analysed as follows:				
- other fees	73	39	-	-
- short term employee benefits	901	632	901	632
	974	671	901	632
Total remuneration for directors and other key management personnel	1,668	1,002	1,595	963

Notes to the financial statements 31 December 2017 (continued)

	The Group		The Bank	
	2017 15 months to Dec 2017	2016 12 months to Sep 2016	2017 15 months to Dec 2017	2016 12 months to Sep 2016
	€000	€000	€000	€000
10. INCOME TAX EXPENSE				
Current				
- for the period	46,149	31,677	47,091	31,729
- over provision in prior years	-	(1,307)	-	(1,307)
Deferred	9,089	20,338	9,089	20,338
	55,238	50,708	56,180	50,760

The charge for income tax is based on the taxable profit for the period at a rate of 35%. The income tax expense and the product of accounting profit multiplied by the statutory domestic income tax rate are reconciled as follows:

	The Group 2017	The Group 2016	The Bank 2017	The Bank 2016
Profit before tax	174,736	145,906	165,024	144,943
Tax at the applicable rate of 35%	61,158	51,067	57,758	50,730
Tax effect of:				
Exempt and untaxed dividends	(56)	(117)	(2,460)	(1,044)
Share of results of equity-accounted investees	(6,750)	(1,306)	-	-
Withholding tax on property sales	26	173	26	173
Depreciation on premises	503	303	503	303
Non-deductable expenses	416	821	416	821
Investment holdings	-	21	-	21
Actuarial losses on defined benefit plans	(36)	1,060	(36)	1,060
Over provision in prior years	-	(1,307)	-	(1,307)
Other differences	(23)	(7)	(27)	3
Income tax expense	55,238	50,708	56,180	50,760

	The Group		The Bank	
	2017 15 months to Dec 2017	2016 12 months to Sep 2016	2017 15 months to Dec 2017	2016 12 months to Sep 2016
	cents per share	cents per share	cents per share	cents per share
11. EARNINGS PER SHARE				
Earnings per share	27c1	21c6	24c7	21c5

The earnings per share for the Group and the Bank have been calculated on the profits attributable to shareholders of the Group and the Bank, as shown in the statements of profit or loss, divided by the weighted average number of shares in issue. The calculation of the earnings per share for all periods presented was adjusted retrospectively in view of the increase in the number of ordinary shares outstanding as a result of both the bonus issue and rights issue of shares, as disclosed in note 31.

Earnings per share was calculated on profit attributable to shareholders of the Group €119,498,000 (2016: €94,742,000) and the Bank €108,844,000 (2016: €94,183,000) divided by 440,692,054 weighted average number of shares for the period as at 31 December 2017 (2016: 438,805,970 shares).

Notes to the financial statements 31 December 2017 (continued)

12. DIVIDENDS

The amount of dividends recognised as distributions to equity holders during the period, and the related amount per share, are as follows:

	The Bank			
	2017 15 months to Dec 2017	2016 12 months to Sep 2016	2017 15 months to Dec 2017	2016 12 months to Sep 2016
	cents per share	cents per share	€000	€000
Gross of income tax				
- prior year's final paid	7.9	7.3	33,228	30,600
- interim paid	4.5	3.6	18,900	15,249
	12.4	10.9	52,128	45,849
Net of income tax				
- prior year's final paid	5.1	4.7	21,598	19,890
- interim paid	2.9	2.4	12,285	9,912
	8.0	7.1	33,883	29,802

The calculation of the dividend per share for all periods presented was adjusted retrospectively in view of the increase in the number of ordinary shares outstanding as a result of the bonus issue of shares, as disclosed in note 31, but excluding the increase in number of shares from the rights issue which occurred after distribution of the above dividends.

For tax purposes, the dividend is being paid out of profits taxed at 35% (2016: 35%).

In respect of the current period, the directors propose that a final gross ordinary dividend of €0.08 per share amounting to €42.0 million (net ordinary dividend of €0.052 per share - €27.3 million) be paid to shareholders. This dividend is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements. The proposed dividend is payable to all shareholders on the register of members on 10 April 2018.

13. BALANCES WITH CENTRAL BANK OF MALTA, TREASURY BILLS AND CASH

	Note	The Group 2017 €000	The Group 2016 €000	The Bank 2017 €000	The Bank 2016 €000
Balances with Central Bank of Malta		99,032	87,779	99,032	87,779
Malta Government Treasury Bills		4,503	39,017	4,503	39,017
Cash	36	56,149	44,254	56,149	44,254
		159,684	171,050	159,684	171,050

Balances with the Central Bank of Malta include Reserve Deposit amounting to €99.0 million (2016: €87.8 million) in respect of both the Group and the Bank, in terms of Regulation (EC) No. 1745/2003 of the European Central Bank. Balances with Central Bank of Malta and Malta Government Treasury Bills are subject to negative interest rates.

Notes to the financial statements 31 December 2017 (continued)

	The Group 2017 €000	2016 €000	The Bank 2017 €000	2016 €000
14. FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS				
Financial assets at fair value through profit or loss				
Financial assets classified as held for trading:				
Derivative financial instruments	7,490	5,365	7,490	5,365
Financial assets designated at fair value through profit or loss:				
Debt and other fixed income instruments	111,417	186,015	111,417	186,015
Equity and other non-fixed income instruments	64,811	79,734	63,836	78,596
Loans and advances to customers (note 17)	142,573	121,316	142,573	121,316
	318,801	387,065	317,826	385,927
	326,291	392,430	325,316	391,292
Financial liabilities at fair value through profit or loss				
Financial liabilities classified as held for trading:				
Derivative financial instruments	11,957	20,327	11,957	20,327

14.1 Debt and other fixed income instruments

	The Group 2017 €000	2016 €000	The Bank 2017 €000	2016 €000
Issued by public bodies				
- local general government	33,680	56,238	33,680	56,238
- foreign general government	30,660	34,199	30,660	34,199
	64,340	90,437	64,340	90,437
Issued by other issuers				
- local banks	1,890	4,508	1,890	4,508
- foreign banks	26,922	49,289	26,922	49,289
- foreign other	15,437	33,206	15,437	33,206
- local other	2,828	8,575	2,828	8,575
	47,077	95,578	47,077	95,578
	111,417	186,015	111,417	186,015
Listing status				
- listed on Malta Stock Exchange	38,398	69,321	38,398	69,321
- listed elsewhere	72,888	113,399	72,888	113,399
- foreign unlisted	131	3,295	131	3,295
	111,417	186,015	111,417	186,015
Summary of movements during the period:				
At the beginning of the period	186,015	275,935	186,015	275,935
Acquisitions	821	7,710	821	7,710
Disposals	(69,790)	(95,821)	(69,790)	(95,821)
Movement in fair value	(4,076)	(1,742)	(4,076)	(1,742)
Exchange adjustment	(1,553)	(67)	(1,553)	(67)
At the end of the period	111,417	186,015	111,417	186,015

Notes to the financial statements 31 December 2017 (continued)

14. FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS (continued)

	The Group		The Bank	
	2017	2016	2017	2016
	€000	€000	€000	€000
14.2 Equity and other non-fixed income instruments				
Issued by other issuers				
- local banks	6,148	12,936	6,148	12,936
- foreign banks	14,362	14,527	14,362	14,527
- foreign other	24,479	26,576	24,479	26,576
- local other	19,822	25,695	18,847	24,557
	64,811	79,734	63,836	78,596
Listing status				
- listed on Malta Stock Exchange	25,974	38,634	24,999	37,496
- listed elsewhere	13,617	16,306	13,617	16,306
- foreign unlisted	25,220	24,794	25,220	24,794
	64,811	79,734	63,836	78,596
Summary of movements during the period:				
At the beginning of the period	79,734	77,210	78,596	75,246
Acquisitions	6,423	1,550	6,422	1,550
Disposals	(22,266)	(2,853)	(22,102)	(2,027)
Movement in fair value	1,345	4,527	1,345	4,527
Exchange adjustment	(425)	(700)	(425)	(700)
At the end of the period	64,811	79,734	63,836	78,596

14.3 Derivative financial instruments

Fair value of assets	7,490	5,365	7,490	5,365
Fair value of liabilities	11,957	20,327	11,957	20,327

The above comprise over-the-counter forward exchange contracts and interest rate swaps that have not been designated as hedging instruments stated at fair value with notional amounts analysed with remaining life as follows :

- less than 3 months	520,938	546,091	520,938	546,091
- between 3 months and 1 year	41,790	67,599	41,790	67,599
- more than 1 year	171,866	192,015	171,866	192,015
	734,594	805,705	734,594	805,705

Notes to the financial statements 31 December 2017 (continued)

	The Group		The Bank	
	2017	2016	2017	2016
	€000	€000	€000	€000
15. INVESTMENTS				
Debt and other fixed income instruments				
- available-for-sale	139,328	272,243	139,328	272,243
- held-to-maturity	3,229,915	3,460,446	3,229,915	3,460,446
Equity and other non-fixed income instruments				
- available-for-sale	5,298	3,583	5,298	3,583
	3,374,541	3,736,272	3,374,541	3,736,272

Investments with a nominal value of €122.2 million (2016: €74.1 million) have been pledged against the provision of credit lines by the Central Bank of Malta.

	The Group		The Bank	
	2017	2016	2017	2016
	€000	€000	€000	€000
15.1 Debt and other fixed income instruments available-for-sale				
Issued by public bodies				
- local general government	66,080	179,461	66,080	179,461
- local public sector	73,248	88,805	73,248	88,805
Issued by other issuers				
- foreign banks	-	3,977	-	3,977
	139,328	272,243	139,328	272,243
Listing status				
- listed on Malta Stock Exchange	139,328	268,266	139,328	268,266
- foreign unlisted	-	3,977	-	3,977
	139,328	272,243	139,328	272,243
Summary of movements during the year:				
At the beginning of the period	272,243	257,453	272,243	257,453
Acquisitions	-	150,745	-	150,745
Disposals	(60,300)	(130,842)	(60,300)	(130,842)
Redeemed	(51,753)	(12,094)	(51,753)	(12,094)
Amortisation	(2,481)	(2,463)	(2,481)	(2,463)
Movement in fair value	(16,456)	1,780	(16,456)	1,780
Profit on disposal	3,093	7,365	3,093	7,365
Exchange adjustment	(5,018)	299	(5,018)	299
At the end of the period	139,328	272,243	139,328	272,243

Notes to the financial statements 31 December 2017 (continued)

15. INVESTMENTS (continued)

	The Group		The Bank	
	2017	**2016**	**2017**	**2016**
	€000	**€000**	**€000**	**€000**
15.2 Debt and other fixed income instruments held-to-maturity				
Issued by public bodies				
- local general government	496,692	484,791	496,692	484,791
- foreign general government	511,941	671,749	511,941	671,749
	1,008,633	1,156,540	1,008,633	1,156,540
Issued by other issuers				
- foreign banks	1,580,844	1,653,880	1,580,844	1,653,880
- foreign other	640,438	650,026	640,438	650,026
	2,221,282	2,303,906	2,221,282	2,303,906
	3,229,915	3,460,446	3,229,915	3,460,446
Listing status				
- listed on Malta Stock Exchange	496,692	484,791	496,692	484,791
- listed elsewhere	2,097,351	2,252,717	2,097,351	2,252,717
- foreign unlisted	635,872	722,938	635,872	722,938
	3,229,915	3,460,446	3,229,915	3,460,446

At 31 December 2017, the fair value of held-to-maturity securities, without deducting transaction costs, amounted to €3,269.3 million (2016: €3,511.4 million).

	The Group		The Bank	
	2017	**2016**	**2017**	**2016**
	€000	**€000**	**€000**	**€000**
Summary of movements during the period:				
At the beginning of the period	3,460,446	3,117,808	3,460,446	3,117,808
Acquisitions	897,650	1,106,801	897,650	1,106,801
Redemptions	(1,043,837)	(726,248)	(1,043,837)	(726,248)
Amortisation	(14,345)	(9,308)	(14,345)	(9,308)
Loss on early redemptions	43	-	43	-
Exchange adjustment	(70,042)	(28,607)	(70,042)	(28,607)
At the end of the period	3,229,915	3,460,446	3,229,915	3,460,446

15.3 Equity and other non-fixed income instruments available-for-sale

	The Group		The Bank	
	2017	**2016**	**2017**	**2016**
	€000	**€000**	**€000**	**€000**
Issued by other issuers				
- foreign other	5,298	3,583	5,298	3,583
	5,298	3,583	5,298	3,583
Listing status				
- foreign listed	5,298	3,583	5,298	3,583
	5,298	3,583	5,298	3,583
Summary of movements during the period:				
At the beginning of the period	3,583	1,044	3,583	1,044
Shares acquired under Visa transaction	-	3,583	-	3,583
Disposals	-	(1,044)	-	(1,044)
Movement in fair value	1,715	-	1,715	-
At the end of the period	5,298	3,583	5,298	3,583

Notes to the financial statements 31 December 2017 (continued)

16. LOANS AND ADVANCES TO BANKS

	The Group		The Bank	
	2017	2016	2017	2016
	€000	€000	€000	€000
Repayable on call and at short notice	345,193	181,645	345,193	181,645
Term placements with Central Bank of Malta	2,906,971	1,619,029	2,906,971	1,619,029
Term placements with other banks	173,716	283,450	173,716	283,450
Cheques in course of collection	5,503	14,315	5,503	14,315
	3,431,383	2,098,439	3,431,383	2,098,439

Following amendments to the Depositor Compensation Scheme (DCS) Regulations (Regulation (27)(2) of the DCS Regulations, 2015), Banks can opt to pledge securities instead of deposits with Central Bank of Malta. In this respect, no balances with Central Bank of Malta have been pledged in favour of the Depositor Compensation Scheme as at 31 December 2017 (2016: €9.1million). This resulted in an increase in securities pledged in favour of the Scheme as reported in Note 15.

Balances with a value of €27.3 million (2016: €40.4 million) were held as collateral against derivative contracts.

Balances held with Central Bank of Malta and with other banks are subject to negative interest rates.

17. LOANS AND ADVANCES TO CUSTOMERS

	The Group		The Bank	
	2017	2016	2017	2016
	€000	€000	€000	€000
Repayable on call and at short notice	524,993	504,272	524,993	504,272
Term loans and advances	3,803,239	3,683,096	3,803,239	3,683,096
	4,328,232	4,187,368	4,328,232	4,187,368
Less impairment losses	(166,200)	(185,712)	(166,200)	(185,712)
Net loans and advances at amortised cost	4,162,032	4,001,656	4,162,032	4,001,656
Loans and advances designated at fair value through profit or loss (note 14)	142,573	121,316	142,573	121,316
Total loans and advances	4,304,605	4,122,972	4,304,605	4,122,972
Impairment losses				
- individually assessed allowances	149,998	170,776	149,998	170,777
- collective allowances	16,202	14,936	16,202	14,935
	166,200	185,712	166,200	185,712

The balance of individually assessed allowances at the reporting date includes €46.0 million (2016: €53.6million) in respect of interest in suspense which has been netted off against interest receivable.

During the financial years ending 31 December 2017 and 2016 a number of long outstanding non performance exposures, which were mostly provided for, were written off. As a result, the allowances held in respect of those exposures were duly reversed.

Notes to the financial statements 31 December 2017 (continued)

	The Group		The Bank	
	2017 15 months to Dec 2017	2016 12 months to Sep 2016	2017 15 months to Dec 2017	2016 12 months to Sep 2016
	€000	€000	€000	€000
18. INVESTMENTS IN EQUITY-ACCOUNTED INVESTEES				
At the beginning of the period	97,041	96,904	52,870	52,870
Share of results, net of tax	19,287	3,730	-	-
Dividend received	(6,867)	(3,593)	-	-
At the end of the period	109,461	97,041	52,870	52,870
Amounts include:				
Local listed	28,857	24,483	22,304	22,304
Local unlisted	80,604	72,558	30,566	30,566
	109,461	97,041	52,870	52,870

On the historical cost basis, shares in equity-accounted investees of the Group, would have been included at a cost of €52.9 million (2016: €52.9 million).

The fair value of the equity-accounted investees' that is publicly quoted amounted to €50.9 million at 31 December 2017 (2016: €60.0 million).

The fair value measurement is a Level 1 input.

	Equity Interest		Class	Incorporated in	Nature of Business
	2017	2016			
Name of company	%	%			
Mapfre Middlesea p.l.c.	31.08	31.08	Ordinary	Malta	Insurance
MSV Life p.l.c.*	50.00	50.00	Ordinary	Malta	Life Assurance

	Group's share of results	
	2017	2016
Name of company	€000	€000
Mapfre Middlesea p.l.c.	5,468	333
MSV Life p.l.c.	13,819	3,397
	19,287	3,730

*A further 15.54% (2016:15.54%) is held indirectly via another equity accounted investee. Although the Bank has an effective participating interest of 65.54% (2016: 65.54%), it does not exercise control over the financial and operating decisions of the entity as it only has the right for equal representation on the Board of Directors of the company together with the other shareholders. Furthermore, as from 1 October 2011 the Bank is deemed to exercise significant influence on MSV Life p.l.c. as opposed to joint control as a result of a shareholders' agreement which gives the other shareholder control and as from financial year 2012 it is being treated as an equity accounted investee.

The financial statements of the equity-accounted investees are prepared to 31 December. Due to the change in financial year end from September 2017 to December 2017 the share of results of equity-accounted investees for FY17 comprise the Group's share of profits and the Group's share of the movement in the valuation of the in-force business of the entities, for the eighteen month period July 2016 to December 2017. The share of results of equity-accounted investees for FY16 comprise the Group's share of profits and the Group's share of the movement in the valuation of the in-force business of the entities, for the twelve month period June 2015 to June 2016.

The registered addresses of the above undertakings are as follows:

Mapfre Middlesea p.l.c.	Middlesea House, Floriana FRN 1442, Malta
MSV Life p.l.c.	The Mall, Mall Street, Floriana FRN 1470, Malta

Notes to the financial statements 31 December 2017 (continued)

18. INVESTMENTS IN EQUITY-ACCOUNTED INVESTEES (continued)

Summarised financial information extracted from the published preliminary statement of annual results as at 31 December 2017 (2016: as at 30 June 2016) in respect of the equity-accounted investees:

	Equity-accounted investees	Equity-accounted investees
	2017	**2016**
	€000	**€000**
Total assets	2,214,752	1,899,580
Total liabilities	2,041,272	1,741,420
Revenues	379,690	170,891
Results for the period	13,521	4,020

	The Group	
	2017	**2016**
	€000	**€000**
Share of net assets of equity-accounted investees	109,461	97,041
Share of results of equity-accounted investees	19,287	3,730

The share of results of equity-accounted investees comprise the Group's share of profits and the Group's share of the movement in the valuation of the in-force business of the entities, for the eighteen month period June 2016 to December 2017.

The judgements made by the equity-accounted investees and the key sources of estimation uncertainties are disclosed below:

Estimate of in-force business

Assumptions
The value of in-force business is determined by the directors of the equity-accounted investee based on the advice of the entity's consulting actuaries. The valuation represents the discounted value of projected future transfers to shareholders from policies in force at the period end, after making provision for taxation. In determining this valuation, assumptions relating to future mortality, persistence and levels of expenses are based on experience of the type of business concerned. Gross investment returns assumed vary depending upon the mix of investments held by the entity and expected market conditions. The value depends on assumptions made regarding future economic and demographic experience. The impact of the change of the present value of in-force (PVIF) accounts was 23% of the result for the period. The PVIF represents 35% of the carrying value of the investments in equity-accounted investees.

This valuation assumes a spread of 1% (2016: 1%) between the weighted average projected investment return and the risk adjusted discount factor applied of 6.5% (2016: 6.5%). The calculation also assumes lapse rates varying from 0.5% to 8% per annum (2016: 0.5% to 8% per annum) and an expense inflation rate of 3.5% (2016: 3.5%).

Changes in assumptions
Assumptions are reviewed on an annual basis to reflect the development of experience and to improve on the reliability of the estimation process.

Ultimate liability arising from claims made under insurance contracts
There are several sources of uncertainty that need to be considered in the estimate of the liability that the equity-accounted investees will ultimately pay for such claims. In particular insurance risks including exposure to liability can span over more than one accounting year, and this increases the uncertainty surrounding the estimate for final settlement.

In calculating the estimated cost of unpaid claims, the equity-accounted investees uses a combination of estimation techniques, based partly on known information at period end, partly on statistical analysis of historical experience and on actuarial valuations carried out by an independant external actuary.

Notes to the financial statements 31 December 2017 (continued)

19. INVESTMENTS IN SUBSIDIARY COMPANIES

Name of company	Equity interest 2017 %	Equity interest 2016 %	Class	Incorporated in	Nature of Business
BOV Asset Management Limited	100	100	Ordinary	Malta	Fund Management
BOV Fund Services Limited	100	100	Ordinary	Malta	Fund Administration

Name of company	The Bank 2017 €000	The Bank 2016 €000
BOV Asset Management Limited	5,481	5,481
BOV Fund Services Limited	749	749
	6,230	6,230

The registered address of the above unlisted undertakings is as follows:

BOV Asset Management Limited	58, Zachary Street, Valletta VLT1130
BOV Fund Services Limited	58, Zachary Street, Valletta VLT1130

All subsidiaries prepared their financial statements to the same date, 31 December.

In August 2016, the Group acquired an additional 40% interest in BOV Asset Management Limited for a cash consideration of €5 million. The Group:
- derecognised a Non-controlling interest of €954,000, comprising of Non-Controlling Interest to date of acquisition less dividends paid to the Non-controlling interest;
- recognised a decrease of €4,046,000 in Retained Earnings.

	The Group 2017 €000	The Group 2016 €000	The Bank 2017 €000	The Bank 2016 €000
20. INTANGIBLE ASSETS				
Software				
Cost				
1 October	29,650	25,561	29,650	25,561
Additions	20,114	4,089	20,114	4,089
31 December 2017 / 30 September 2016	49,764	29,650	49,764	29,650
Accumulated amortisation				
1 October	16,378	12,839	16,378	12,839
Charge for the period	4,933	3,539	4,933	3,539
31 December 2017 / 30 September 2016	21,311	16,378	21,311	16,378
Carrying amount at 31 December / 30 September	28,453	13,272	28,453	13,272
Future capital expenditure:				
- contracted but not provided for in the financial statements	14,188	112	14,188	112
- authorised by the directors but not contracted	15,758	1,199	15,758	1,199

Notes to the financial statements 31 December 2017 (continued)

21. PROPERTY AND EQUIPMENT

	Note	Land and buildings €000	IT infrastructure and equipment €000	Other €000	Total €000
The Group					
Cost or valuation					
30 September 2015		88,395	20,604	28,402	137,401
Additions		931	2,211	880	4,022
Disposals		(532)	-	-	(532)
Revaluation		960	-	-	960
30 September 2016		89,754	22,815	29,282	141,851
Additions		2,445	9,067	1,715	13,227
Reclassification from Assets held for realisation	40	7,501	-	-	7,501
Assets retired from active use		-	-	20	20
Revaluation		2,005	-	-	2,005
31 December 2017		101,705	31,882	31,017	164,604
Accumulated depreciation					
30 September 2015		13,652	13,391	20,557	47,600
Provision for the year		865	2,597	1,506	4,968
Disposals		(291)	-	-	(291)
30 September 2016		14,226	15,988	22,063	52,277
Provision for the period		1,437	3,938	1,710	7,085
Accumulated depreciation on assets retired from active use		-	-	20	20
31 December 2017		15,663	19,926	23,793	59,382
Carrying amount at:					
30 September 2015		**74,743**	**7,213**	**7,845**	**89,801**
30 September 2016		**75,528**	**6,827**	**7,219**	**89,574**
31 December 2017		**86,042**	**11,956**	**7,224**	**105,222**
The Bank					
Cost or valuation					
30 September 2015		88,356	19,960	26,884	135,200
Additions		931	2,211	839	3,981
Disposals		(532)	-	-	(532)
Revaluation		960	-	-	960
30 September 2016		89,715	22,171	27,723	139,609
Additions		2,445	9,067	1,613	13,125
Reclassification from Assets held for realisation		7,501	-	-	7,501
Revaluation		2,005	-	-	2,005
31 December 2017		101,666	31,238	29,336	162,240
Accumulated depreciation					
30 September 2015		13,559	12,568	19,422	45,549
Provision for the year		865	2,597	1,437	4,899
Disposals		(291)	-	-	(291)
30 September 2016		14,133	15,165	20,859	50,157
Provision for the period		1,437	3,938	1,660	7,035
31 December 2017		15,570	19,103	22,519	57,192
Carrying amount at:					
30 September 2015		**74,797**	**7,392**	**7,462**	**89,651**
30 September 2016		**75,582**	**7,006**	**6,864**	**89,452**
31 December 2017		**86,096**	**12,135**	**6,817**	**105,048**

Notes to the financial statements 31 December 2017 (continued)

21. PROPERTY AND EQUIPMENT (continued)

	The Group		The Bank	
	2017	2016	2017	2016
	€000	€000	€000	€000
Carrying amount of land and buildings occupied for own use	86,042	75,528	86,096	75,582
Future capital expenditure:				
- contracted but not provided for in the financial statements	4,886	3,465	4,886	3,465
- authorised by the directors but not contracted for	15,874	2,555	15,874	2,555

Land and buildings are revalued by professionally qualified architects in accordance with the policy documented in Note 1. The carrying amounts of land and buildings that would have been included in the financial statements had these assets been carried at cost less accumulated depreciation are:
2017: Group and Bank €44.8 million (2016: Group and Bank €43.8 million).

Property valuations are mainly valued using the 'comparative investment approach' whereby market value is arrived at by capitalising at an appropriate yield rate, the annual income produced, should the property be leased out to third parties. The income is arrived at by analysing a number of estate agent listings for comparative properties and determining a mean rental value rate. The valuation techniques were consistent with those applied for the year ended 30 September 2016. Revaluations are carried out during the year and, as at 31 December 2017, there were no material changes from date of valuation.

Property fair value measurement is classified as Level 3. Significant unobservable inputs used in the valuation of these properties is the rental income for office space and the percentage capitalisation rate which indicates the multiplier relationship between Net Rental Income and Property Value. Further details about these significant inputs are summarised in the table below:

	Significant unobservable input	Narrative sensitivity
Buildings in Commercial Area	Price per square metre, ranging from EUR 52/sqm to EUR 865/sqm	The higher the price per square metre the higher the fair value
	Capitalisation rate, ranging from 5% to 8%	The higher the capitalisation rate the lower the fair value
Buildings in Residential Area	Price per square metre, ranging from EUR 10/sqm to EUR 293/sqm	The higher the price per square metre the higher the fair value
	Capitalisation rate, ranging from 5.25% to 6%	The higher the capitalisation rate the lower the fair value

Notes to the financial statements 31 December 2017 (continued)

	The Group		The Bank	
	2017	2016	2017	2016
	€000	€000	€000	€000
22. DEFERRED TAX				
Deferred taxation is analysed as follows:				
Net deferred tax asset arising on:				
Fair value movement of financial instruments	(1,793)	(4,221)	(1,793)	(4,221)
Impairment losses	58,298	66,947	58,298	66,947
Allowance for employee benefits	7,111	6,960	7,111	6,960
Excess of capital allowances over depreciation	(5,469)	(4,563)	(5,469)	(4,563)
Defined benefit plans	2,070	2,075	2,070	2,075
Other temporary differences	-	(10)	-	(10)
	60,217	67,188	60,217	67,188
Deferred tax liability arising on:				
Property revaluation	4,519	4,318	4,519	4,318

	The Group and the Bank			
	At 1 October 2016	Recognised in profit or loss	Recognised in equity	At 31 December 2017
	€000	€000	€000	€000
Movement in temporary differences relating to:				
Fair value movement of financial instruments	(4,221)	315	2,113	(1,793)
Impairment losses	66,947	(8,649)	-	58,298
Allowance for employee benefits	6,960	151	-	7,111
Excess of capital allowances over depreciation	(4,563)	(906)	-	(5,469)
Defined benefit plans	2,075	-	(5)	2,070
Property revaluation	(4,318)	-	(201)	(4,519)
Other temporary differences	(10)	10	-	-
	62,870	(9,079)	1,907	55,698

	The Group and the Bank			
	At 1 October 2015	Recognised in profit or loss	Recognised in equity	At 30 September 2016
	€000	€000	€000	€000
Movement in temporary differences relating to:				
Fair value movement of financial instruments	(4,605)	-	384	(4,221)
Impairment allowances	85,384	(18,437)	-	66,947
Allowance for employee benefits	8,825	(1,865)	-	6,960
Excess of capital allowances over depreciation	(4,529)	(34)	-	(4,563)
Defined benefit plans	1,567	-	508	2,075
Property revaluation	(4,382)	20	44	(4,318)
Other temporary differences	12	(22)	-	(10)
	82,272	(20,338)	936	62,870

The Group's deferred tax assets and liabilities on the statement of financial position have not been off-set to the extent that there is no legally enforceable right of set-off with the tax authorities.

Notes to the financial statements 31 December 2017 (continued)

	The Group		The Bank	
	2017	2016	2017	2016
	€000	€000	€000	€000
23. PREPAYMENTS AND ACCRUED INCOME				
Accrued income	33,144	18,788	33,144	18,788
Prepayments	6,241	4,289	7,173	3,909
	39,385	23,077	40,317	22,697
24. AMOUNTS OWED TO BANKS				
Term deposits	119,734	118,202	119,734	118,202
Repayable on demand	72,462	131,953	72,462	131,953
	192,196	250,155	192,196	250,155
25. AMOUNTS OWED TO CUSTOMERS				
Term deposits	1,750,910	2,084,220	1,750,910	2,084,220
Repayable on demand	8,349,715	7,100,297	8,351,254	7,103,720
	10,100,625	9,184,517	10,102,164	9,187,940
26. DEBT SECURITIES IN ISSUE				
4.80% Euro debt securities	55,400	55,400	55,400	55,400
4.25% Euro debt securities	40,000	40,000	40,000	40,000
	95,400	95,400	95,400	95,400

The 4.8% Euro unsubordinated bonds are redeemable at par on 27 August 2018 and are listed on the Malta Stock Exchange. The fair value of these unsecured bonds as at 31 December 2017 is €56.0 million (2016: €58.1 million).

The 4.25% Euro unsubordinated bonds are redeemable at par on 17 May 2019 and are listed on the Malta Stock Exchange. The fair value of these unsecured bonds as at 31 December 2017 is €41.5 million (2016: €40.9 million).

Notes to the financial statements 31 December 2017 (continued)

	The Group		The Bank	
	2017	2016	2017	2016
	€000	€000	€000	€000
27. OTHER LIABILITIES				
Post employment and termination liabilities (see note 35)	26,229	25,813	26,229	25,813
Cash collateral for commitments	50,912	33,252	50,912	33,252
Deposits from companies in formation	3,520	3,498	3,520	3,498
Bills payable	39,511	41,401	39,511	41,401
Accruals and deferred income	26,158	22,256	26,158	22,256
Payment orders outwards	16,532	23,026	16,532	23,026
Other	34,889	21,272	34,566	21,087
	197,751	170,518	197,428	170,333
28. ACCRUALS AND DEFERRED INCOME				
Accrued interest	12,451	16,215	11,958	15,802
29. DERIVATIVES DESIGNATED FOR HEDGE ACCOUNTING				
Derivative financial instruments designated as fair value hedges	12,053	20,649	12,053	20,649

The notional amount of the over-the-counter interest rate swaps stated above at fair value, amount to €59.2m (FY16: €63.2m). The remaining life of these instruments is more than 1 year .

30. SUBORDINATED LIABILITIES

5.35% Euro subordinated unsecured bonds	50,000	50,000	50,000	50,000
4.80% Euro subordinated unsecured bonds	70,000	70,000	70,000	70,000
3.50% Euro subordinated unsecured bonds	111,591	111,591	111,591	111,591
	231,591	231,591	231,591	231,591

The 5.35% Euro subordinated bonds are redeemable at par on 15 June 2019 and are listed on the Malta Stock Exchange. The fair value of these unsecured bonds as at 31 December 2017 is €51.4 million (2016: €52.6 million).

The 4.8% Euro subordinated bonds are redeemable at par on 15 March 2020 and are listed on the Malta Stock Exchange. The fair value of these unsecured bonds as at 31 December 2017 is €72.2 million (2016: €73.5 million).

The 3.5% Euro subordinated bonds are redeemable at par on 8 August 2030 and are listed on the Malta Stock Exchange. The fair value of these unsecured bonds as at 31 December 2017 is €111.8 million (2016: €109.4 million).

	The Bank	
	2017	2016
31. SHARE CAPITAL AND SHARE PREMIUM	€000	€000
Share capital		
Authorised:		
1,000,000,000 Ordinary shares of €1.00 each	1,000,000	500,000
(2016: 500,000,000 Ordinary shares of €1.00 each)		
Issued and paid up:		
525,000,000 Ordinary shares of €1.00 each fully paid	525,000	390,000
(2016: 390,000,000 Ordinary shares of €1.00 each fully paid)		

Notes to the financial statements 31 December 2017 (continued)

31. SHARE CAPITAL AND SHARE PREMIUM (continued)

During this financial year the Bank increased its authorised share capital from €500 million to €1 billion as approved by its shareholders during the Extraordinary General Meeting held on 27 July 2017.

On 16 January 2017 the Bank made a bonus issue of 30 million fully paid ordinary shares of a nominal value of €1.00 per share, representing one bonus share for every 13 shares held, thereby increasing the issued share capital from 390 million shares to 420 million shares, resulting in a paid up capital of €420 million. Furthermore, pursuant to Company Announcement No 325, the Bank announced that 105,000,000 new ordinary shares, resulting from the Rights Issue, have been admitted to the Official List and commenced trading with effect from 22 December 2017.

On 15 January 2016 the Bank made a bonus issue of 30 million fully paid ordinary shares of a nominal value of €1.00 per share, representing one bonus share for every 12 shares held, thereby increasing the issued share capital from 360 million shares to 390 million shares, resulting in a paid up capital of €390 million.

	The Bank	
	2017	2016
Share Premium	€000	€000
Share Premium	45,427	988

During this financial year, as a result of the rights issue mentioned above, share premium account increased by 0.43c per share, for the 105,000,000 new ordinary shares, net of share issue expenses.

32. OTHER RESERVES

Retained Earnings
Retained earnings represent the profits retained over the years and primarily comprise the profit attributable to equity holders after deducting dividends paid and transfers to share capital in respect of bonus issues. This reserve includes the amount held in respect of General Banking Reserves.

General Banking Reserves
The revised Banking Rule 09 requires banks in Malta to hold additional reserves for general banking risks against non-performing loans. This reserve is required to be funded from planned dividend. As at the reporting date this reserve amounts to €4.7 million.

Revaluation Reserves
Revaluation reserves represent fair value movements on land and buildings and available-for-sale investments, net of tax, which are recognised in Other Comprehensive Income.

	The Group	The Bank
	€000	€000
On land and buildings:		
1 October 2015	26,629	26,598
Property revaluation	960	960
Deferred tax and effect of changes in property tax rates	44	44
Release of surplus on sale of property, net of tax	(174)	(174)
30 September 2016	27,459	27,428
Property revaluation	2,005	2,005
Deferred tax and effect of changes in property tax rates	(201)	(201)
31 December 2017	**29,263**	**29,232**
On available-for-sale investments:		
1 October 2015	8,588	8,507
Fair value adjustments	33,777	33,777
Transfer to profit or loss on disposal	(34,876)	(34,876)
Deferred tax	384	384
30 September 2016	7,873	7,792
Fair value adjustments	1,379	1,379
Transfer to profit or loss on disposal	(7,443)	(7,443)
Deferred tax	2,122	2,122
31 December 2017	**3,931**	**3,850**
Total	**33,194**	**33,082**

Notes to the financial statements 31 December 2017 (continued)

	The Group		The Bank	
	2017	2016	2017	2016
	€000	€000	€000	€000
33. CONTINGENT LIABILITIES AND SIGNIFICANT CLAIMS				
Acceptances and endorsements	3,191	2,502	3,191	2,502
Guarantees	223,625	209,209	223,625	209,209
Provision for default on forward contracts	7,133	1,356	7,133	1,356
Other contingent liabilities	19,902	12,340	19,902	12,340
	253,851	225,407	253,851	225,407

Contingent liabilities

Contingent liabilities are backed by corresponding obligations from third parties.

Bank of Valletta is party to legal proceedings arising out of its normal business operations. Matters arising from a set of similar circumstances can give rise to either a provision or a contingent liability, depending on the relevant facts and circumstances. The recognition of provisions and contingents in relation to such matters involves critical accounting estimates and judgments and is determined in accordance with the relevant accounting policies described in Note 1 (1.24.7).

It is not practicable to provide an aggregate estimate of potential liability for the Bank's legal proceedings as a class of contingent liabilities.

Significant claims

On the basis of legal opinions, the Bank has concluded that it has a strong legal position on these claims and, accordingly, no provisions are required.

Deiulemar Trust

In November 2014, court action was instituted against the Bank by the curator of a failed group while under the trust of the Bank, by virtue of which a claim of €363 million was made. While the case has not as yet started to be heard, over the last three years there were various actions by the curator, the latest being a request for a precautionary warrant of seizure, in respect of which the Italian court has reserved its decision. The amount of the claim does not necessarily reflect Bank of Valletta's potential financial exposure if a ruling were to be made against it on this matter.

La Valette Multi Manager Property Fund (LVMMPF)

Proceedings in front of the Office of the Arbiter for Financial Services (OAFS) were instituted by a number of investors in the defunct La Valette Multi Manager Property Fund against Financial Service Providers (FSPs), namely the Bank, the fund manager (a subsidiary of the BOV Group) and the SICAV. On 23 February 2018, the arbiter found in favour of the claimants and ordered the FSPs, *in solidum* between them, to pay the complainants the sum of €3.4 million, together with legal interest from the date when each complainant filed his claim before OAFS up to date of effective payment and also together with legal costs. On 14 March 2018, the Group filed an appeal before the Court of Appeal (Inferior Jurisdiction) from the afore mentioned decision.

Falcon Fund SICAV

The Bank has received a claim from Hammaeskiold & Co as legal representatives of the Swedish Pension Agency (SPA), being the sole investor in the Falcon Fund SICAV (FFS). The damages claimed to be have been suffered by SPA amount to at least SEK 740 million (€ 75 million). While no court proceedings have been yet been initiated, SPA has indicated their intention to do so. The amount of the claim does not necessarily reflect Bank of Valletta's potential financial exposure if a ruling were to be made against it on this matter.

	The Group		The Bank	
	2017	2016	2017	2016
	€000	€000	€000	€000
34. COMMITMENTS				
Documentary credits	87,707	110,671	87,707	110,671
Undrawn formal standby facilities, credit facilities and other commitments to lend	1,746,399	1,467,135	1,746,399	1,467,135
Capital expenditure contracted but not provided for in the financial statements	19,074	3,577	19,074	3,577
Commitments to financial institutions	5,011	8,773	5,011	8,773
	1,858,191	1,590,156	1,858,191	1,590,156

Notes to the financial statements 31 December 2017 (continued)

35. POST EMPLOYMENT AND TERMINATION LIABILITIES

The Group's and the Bank's major post-employment benefit plan (the "plan") applies to eligible individuals. The benefits provided to the individuals in terms of the plan are computed on a specified formula which takes into consideration, amongst other things, the employees' salary on retirement and the pension entitlement in terms of Maltese law. The provision is computed in accordance with the accounting policy for post-employment benefit plans.
This provision represents the Group's and the Bank's obligation

(i) discounted to the net present value at the rate which has been determined by reference to market yields at the end of the reporting period on Malta government bonds (the Directors consider this to be an appropriate proxy to a high quality corporate bond),
(ii) after considering the life expectancy of such employees based on the latest publicly available mortality tables,
(iii) the expected terminal salaries, and
(iv) the Bank's expectations of the employees' retirement date.

The Group and the Bank also operate an early retirement scheme whereby accepted applicants are given a lump sum payment of three times their terminal salary, or are paid two thirds of their terminal salary on a monthly basis until reaching retirement age. Furthermore, the Group and the Bank makes payments to certain eligible employees in consideration of the liquidation of a defunct pension scheme.

The movement in the plans may be analysed as follows:

	The Group and the Bank	
Post Employment and Termination Liabilities	**2017**	**2016**
	€000	**€000**
Present value at 1 October	25,813	26,666
Payments effected	(3,232)	(5,698)
Recognised in profit or loss:		
- Interest expense	(98)	448
- Service cost	-	3
- Terminal benefits	3,761	2,946
Remeasurement of actuarial gains and losses recognised in other comprehensive income resulting from:		
- Experience adjustments	(79)	(94)
- Changes in financial assumptions	(109)	1,398
- Changes in demographic assumptions	173	144
Present value at 31 December	26,229	25,813

The year-end obligation in relation to the plan is mainly in relation to retired employees.

The plan exposes the Group and the Bank to the following main risks:
(i) interest risk, since a decrease in market yields will increase the plan liability
(ii) longevity risk, since an increase in the life expectancy of the plan participants will increase the plan liability.

The significant actuarial assumptions applied by the Group and the Bank in respect of the plan were as follows:

	The Group and the Bank	
	2017	**2016**
Discount rates	0.4%	0.4%
Life expectancy (years):		
Males	78	78
Females	83	83

Notes to the financial statements 31 December 2017 (continued)

The Group and the Bank are providing sensitivity analysis in connection with each significant actuarial assumption applied in respect of the plan. These analysis are prepared as of the end of the reporting period, showing how the liability would have been affected by hypothetical changes in the relevant actuarial assumptions that were reasonably possible at that date, while holding all other assumptions constant. The analysis presented below are for illustrative purposes only and may not be representative of the actual change in the defined benefit obligation as it is unlikely that the change in assumptions would occur in isolation of one another. In presenting the sensitivity analysis, the present value of the obligation has been calculated using the projected unit credit method at the end of the reporting period. The amounts generated from the analysis represent forward-looking estimates and hence, actual results in the future may differ materially from those projected results. In accordance with the transitional provisions in the revised IAS 19, the Group and the Bank have not disclosed comparative information in this respect.

- If the discount rate is 100 basis points higher (lower) with all other assumptions held constant, the defined benefit obligation decreases by €1.3m (increases by €1.3m)
- If the life expectancy increases (decreases) by two years for both men and women with all other assumptions held constant, the defined benefit obligation increases by €3.4m (decreases by €3.4m).

The weighted average duration of the liability in respect of the plan at 31 December 2017 is 9.5 years (2016 :10 years).

36. NOTES TO THE CASH FLOW STATEMENTS	Note	The Group		The Bank	
		2017	2016	2017	2016
		€000	€000	€000	€000
Cash	13	56,149	44,254	56,149	44,254
Treasury bills (with original maturity of less than 3 months)		-	39,017	-	39,017
Money at call and short notice		3,414,190	1,896,720	3,414,190	1,896,720
Amounts owed to banks		(191,732)	(131,953)	(191,732)	(131,953)
Cash and cash equivalents included in the cash flow statement		**3,278,607**	**1,848,038**	**3,278,607**	**1,848,038**
Balances with contractual maturity of more than 3 months		32,485	83,517	32,485	83,517
		3,311,092	1,931,555	3,311,092	1,931,555
Equivalent items reported in the statement of financial position:					
Balances with Central Bank of Malta, Treasury bills and cash (excluding Reserve Deposit)		71,905	83,271	71,905	83,271
Loans and advances to banks		3,431,383	2,098,439	3,431,383	2,098,439
Amounts owed to banks		(192,196)	(250,155)	(192,196)	(250,155)
		3,311,092	1,931,555	3,311,092	1,931,555

37. RELATED PARTY TRANSACTIONS

During the current and the prior year, the Group and the Bank entered into transactions during the course of their normal business, with equity-accounted investees, subsidiaries, the Government of Malta ("The Government") (which has a 25.23% holding in the Bank), Government related entities, key management personnel, and other related parties. Government related entities are those where, in the opinion of the Bank, the Government is either deemed to exercise control, that is, it has the power to govern the financial and operating policies of the entity or linked to the Government but not controlled by the Government.

Key management personnel includes the Chairman, Directors, the members of the Management Board and their respective spouses, spousal equivalent and dependents. Other related parties are those companies over which the key management personnel hold control or significant influence (directorship).

Transactions with related parties are made on an arm's length basis.

The Bank also entered into related party transactions on an arm's length basis with its subsidiaries and equity-accounted investees. Transactions between the Bank and its subsidiaries have been eliminated on consolidation.

Notes to the financial statements 31 December 2017 (continued)

37. RELATED PARTY TRANSACTIONS (continued)

The amounts due to or from related parties are settled in cash and the amount of related party transactions and outstanding balances at the reporting date are disclosed below:

The Group	2017 15 months to Dec 2017 Related party transactions €000	Total activity/ balance €000	% of total	2016 12 months to Sep 2016 Related party transactions Re-Stated €000	Total activity/ balance €000	% of total
Interest and similar income:						
- on loans and advances, balances with Central Bank of Malta and treasury bills						
Equity-accounted investees	-			-		
The Government	2,182			1,934		
Government related entities	18,305			14,953		
Key management personnel	66			4		
Other related parties	119			376		
	20,672	198,997	10%	17,267	160,339	11%
Interest and similar income:						
- on debt and other fixed income instruments						
The Government	23,031	60,197	38%	26,322	54,063	49%
Interest expense						
Equity-accounted investees	641			1,073		
The Government	11,878			4,676		
Government related entities	320			199		
Key management personnel	38			11		
Other related parties	-			4		
	12,877	76,247	17%	5,963	65,573	9%
Fee and commission income						
Equity-accounted investees	7,291			5,895		
The Government	208			157		
Government related entities	452			327		
Key management personnel	5			2		
Other related parties	15			10		
	7,971	98,787	8%	6,391	75,021	9%
Employee compensation and benefits						
Key management personnel	1,668	79,750	2%	1,002	64,168	2%
General administrative expenses						
Equity-accounted investees	135			123		
Key management personnel	39			38		
Other related parties	4			199		
	178	59,463	0%	360	40,103	1%
Movement in impairment allowances						
The Government	(11)			(20)		
Government related entities	(730)			1,789		
Key management personnel	-			-		
Other related parties	(5)			(398)		
	(746)	(6,227)	12%	1,371	23,249	6%

Notes to the financial statements 31 December 2017 (continued)

37. RELATED PARTY TRANSACTIONS (continued)

	2017 15 months to Dec 2017 Related party balances	Total activity/ balance		2016 12 months to Sep 2016 Related party balances Re-stated	Total activity/ balance	
	€000	€000	% of total	€000	€000	% of total
Balances with Central Bank of Malta, treasury bills and cash						
The Government	103,535	159,684	65%	126,796	171,050	74%
Financial assets at fair value through profit or loss						
The Government	33,680	326,291	10%	56,238	392,430	14%
Investments						
The Government	562,772	3,374,541	17%	664,252	3,736,272	18%
Loans and advances to customers						
Equity-accounted investees	-			-		
The Government	58,273			47,517		
Government related entities	429,657			433,738		
Key management personnel	3,530			1,512		
Other related parties	1,955			5,393		
	493,415	4,162,032	12%	488,160	4,001,656	12%
Loans and advances to banks						
The Government	2,906,971	3,431,383	85%	1,619,029	2,098,439	77%
Impairment allowances						
The Government	(135)			(146)		
Government related entities	(11,078)			(11,808)		
Key management personnel	-			-		
Other related parties	(15)			(20)		
	(11,228)	(166,200)	7%	(11,974)	(185,712)	6%
Amounts owed to customers						
Equity-accounted investees	218,070			229,000		
The Government	218,844			313,735		
Government related entities	105,252			94,795		
Key management personnel	4,789			2,112		
Other related parties	3,817			6,036		
	550,772	10,100,625	5%	645,678	9,184,517	7%
Total Assets less Liabilities						
Equity-accounted investees	(218,070)			(229,000)		
The Government	3,446,252			2,199,951		
Government related entities	313,327			327,135		
Key management personnel	(1,259)			(601)		
Other related parties	(1,877)			(663)		
	3,538,373			2,296,822		
Commitments						
Equity-accounted investees	396			378		
The Government	48,075			13,900		
Government related entities	111,689			106,712		
Key management personnel	683			492		
Other related parties	1,126			9,248		
	161,969	1,858,191	9%	130,730	1,590,156	8%

Notes to the financial statements 31 December 2017 (continued)

37. RELATED PARTY TRANSACTIONS (continued)

The Bank	2017 15 months to Dec 2017 Related party transactions €000	Total activity/ balance €000	% of total	2016 12 months to Sep 2016 Related party transactions Re-Stated €000	Total activity/ balance €000	% of total
Interest and similar income:						
- on loans and advances, balances with Central Bank of Malta and treasury bills						
The Government	2,182			1,934		
Government related entities	18,305			14,953		
Key management personnel	10			4		
Other related parties	97			186		
	20,594	198,997	10%	17,077	160,339	11%
Interest and similar income:						
- on debt and other fixed income instruments						
The Government	23,031	60,197	38%	26,322	54,063	49%
Interest expense						
Equity-accounted investees	641			1,073		
Subsidiaries	2			-		
The Government	11,878			4,676		
Government related entities	320			199		
Key management personnel	38			9		
Other related parties	-			3		
	12,879	76,247	17%	5,960	65,573	9%
Fee and commission income						
Equity-accounted investees	7,291			5,895		
Subsidiaries	2,654			2,860		
The Government	208			157		
Government related entities	452			327		
Key management personnel	3			2		
Other related parties	2			9		
	10,610	87,587	12%	9,250	66,840	14%
Dividend income						
Equity-accounted investees	6,869			4,103		
Subsidiaries	8,888			3,631		
	15,757	17,682	89%	7,734	9,635	80%
Employee compensation and benefits						
Key management personnel	1,595	76,507	2%	963	62,036	2%
General administrative expenses						
Equity-accounted investees	135			123		
Key management personnel	31			37		
Other related parties	4			199		
	170	57,806	0%	359	39,085	1%
Movement in impairment allowances						
The Government	(11)			(20)		
Government related entities	(730)			1,789		
Key management personnel	-			-		
Other related parties	11			(417)		
	(730)	(6,227)	12%	1,352	23,249	6%

Notes to the financial statements 31 December 2017 (continued)

37. RELATED PARTY TRANSACTIONS (continued)

The Bank	2017 15 months to Dec 2017 Related party transactions €000	Total activity/ balance €000	% of total	2016 12 months to Sep 2016 Related party transactions Re-Stated €000	Total activity/ balance €000	% of total
Balances with Central Bank of Malta, treasury bills and cash						
The Government	103,535	159,684	65%	126,796	171,050	74%
Financial assets at fair value through profit or loss						
The Government	33,680	325,316	10%	56,238	391,292	14%
Investments						
The Government	562,772	3,374,541	17%	664,252	3,736,272	18%
Loans and advances to customers						
The Government	58,273			47,517		
Government related entities	429,657			433,738		
Key management personnel	2,321			1,330		
Other related parties	1,729			186		
	491,980	4,162,032	12%	482,771	4,001,656	12%
Loans and advances to banks						
Equity-accounted investees						
The Government						
Government related entities						
Key management personnel						
Other related parties						
The Government	2,906,971	3,431,383	85%	1,619,029	2,098,439	77%
Impairment allowances						
The Government	(135)			(146)		
Government related entities	(11,078)			(11,808)		
Key management personnel	-			-		
Other related parties	(12)			(1)		
	(11,225)	(166,200)	7%	(11,955)	(185,712)	6%
Other assets						
Subsidiaries	172	5,872	3%	319	4,809	7%
Amounts owed to customers						
Equity-accounted investees	218,070			229,000		
Subsidiaries	1,539			3,423		
The Government	218,844			313,735		
Government related entities	105,252			94,795		
Key management personnel	3,968			1,885		
Other related parties	443			4,297		
	548,116	10,102,164	5%	647,135	9,187,940	7%

Notes to the financial statements 31 December 2017 (continued)

37. RELATED PARTY TRANSACTIONS (continued)

The Bank	2017 15 months to Dec 2017 Related party transactions €000	Total activity/ balance €000	% of total	2016 12 months to Sep 2016 Related party transactions Re-Stated €000	Total activity/ balance €000	% of total
Total Assets less Liabilities						
Equity-accounted investees	(218,070)			(229,000)		
Subsidiaries	(1,367)			(3,423)		
The Government	3,446,252			2,199,951		
Government related entities	313,327			327,135		
Key management personnel	(1,647)			(555)		
Other related parties	1,274			(4,112)		
	3,539,769			2,289,996		
Commitments						
Equity-accounted investees	396			378		
The Government	48,075			13,900		
Government related entities	111,689			106,712		
Key management personnel	521			427		
Other related parties	1,045			5,543		
	161,726	1,858,191	9%	126,960	1,590,156	8%

	The Group 2017 €000	The Group 2016 €000	The Bank 2017 €000	The Bank 2016 €000
All outstanding balances are secured except for the following:				
Loans and advances to customers:				
- Key management personnel	144	21	132	11
- Other related parties	159	5	-	5
	303	26	132	16
Details of guarantees received are disclosed below:				
Loans and advances to customers:				
- Amounts guaranteed by The Government	485,278	528,441	485,278	528,441

Notes to the financial statements 31 December 2017 (continued)

37. RELATED PARTY TRANSACTIONS (continued)

Loans to and commitments on behalf of directors and other key management personnel (including connected persons):

	The Group		The Bank	
	Loans and advances	Commitments	Loans and advances	Commitments
	€000	€000	€000	€000
Directors				
At 1 October 2015	230	349	139	326
Additions	444	87	342	39
	674	436	481	365
Less reductions/repayments	(186)	(240)	(175)	(234)
At 30 September 2016	488	196	306	131
Additions	1,634	210	496	91
	2,122	406	802	222
Less reductions/repayments	(153)	(73)	(42)	(52)
At 31 December 2017	1,969	333	760	170
Other key management personnel				
At 1 October 2015	534	382	534	382
Additions	640	47	640	47
	1,174	429	1,174	429
Less reductions/repayments	(150)	(133)	(150)	(133)
At 30 September 2016	1,024	296	1,024	296
Additions	691	194	691	194
	1,715	490	1,715	490
Less reductions/repayments	(154)	(139)	(154)	(139)
At 31 December 2017	1,561	351	1,561	351

The above facilities do not involve more than the normal risk of repayment or present other unfavourable features and were made in the ordinary course of business on substantially the same terms as for comparable transactions with persons of a similar standing, or where applicable, other employees.

Notes to the financial statements 31 December 2017 (continued)

38. SEGMENTAL INFORMATION BY CLASSES OF BUSINESS

The Group's reportable segments are shown in the table below. This segment information covers a fifteen month period from 1 October 2016 to 31 December 2017. The comparative period is the twelve months from 1 October 2015 to 30 September 2016.

Interest income is the main revenue generating activity for all segments. The customer-oriented segments also have income derived from fees and commissions and earnings arising on foreign exchange transactions.

	Personal Banking & Wealth Management		Corporate Banking		Proprietary Investments		Liquidity Management		Total Reportable Segments	
	Dec-17	Sep-16	Dec-17	Sep-16	Dec-17	Sep-16	Dec-17	Sep-16	Dec-17	Sep-16
	€000	€000	€000	€000	€000	€000	€000	€000	€000	€000
Net interest income	80,951	59,274	101,486	81,113	50,543	42,771	(50,033)	(34,329)	182,947	148,829
Net fee and commission income	55,245	43,040	22,241	16,169	619	841	8,184	6,035	86,289	66,085
Trading income	636	315	14,953	13,549	7,023	9,111	8,162	6,463	30,774	29,438
(Loss)/Gain from financial assets at FVTPL	-	-	-	-	(1,462)	4,332	-	-	(1,462)	4,332
Gain on Visa transaction	-	-	-	-	-	27,511	-	-	-	27,511
Other income	-	-	-	-	1,925	1,901	-	-	1,925	1,901
Depreciation/amortisation	(6,699)	(4,638)	(1,962)	(1,347)	(55)	(63)	(3,322)	(2,459)	(12,038)	(8,507)
Other costs	(69,105)	(53,150)	(21,864)	(16,162)	(5,541)	(3,605)	(42,703)	(31,354)	(139,213)	(104,271)
	878	13,318	5,349	(36,562)	-	102	-	-	6,227	(23,142)
Impairment (losses)/reversal	-	-	-	-	-	-	-	-	-	-
Operating profit before share of results of equity-accounted investees	61,906	58,159	120,203	56,760	53,052	82,901	(79,712)	(55,644)	155,449	142,176
Group share of results after tax of equity-accounted investees	-	-	-	-	19,287	3,730	-	-	19,287	3,730
Group profit before taxation for the fifteen months									174,736	145,906

	Personal Banking & Wealth Management		Corporate Banking		Proprietary Investments		Liquidity Management		Total Reportable Segments	
	Dec-17	Sep-16	Dec-17	Sep-16	Dec-17	Sep-16	Dec-17	Sep-16	Dec-17	Sep-16
	€000	€000	€000	€000	€000	€000	€000	€000	€000	€000
ASSETS										
Total assets	2,123,830	2,015,064	2,263,501	2,177,843	3,599,146	4,060,626	3,591,017	2,269,431	11,577,494	10,522,964
Property and equipment and Intangible assets	-	-	-	-	100,334	94,735	-	-	100,334	94,735
Additions to property and equipment and intangible assets	-	-	-	-	33,341	8,111	-	-	33,341	8,111
Carrying value of equity-accounted investees	-	-	-	-	109,461	97,041	-	-	109,461	97,041
Total Assets									11,820,630	10,722,851
LIABILITIES										
Total liabilities	2,236,426	2,046,091	2,681,112	2,371,755	3,747,437	4,161,701	2,193,568	1,414,143	10,858,543	9,993,690

The revenue which is reported above represents revenue generated from external customers. There were no inter-segment sales during the period (2016: nil).

The accounting policies of the reportable segments are the same as the Group's accounting policies described in note 1. Segment's operating profit represents the profit earned by each segment.

There are no material activities which are carried out outside Malta.

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT

39.1 Use of financial instruments

By their nature, the Group's activities are principally related to the use of financial instruments including derivatives. The Group accepts deposits from customers at both fixed and floating rates and for various periods, and seeks to earn interest margins by investing these funds in high-quality assets. The Group seeks to increase these margins by consolidating short-term funds and lending for longer periods at higher rates, while maintaining sufficient liquidity to meet all claims that might fall due.

The Group also seeks to increase its interest margins through lending to commercial and retail borrowers with a range of credit standings. Such exposures involve both on-balance sheet loans and advances, as well as guarantees and other commitments such as performance and other bonds and letters of credit.

The Board places trading limits on the level of exposure that can be taken in relation to both overnight and intra-day market positions. Foreign exchange and interest rate exposures are normally offset by entering into counterbalancing positions, thereby controlling the variability in the net cash amounts required to liquidate market positions.

Given that the difference between the Group and the Bank balances in respect of financial instruments, and the corresponding effect on the income statement and reserves in respect thereof, are not material, references in this note to the Group are to be construed as references to the Bank, unless otherwise stated.

The principal areas of financial risk are detailed below:

39.2 Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss to the other party by failing to discharge an obligation.

Financial assets which could potentially expose the Group to credit risk, mainly include balances with Central Bank of Malta, treasury bills and cash, derivative financial assets, debt and other fixed income instruments, and loans and advances to banks and customers.

39.2.1 Credit risk management and exposure

(i) Loans and advances

The purpose of credit risk management is to keep credit risk exposure to a permissible level relative to capital, to maintain the soundness of assets, and to ensure returns commensurate with risk. This leads to a loan portfolio that achieves high returns on capital and assets.

Credit risk is managed and controlled throughout the Bank on the basis of established credit processes, and within a framework of credit policy and delegated authorities based on responsibility, skill and experience.

Credit grading and monitoring systems are in place to accommodate the early identification and management of deterioration in loan quality. In addition, the credit management process is underpinned by an independent system of credit review.

Credit risk analysis is carried out on two levels: the single name; and the bank's lending portfolio review. The Bank uses a number of tools to limit its exposure to undue credit risk. These include the application of:

- High-level credit policies designed to ensure a balanced and managed approach to the identification and mitigation of credit risk;
- Lending guidelines defining the responsibilities of lending officers that seek to provide a disciplined and focused benchmark for credit decisions;
- Independent reviews of credit exposures;
- Sector caps, encompassing both industry and specific product types, to communicate the Board's risk appetite for specific types of business;
- Establishment and maintenance of large exposures and provisioning policies in accordance with regulatory reporting requirements;
- Communication and provision of general guidance on all credit-related risk issues, including regulatory changes to promote consistent and best practice throughout the Bank.

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.1 Credit risk management and exposure (continued)

Where possible the Bank aims to reduce and control risk concentrations. Broadly stated, concentration results when the Bank has a high level of exposure to a single or related group of borrowers, credit exposures secured by a single security, or credit exposures with common characteristics within an industry, such that adverse developments in this exposure would be damaging to the Bank.

Given the size and nature of the domestic financial sector and the local economy, the Bank is exposed to concentration risk in its credit business. The Bank has systems in place to identify material concentrations in the loan portfolio, and to ensure adherence to prudential limits set by the Board of Directors and/or the regulators to single borrowers or groups of related borrowers and other significant risk concentrations. The CEO and the Board of Directors are regularly informed on the concentration of the Bank's portfolio.

The following industry concentrations in connection with loans and advances to banks and customers are considered significant:

	The Group	
	2017	2016
	€000	€000
Agriculture	6,060	7,497
Fishing	27,172	3,716
Mining and quarrying	2,111	4,100
Manufacturing	171,995	125,793
Electricity, gas, steam and air conditioning supply	126,230	139,482
Water supply, sewerage waste management and remediation activities	19,862	22,680
Construction	211,342	242,383
Wholesale and retail trade	348,212	370,721
Transportation and storage	236,829	275,410
Accommodation and food service activities	254,182	221,999
Information and communication	33,251	23,417
Financial and insurance activities	446,877	407,120
Real estate activities	247,008	262,998
Professional, scientific and technical activities	22,975	24,943
Administrative and support service activities	50,600	45,774
Public administration and defence, compulsory social security	29,995	14,222
Education	15,266	13,192
Human health and social work activities	35,907	20,168
Arts, entertainment and recreation	29,389	36,182
Other services activities	18,072	17,139
Households and individuals	2,137,470	2,029,748
Loans and advances to customers	4,470,805	4,308,684
Loans and advances to banks	3,431,383	2,098,439
	7,902,188	**6,407,123**

(ii) Other financial assets

The credit risk in respect of other financial assets is mitigated through limits set in the Treasury Management Policy. The Bank assigns limits on the level of credit risk undertaken in relation to any single counterparty or sovereign exposure in accordance with external ratings based on Fitch's ratings or on those of other major rating agencies.

Changes in credit ratings are monitored on a daily basis and are subject to frequent review, when considered necessary. The limits on the level of credit risk are reviewed consistently and approved by the Board of Directors at regular intervals. Actual exposures are monitored against limits on an on going basis. The Bank enters into security transactions only with such authorised counterparties and it invests only in securities or paper with credit quality within specific parameters stated in the Treasury Management Policy.

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.1 Credit risk management and exposure (continued)

(ii) Other financial assets (continued)

The level of concentration in respect of other significant financial assets is disclosed in the remaining notes to the financial statements.

Maximum exposure
The carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, represents the maximum exposure to credit risk without taking account of the value of any collateral obtained, except as disclosed below:

Financial guarantees
The maximum exposure to credit risk is the full amount that the Group would have to pay if the guarantees are called upon.

Loan commitments
The maximum exposure to credit risk arising on loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities is the full amount of the committed facilities.

Collateral and other credit enhancements
Credit risk mitigation is one of the key elements of the Group's credit policy. This includes the requirement to obtain collateral, depending on the nature of the proposal, as set out in the Bank's policies and procedures. The nature and level of collateral required depends on a number of factors, including, but not limited to the amount of the exposure, the type of facility provided, the term of the facility, the amount of the counterparty's contribution and an evaluation of the level of the credit risk or probability of default involved.

Security values are reviewed on a regular basis and are also re-assessed at time of default if it is found that the carrying value of the collateral item could have materially changed since last valuation. The Bank calculates the value of collateral as the market value less a haircut, with the latter representing a conservative estimate of the costs to sell and the potential loss of value in a forced sale scenario. For financial instruments, haircuts are calculated according to the risk profile of each individual security and depend on a number of variables including price volatility and liquidity/marketability of the instrument.

The table below shows the financial effect and main types of collateral held against the Group's customer loan exposures:

The Group **As at 31 December 2017**	**Loans and advances to customers**	**Undrawn credit facilities and other commitments to lend**
	€000	**€000**
Loans collateralised by:		
Prime bank guarantees	1,464	572
Cash or quasi cash	152,259	59,476
Guarantees and/or letters of comfort issued by the Malta Government,		
the Central Bank of Malta or public agencies	509,939	199,192
Residential property	1,804,873	705,020
Commercial property	1,032,465	403,302
Personal guarantees and others	232,148	90,681
	3,733,148	**1,458,243**

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.1 Credit risk management and exposure (continued)

(ii) Other financial assets (continued)

The Group	**Loans and advances to customers**	**Undrawn credit facilities and other commitments to lend**
As at 30 September 2016	**€000**	**€000**
Loans collateralised by:		
Prime bank guarantees	1,058	358
Cash or quasi cash	123,619	41,804
Guarantees and/or letters of comfort issued by the Malta Government,		
the Central Bank of Malta or public agencies	526,269	177,965
Residential property	1,675,477	566,588
Commercial property	1,053,599	356,291
Personal guarantees and others	177,557	60,044
	3,557,579	**1,203,050**

Residential lending

The table below stratifies credit exposures, covered by residential property, to retail customers by ranges of loan-to-value ('LTV'). LTV is calculated as the ratio of the gross amount of loan or the amount committed for loan commitments to the value of the collateral. The gross amounts exclude any impairment allowances. The valuation of the collateral excludes any adjustments for obtaining and selling the collateral. The value of the collateral for these loans is based on the collateral value at origination updated based on changes in house price indices.

Residential lending and commitments for residential lending

	2017	**2016**
	€000	**€000**
Less than 25%	166,444	160,354
25% to 50%	504,234	488,236
51% to 75%	815,181	758,454
76% to 90%	1,040,848	1,028,534
	2,526,707	2,435,578

Settlement Risk

The Group's activity may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to failure of a company to honour its obligations to deliver cash, securities or other assets as contractually agreed. Settlement risk in respect of security transactions is mitigated through settlement limits assigned to counterparties based on external credit ratings or by effecting payment on a delivery versus payment (DVP) basis.

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.2 Credit Quality

(i) Debt securities and other bills by rating agency (Fitch) designation

The Group	Balances with CBM and Treasury Bills €000	Debt Securities €000	Loans and Advances to Banks €000	Derivatives €000	Total €000
As at 31 December 2017					
AAA	-	255,936	25,075	-	281,011
AA- to AA+	-	588,077	20,149	422	608,648
A- to A+	103,535	2,294,539	3,229,427	5,068	5,632,569
BBB- to BBB+	-	314,611	133,953	542	449,106
Lower than BBB-	-	17,781	7,187	-	24,968
Unrated	-	9,716	15,592	1,458	26,766
	103,535	**3,480,660**	**3,431,383**	**7,490**	**7,023,068**
As at 30 September 2016					
AAA	-	346,790	26,141	35	372,966
AA- to AA+	-	747,210	90,039	540	837,789
A- to A+	-	1,560,560	294,672	3,070	1,858,302
BBB- to BBB+	126,796	1,264,144	1,669,374	145	3,060,459
Unrated	-	-	18,213	1,575	19,788
	126,796	**3,918,704**	**2,098,439**	**5,365**	**6,149,304**

(ii) Loans and advances to customers analysed into performing and non-performing exposures

	The Group			
Total Gross/Forborne Exposures	**Total 2017 €000**	**of which Forborne 2017 €000**	**Total 2016 €000**	**of which Forborne 2016 €000**
Performing				
Neither past due nor impaired	4,156,498	35,863	3,965,323	47,003
Past due < 90 days, but not impaired	32,088	1,242	38,796	454
	4,188,586	37,105	4,004,119	47,457
Non performing				
Past due > 90 days, but not impaired	96,720	39,212	92,040	49,157
Impaired	185,499	91,553	212,525	113,208
	282,219	130,765	304,565	162,365
Total Gross/Forborne Exposures	4,470,805	167,870	4,308,684	209,822

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.2 Credit Quality (continued)

(ii) Loans and advances to customers analysed into performing and non-performing exposures (continued)

Impairment Allowances on Total/Forborne Exposures	**The Group**			
	Total	**of which Forborne**	**Total**	**of which Forborne**
	2017	**2017**	**2016**	**2016**
	€000	**€000**	**€000**	**€000**
Performing				
Neither past due nor impaired	32,092	2,312	34,414	3,092
Past due < 90 days, but not impaired	1,196	87	2,250	36
	33,288	2,399	36,664	3,128
Non performing				
Past due > 90 days, but not impaired	31,261	8,398	34,131	10,654
Impaired	101,651	54,746	114,917	63,610
	132,912	63,144	149,048	74,264
Total Impairment Allowances	166,200	65,543	185,712	77,392

Net Carrying Amounts of Total/Forborne Exposures				
Performing				
Neither past due nor impaired	4,124,406	33,551	3,930,908	43,911
Past due < 90 days, but not impaired	30,894	1,154	36,545	418
	4,155,300	34,705	3,967,453	44,329
Non performing				
Past due > 90 days, but not impaired	65,458	30,814	57,909	38,503
Impaired	83,847	36,807	97,610	49,598
	149,305	67,621	155,519	88,101
Total Net Carrying Amounts	4,304,605	102,326	4,122,972	132,430

Interest income recognised during the period ended 31 December 2017 in respect of forborne assets amounted to €8.8 million (2016: €11.6 million).

The tables above analyse the loan book into performing and non-performing exposures together with the related allowances. Impairment allowances comprise both collective and specific.

Gross Forborne Exposures	**Modification in Terms**	**Refinancing**	**Modification in Terms**	**Refinancing**
	2017	**2017**	**2016**	**2016**
	€000	**€000**	**€000**	**€000**
Performing				
Personal	3,483	338	3,652	577
Business	31,560	1,724	42,413	815
	35,043	2,062	46,065	1,392
Non performing				
Personal	27,166	654	31,494	446
Business	99,357	3,588	129,987	438
	126,523	4,242	161,481	884

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.2 Credit Quality (continued)

(iii) Loans and advances to customers by internal rating based on the Banking directives/rules

	Loans & Advances	
	2017	**2016**
	€000	**€000**
Neither past due nor impaired:		
Regular	3,896,165	3,634,542
Watch list	233,081	288,758
Sub-Standard	27,252	42,023
	4,156,498	3,965,323

The neither past due nor impaired balances include performing forborne facilities.

Past due but not impaired:		
Past due up to 29 days	14,281	16,120
Past due 30 - 59 days	12,833	17,020
Past due 60 - 89 days	4,974	5,656
	32,088	38,796

A financial asset is past due when a counterparty has failed to make a payment when contractually due.

Individually impaired gross loans by segment:		
Personal	36,766	40,532
Business	148,733	171,993
	185,499	**212,525**

Impaired facilities are those credit facilities with payments of interest and/or capital overdue by 90 days or more or where the Group has reasons to doubt the eventual recoverability of funds.

Collateral for impaired loans
As detailed above, a variety of types of collateral are accepted including property, securities, cash, guarantees and insurance.

(iv) Movement in forbearance activity during the period

	Loans & Advances	
	2017	**2016**
	€000	**€000**
1 October	209,822	296,869
Additions	15,907	26,154
Retired from forborne	(57,859)	(113,201)
31 December / 30 September	167,870	209,822

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.3 Movement in allowance accounts for loans and advances to customers

	The Group			
	Individually assessed allowances	Collective allowances	Individually assessed allowances	Collective allowances
	2017	2017	2016	2016
	€000	€000	€000	€000
Change in allowances for uncollectability:				
At 1 October	170,776	14,936	220,272	18,038
Additions	55,134	3,251	69,074	1,579
Reversals	(75,912)	(1,985)	(118,570)	(4,681)
	(20,778)	1,266	(49,496)	(3,102)
At 31 December / 30 September	149,998	16,202	170,776	14,936

39.2.4 Debt securities

Sovereign Debt

Sovereign risk refers to the risk that a government may default on its obligations, and includes refinancing risk related to the inability to raise capital to repay maturing bonds. The Group monitors sovereign risks through sovereign credit ratings issued by credit rating agencies which include Fitch, Moody's, and S&P. The Treasury Management Policy seeks to mitigate sovereign risk, whether directly or indirectly through exposures to corporate and financial institutions domiciled therein, through investment limits assigned on the basis of the long-term credit rating of such sovereigns. This is further supplemented by in depth economic reviews undertaken periodically and assessments of the fiscal, economic and socio-political aspects upon which such limits are accordingly aligned.

The tables below analyse debt securities by sector, classification and residency.

	The Group and The Bank		
Sector	Held-to-maturity	Available-for-sale	Fair Value through Profit or Loss
	€000	€000	€000
2017			
15 months			
Banks	1,580,843	-	28,811
Government	1,008,633	66,079	64,340
Public	-	73,249	-
Others	640,439	-	18,266
	3,229,915	139,328	111,417

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.4 Debt securities (continued)

Sovereign Debt (continued)

	The Group and The Bank		
	Held-to-maturity	Available-for-sale	Fair Value through Profit or Loss
	€000	€000	€000
2016			
12 months			
Banks	1,653,880	3,977	53,797
Government	1,156,540	179,461	90,437
Public	-	88,805	-
Others	650,026	-	41,781
	3,460,446	272,243	186,015

	The Group and The Bank		
Residency	Held-to-maturity	Available-for-sale	Fair Value through Profit or Loss
	€000	€000	€000
2017			
15 months			
Malta	496,691	139,328	38,398
Monetary Union member states	1,029,653	-	39,090
Rest of the world	1,703,571	-	33,929
	3,229,915	139,328	111,417
2016			
12 months			
Malta	484,791	268,266	69,321
Monetary Union member states	1,058,278	-	53,798
Rest of the world	1,917,377	3,977	62,896
	3,460,446	272,243	186,015

39.3 Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may result from an inability to sell a financial asset quickly at close to its fair value. The Group 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 Group is exposed to daily calls on its available cash resources from overnight deposits, current and call deposits, maturing term deposits, loan drawdowns, guarantees and from margin and other calls on cash-settled derivatives. In order to ensure that maturing funds are always available to meet expected demand for cash, the Board sets parameters within which maturities of assets and liabilities may be mismatched. Unmatched positions potentially enhance profitability, but also increase the risk of losses. In addition, the Group manages its risk to a shortage of funds by monitoring forecast and actual cashflows, 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.

The table below analyses Group financial liabilities into relevant maturity groupings, based on the remaining period at the reporting date to the contractual maturity date. The balances in this table will not agree directly to the balances in the statement of financial position as the table incorporates all cash flows, on an undiscounted basis, related to both principal as well as those associated with all future coupon payments. Furthermore, loan commitments do not meet the criteria for recognition in the statement of financial position.

Financial liabilities at fair value through profit or loss and derivatives designated for hedge accounting, disclosed below, represent amounts for which net cash flows are exchanged.

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.3 Liquidity risk (continued)

The Group

At 31 December 2017	Due within 3 months €000	Due between 3 & 12 months €000	Due between 1 & 5 years €000	Due after 5 years €000	Gross nominal outflow €000	Carrying amount €000
Financial liabilities at fair value through profit or loss	1,390	2,475	7,517	2,952	14,334	11,957
Amounts owed to banks	192,591	8	-	-	192,599	192,196
Amounts owed to customers	8,894,632	976,064	306,336	3,139	10,180,171	10,100,625
Debt securities in issue	1,330	58,430	40,850	-	100,610	95,400
Subordinated liabilities	3,633	6,308	142,000	142,836	294,777	231,591
Derivatives designated for hedge accounting	593	1,312	6,004	7,450	15,359	12,053
Other financial liabilities	180,812	4,747	9,598	10,470	205,627	214,721
	9,274,981	**1,049,344**	**512,305**	**166,847**	**11,003,477**	**10,858,543**
Loan commitments	1,746,399					
At 30 September 2016						
Financial liabilities at fair value through profit or loss	2,053	3,617	11,154	8,503	25,327	20,327
Amounts owed to banks	246,465	24	753	-	247,242	250,155
Amounts owed to customers	7,725,817	1,195,034	287,916	2,781	9,211,548	9,184,517
Debt securities in issue	850	3,509	101,459	-	105,818	95,400
Subordinated liabilities	1,338	4,698	136,768	146,742	289,546	231,591
Derivatives designated for hedge accounting	1,364	1,949	7,866	10,856	22,035	20,649
Other financial liabilities	174,230	5,935	7,864	14,741	202,770	191,051
	8,152,117	**1,214,766**	**553,780**	**183,623**	**10,104,286**	**9,993,690**
Loan commitments	1,467,135					

Assets available to meet these liabilities, and to cover outstanding commitments, include balances with Central Bank of Malta, treasury bills and cash, cheques in course of collection, loans to banks and to customers and marketable securities and undrawn credit lines.

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.3 Liquidity risk (continued)

The table below analyses the assets and liabilities that are recognised in the statement of financial position into relevant maturity groupings, based on the remaining period at the reporting date to their contractual maturity date.

The Group	Less than 3 months	Between 3 months and 1 year	Between 1 and 5 years	More than 5 years	Other	Carrying amount
	€000	€000	€000	€000	€000	€000
At 31 December 2017						
Assets						
Balances with Central Bank of Malta, treasury bills and cash	4,503	-	-	-	155,181	**159,684**
Financial assets at fair value through profit or loss						
- Debt and other fixed income instruments	8,248	16,422	71,422	15,325	-	**111,417**
- Equity and other non-fixed income instruments	-	-	-	-	64,811	**64,811**
- Loans and advances	-	-	-	142,573	-	**142,573**
- Derivative financial instruments	6,889	472	87	42	-	**7,490**
Investments						
- Debt and other fixed income financial instruments						
- available-for-sale	-	-	48,635	90,693	-	**139,328**
- held-to-maturity	158,210	620,614	2,338,395	112,696	-	**3,229,915**
- Equity and other non-fixed income instruments						
- available-for-sale	-	-	-	-	5,298	**5,298**
Loans and advances to banks	3,411,769	12,001	-	-	7,613	**3,431,383**
Loans and advances to customers	538,307	44,084	365,246	3,214,395	-	**4,162,032**
Investments in equity-accounted investees	-	-	-	-	109,461	**109,461**
Other assets	-	-	-	-	257,238	**257,238**
	4,127,926	**693,593**	**2,823,785**	**3,575,724**	**599,602**	**11,820,630**
Liabilities and Equity						
Financial liabilities at fair value through profit or loss	4,035	1,682	3,223	3,017	-	**11,957**
Amounts owed to banks	154,544	37,652	-	-	-	**192,196**
Amounts owed to customers	8,857,595	957,285	285,745	-	-	**10,100,625**
Debt securities in issue	-	55,400	40,000	-	-	**95,400**
Other liabilities	-	-	-	-	214,721	**214,721**
Derivatives designated for hedge accounting	-	-	379	11,674	-	**12,053**
Subordinated liabilities	-	-	120,000	111,591	-	**231,591**
Equity holders of the Bank	-	-	-	-	962,087	**962,087**
	9,016,174	**1,052,019**	**449,347**	**126,282**	**1,176,808**	**11,820,630**

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.3 Liquidity risk (continued)

The Group At 30 September 2016	Less than 3 months €000	Between 3 months and 1 year €000	Between 1 and 5 years €000	More than 5 years €000	Other €000	Carrying amount €000
Assets						
Balances with Central Bank of Malta, treasury bills and cash	39,017	-	-	-	132,033	**171,050**
Financial assets at fair value through profit or loss						
- Debt and other fixed income instruments	9,924	26,424	124,890	24,777	-	**186,015**
- Equity and other non-fixed income instruments	-	-	-	-	79,734	**79,734**
- Loans and advances	-	-	-	121,316	-	**121,316**
- Derivative financial instruments	3,472	610	1,283	-	-	**5,365**
Investments						
- Debt and other fixed income financial instruments						
- available-for-sale	48,387	3,977	36,229	183,650	-	**272,243**
- held-to-maturity	171,798	562,940	2,533,287	192,421	-	**3,460,446**
- Equity and other non-fixed income instruments						
- available-for-sale	-	-	-	-	3,583	**3,583**
Loans and advances to banks	2,000,527	82,000	-	-	15,912	**2,098,439**
Loans and advances to customers	517,983	125,253	345,240	3,013,180	-	**4,001,656**
Investments in equity-accounted investees	-	-	-	-	97,041	**97,041**
Other assets	-	-	-	-	225,963	**225,963**
	2,791,108	**801,204**	**3,040,929**	**3,535,344**	**554,266**	**10,722,851**
Liabilities and Equity						
Financial liabilities at fair value through profit or loss	2,860	371	5,813	11,283	-	**20,327**
Amounts owed to banks	142,322	103,225	4,608	-	-	**250,155**
Amounts owed to customers	7,731,659	1,184,350	264,949	89	-	**9,181,047**
Debt securities in issue	-	-	95,400	-	-	**95,400**
Other liabilities	-	-	-	-	194,521	**194,521**
Derivatives designated for hedge accounting	-	-	616	20,033	-	**20,649**
Subordinated liabilities	-	-	120,000	111,591	-	**231,591**
Equity holders of the Bank	-	-	-	-	729,161	**729,161**
	7,876,841	1,287,946	491,386	142,996	923,682	**10,722,851**

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.3 Liquidity risk (continued)

The Bank

At 31 December 2017	Less than 3 months €000	Between 3 months and 1 year €000	Between 1 and 5 years €000	More than 5 years €000	Other €000	Carrying Amount €000
Assets						
Balances with Central Bank of Malta, treasury bills and cash	4,503	-	-	-	155,181	**159,684**
Financial assets at fair value through profit or loss						
- Debt and other fixed income instruments	8,248	16,422	71,422	15,325	-	**111,417**
- Equity and other non-fixed income instruments	-	-	-	-	63,836	**63,836**
- Loans and advances	-	-	-	142,573	-	**142,573**
- Derivative financial instruments	6,889	472	87	42	-	**7,490**
Investments						
- Debt and other fixed income financial instruments						
- available-for-sale	-	-	48,635	90,693	-	**139,328**
- held-to-maturity	158,210	620,614	2,338,395	112,696	-	**3,229,915**
- Equity and other non-fixed income instruments - available-for-sale	-	-	-	-	5,298	**5,298**
Loans and advances to banks	3,411,768	12,001	-	-	7,614	**3,431,383**
Loans and advances to customers	538,307	44,084	365,246	3,214,395	-	**4,162,032**
Investments in equity-accounted investees and subsidiaries	-	-	-	-	59,100	**59,100**
Other assets	-	-	-	-	255,258	**255,258**
	4,127,925	**693,593**	**2,823,785**	**3,575,724**	**546,287**	**11,767,314**
Liabilities and Equity						
Financial liabilities at fair value through profit or loss	4,035	1,682	3,223	3,017	-	**11,957**
Amounts owed to banks	154,543	37,653	-	-	-	**192,196**
Amounts owed to customers	8,859,134	957,285	285,745	-	-	**10,102,164**
Debt securities in issue	-	55,400	40,000	-	-	**95,400**
Other liabilities	-	-	-	-	213,905	**213,905**
Derivatives designated for hedge accounting	-	-	379	11,674	-	**12,053**
Subordinated liabilities	-	-	120,000	111,591	-	**231,591**
Equity holders of the Bank	-	-	-	-	908,048	**908,048**
	9,017,712	**1,052,020**	**449,347**	**126,282**	**1,121,953**	**11,767,314**

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.3 Liquidity risk (continued)

The Bank

At 30 September 2016	Less than 3 months €000	Between 3 months and 1 year €000	Between 1 and 5 years €000	More than 5 years €000	Other €000	Carrying amount €000
Assets						
Balances with Central Bank of Malta, treasury bills and cash	39,017	-	-	-	132,033	**171,050**
Financial assets at fair value through profit or loss						
- Debt and other fixed income instruments	9,924	26,424	124,890	24,777	-	**186,015**
- Equity and other non-fixed income instruments	-	-	-	-	78,596	**78,596**
- Loans and advances	-	-	-	121,316	-	**121,316**
- Derivative financial instruments	3,472	610	1,283	-	-	**5,365**
Investments						
- Debt and other fixed income financial instruments						
- available-for-sale	48,387	3,977	36,229	183,650	-	**272,243**
- held-to-maturity	171,798	562,940	2,533,287	192,421	-	**3,460,446**
- Equity and other non-fixed income instruments						
- available-for-sale	-	-	-	-	3,583	**3,583**
Loans and advances to banks	2,000,528	82,000	-	-	15,911	**2,098,439**
Loans and advances to customers	517,984	125,253	345,240	3,013,179	-	**4,001,656**
Investments in equity-accounted investees and subsidiaries	-	-	-	-	59,100	**59,100**
Other assets	-	-	-	-	224,482	**224,482**
	2,791,110	**801,204**	**3,040,929**	**3,535,343**	**513,705**	**10,682,291**
Liabilities and Equity						
Financial liabilities at fair value through profit or loss	2,860	371	5,813	11,283	-	**20,327**
Amounts owed to banks	142,321	103,226	4,608	-	-	**250,155**
Amounts owed to customers	7,735,082	1,184,350	264,949	89	-	**9,184,470**
Debt securities in issue	-	-	95,400	-	-	**95,400**
Other liabilities	-	-	-	-	193,923	**193,923**
Derivatives designated for hedge accounting	-	-	616	20,033	-	**20,649**
Subordinated liabilities	-	-	120,000	111,591	-	**231,591**
Equity holders of the Bank	-	-	-	-	685,776	**685,776**
	7,880,263	**1,287,947**	**491,386**	**142,996**	**879,699**	**10,682,291**

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.3 Liquidity risk (continued)

Banking Rule 07 transposing the provisions of the EBA Guidelines on Disclosures of Encumbered and Unencumbered Assets (EBA/GL/2014/03) requires disclosure on asset encumbrance. The Group is in compliance with the contents thereof.

This disclosure provides details of available and unrestricted assets that could be used to support potential future funding and collateral needs. An asset is considered as encumbered when it has been pledged as collateral against an existing liability, and as a result is no longer available to the Group to secure funding, satisfy collateral needs or be sold to reduce the funding requirement.

This disclosure is limited to assets available for Central Bank refinancing and securities that are transferable and is not designed to identify assets which would be available to meet the claims of creditors or to predict assets that would be available to creditors in the event of a resolution or bankruptcy.

Asset Encumbrance

	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
	€000	€000	€000	€000
The Group				
As at 31 December 2017				
Equity instruments	-	-	70,109	70,109
Debt securities	209,084	214,254	3,271,576	3,305,840
Loan and advances	-	-	7,835,019	-
Other assets	-	-	434,842	-
	209,084	**214,254**	**11,611,546**	**3,375,949**
The Group				
As at 30 September 2016				
Equity instruments	-	-	83,317	83,317
Debt securities	187,360	187,360	3,731,344	3,663,690
Loan and advances	-	-	6,309,190	-
Other assets	-	-	411,640	-
	187,360	**187,360**	**10,535,491**	**3,747,007**
The Bank				
As at 31 December 2017				
Equity instruments	-	-	69,134	69,134
Debt securities	209,084	214,254	3,271,576	3,305,840
Loan and advances	-	-	7,835,019	-
Other assets	-	-	382,501	-
	209,084	**214,254**	**11,558,230**	**3,374,974**
The Bank				
As at 30 September 2016				
Equity instruments	-	-	82,179	82,179
Debt securities	187,360	187,360	3,731,344	3,663,690
Loan and advances	-	-	6,309,190	-
Other assets	-	-	372,218	-
	187,360	**187,360**	**10,494,931**	**3,745,869**

The Group does not encumber any of the collateral received or any of its debt securities issued.

As at 31 December 2017 the Group and the Bank did not have any outstanding liabilities associated with encumbered assets and collateral received.

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.3 Liquidity risk (continued)

Asset Encumbrance (continued)

The Group and the Bank undertake the following types of encumbrance:

(i) Pledging of debt securities against the provision of credit lines by the Central Bank of Malta; and
(ii) Pledging of balances held with the Central Bank of Malta and debt securities in favour of the Depositor Compensation Scheme.

39.4 Market risk

Market Risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: interest rate risk, currency risk and other price risk. It arises in all areas of the Group's activities and is managed by a variety of different techniques as detailed below.

The objective of the Group is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with the Bank's status as a leading Bank in providing financial products and services.

The market risk appetite is articulated in the Treasury Management Policy. It is defined as the quantum and composition of market risk that the Bank is currently exposed to and the direction in which the Bank desires to manage this risk. Market risk is managed through limits set in the Treasury Management Policy. The Policy is reviewed by Treasury department in co-ordination with Risk Management department and is approved by the Asset and Liability Management Committee (ALCO) and the Board of Directors.

39.4.1 Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Group is exposed to fair value interest rate risk arising from financial assets and liabilities with fixed interest rates and to cash flow interest rate risk arising from financial assets and liabilities with floating interest rates. The Group is not directly exposed to interest rate risk on investment in equity instruments. The Group uses interest rate swaps to hedge the interest rate risk of certain financial instruments.

The Group manages this risk by using sensitivity analysis using modified duration and interest rate repricing gaps.

For financial instruments held or issued, the Group has used techniques that measure the change in the fair value and cash flows of the Group's financial instruments at the reporting date for hypothetical changes in the relevant market risk variables. The sensitivity due to changes in the relevant risk variables is set out below. The amounts generated from the analysis are forward-looking estimates of market risk assuming certain market conditions. Actual results in the future may differ materially from those projected results due to the inherent uncertainty of global financial markets. The sensitivity analyses are for illustrative purposes only, as in practice market rates rarely change in isolation and are likely to be interdependent.

The Bank makes use of a variety of measurement techniques including sensitivity analysis using Modified Duration and interest rate risks on economic value and interest margin.

(i) Modified Duration

The Modified Duration is a measure of the price sensitivity to yields. By calculating the Modified Duration, the Bank estimates the impact on Profit or Loss and Capital of changes in the market values of the securities in the treasury portfolio and of the interest rate swaps entered into to hedge the interest rate risk of the treasury portfolio, in response to a parallel shift in yields of 100 basis points. The Modified Duration does not represent a forecast of potential losses in the portfolio, but rather an analysis of how the market value of the treasury portfolio may change in response to a change in interest rates.

In addition, the Bank calculates the Modified Duration on the unhedged fixed securities which are marked to market by major currencies.

As with most financial management tools, Modified Duration also has its limitations. The market value of a bond is dependent on many variables apart from the duration calculation and rarely correlates perfectly with the duration number. With rates not moving in parallel shifts and the yield curve constantly changing, duration can be used to determine how the market values of bonds may (but not necessarily will) react.

	2017	2016
The Group	**€000**	**€000**
Modified Duration		
Impact on Profit or Loss	(578)	(1,809)
Impact on Capital	(3,656)	(10,613)

The nominal amount of floating rate notes as at 31 December 2017 is €2,130.9 million (Sep 2016: €2,590.4 million).

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.4 Market risk (continued)

39.4.1 Interest rate risk (continued)

(ii) Interest rate repricing gap

The table below summarises the Group's exposure to interest rate risk. Included in the table are Group assets and liabilities, including derivative financial instruments which are principally used to reduce exposure to interest rate risk, categorised by repricing date.

The Group's assets and liabilities are set to reprice as follows:

	Up to 1 Month €000	3 months or less but over 1 month €000	1 year or less but over 3 months €000	Over 1 year €000	Others €000	Total €000
ASSETS						
Balances with Central Bank of Malta, treasury bills and cash	101,032	2,502	-	-	56,150	**159,684**
Financial assets at fair value through profit or loss						
- Debt and other fixed income instruments	11,928	25,002	9,038	64,011	1,438	**111,417**
- Equity and other non- fixed income instruments	-	-	-	-	64,811	**64,811**
- Loans and advances	142,573	-	-	-	-	**142,573**
- Derivative financial instruments	-	-	42	-	7,448	**7,490**
Investments						
- Debt and other fixed income financial instruments						
- available-for-sale	-	-	-	139,328	-	**139,328**
- held-to-maturity	579,516	1,312,019	362,171	976,209	-	**3,229,915**
- Equity and other non-fixed income instruments						
- available-for-sale	-	-	-	-	5,298	**5,298**
Loans and advances to banks	3,065,869	2,817	12,001	-	350,696	**3,431,383**
Loans and advances to customers	4,015,638	574	15,612	130,208	-	**4,162,032**
Investments in equity-accounted investees	-	-	-	-	109,461	**109,461**
Other assets	-	-	-	-	257,238	**257,238**
Total 2017	**7,916,556**	**1,342,914**	**398,864**	**1,309,756**	**852,540**	**11,820,630**
Total 2016	6,558,550	1,915,942	412,470	1,184,407	651,482	10,722,851
LIABILITIES and EQUITY						
Financial liabilities at fair value through profit or loss	936	2,114	4,312	-	4,595	**11,957**
Amounts owed to banks	79,259	40,474	-	-	72,463	**192,196**
Amounts owed to customers	5,857,128	246,927	948,359	294,686	2,753,525	**10,100,625**
Debt securities in issue	-	-	55,400	40,000	-	**95,400**
Other liabilities	-	-	-	-	214,721	**214,721**
Derivatives designated for hedge accounting	-	379	11,674	-	-	**12,053**
Subordinated liabilities	-	-	-	231,591	-	**231,591**
Equity holders of the Bank	-	-	-	-	962,087	**962,087**
Total 2017	**5,937,323**	**289,894**	**1,019,745**	**566,277**	**4,007,391**	**11,820,630**
Total 2016	4,995,655	464,369	1,181,766	617,595	3,463,466	10,722,851
Interest rate swaps - 2017	**77,564**	**71,830**	**134,043**	**(283,437)**	-	
Interest rate swaps - 2016	91,548	188,167	35,678	(315,394)	-	
Gap - 2017	**2,056,797**	**1,124,850**	**(486,838)**	**460,042**	**-**	
Gap - 2016	1,654,849	1,637,542	(756,037)	254,794	-	
Cumulative Gap - 2017	**2,056,797**	**3,181,647**	**2,694,809**	**3,154,851**	**-**	
Cumulative Gap - 2016	1,654,849	3,292,391	2,536,354	2,791,148	-	

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.4 Market risk (continued)

39.4.2 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, which levels are monitored daily.

The following table summarises the Group's exposure to foreign currency exchange rate risk at the reporting date. Included in the table are the Group's assets and liabilities at carrying amounts, analysed into relevant currency groupings.

The Group 31 December 2017	EUR €000	USD €000	GBP €000	AUD €000	Other Currencies €000	Total €000
Assets						
Balances with Central Bank of Malta, treasury bills and cash	157,059	1,089	933	86	517	**159,684**
Financial assets at fair value through profit or loss						
- Debt and other fixed income instruments	92,132	17,581	40	1,663	3	**111,419**
- Equity and other non-fixed income instruments	59,595	744	2,592	-	1,878	**64,809**
- Loans and advances	142,573	-	-	-	-	**142,573**
- Derivative financial instruments	42	5,097	304	2,011	36	**7,490**
Investments						
- available-for-sale	66,079	73,249	-	-	-	**139,328**
- held-to-maturity	2,037,921	697,554	231,473	184,414	78,553	**3,229,915**
- Equity and other non-fixed income instruments						
- available-for-sale	-	5,298	-	-	-	**5,298**
Loans and advances to banks	3,040,077	89,554	90,147	19,336	192,269	**3,431,383**
Loans and advances to customers	4,104,307	38,036	18,726	-	963	**4,162,032**
Other assets	363,092	2,154	614	730	109	**366,699**
	10,062,877	**930,356**	**344,829**	**208,240**	**274,328**	**11,820,630**
Liabilities and Equity						
Financial liabilities at fair value through profit or loss	6,976	3,099	526	637	719	**11,957**
Amounts owed to banks	50,897	126,224	7,919	1,660	5,496	**192,196**
Amounts owed to customers	8,742,634	744,239	330,133	61,528	222,091	**10,100,625**
Debt securities in issue	95,400	-	-	-	-	**95,400**
Other liabilities	198,467	9,113	4,130	1,392	1,619	**214,721**
Derivatives designated for hedge accounting	380	11,761	(64)	(24)	-	**12,053**
Subordinated liabilities	231,591	-	-	-	-	**231,591**
Equity	965,761	(4,094)	21,667	736	(21,983)	**962,087**
	10,292,106	**890,342**	**364,311**	**65,929**	**207,942**	**11,820,630**

	USD	GBP	AUD	Other Currencies
Net on balance sheet financial position	40,014	(19,482)	142,311	66,386
Notional amount of derivative instruments	(42,667)	(497)	(141,198)	(43,230)
Net open position	(2,653)	(19,979)	1,113	23,156

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.4 Market risk (continued)

39.4.2 Currency risk (continued)

The Group 30 September 2016	EUR €000	USD €000	GBP €000	AUD €000	Other Currencies €000	Total €000
Assets						
Balances with Central Bank of Malta, treasury bills and cash	168,063	663	971	851	502	**171,050**
Financial assets at fair value through profit or loss						
- Debt and other fixed income instruments	146,312	30,172	3,625	5,903	3	**186,015**
- Equity and other non-fixed income instruments	67,640	4,860	3,090	-	4,144	**79,734**
Loans and advances	121,316	-	-	-	-	**121,316**
- Derivative financial instruments	676	1,707	2,140	370	472	**5,365**
- Investments						
- available-for-sale	181,385	89,784	772	302	-	**272,243**
- held-to-maturity	1,916,235	1,004,014	243,621	186,601	109,975	**3,460,446**
- Equity and other non-fixed income instruments						
- available-for-sale	-	3,583	-	-	-	**3,583**
Loans and advances to banks	1,839,274	83,533	87,787	8,435	79,410	**2,098,439**
Loans and advances to customers	3,940,654	31,179	28,753	-	1,070	**4,001,656**
Other assets	316,059	3,771	1,651	1,031	492	**323,004**
	8,697,614	**1,253,266**	**372,410**	**203,493**	**196,068**	**10,722,851**
Liabilities and Equity						
Financial liabilities at fair value through profit or loss	16,595	1,677	1,572	427	56	**20,327**
Amounts owed to banks	95,466	143,723	5,978	1,534	3,454	**250,155**
Amounts owed to customers	7,776,994	864,603	328,029	75,648	135,773	**9,181,047**
Debt securities in issue	95,400	-	-	-	-	**95,400**
Other liabilities	181,654	8,039	996	1,045	2,787	**194,521**
Derivatives designated for hedge accounting	616	20,131	(73)	(25)	-	**20,649**
Subordinated liabilities	231,591	-	-	-	-	**231,591**
Equity	702,831	22,323	11,017	14,549	(21,559)	**729,161**
	9,101,147	**1,060,496**	**347,519**	**93,178**	**120,511**	**10,722,851**

	USD	GBP	AUD	Other Currencies
Net on balance sheet financial position	192,770	24,891	110,315	75,557
Notional amount of derivative instruments	(216,983)	(31,032)	(125,136)	(52,944)
Net open position	(24,213)	(6,141)	(14,821)	22,613

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.4 Market risk (continued)

39.4.3 Other price risk

Other price risk 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.

The Group is exposed to equity price risks arising from the holding of equity instruments classified either as available for sale or at fair value through profit or loss.

The carrying amounts of financial instruments at the reporting date which could potentially subject the Group to equity price risk are disclosed in the notes to the financial statements.

This risk is monitored and managed by the Risk management function of the Bank, as disclosed in more detail above.

39.5 Transferred financial assets that are not derecognised in their entirety

	The Group and the Bank	
	2017	**2016**
	€000	**€000**
Debt securities classified as		
- held-to-maturity	37,655	103,226
Amounts owed to banks	37,655	103,226

These transactions are covered by the TBMA/ISMA Global Repurchase Master Agreement ("the Agreement") and involve the sale of financial assets with a simultaneous agreement to repurchase them at a pre-determined price at a future date. The securities sold comprise financial assets at fair value through profit and loss and investment securities. The counterparty's liability is included in amounts owed to banks. The Group and the Bank continue to recognise the transferred assets since all the risks and rewards of the assets will be substantially retained in a manner that does not result in the transferred assets being derecognised for accounting purposes.

Each party to a transaction is subject to the events of default listed in the Agreement. In the event that any of the events of default is/are triggered, transactions are immediately terminated. Consequently, performance of the respective obligations of the parties with respect to the delivery of securities, the payment of the repurchase prices for any equivalent securities and the repayment of any cash margin shall become due and payable.

39.6 Fair value of financial instruments

The Group's accounting policy for determining the fair value of financial instruments is described in notes 1.3, 1.19 and 1.24 to these Financial Statements.

For financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly. This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.
- Level 3 inputs are unobservable inputs for the asset or liability. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instruments' valuation. This category includes instruments that are valued based on quoted prices for similar instruments' for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

For assets and liabilities that are recognised in the financial statements at fair value on a recurring basis, the Group and the Bank determine when transfers are deemed to have occurred between Levels in the hierarchy at the end of each reporting period.

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.6 Fair value of financial instruments (continued)

Bases of valuing financial assets and liabilities measured at fair value

	Fair value measurement			
	Level 1 €000	**Level 2 €000**	**Level 3 €000**	**Total €000**
The Group				
At 31 December 2017				
Assets				
Financial assets at fair value through profit or loss				
- debt and other fixed income instruments	99,015	12,402	-	111,417
- equity and other non-fixed income instruments	36,501	23,193	5,117	64,811
- loans and advances	-	142,573	-	142,573
- derivative financial instruments	-	7,490	-	7,490
Investments				
Debt and other fixed income instruments				
- available-for-sale	66,079	73,249	-	139,328
Equity and other non-fixed income instruments				
- available-for-sale	-	-	5,298	5,298
	201,595	**258,907**	**10,415**	**470,917**
Liabilities				
Financial liabilities at fair value through profit or loss	-	11,957	-	11,957
Derivatives designated for hedge accouting	-	12,053	-	12,053
	-	**24,010**	**-**	**24,010**
The Group				
At 30 September 2016				
Assets				
Financial assets at fair value through profit or loss				
- debt and other fixed income instruments	173,065	12,950	-	186,015
- equity and other non-fixed income instruments	50,294	23,762	5,678	79,734
- loans and advances	-	121,316	-	121,316
- derivative financial instruments	-	5,365	-	5,365
Investments				
Debt and other fixed income instruments				
- available-for-sale	179,461	92,782	-	272,243
Equity and other non-fixed income instruments				
- available-for-sale	-	-	3,583	3,583
	402,820	**256,175**	**9,261**	**668,256**
Liabilities				
Financial liabilities at fair value through profit or loss	-	20,327	-	20,327
Derivatives designated for hedge accounting	-	20,649	-	20,649
	-	**40,976**	**-**	**40,976**

During the period under review financial assets at fair value through profit or loss amounting to €0.8 million were transferred from Level 2 to Level 1 (2016: Level 1 to level 2 €14.1 million and Level 3 to Level 2 €1.1 million). The transfer from Level 1 to Level 2 was due to securities which had observable inputs as at the same date. During the same period no change in levels was made in financial assets classified as available-for-sale.

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.6 Fair value of financial instruments (continued)

Control Framework

Fair values are subject to a control framework designed to ensure that they are either determined or validated by a function independent of the risk taker and that they are appropriately performed and reviewed by competent personnel. To this end, the determination of fair values is a process which is performed by Financial Markets and Investments and reviewed by Finance. Finance establishes the accounting policies and, in conjunction with Financial Markets and Investments, it establishes the procedures governing valuation, and is responsible for ensuring that they comply with all relevant accounting standards. The valuation techniques and procedures applied are subject to a process of due diligence, which process was duly approved by the Board and the Audit Committee and documented accordingly.

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to valuation techniques, independent price determination or validation is utilised, to the extent practicable. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, the Bank sources alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable. The factors which are mainly considered are the following:

- the extent to which prices may be expected to represent genuine traded or tradable prices
- the degree of similarity between financial instruments
- the degree of consistency between different sources
- the process followed by the pricing provider to derive the data
- the elapsed time between the date to which the market data relates and the end of the reporting period;
- the manner in which the data was sourced.

In determining the fair values for financial instruments measured at fair value the credit risk adjustment for the counterparty, the Bank or both, as the case may be, is deemed to be immaterial and hence no adjustment to the fair value of financial instruments at fair value through profit or loss was effected.

The Group calculates the credit risk adjustment by applying the probability of default of the counterparty to the expected positive exposure to the counterparty, and multiplying the result by the loss expected in the event of default. The calculation is performed over the life of the potential exposure.

Financial instruments at fair value through profit or loss and financial assets which are held for investment purposes as available-for-sale are carried at their fair value.

(i) Investments - Debt and other fixed income instruments held to maturity
This category of asset is carried at amortised cost. Their fair value is disclosed separately in the respective note to the financial statements.

(ii) Loans and advances to customers
Loans and advances to customers are the largest financial asset held by the Group, and are reported net of allowances to reflect the estimated recoverable amounts. The carrying amount of loans and advances to customers is a reasonable approximation of fair value because these are re-priced to take into account changes in both benchmark rate and credit spreads. Their fair value measurement is a Level 2 input.

(iii) Loans and advances to banks, balances with Central Bank and Treasury Bills
The majority of these assets reprice or mature in less than 1 year. Hence their fair value is not deemed to differ materially from their carrying amount at the respective reporting dates.

(iv) Amounts owed to banks and customers
These liabilities are carried at amortised cost. The majority of these liabilities reprice or mature in less than 1 year. Hence their fair value is not deemed to differ materially from their carrying amount at the respective reporting dates. Their fair value measurement is a Level 2 input.

(v) Debt securities in issue and subordinated liabilities
These liabilities are carried at amortised cost. Their fair value is disclosed separately in the respective notes to the financial statements.

(vi) Other financial liabilities
The fair value of other financial liabilities is not deemed to differ materially from their carrying amount at the respective reporting dates.

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.6 Fair value of financial instruments (continued)

Bases of valuing financial assets and liabilities not measured at fair value

The following table provides an analysis of financial instruments that are not measured at fair value subsequent to initial recognition:

	Fair value measurement				Carrying
	Level 1 €000	Level 2 €000	Level 3 €000	Total €000	Amount €000
2017					
Financial assets					
Held-to-maturity investments	2,643,695	625,651	-	3,269,346	3,229,915
Financial liabilities					
Debt securities in issue	97,454	-	-	97,454	95,400
Subordinated liabilities	235,328	-	-	235,328	231,591
	332,782	-	-	332,782	326,991

	Fair value measurement				Carrying
	Level 1 €000	Level 2 €000	Level 3 €000	Total €000	Amount €000
2016					
Financial assets					
Held-to-maturity investments	2,857,554	653,881	-	3,511,435	3,460,446
Financial liabilities					
Debt securities in issue	99,000	-	-	99,000	95,400
Subordinated liabilities	235,500	-	-	235,500	231,591
	334,500	-	-	334,500	326,991

The reconciliation of Level 3 fair value measurements of financial instruments is disclosed below.

	Fair value through profit or loss		Available-for-sale investments		
	Debt and other fixed income instruments €000	Equity and other non-fixed income instruments €000	Debt and other fixed income instruments €000	Equity and other non-fixed income instruments €000	Total €000
2017					
Opening balance	-	5,678	-	3,583	9,261
- in profit or loss	-	(7)	-	1,715	1,708
Purchases	-	3,088	-	-	3,088
Sales	-	(3,642)	-	-	(3,642)
Closing balance	-	5,117	-	5,298	10,415

	Fair value through profit or loss		Available-for-sale investments		
	Debt and other fixed income instruments €000	Equity and other non-fixed income instruments €000	Debt and other fixed income instruments €000	Equity and other non-fixed income instruments €000	Total €000
2016					
Opening balance	-	5,319	-	-	5,319
- in profit or loss					
Purchases	-	(12)	-	-	(12)
Transfers	-	1,550	-	-	1,550
Sales	-	(1,104)	-	-	(1,104)
Consideration	-	(75)	-	-	(75)
Closing balance	-	-	-	3,583	3,583
	-	5,678	-	3,583	9,261

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.6 Fair value of financial instruments (continued)

The unrealised gains/losses as of 31 December 2017 and 30 September 2016 were immaterial.

Consideration in Equity and other non-fixed income instruments refer to preferred stock in Visa Inc. convertible into ordinary shares.

The instruments classified within Level 3 comprise externally managed funds. Approximately 50% of the carrying amount represents funds with underlying investments which mainly comprise properties with the remaining 50% representing a European fund which invests in projects related to energy, climate change and infrastructure having 65% of its assets focused on new projects, with the remaining 35% focused on replacement, modernisation and capacity enhancement. The Bank has determined that the reported net asset value of these funds represents their fair value at the end of the reporting period. For one of the property funds, the Bank has adjusted the reported net asset value to take cognisance of factors which resulted in a lower fair value for the fund; in respect of another property fund, the fair value of the Bank's interest was determined to be nil in view of the fact that the value of the Fund's reported liabilities approximated the value of its reported assets. The net asset value of these funds was determined using statements or other information provided by the fund managers. The Bank considers that such valuations may rely significantly on the judgments and estimates made by the fund managers and given the level of subjectivity involved, these are included within level 3.

39.7 Capital risk management

The Group's capital management approach ensures a sufficient level of capitalisation to manage the risk exposures whilst supporting business growth and providing adequate returns to the shareholders. Risk capital management does not in any way substitute risk mitigation measures. It is vital that the structure of limits and thresholds should be able to prevent concentrations of risk from building up in such a way as to compromise a significant proportion of the Group's capital resources.

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 Group has made the necessary changes in order to ensure that it is compliant with the Pillar I capital requirements set by the CRR. Other material risks are also allocated capital as part of the Internal Capital Adequacy Assessment Process (ICAAP) embedded in the Pillar II process. This process helps to measure with greater risk sensitivity the amount of regulatory capital which the Group requires to cover risks assumed in the course of its business, including risks not covered in Pillar I. The Board submitted the latest ICAAP capital document to the JST in April 2017.

Capital management is under the direct control of the Asset and Liability Committee (ALCO). During the financial year, ALCO has monitored the adequacy of the Group's capital and gave strategic direction on the most efficient use of capital.

During the period under review and during the comparative period, there were no reported breaches in respect of the externally imposed capital requirements. The Group uses the Standardised Approach for credit risk, the Basic Indicator Approach for operational risk and the Base Method with respect to the Group's foreign exchange risk in line with CRR requirements.

The following table shows the components and basis of calculation of the Group's and the Bank's own funds.

	The Group €000	The Bank €000
Own funds		
Tier 1		
- Paid up capital instruments	525,000	525,000
- Share premium	45,427	45,427
- Retained earnings*	245,861	248,526
- Accumulated other comprehensive income	3,931	3,850
- Other reserves	29,263	29,232
- Funds for general banking risk	4,713	4,713
- Deductions:		
Other intangible assets	(28,453)	(28,453)
Other transitional adjustments	(6,639)	(6,617)
Additional adjustments due to Article 3 CRR	(44,634)	(44,634)
Total Tier 1 Capital	774,469	777,044

**Retained earnings include current period profit which is subject to regulatory approval.*

Notes to the financial statements 31 December 2017 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.7 Capital risk management (continued)

	The Group €000	The Bank €000
Tier 2		
- Capital instruments and subordinated loans	157,016	157,016
Total Own Funds	931,485	934,060

Further information on the Group's and the Bank's capital adequacy ratios may be found in section 3.2 in the Capital and Risk Management report, which are subject to internal verification as set out in paragraph 1.1 of that report.

39.8 Offsetting financial assets and financial liabilities

The derivative financial assets with a positive carrying amount and the derivative financial liabilities with a negative carrying amount do not meet the offsetting criteria in IAS 32 and hence they are presented separately in the Statement of Financial Position. These instruments are subject to the ISDA Master Agreement. The ISDA Master Agreement provides, amongst others, for the netting of termination values for purposes of determining a single lump-sum termination amount upon the insolvency of a counterparty. By virtue of the Set-off and Netting on Insolvency Act, 2003 (Chapter 459, Laws of Malta), the close-out netting provisions contained in the ISDA Master Agreement are valid and enforceable under Maltese law. The set-off provisions under the ISDA Master Agreement can be triggered where an event of default, credit event upon merger or any termination event has been declared.

The Bank also has in place credit support annexes "CSAs" with a number of its financial counterparties for purposes of the collateralisation of exposures between the Bank and its counterparties. The CSA is a schedule to the ISDA Master Agreement. By virtue of such CSAs, a party to a derivative that has an exposure to its counterpart, will post collateral to its counterpart to cover such exposure by way of an outright title transfer of such collateral. All CSAs that the Bank has in place are of a two-way nature.

In the case of non-financial counterparties, the Bank enters into pledging collateral arrangements with the counterparties, in favour of the Bank. Such pledging agreements are of a one-way nature, in favour of the Bank.

	The Group	
	2017 €000	2016 €000
Derivative financial assets		
Gross amounts of recognised financial assets	7,490	5,365
Net amounts of financial assets presented in the statement of financial position	7,490	5,365
Related amounts not set off in the statement of financial position:		
Financial instruments	(7,490)	(5,365)
Net amount	-	-

Financial liabilities subject to offsetting, enforcable master netting arrangements and similar agreements

	2017 €000	2016 €000
Derivative financial liabilities		
Gross amounts of recognised financial liabilities	24,010	40,976
Net amounts of financial liabilities presented in the statement of financial position	24,010	40,976
Related amounts not set off in the statement of financial position:		
Financial instruments	(7,490)	(5,365)
Financial collateral pledged	(27,325)	(40,380)
Net amount	(10,805)	(4,769)

40. ASSETS HELD FOR REALISATION

The assets held for realisation mainly comprise immovable properties that were held as collateral for outstanding loans, which properties were taken into the possession of the Bank following defaults by the counterparty. The Bank's policy is to dispose of such assets within a reasonable timeframe from the date of classification, unless events or circumstances which are beyond the Bank's control extend the period to complete the sale. Such assets meet the criteria for classification as non-current assets held for sale in accordance with IFRS 5. Assets not disposed of during the reasonable timeframe are reclassified to PPE.

During the period ended 31 December 2017, €7.5m in Assets held for realisation were reclassified to Property and equipment.

Notes to the financial statements 31 December 2017 (continued)

41. TRUST ACTIVITIES

The Group acts as trustee and provides trust activities that result in the holding and placing of assets on behalf of third parties. Trust assets are not assets of the Group and therefore they are not included in its Statement of Financial Position.

Income derived from trust assets is excluded from revenue. Fees arising from the rendering of trustee services are recognised in the Group's profit or loss.

At 31 December 2017, the total assets held by the Group on behalf of its customers amounted to €173.8 million (2016: €267.0 million).

Details on significant claims related to trusts are given in Note 33.

42. REGULATORY COMPENSATION SCHEMES

As at 31 December 2017, no balances with Central Bank of Malta have been pledged in favour of the Depositor Compensation Scheme (refer to note 16).

In accordance with the provisions of the Investor Compensation Scheme Regulations, 2003, issued under the Investment Services Act, 1994, licence holders are required to transfer a variable contribution to an Investor Compensation Scheme Reserve and place the equivalent amount with a bank, pledged in favour of the Scheme. Alternatively licence holders can elect to pay the amount of variable contribution directly to the Scheme.

Bank of Valletta p.l.c. has elected to pay the amount of the variable contribution directly to the Scheme.

Regulatory contributions amounting to €8.3 million (2016: €4.6 million), included with administrative expenses, reflect the Group's annual obligations arising from the recent EU Directives on Deposit Guarantee Scheme and Single Resolution Fund.

43. REGISTERED OFFICE

The registered and principal office of the Bank is 58, Zachary Street, Valletta VLT1130, Malta.

Independent auditors' report to the Shareholders of Bank of Valletta p.l.c.

1 Report on the Audit of the Financial Statements

Opinion

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

In our opinion, the accompanying financial statements:

(a) give a true and fair view of the financial position of the Bank and the Group as at 31 December 2017, and of their financial performance and their cash flows for the period then ended in accordance with International Financial Reporting Standards ("IFRS") as adopted by the EU; and

(b) have been properly prepared in accordance with the provisions of the Companies Act, 1995 (Chapter 386, Laws of Malta) (the "Act") and the Banking Act, 1994 (Chapter 371, Laws of Malta) (the "Banking Act") and, additionally, specifically in relation to those of the Group, with the requirements of article 4 of the Regulation on the application of IFRS as adopted by the EU.

Basis for opinion

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

Key audit matters

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

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

Impairment of loans and advances to corporate customers

Accounting policy notes 1.3.3 and 1.24.1 to the financial statements and notes 8, 17and 39.2 for further disclosures.

Loans and advances to corporate clients (Bank and Group: €2,333 million) included within the loans and advances to customers at amortised cost caption

The Bank's corporate portfolio is inherently more complex than its retail portfolio and therefore poses a more difficult task for the directors to identify an impairment and the extent to which a loss should be recognised.

A loan or an advance to a corporate customer may be impaired and impairment losses (also referred to as 'impairment allowances' in the financial statements) are incurred by the Bank on the occurrence of a loss event that impacts the estimated future cash flows of that loan or advance. The Bank's process of determining (a) whether a loss event has occurred; and (b) the magnitude of the impairment loss incurred, involves significant judgment.

Our response

We have tested the design, implementation and operating effectiveness of controls established by the Bank in determining specific impairment calculations for the corporate loans and advances portfolio. These included:

- the controls over the sanctioning of facilities within established authorisation limits in accordance with the Bank's credit policy;
- the automated control over downgrade of loan credit ratings upon delinquency;
- the monitoring control performed related to delinquent facilities maintained across the Bank; and
- the quarterly review of specific impairment losses recognized, performed by the Bank's provisions' committee.

Independent auditors' report to the Shareholders of Bank of Valletta p.l.c. (continued)

We performed detailed credit reviews for a sample of exposures selected qualitatively on the basis of risk. In performing these reviews, we:

— considered relevant internal information available used in the Bank's assessment and, where available, external data in relation to those exposures;
— evaluated whether those exposures were graded in line with the Bank's credit policy;
— specifically in relation to impaired exposures, assessed impairment calculations by evaluating the appropriateness of provisioning methodologies and policies, and, where applicable, evaluated the Bank's extendible value of collateral by reference to specific external data sources, where relevant; and
— evaluated the appropriateness of key assumptions used by the Bank's provisions committee in determining the need for additional provisions in the case of outliers.

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

Significant claims

Accounting policy notes 1.14 and 1.24.7 to the financial statements and note 33 for further disclosures.

Significant claims disclosure included within the contingent liabilities and significant claims note

The Bank is exposed to various litigation and claims, some of which may potentially have a material impact on the financial statements as a whole, and which are subject to varying degrees of complexity. More specifically, the directors have assessed the potential financial impact of significant claims disclosed in Note 33.

The significant judgement involved is in determining whether an obligation is a present obligation or a possible one. That assessment determines whether such obligation is recognised as a provision (on the face of the statement of financial position) or as a contingent liability (disclosed in notes to the financial statements). The directors base their judgement on advice obtained from in-house and/or external legal counsel.

When a liability is not recognised for a possible significant outflow, but there is more than a remote likelihood of an adverse outcome, the related disclosure is key to understanding the risks and potential effects on the Group and the Bank.

Our response

We inspected the Bank's litigations and claims report together with relevant legal documentation for significant claims as disclosed in Note 33.

We considered the assessment made by the Bank's internal legal counsel, the CEO, Chief Officer Finance, Chief Risk Officer and the Chairman of the Board on the (i) status of such claims as well the (ii) action being taken by the Bank in relation to those claims.

Specifically for the significant claims disclosed in Note 33, we were directly provided with written opinions by and held discussions with the Bank's external legal counsel, and evaluated their conclusion. Additionally, we independently assessed the estimated values of the provisions based on our enquiries of legal counsel.

Based on these procedures we evaluated the Bank's view on the absence of a present obligation that would otherwise call for a provision in the financial statements.

We assessed whether disclosures, in relation to the significant claims adequately disclose the potential liabilities and the significant uncertainties that exist.

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

IT Access Controls

Section 8.3 of the Capital and risk management report contained in the Annual Report (unaudited).

Information security risk disclosures included within the Capital and risk management report

A significant component of the General IT Controls environment is access controls. More specifically, ensuring authorised access to the Bank's applications, operating systems and data in financial reporting processes is appropriate.

The conduct of security reviews on systems that provide assurance on an on-going basis on the user access configuration and systems security is being addressed by the Bank concurrently with other projects. The Bank's risk management function is performing reviews and looking at the risk register and policies but is still embedding its information security and user access reviews.

The above reviews may be impacted, at the present time, as resources are engaged in its core banking transformation programme,

Independent auditors' report to the Shareholders of Bank of Valletta p.l.c. (continued)

the implementation of system changes in view of a new accounting standard, and numerous other projects that are imperative to meet current operational and regulatory requirements.

As part of our audit strategy, we place reliance on a number of IT systems supporting the Bank's operations. However, our ability to rely on fully or partially automated controls becomes impaired when deficiencies in access controls over these systems are not mitigated.

Our response

We tested the design, implementation and operating effectiveness of the following access controls for the systems relied upon for financial reporting:

- creation, modification and revocation of user access rights;
- systems administrator rights;
- adherence to the Bank's password complexity policy; and
- access to migrate application development.

Where the above tests were inconclusive, we conducted an additional retrospective review, to evaluate whether:

- system access assigned to terminated employees was used prior to access rights being revoked; and
- generic elevated system privileges were used by unauthorised personnel.

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

Other matter – scope of our audit: disclosure of IFRS 9 effect

The Group is adopting IFRS 9 Financial Instruments from 1 January 2018 and has included an estimate of the financial impact of the change in accounting standard in accordance with IAS 8 Changes in Accounting Estimates and Errors as set out in note 1.1.11.5. This disclosure notes that the estimate has been prepared under an interim control environment with models that continue to undergo validation. While further testing of the financial impact will be performed as part of our 2018 year-end audit, we have performed sufficient audit procedures for the purposes of assessing the disclosures made in accordance with IAS 8. Specifically we have:

- Considered the appropriateness of key technical decisions, judgements, assumptions and elections made in determining the estimate;
- Considered key classification and measurement decisions, including business model assessments and solely payment of principal and interest outcomes;
- Involved credit risk modelling and economics specialists in the consideration of credit risk modelling decisions and macroeconomic variables, including forward economic guidance and generation of multiple economic scenarios, for a sample of models used in determining the estimate; and
- Considered interim controls and governance processes related to the calculation and approval of the estimated transitional impact.

Other information

The directors are responsible for the other information which comprises:

- the Contents and General information;
- the Board of Directors & Group Company Secretary;
- the Chairman's Statement;
- the CEO Review;
- the Corporate Responsibility;
- the Directors' report;
- the Capital and risk management report;
- the Corporate governance statement of compliance;
- the Remuneration report;
- the Nominations report;
- the Group's five year summary; and
- the Group Financial Highlights in US dollars,

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

Our opinion on the financial statements does not cover the other information and, other than in the case of the Directors' Report on which we report separately below in our 'Opinion on the Directors' Report', we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information, and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Independent auditors' report to the Shareholders of Bank of Valletta p.l.c. (continued)

Responsibilities of the directors for the financial statements

The directors are responsible for the preparation of financial statements that (a) give a true and fair view in accordance with IFRS as adopted by the EU, and (b) are properly prepared in accordance with the provisions of the Act and the Banking Act, and, additionally, specifically in relation to those of the Group, with the requirements of article 4 of the Regulation on the application of IFRS as adopted by the EU. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

The directors are responsible for overseeing the financial reporting process.

Auditors' responsibilities for the audit of the financial statements

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

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

We also:

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

- Consider the extent of compliance with those laws and regulations that directly affect the financial statements, as part of our procedures on the related financial statement items. For the remaining laws and regulations, we make enquiries of directors and other management, and inspect correspondence with the regulatory authority, as well as legal correspondence. As with fraud, there remains a higher risk of non-detection of other irregularities (whether or not these relate to an area of law directly related to the financial statements), as these may likewise involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's and the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's and the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Company and/or the Group to cease to continue as a going concern.

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

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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

Independent auditors' report to the Shareholders of Bank of Valletta p.l.c. (continued)

Auditors' responsibilities for the audit of the financial statements (continued)

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

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

2 Opinion on the Directors' Report

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

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

Pursuant to article 179(3) of the Act, other than for the non-financial information that is exclusively required to be disclosed by paragraph 8 of the Sixth Schedule of the Act with respect to the Bank, and paragraph 11 of that Schedule with respect to the Group (and on which we report separately below in our 'Report on Other Legal and Regulatory Requirements'), we are also required to:

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

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

In such regards:

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

Independent auditors' report to the Shareholders of Bank of Valletta p.l.c. (continued)

3 Report on Other Legal and Regulatory Requirements

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

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

- we were first appointed as auditors by the shareholders on 19 June 2015, and subsequently reappointed at the Company's general meetings for each financial period thereafter. The period of total uninterrupted engagement is three financial periods;
- our opinion on our audit of the financial statements is consistent with the additional report to the audit committee required to be issued by the Audit Regulation (as referred to in the Act); and
- we have not provided any of the prohibited services as set out in the APA.

Matters on which we are required to report by the Act, specific to large undertakings which are public-interest entities and public-interest entities which are parent undertakings of a large group that (individually and on a consolidated basis, respectively) exceed the criterion of an average number of five hundred employees during the financial year

Pursuant to article 179(3) of the Act, we report as under matters not already reported upon in our 'Opinion on the Directors' Report:

The Directors' Report contains the information required by paragraph 8 of the Sixth Schedule, with respect to the Bank and paragraph 11 of that Schedule with respect to the Group.

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

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

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

Furthermore, we have nothing to report in respect of the above matters, where the Act requires us to report to you by exception pursuant to articles 179 (10) and (11).

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

The Principals authorised to sign on behalf of KPMG on the audit resulting in this independent auditors' report are Noel Mizzi and Jonathan Bingham.

Noel Mizzi
Partner, for and on behalf of
KPMG
Registered Auditors,
Portico Building,
Marina Street,
Pietà PTA 9044,
Malta

Jonathan Bingham
Partner, for and on behalf of
KPMG LLP
Chartered Accountants,
15 Canada Square,
Canary Wharf,
London E14 5GL,
United Kingdom

23 March 2018

The Group's five year summary - extracted from the respective audited financial statements

A. STATEMENTS OF PROFIT OR LOSS

For the financials years

	2017* 15 months to Dec 2017 €000	2016 12 months to Sep 2016 €000	2015 12 months to Sep 2015 €000	2014 12 months to Sep 2014 €000	2013 12 months to Sep 2013 €000
Interest and similar income	259,194	214,258	215,612	212,925	222,446
Interest expense	(76,247)	(65,429)	(70,834)	(86,922)	(91,432)
Net interest income	182,947	148,829	144,778	126,003	131,014
Other operating income	117,526	101,756	102,093	83,802	87,113
Gain on Visa transaction	-	27,511	-	-	-
Other operating charges	(151,251)	(112,778)	(108,032)	(93,499)	(89,138)
Net impairment losses	6,227	(23,142)	(32,710)	(19,431)	(25,595)
Share of results of equity-accounted investees	19,287	3,730	11,786	7,227	12,384
Profit before tax	174,736	145,906	117,915	104,102	115,778
Income tax expense	(55,238)	(50,708)	(37,971)	(34,718)	(36,305)
Profit for the period	119,498	95,198	79,944	69,384	79,473
Attributable to:					
Equity holders of the Bank	119,498	94,742	79,378	68,945	79,055
Non-controlling interest	-	456	566	439	418
	119,498	95,198	79,944	69,384	79,473
Earnings per share	27c1	21c6	18c1	15c7	18c0

The earnings per share figures have been adjusted retrospectively to reflect the increase in the number of ordinary shares following capitalisation of retained earnings and a bonus issue which occurred on 16 January 2017 and a rights issue which occurred on 31 December 2017.

*Financial year 2017 includes a fifteen month period from 1 October 2016 to 31 December 2017

The Group's five year summary - extracted from the respective audited financial statements (continued)

B. STATEMENTS OF FINANCIAL POSITION

	2017	2016	2015	2014	2013
	€000	€000	€000	€000	€000
ASSETS					
Balances with Central Bank of Malta, treasury bills and cash	159,684	171,050	126,652	130,966	194,587
Investments and financial assets at fair value through profit or loss	3,700,832	4,128,702	3,793,827	2,950,011	2,247,351
Loans and advances to banks	3,431,383	2,098,439	1,656,346	1,045,988	860,957
Loans and advances to customers	4,162,032	4,001,656	4,001,839	3,861,532	3,667,739
Investments in equity-accounted investees	109,461	97,041	96,904	88,553	84,880
Property and equipment	133,675	102,846	102,523	99,759	91,618
Current tax	12,034	16,061	965	-	-
Deferred tax	60,217	67,188	86,654	78,550	70,205
Assets held for realisation	5,972	11,973	11,601	9,755	10,361
Other assets	5,955	4,818	2,990	7,659	5,045
Prepayments and accrued income	39,385	23,077	21,661	24,018	25,215
Total Assets	**11,820,630**	**10,722,851**	**9,901,962**	**8,296,791**	**7,257,958**
LIABILITIES					
Financial liabilities at fair value through profit or loss and derivatives held for hedging	24,010	40,976	60,278	81,812	62,048
Amounts owed to banks	192,196	250,155	197,760	86,579	36,040
Amounts owed to customers	10,100,625	9,181,047	8,559,731	7,119,530	6,219,666
Debt securities in issue	95,400	95,400	95,400	95,400	95,400
Current tax	-	-	-	16,090	4,697
Deferred tax	4,519	4,318	4,382	5,100	5,003
Other liabilities	197,751	173,988	172,905	130,168	108,864
Accruals and deferred income	12,451	16,215	21,317	27,643	29,235
Subordinated liabilities	231,591	231,591	120,000	120,000	120,000
Total Liabilities	10,858,543	9,993,690	9,231,773	7,682,322	6,680,953
EQUITY					
Called up share capital	525,000	390,000	360,000	330,000	300,000
Share premium account	45,427	988	988	988	988
Revaluation reserve	33,194	35,332	35,217	29,136	24,621
Retained earnings	358,466	302,841	272,713	253,245	250,735
Total Equity attributable to equity holders of the Bank	962,087	729,161	668,918	613,369	576,344
Non-controlling interest	-	-	1,271	1,100	661
Total Equity	962,087	729,161	670,189	614,469	577,005
Total Liabilities and Equity	**11,820,630**	**10,722,851**	**9,901,962**	**8,296,791**	**7,257,958**
MEMORANDUM ITEMS					
Contingent liabilities	253,851	225,407	251,670	233,451	213,598
Commitments	1,858,191	1,590,156	1,612,122	1,647,091	1,190,714

The Group's five year summary - extracted from the respective audited financial statements (continued)

C. STATEMENTS OF CASH FLOWS

	2017 €000	2016 €000	2015 €000	2014 €000	2013 €000
Net cash from operating activities	1,002,202	768,054	1,124,108	766,887	509,520
Cash flows from investing activities					
Dividends received from equity shares	8,794	5,628	5,808	4,926	5,433
Interest received from investing securities	74,725	59,783	58,998	45,394	37,484
Acquisition of non-controlling interest	-	(5,000)	-	-	-
Purchase of equity investments	-	-	(100)	(200)	-
Proceeds from Visa transaction	-	22,042	-	-	-
Proceeds from sale of equity instruments	4,350	3,043	-	-	-
Net increase in investment securities	258,283	(388,362)	(853,476)	(692,500)	(379,284)
Purchase of property and equipment	(33,341)	(8,111)	(9,132)	(14,649)	(10,414)
Proceeds on disposal of property and equipment	-	598	-	8	-
Net cash (used in)/from investing activities	312,811	(310,379)	(797,902)	(657,021)	(346,781)
Cash flows from financing activities					
Proceeds from rights issue	149,439	-	-	-	-
Proceeds from issue of subordinated bonds	-	111,591	-	-	-
Dividends paid	(33,883)	(30,575)	(29,362)	(34,466)	(34,516)
Net cash from/(used in) financing activities	115,556	81,016	(29,362)	(34,466)	(34,516)
Increase in cash and cash equivalents	1,430,569	538,691	296,844	75,400	128,223

D. PERFORMANCE EXPRESSED IN RELATION TO AVERAGE TOTAL ASSETS AND AVERAGE CAPITAL EMPLOYED

	2017 %	2016* %	2015 %	2014 %	2013 %
Operating income to total assets	2.1	2.4	2.7	2.7	3.1
Operating expenses to total assets	1.1	1.1	1.2	1.2	1.3
Profit before tax to total assets	1.2	1.1	1.3	1.3	1.6
Profit before tax to capital employed	16.5	16.9	18.4	17.5	21.1
Profit attributable to equity holders to total assets	0.8	0.7	0.9	0.9	1.1
Profit attributable to equity holders to capital employed	11.3	11.0	12.4	11.6	14.4

**Ratios exclude gain on Visa transaction.*

Group Financial Highlights in US dollars for the fifteen months ended 31 December 2017

The following figures were converted from Euro to US Dollars using the rate of exchange ruling on 31 December 2017. The rate used was €1 = US$ 1.1986. This does not reflect the effect of the change in the rate of exchange since 30 September 2016 which was €1 = US$ 1.1169.

	2017	**2016**
	US$000	**US$000**
Net income attributable to equity holders of the Bank	143,230	105,817
Net income per share	33c	27c
Gross dividend paid	62,481	51,209
Net dividend paid	40,612	33,286
Gross dividend per share	14c	13c
Total assets	14,168,207	11,976,352
Liquid funds	191,397	191,046
Investments and financial assets at fair value through profit or loss	4,435,817	4,611,347
Advances	9,101,467	6,813,196
Investments in equity-accounted investees	131,200	108,385
Share capital	629,265	435,591
Capital reserves	94,235	40,566
Retained earnings	429,657	338,243

Notes

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Notes