HSBC Bank Malta p.l.c.

Annual Report and Accounts 2018

HSBC

The HSBC Group

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Chairman's Statement

2018 was characterised by ongoing international instability. Geopolitical uncertainty persists, driven by great power competition, deliberate disruptiveness, a return to populism and nationalism, violent extremism, terrorism and raging wars. On the whole, external downward risks to economic activity are now predominant over the medium term. In this vein, the most recent discussion on trade started by the United States, has again led to an increased risk of growing protectionism worldwide. An escalating global trade dispute or widespread rises in import tariffs would have a marked negative impact on Global economies.

Within the EU, a historical analysis shows that the European economy registered its fastest economic growth rate in the last decade, peaking in 2017. However, growth has moderated since 2018 and the outlook is now less favourable. At the back of heightened geopolitical uncertainty, long-term risk-free rates have declined, in parallel with a deteriorating macroeconomic outlook. Concern over the downside risks linked to Italy, global trend tensions and Brexit are likely to persist in the foreseeable future, invariably leading to repercussions around slower growth momentum ahead.

The upcoming European Parliament elections, in May 2019, will test the core foundations of the European Union, likely subjecting Europe's political mainstream to a populist challenge which, if successful, would negatively impact the prospect of a stronger and more workable monetary union in the short and medium term.

Locally, Malta's economic growth is projected to remain robust. While this is invariably welcome, areas of concern, mostly relating to long-term sustainability, allegations of corruption, and money laundering are impacting negatively on Malta's hard-earned reputation as a trusted financial services jurisdiction. It is therefore imperative that across the financial services industry, efforts are doubled to ensure the maintenance of the highest standards of regulatory compliance. Our continued presence among international jurisdictions of repute will be dependent on our determination to operate to the highest standards of governance and compliance.

L-2018 kienet ikkaratterizzata minn instabilità kontinwa mad-dinja kollha. L-inċertezza ġeopolitika għadha hemm, misjuqa mill-kompetizzjoni għall-potenza, tħarbit intenzjonat, ritorn għall-populiżmu u n-nazzjonaliżmu, estremiżmu vjolenti, terroriżmu u gwerer kontinwi. B'mod ġenerali, fuq tul ta' żmien medju, illum hawn predominanza ta' riskji esterni li jistgħu jiġbdu l-attività ekonomika 'l isfel. F'din l-istess vena, l-argument reċenti li nbeda mill-Istati Uniti dwar il-kummerċ reġa' wassal għal żieda fir-riskju li l-protezzjoniżmu jinfirex iżjed madwar id-dinja. Jekk it-tilwim fil-kummerċ globali jkompli jikber jew jogħlew b'mod mifrux it-tariffi tal-importazzjoni, dan se jkollu impatt negattiv qawwi fl-ekonomiji globali.

Fl-Unjoni Ewropea, l-analiżi tal-passat turi li l-ekonomija Ewropea rreġistrat l-aktar ritmu mgħaġġel ta' tkabbir fl-ekonomija f'dan l-aħħar deċennju, bl-ogħla figura tintlaħaq fl-2017. Madankollu, mill-2018 it-tkabbir immodera u l-prospettiva m'għadhiex daqshekk favorevoli. Fuq l-isfond ta' inċertezza ġeopolitika aktar akuta, ir-rati fit-tul ħielsa mir-riskju waqgħu, hekk kif imxew mal-prospettiva ta' makroekonomija li sejra lura. It-tħassib dwar riskji negattivi marbutin mal-Italja, max-xejra ta' tensjonijiet globali u ma' Brexit x'aktarx jibqgħu magħna fil-futur qarib, u bla dubju se jwasslu għal riperkussjonijiet ta' tkabbir aktar kajman 'il quddiem.

L-elezzjonijiet tal-Parlament Ewropew li se jsiru f'Mejju 2019 se jkunu ta' prova għall-Unjoni Ewropea mill-pedamenti tal-qiegħ tagħha. Hemm ċans li l-esponenti tal-politika ewlenija Ewropea jsibu ruħhom jiffaċċaw sfida populista li, jekk tirnexxi, se jkollha impatt negattiv fuq il-prospett ta' għaqda monetarja aktar b'saħħitha u aktar prattikabbli fuq medda qasira u dik medja.

Hawn Malta, it-tbassir hu li t-tkabbir ekonomiku jibqa' sod. Waqt li din hija ċertament aħbar tajba, hemm oqsma ta' tħassib, l-aktar dawk marbuta mas-sostenibilità fit-tul, l-allegazzjonijiet ta' korruzzjoni u l-ħasil ta' flus, li qed iħallu impatt negattiv fuq ir-reputazzjoni miksuba b'tant ħidma li Malta għandha bħala ġurisdizzjoni ta' fiduċja fis-servizzi finanzjarji. Għalhekk huwa importantissimu li kull min hu fl-industrija tas-servizzi finanzjarji jirdoppja l-isforzi tiegħu biex jassigura li jintlaħqu l-ogħla standards fl-osservanza regolatorja. Il-kontinwazzjoni tal-preżenza tagħna fost il-ġurisdizzjonijiet internazzjonali ta' reputazzjoni se tkun tiddependi fuq kemm aħna determinati li napplikaw l-ogħla standards ta' governanza u osservanza fil-ħidma tagħna.

Results

At HSBC Bank Malta p.l.c., your bank, at the year-end profits before tax were €38.6m, a decrease of 23% when compared to the 2017 results. During the year, we completed the final phase of our de-risking strategy and managed the ongoing impact of negative interest rates. A detailed breakdown of the financial results is included in the CEO’s Review.

During the course of 2018, capital ratios continued to improve with CET1 increasing from 13.9% to 14.6% and the total capital ratio improving from 14.4% to 17.0%. The subordinated loan issued in December 2018 was the main driver for the increase in the total capital ratio. Consequently, your bank continues to have a strong capital base and is fully compliant with the regulatory capital requirements.

The European Central Bank has recently introduced new requirements which require the bank to hold additional capital for any non-performing loans aged over 7 years, that are not 100% provided for through IFRS 9 Expected Credit Loss provisioning, regardless of security held. To ensure that your bank holds sufficient capital to support future growth as well as meeting this new requirement, the Board has recommended a final dividend pay-out ratio of 30% of net profit. This will bring the full year 2018 dividend pay-out ratio to 47%. The final gross dividend will be 1.8 cent per share (1.2 cent per share net of tax) which brings the total dividend for 2018 to 5.8 cents (3.8 cents net of tax).

In this manner we will be sustaining your bank’s position as a strong dividend generating company. The final dividend will be paid on 25 April 2019 to shareholders who are on the bank’s register of shareholders at 18 March 2019.

Riżultati

Fl-HSBC Bank Malta p.l.c., il-bank tagħkom, fl-aħħar tas-sena l-profitti qabel it-taxxa kienu ta’ €38.6 miljun, tnaqqis ta’ 23% meta mqabbla mar-riżultati tal-2017. Matul is-sena lestejna l-aħħar fażi tal-istrateġija għat-tnaqqis tar-riskju u kellna niġġestixxu l-impatt kontinwu ta’ rati tal-imgħax negattivi. Analiżi dettaljata tar-riżultati finanzjarji ssibuha fir-Rapport tas-CEO.

Matul l-2018, ir-relazzjonijiet tal-kapital komplew jitjiebu – is-CET1 tela’ minn 13.9% għal 14.6% u r-relazzjoni tal-kapital totali minn 14.4% għal 17.0%. Is-self subordinat li nħareġ f’Diċembru 2018 kien il-fattur ewlieni responsabbli għal din iż-żieda fir-relazzjoni tal-kapital totali. Għaldaqstant, il-bank tagħkom għadu jgawdi bażi kapitali soda u huwa totalment konformi mar-rekwiżiti regolatorji dwar il-kapital.

Il-Bank Ċentrali Ewropew dan l-aħħar daħħal rekwiżiti ġodda li jirrikjedu li l-bank iżomm kapital addizzjonali għal self li ma jirrendix, li jkun ilu ‘l fuq minn 7 snin, u li ma jkunx kopert 100% bil-provvedimenti għat-telf mistenni ta’ kreditu taħt l-IFRS 9, irrispettivament mill-garanziji u sigurtà li jkun hemm kontrih. Biex jiżgura li l-bank tagħkom ikollu kapital biżżejjed biex isostni t-tkabbir futur u wkoll biex jissodisfa dan ir-rekwiżit ġdid, il-Bord irrakkomanda ħlas ta’ dividend finali ta’ 30% tal-profitt nett. Dan ifisser li għas-sena sħiħa 2018 il-proporzjon imħallas bħala dividend ikun ta’ 47%. Id-dividend finali gross se jkun ta’ 1.8 ċenteżmi għal kull sehem (1.2 ċenteżmi wara t-taxxa), li jġib id-dividend totali għall-2018 għal 5.8 ċenteżmi (3.8 ċenteżmi wara t-taxxa).

B’dan il-mod inkunu qed inżommu l-pożizzjoni tal-bank tagħkom bħala kumpanija li tiġġenera dividendi tajbin. Id-dividend finali se jitħallas fil-25 t’April 2019 lill-azzjonisti li jkunu mniżżla fir-reġistru tal-azzjonisti tal-bank fit-18 ta’ Marzu 2019.

HSBC Bank Malta p.l.c. has commenced transition to a new phase focused on growth and value creation.

HSBC Bank Malta p.l.c. has successfully achieved the highest global standards of financial crime compliance.

Our regulatory environment

During the year under review, the dynamic regulatory environment continued to unfold, bringing into force a number of significant changes to the payments and consumer protection rules and regulations. The European Central Bank, under the framework of the Single Supervisory Mechanism (SSM), continued to intensify its supervisory activities in business model sustainability, profitability assessment, risk management, and credit risk as part of its ongoing supervisory review evaluation process of significant institutions.

In this regard, your bank has continued to maintain sharp focus and discipline to meet all its capital and liquidity regulatory requirements, while continuing to consolidate effective risk management and governance, proactively managing conduct risk, and ensuring the sustainability of the bank's business model.

As in the previous financial year, within the context of its business model and risk imperatives, the bank continued to face a challenging negative interest rate environment, heightened compliance costs and increased competition from existing and new players in the local banking sector.

The regulatory engagement and change programme continues to progress at a very intense pace and your bank remains focused on achieving compliance with the vast array of new or enhanced investor and consumer protection regulations, namely, the Markets in Financial Instruments Directive II (MiFID II), the Packaged Retail and Insurance-based Investment Products (PRIIPS) Regulation, the Insurance Distribution Directive (IDD), the Payment Account Directive (PAD), and the MFSA Conduct of Business Rulebook.

These newly introduced regulatory requirements include enhanced product governance arrangements, and more transparent and clearer disclosure to investors and consumers, while also bringing about more financial inclusivity in banking products.

Additionally, the General Data Protection Regulation (GDPR) was also implemented by your bank during 2018. This important regulation is designed to create harmonisation

L-ambjent regolatorju

Matul is-sena li qed nitkellmu fuqha, kien hemm żviluppi oħra fl-ambjent regolatorju dinamiku li naħdmu fih, u dawn ġabu fis-seħħ għadd ta' tibdiliet ta' sostanza fir-regoli u r-regolamenti tal-pagamenti u tal-protezzjoni tal-klijenti. Il-Bank Ċentrali Ewropew, taħt il-qafas tal-Mekkanizmu Uniku tas-Sorveljanza, kompla jintensifika l-attivitajiet ta' sorveljanza tiegħu fuq is-sostenibilità tal-mudell tan-negozju, l-evalwazzjoni tal-profittabilità, l-immaniġġjar tar-riskju, u r-riskju tal-kreditu, u dan bħala parti mill-proċess dejjem għaddej ta' sorveljanza li jwettaq fuq istituzzjonijiet ta' importanza.

F'dan ir-rigward il-bank tagħkom baqa' jżomm ruħu ffokat sewwa u attent biex jaqdi l-obbligi regolatorji kollha li għandu dwar il-kapital u l-likwidità. Fl-istess ħin kompla jikkonsolida l-effettività fl-immaniġġjar tar-riskju u fil-governanza, jikkontrolla b'mod proattiv ir-riskju tal-kondotta, u jassigura s-sostenibilità tal-mudell tan-negozju tal-bank.

L-istess kif ġara fis-sena finanzjarja ta' qabel, fil-kuntest tal-mudell tan-negozju u tal-ħtiġijiet tar-riskju, il-bank baqa' jiffaċċa l-isfida ta' ambjent ta' rati tal-imgħax negattivi, ta' spejjeż ogħla fl-osservanza tar-regoli, u ta' kompetizzjoni aktar ħarxa minn operaturi eżistenti u oħrajn ġodda fis-settur bankarju lokali.

Il-programm ta' ingaġġ regolatorju u bidla għadu miexi 'l quddiem b'pass mgħaġġel, u l-bank tagħkom jibqa' mmirat li jilħaq konformità sħiħa mal-firxa vasta ta' regolamenti ġodda jew ameljorati dwar il-protezzjoni tal-investituri u l-klijenti. B'regolamenti hawn qed infissru t-Tieni Direttiva għas-Swieq fl-Istrumenti Finanzjarji (MiFID II), ir-Regolament dwar Prodotti ta' Investiment Ippakkeġġjati għall-Konsumatur fuq Bażi ta' Assigurazzjoni (PRIIPS), id-Direttiva dwar id-Distribuzzjoni tal-Assigurazzjoni (IDD), id-Direttiva dwar Kontijiet ta' Pagament (PAD), u l-Ktejjeb tar-Regoli tal-MFSA dwar il-Kondotta tan-Negozju.

Dawn ir-rekwiżiti regolatorji ġodda li daħlu jinkludu arranġamenti aħjar għall-governanza tal-prodotti, u informazzjoni aktar ċara u trasparenti għall-investituri u l-konsumaturi, filwaqt li jwasslu wkoll biex ikun hemm aktar inklużività finanzjarja fil-prodotti bankarji.

between data privacy laws across the EU Member States and to provide greater protection and rights to individuals. Your bank was actively involved in the consultation process specific to the GDPR's application to the banking sector during the transposition of the Regulation into local legislation.

Your bank has also fully implemented the first tranche of requirements relating to the Payment Services Directive II (PSD II) as transposed into local rules by the Central Bank of Malta Directive 1. This payments-related legislation aims to increase competition amongst payment services operators while bringing into scope new types of payments services and enhanced customer protection and security.

Additional to the regulatory developments I have mentioned above, your bank was closely engaged with Regulators and Industry Bodies during the consultation processes of other major regulatory changes, namely: the Fifth Anti-Money Laundering Directive, and the proposed Central Bank of Malta Directive on Borrower Based Measures.

Your bank will continue to monitor, on an ongoing basis, all of the upcoming relevant regulatory developments, to continue to discharge its regulatory obligations, and to add value by contributing proactively in the jurisdiction's evolving regulatory agenda and consultation process.

Our responsibility towards the community

The HSBC Group has long supported education across the globe, especially helping disadvantaged young people access primary, secondary and higher education. The Group is now focusing its efforts on helping people develop the employability and financial skills they need to thrive in the modern world. With technology developing at a rapid pace, a secondary education or university degree is no longer a guarantee of employment. A range of skills are now an absolute requirement to succeed in the workplace. Hence the reason why we are focusing an important section of our sustainability strategy on future skills, for our customers, for our people, and for the members in the communities which

Barra minn hekk, fl-2018 il-bank tagħkom implimenta wkoll ir-Regolament Ġenerali dwar il-Protezzjoni tad-Data (GDPR). Dan ir-regolament importanti huwa maħsub biex iġib armonizzazzjoni bejn il-liġijiet tal-privatezza tad-data fost l-Istati Membri tal-UE u biex joffri protezzjoni u drittijiet aqwa lill-individwi. Meta kienet qed issir it-traspożizzjoni ta' dan ir-regolament fil-liġi Maltija, il-bank tagħkom kellu sehem attiv fil-proċess ta' konsultazzjoni li kien jittratta speċifikament il-mod kif il-GDPR kellu japplika għas-settur bankarju.

Il-bank tagħkom implimenta wkoll bis-sħiħ l-ewwel 'tranche' ta' rekwiżiti marbuta mat-Tieni Direttiva dwar is-Servizzi ta' Pagament (PSD II) kif trasposta fir-regoli lokali bid-Direttiva Nru 1 tal-Bank Ċentrali ta' Malta. Din il-leġislazzjoni dwar pagamenti għandha l-għan li twessa' l-kompetizzjoni fost l-operaturi tas-servizzi ta' pagament waqt li ddaħħal fl-ambitu tagħha tipi ġodda ta' servizzi ta' pagament u metodi aħjar ta' protezzjoni u sigurtà għall-klijenti.

Apparti l-iżviluppi regolatorji li semmejt, il-bank tagħkom ħadem fil-qrib mar-Regolaturi u l-Korpi fl-Industrija waqt il-proċessi ta' konsultazzjoni fuq bidliet importanti oħra fir-regolamenti, li kienu: il-Ħames Direttiva Kontra l-Ħasil tal-Flus, u d-Direttiva proposta tal-Bank Ċentrali ta' Malta dwar Miżuri Bbażati fuq Min Jissellef.

Il-bank tagħkom se jibqa' jsegwi, fuq bażi kontinwa, l-iżviluppi kollha rilevanti regolatorji li mistennija jkun hemm, u jibqa' jaqdi l-obbligi regolatorji tiegħu u jagħti valur miżjud billi jikkontribwixxi b'sens proattiv fil-proċess li jkompli jevolvi fil-ġurisdizzjoni ta' Malta tal-aġenda regolatorja u l-konsultazzjoni dwarha.

Ir-responsabbiltà tagħna lejn il-komunità

Il-Grupp HSBC ilu żmien twil jagħti sehem biex tinfirex l-edukazzjoni madwar id-dinja, speċjalment billi jgħin tfal u żgħażagħ żvantaġġjati biex ikollhom aċċess għall-edukazzjoni primarja, sekondarja u ogħla. Il-Grupp issa qed jiffoka l-isforzi tiegħu biex jgħin in-nies jiżviluppaw il-ħiliet li għandhom bżonn biex jimpjegaw ruħhom u

HSBC Bank Malta p.l.c. is enabling future skills for young people.

we serve. We plan to reach these goals by concentrating on two key areas: employability and financial capability.

Our chosen vehicle to achieve these aims is the HSBC Malta Foundation. During 2018, the Foundation worked closely with a number of local organisations actively engaged in improving the employability and the financial capability of the persons they assist, in the various fields and organisations around the country.

At your bank, we take pride and encourage voluntary work undertaken by our colleagues who regularly contribute, through their time and efforts, to charities and causes which they feel passionate about. One tangible example of how your bank supports our people in these initiatives is the addition of an extra day of leave granted for voluntary work around our country.

The HSBC Malta Water Programme

Since 2013, HSBC Bank Malta p.l.c. has invested close to €1 million in water conservation projects and programmes, drawing from the resources provided by the HSBC Group's Global Water Programme. The bulk of the investment has been stewarded by the international award-winning 'Catch the Drop' campaign, which, since 2013, has been used to finance water-related projects to create awareness across all social strata, and to encourage public participation.

A fund of €400,000 fully subscribed to by HSBC Group ensures the sustainability of these, and other similar programmes.

On your behalf, I avail myself of this opportunity to thank all our people whose support and dedication towards these initiatives ensured their success.

jitgħallmu jħaddmu l-flus ħa jirnexxu fid-dinja moderna. Bil-pass mgħaġġel li qed tavvanza t-teknoloġija, illum m'għadux biżżejjed li jkollok edukazzjoni sekondarja jew grad universitarju biex jiggarantilek impjieg. Irid assolutament ikollok firxa ta' ħiliet varji biex tirnexxi fuq ix-xogħol. Din hi r-raġuni li qed niffokaw parti importanti mill-istrateġija tagħna ta' sostenibilità fuq il-ħiliet futuri tal-klijenti tagħna, tan-nies tagħna, u tal-membri tal-komunitajiet li naqdu. Il-pjan hu li nilħqu dawn l-għanijiet billi nikkonċentraw fuq żewġ oqsma kruċjali: li wieħed ikun kapaċi jaħdem, u kapaċi jħaddem flusu.

Il-mezz li għażilna biex nilħqu dawn l-għanijiet huwa l-HSBC Malta Foundation. Matul l-2018 il-Fondazzjoni kkollaborat fil-qrib ma' numru ta' għaqdiet lokali f'ħidma attiva biex itejbu l-kapaċitajiet ta' impjieg u finanzjarji ta' dawk li kienu qed jassistu, fl-oqsma u organizzazzjonijiet varji fil-pajjiż.

Fil-bank tagħkom, aħna kburin bil-kollegi tagħna li jagħmlu xogħol volontarju u nagħmlulhom kuraġġ meta jikkontribwixxu regolarment, bil-ħin u l-ħidma tagħhom, lejn għanijiet u kawżi ta' karità li huma ddedikati għalihom. Eżempju tanġibbli ta' kif il-bank tagħkom jappoġġa lil dawn in-nies fl-inizjattivi tagħhom hu ż-żieda ta' jum ieħor ta' frank mogħti għal xogħol volontarju fil-pajjiż.

Il-Kampanja tal-HSBC Malta Water Programme

Mill-2013 'il hawn, l-HSBC Bank Malta p.l.c. investa qrib il-miljun ewro fi proġetti u programmi ta' konservazzjoni tal-ilma, billi ħa mir-riżorsi pprovduti mill-Global Water Programme tal-Grupp HSBC. Il-parti l-kbira tal-investiment kien taħt il-ħarsien tal-kampanja rebbieħa ta' premjijiet internazzjonali 'Catch the Drop', li ilha mill-2013 tintuża biex tiffinanzja proġetti tal-ilma u tqajjem kuxjenza fost is-saffi soċjali kollha u tinkoraġġixxi l-parteċipazzjoni pubblika.

HSBC Bank Malta p.l.c. continues to highlight the pressing issue of water conservation.

HSBC Bank Malta p.l.c. invests in the holistic well-being of its employees.

Our Board of Directors

During 2018, there was only one change to the membership of the Board. Ms Alison Hewitt resigned in February in order to take up a senior appointment within the HSBC Group.

In December, your bank announced the appointment of Mr Michel Cordina as Executive Director. Mr Cordina's appointment is still subject to regulatory approval.

On your behalf, I thank Ms Hewitt for her service and dedication to your bank throughout her tenure, and welcome Mr Cordina as a colleague on the Board.

The Board of Directors of your bank is composed of colleagues whose varied areas of expertise and experiences contribute unparalleled insights to the varied agendas debated during meetings through the year, thereby ensuring that all decisions taken are based on the highest ethical standards and knowledge of the banking sector. It is my great pleasure and privilege to serve as the Chairman of this outstanding group of persons. On your behalf, I want to express to them my gratitude for their focus and dedication to the work of the Board.

Hemm fond ta' €400,000, sottoskritt kollu kemm hu mill-Grupp HSBC, li jiżgura s-sostenibilità ta' dawn il-programmi u oħrajn simili.

F'isimkom nieħu din l-okkażjoni biex nirringrazzja lin-nies tagħna kollha li, bl-appoġġ u d-dedikazzjoni tagħhom, assiguraw is-suċċess ta' dawn l-inizjattivi.

Il-Bord tad-Diretturi

Fl-2018 kien hemm bidla waħda fil-kompożizzjoni tal-Bord. Ms Alison Hewitt irriżenjat fi Frar biex tkun tista' taċċetta ħatra għolja fi ħdan il-Grupp HSBC.

F'Diċembru, il-bank tagħkom ħabbar il-ħatra tas-Sur Michel Cordina bħala Direttur Eżekuttiv. Il-ħatra tas-Sur Cordina għadha qed tistenna l-approvazzjoni mir-regolatur.

F'isimkom nirringrazzja lil Ms Hewitt għas-servizz u d-dedikazzjoni tagħha lejn il-bank tul iż-żmien tal-ħatra tagħha, u nilqa' lis-Sur Cordina bħala kollega fuq il-Bord.

Il-Bord tad-Diretturi tal-bank tagħkom huwa magħmul minn kollegi li għandhom esperjenza u huma esperti f'oqsma varji hekk li jistgħu joffru l-aqwa perspettivi fuq l-aġendi differenti li jkunu diskussi fil-laqgħat matul is-sena. Hekk inkunu moħħna mistrieħ li d-deċiżjonijiet kollha li jittieħdu jkunu bbażati fuq l-ogħla standards etiċi u fuq għarfien tajjeb tas-settur bankarju. Huwa pjaċir u privileġġ kbir għalija li nservi bħala Chairman ta' dal-grupp ta' nies straordinarju. F'isimkom nixtieq nesprimi l-gratitudni tiegħi lejhom għall-konċentrazzjoni u d-dedikazzjoni tagħhom fil-ħidma tal-Bord.

The Executive Team

I also want to express my deep gratitude and appreciation to the Management Team of your bank whose unfaltering dedication, deep commitment and strong resolve, have delivered excellent results under very trying conditions. Throughout 2018, they have worked long hours and ensured that all the various challenges were met and all tasks implemented and delivered to the highest standards. Your bank is well served by these excellent professionals.

Looking ahead

During the course of the last few years, your bank underwent a transformational exercise aimed at reaching the highest standards of compliance within the banking sector and excellent service to our clients.

It has been an arduous journey, however all of us at HSBC Bank Malta p.l.c., are particularly proud of the achievements and successes which have been delivered, primarily to you, our shareholders, and also to our clients, and to the community which we serve.

Our vision going forward is very clear. We are determined to become Malta's Leading International Bank and Bank of Choice. We have adopted a laser-focused approach towards customer-led growth and at the same time ensuring and sustaining our risk management standards.

Going forward, we will be relentless in the attainment of these objectives.

Concluding, I want to express my gratitude to you, our shareholders, for your continued support and commitment to this bank. I want to assure you, that all at HSBC Bank Malta p.l.c. will continue to strive in order to deliver the best possible results as well as the highest return on your investment. This is our commitment and promise to you all.

Sonny Portelli, Chairman
19 February 2019

It-Tim Eżekuttiv

Irrid ukoll ngħid grazzi mill-qalb u nuri l-apprezzament tiegħi lit-tim tal-'Management' tal-bank tagħkom, li bid-dedikazzjoni sħiħa tagħhom, u b'impenn qawwi u determinazzjoni soda, irnexxielhom jagħtuna riżultati eċċellenti taħt kundizzjonijiet diffiċli immens. Matul l-2018 kollu, ħadmu sigħat twal biex jaraw li l-isfidi kollha quddiemhom jingħelbu u li x-xogħol kollu jsir u jkun tal-ogħla kwalità. Il-bank tagħkom huwa moqdi mill-aħjar li jista' jkun minn dawn il-professjonisti ta' eċċellenza.

Ħarsa 'l quddiem

Fil-kors ta' dawn l-aħħar ftit snin il-bank tagħkom għadda minn eżerċizzju ta' trasformazzjoni bil-għan li jilħaq l-ogħla standards ta' konformità mar-regoli fis-settur bankarju u jagħti servizz ta' eċċellenza lill-klijenti tagħna.

Kien vjaġġ iebes, imma aħna kollha fl-HSBC Bank Malta p.l.c. ninsabu verament kburin bil-kisbiet u s-suċċessi li għamilna, fuq kollox għalikom l-azzjonisti, kif ukoll għall-klijenti tagħna u għall-komunità li nservu.

Il-viżjoni tagħna għall-quddiem hija ċarissima. Aħna determinati li nsiru l-bank Internazzjonali ta' Quddiem Nett f'Malta u l-bank tal-Għażla Tagħkom. Għandna viżjoni b'mira l-aktar preċiża li tindirizza tkabbir misjuq mill-klijent u li fl-istess ħin tassigura li nżommu l-istandards tagħna fl-immaniġġjar tar-riskju.

Għall-quddiem se naħdmu bla heda biex nilħqu dawn l-objettivi.

Biex nagħlaq, irrid nesprimi l-gratitudni tiegħi lejkom l-azzjonisti għall-appoġġ li dejjem tagħtu u l-impenn tagħkom lejn il-bank. Irrid naċċertakom illi kulħadd, fl-HSBC Bank Malta p.l.c., se jibqa' jagħmel l-almu tiegħu biex niksbu l-aħjar riżultati possibbli kif ukoll l-ogħla ritorn għall-investiment tagħkom. Din hi l-wegħda u l-impenn tagħna lejkom.

I am proud of the progress HSBC has made to implement the highest global standards of compliance which, while reducing profitability, has enabled us to build a stronger and safer bank for our shareholders, customers, employees and the jurisdiction. More broadly, 2018 was difficult for the local financial services sector, which suffered further reputational damage. It is essential that all market participants ensure anti money-laundering standards are fully implemented without delay in order to avoid more significant long-term risks. We welcome new initiatives announced by the local authorities which the industry must fully embrace and support.

The local economy continues to perform strongly and, as we enter 2019, HSBC is now able to re-focus our business to be able to deliver measured growth. Our retail and wealth management business is trading well and this year we are also in a position to return our commercial division to measured growth following completion of an extensive restructuring process. New digital innovations will create enduring competitive advantage for HSBC as we bring a range of new world class solutions to benefit our customers and our new account opening process is delivering record volumes.

However, it is also now clear that the new European Central Bank (ECB) requirements relating to the treatment of non-performing loans (NPLs) mean that Malta's current framework for the recovery of security in the event of default requires reform. Banks will be required to hold additional capital against fully secured NPLs as a direct result of the long time to recover through current legal processes. For HSBC, the expected impact relates to loans where the bank does not expect to incur additional losses even though the recovery process currently takes years.

Looking to the future, the Board is focused on enabling the bank to generate growth for shareholders in this next phase while also ensuring full compliance with the new ECB requirements. Accordingly, whilst we will sustain the bank's position as a strong dividend generating company, the Board has recommended a final dividend pay-out ratio of 30% in order to allocate additional capital to grow the business and meet the new ECB NPL requirements in the event that reforms to the current system are not forthcoming.

Jiena kburi bil-progress li għamel l-HSBC biex idaħħal l-ogħla standards globali ta' konformità li, għalkemm naqqsu l-profittabilità, għenuna nibnu bank li hu aktar b'saħħtu u aktar sigur għall-azzjonisti, il-klijenti, l-impjegati u l-ġurisdizzjoni tagħna. B'mod ġenerali, l-2018 kienet sena diffiċli għas-settur tas-servizzi finanzjarji f'Malta, li kompla jġarrab aktar ħsara fir-reputazzjoni. Huwa essenzjali li l-parteċipanti kollha fis-suq jaraw li l-istandards kontra l-ħasil tal-flus ikunu implimentati bis-sħiħ u bla dewmien biex nevitaw li jkun hemm riskji aktar serji fit-tul. Aħna nilqgħu bil-ferħ l-inizjattivi ġodda mħabbra mill-awtoritajiet lokali u nistennew li s-settur iħaddanhom u jsostnihom bil-qawwa kollha.

L-ekonomija lokali għadha b'saħħitha u, hekk kif bdejna l-2019, l-HSBC issa jista' jerġa' jiffoka l-operat tiegħu biex ikun jista' jasal għal tkabbir meqjus. In-negozju tas-servizzi personali u l-amministrazzjoni tal-ġid sejjer tajjeb u dis-sena qegħdin f'pożizzjoni li nerġgħu nġibu d-diviżjoni kummerċjali f'sitwazzjoni ta' tkabbir meqjuż, wara li lestejna proċess estensiv ta' ristrutturar. L-innovazzjonijiet diġitali ġodda se joħolqu vantaġġ kompetittiv fit-tul għall-HSBC. Għandna medda ta' soluzzjonijiet ġodda ta' klassi dinjija li se jgawdu minnhom il-klijenti tagħna, u għandna proċess ġdid għall-ftuħ tal-kontijiet li qed jirrendi numri rekord.

Madankollu issa jidher ċar ukoll illi r-rekwiżiti ġodda tal-Bank Ċentrali Ewropew (ECB) għar-rigward tat-trattament ta' self li ma jirrendix (non-performing loans jew NPL) ifissru li l-qafas li għandna hawn Malta għall-irkupru tas-sigurtà fil-każ li self ma jitħallasx lura għandu bżonn ta' riforma urġenti. Il-banek se jkollhom iżommu aktar kapital kontra NPLs koperti 100% b'sigurtà, u dan bħala riżultat dirett tat-tul ta' żmien meħtieġ biex is-self ikun irkuprat bil-proċessi legali tal-lum. Fejn l-HSBC jara li se jintlaqat huwa proprju f'dak is-self fejn il-bank ma jistenniex li se jkollu aktar telf, anke jekk il-proċess tal-irkupru jista' jieħu s-snin.

B'ħarstu 'l quddiem, il-Bord qed jikkonċentra biex jara li l-bank ikun jista' jiġġenera tkabbir għall-azzjonisti f'din il-fażi li jmiss, waqt li jkun ċert li jibqa' għal kollox konformi mar-rekwiżiti l-ġodda tal-ECB. B'dan il-ħsieb, waqt li nsostnu l-pożizzjoni tal-bank bħala kumpanija b'kapaċità soda li tiġġenera d-dividendi, il-Bord jirrakkomanda proporzjon ta' ħlas għal dividend finali ta' 30%, sabiex

Performance

The reported profit before tax for the year ended 31 December 2018 was €38.6m. This represents a decrease of €11.3m or 23% compared to prior year. The adjusted profit before tax was €36.5m, a decrease of €19.1m or 34% compared to 2017. The adjusted results exclude the impact of the following notable items:

- a collective agreement provision charge of €7.6m in 2017; and
- a provision release relating to the brokerage remediation of €1.8m in 2017 and an additional €2.0m release in 2018.

Profit attributable to shareholders was €28.7m resulting in earnings per share of 8.0 cents compared with 8.6 cents in 2017.

The year under review was characterised by broadly stable but persistently low interest rates and excess liquidity in the market while attractive investment opportunities continued to remain limited.

Net interest income of the bank decreased by 10% to €108.6m compared with the prior year principally due to the reduction in the corporate loan book and margin contraction in the bonds portfolio. The average yield of the investment book declined further due to higher yielding bonds maturing. The ECB negative deposit rate remained unchanged during 2018 resulting in additional interest expense on the bank's excess liquidity.

Net non-interest income remained broadly in line with 2017 with increased commissions in RBWM offsetting reductions in CMB. Over 10% more mortgages were sanctioned in 2018 which drove the increase in RBWM commissions.

Operating expenses were €108.4m, €5.7m or 5% lower compared with prior year. 2017 included a provision of €7.6m relating to the collective agreement, excluding this, adjusted operating expenses increased by €1.9m or 2% driven by continued investments in regulatory programmes, financial crime compliance and business growth. The bank continues to exercise rigorous cost control and to implement initiatives at cost base streamlining, outsourcing and process optimisation.

On 1 January 2018, the bank adopted IFRS 9 'Financial Instruments'. Since adoption the bank registered a charge in Expected Credit Loss (ECL) of €3.5m, €4.7m higher than the €1.2m loan impairment release under IAS 39 in 2017. The year on year increase is driven by the review of the provisioning approach relating to aged defaulted mortgages which led to a recovery in 2017.

There was a €2m positive movement in the provision for brokerage remediation costs in 2018. In 2016, the bank raised a provision totalling €8m in relation to a remediation of the legacy operational failure in the bank's brokerage business. During 2017, the remediation programme was largely completed and it was assessed that a partial reversal of the conservatively estimated provision was warranted. In this regard, a reversal of €1.8m was effected in 2017. In 2018, there was an additional reversal of €2m.

The effective tax rate was 26%. This translated into a tax expense of €9.9m, €9.1m lower that the €19.0m expense for 2017. During 2018, the bank benefited from a different tax treatment applied on a specific transaction.

ikun jista' jalloka kapital addizzjonali biex ikabbar in-negozju u biex jikkonforma mar-rekwiżiti ġodda tal-ECB dwar NPLs, fil-każ li r-riformi għas-sistema attwali ma jaslux.

Riżultati

Il-profitt qabel it-taxxa rrapportat għas-sena li għalqet fil-31 ta' Diċembru 2018 kien ta' €38.6 miljun. Dan jirrappreżenta tnaqqis ta' €11.3 miljun jew 23% meta mqabbel mas-sena ta' qabel. Il-profitt qabel it-taxxa aġġustat kien ta' €36.5 miljun, tnaqqis ta' €19.1 miljun jew 34% imqabbel mal-2017. Ir-riżultati aġġustati jeskludu l-effett ta' dawn l-entrati sinjifikanti:

- provvediment ta' €7.6 miljun għall-ftehim kollettiv fl-2017; u
- treġġigħ lura ta' provvediment ta' €1.8 miljun fl-2017 u ieħor ta' €2.0 miljun fl-2018 għar-rigward tar-rimedju tal-'brokerage'.

Il-profitt attribwibbli lill-azzjonisti kien ta' €28.7 miljun, li jirriżulta fi qligħ sehem b'sehem ta' 8.0 ċenteżmi, imqabbel ma' 8.6 ċenteżmi fl-2017.

Is-sena li qed nitkellmu dwarha kienet karatterizzata b'rati tal-imgħax li kienu ġeneralment stabbli imma dejjem baxxi, u b'eċċess ta' likwidità fis-suq, waqt li l-opportunitajiet attraenti ta' investiment baqgħu limitati.

Id-dħul nett tal-bank mill-imgħax niżel b'10% għal €108.6 miljun imqabbel mas-sena ta' qabel, l-aktar minħabba li naqas is-self lill-kumpaniji u li ċkien bi ftit il-portafoll tal-bonds. Ir-rendita medja tar-reġistru tal-investimenti kompliet tinżel minħabba li ċerti bonds b'rata għolja immaturaw. Ir-rata negattiva għad-depożiti fil-Bank Ċentrali Ewropew baqgħet ma nbidlitx fl-2018, bir-riżultat li kien hemm spiża oħra fl-imgħax fuq l-eċċess tal-likwidità tal-bank.

Id-dħul nett minn sorsi li mhumiex imgħax baqa' bejn wieħed u ieħor bħal tal-2017, peress li żieda fil-kummissjonijiet tal-RBWM pattiet għal tnaqqis fis-CMB. Kien hemm żieda ta' 'l fuq minn 10% fis-self għad-djar fl-2018, li jispjega ż-żieda fil-kummissjonijiet tal-RBWM.

L-ispejjeż tal-operat kienu ta' €108.4 miljun, €5.7 miljun jew 5% inqas meta mqabbel mas-sena ta' qabel. Fl-2017 kien hemm provvediment ta' €7.6 miljun għall-ftehim kollettiv; jekk tneħħi dan, l-ispejjeż tal-operat aġġustati żdiedu b'€1.9 miljun jew 2%, l-aktar minħabba investiment kontinwu li sar fil-programmi regolatorji, osservanza dwar reati finanzjarji, u tkabbir fin-negozju. Il-bank jibqa' jeżerċita kontroll strett fuq l-ispejjeż u jdaħħal inizjattivi biex jirrazjonalizza l-ispejjeż, jagħti xogħol barra, u jottimizza l-proċessi.

Fl-1 ta' Jannar 2018 il-bank adotta l-IFRS 9 'Strumenti Finanzjarji'. Minn dakinhar il-bank irreġistra debitu fit-Telf Mistenni ta' Kreditu ta' €3.5 miljun, li hu €4.7 miljun ogħla mill-€1.2 miljun provvediment imreġġgħa lura taħt l-IAS 39 fl-2017. Iż-żieda minn sena għall-oħra kienet ikkawżata mir-reviżjoni tal-metodu ta' provvediment marbut ma' dejn għal djar li kien ilu hemm u li ma tħallasx, li kien wassal biex ikun hemm irkupru fl-2017.

Fil-provvediment għar-rimedju fil-'brokerage' kien hemm ċaqliq pożittiv ta' €2 miljun fl-2018. Fl-2016, il-bank kien għamel provvediment ta' €8 miljun għar-rigward ta' rimedju li kellu jingħata minħabba nuqqas ġej mill-antik fin-negozju tal-'brokerage' tal-bank. Matul l-2017, il-programm ta' rimedju tlesta kważi kollu u kien meqjus li seta' jsir treġġigħ lura parzjali tal-provvediment li kien ġie stmat b'figura

HSBC Life Assurance (Malta) Limited reported a profit before tax of €3.7m, €3.6m lower than prior year. The decline was largely due to positive market movements in 2017 (+€2m) that were not repeated in 2018 (-€0.2m). A Unit Linked Employee Pension Plan was successfully launched to all HSBC Bank Malta employees in December 2018.

Net loans and advances to customers decreased by 1% to €3,110m. The decline was driven by the corporate loan book due to both risk management actions and a reduction in nonperforming loans. The retail loan book grew by 2% compared with the prior year partially offsetting the reduction in corporate lending. The bank continued to improve the asset quality by managing down non-performing exposures by over 19% versus 31 December 2017.

Customer deposits grew by 3% to €4,887m with a 4% increase in retail deposits more than offsetting the 3% reduction in commercial deposits. The bank maintained a healthy advances to deposits ratio of 64% and its liquidity ratios were well in excess of regulatory requirements.

The financial investments portfolio decreased by 2% to €905m. The bank's risk appetite for investment quality remained unchanged - this portfolio is managed as a high-quality liquidity buffer and consists entirely of securities of sovereign and supranational issuers rated A- (S&P) or better. While the bank partially replaced maturing bonds during the year, attractive investment opportunities in an environment of record low interest rates in Europe were extremely limited.

The bank's capital ratios continued to improve with CET1 increasing from 13.9% to 14.6% and the total capital ratio improving from 14.4% to 17.0%. The additional subordinated loan issued in December was the main driver for the increase in the total capital ratio. The bank continued to have a strong capital base and is fully compliant with the regulatory capital requirements.

The ECB recently introduced new requirements which require the bank to hold additional capital for any unsecured NPLs aged over 2 years and secured NPLs aged over 7 years that are not 100% provided for through IFRS 9 ECL, regardless of security held. To ensure that the bank holds sufficient capital to support future growth as well as meeting these new requirements, the Board has recommended a final dividend pay-out ratio of 30% of net profit. This will bring the full year 2018 dividend pay-out ratio to 47%. The final gross dividend will be 1.8 cent per share (1.2 cent per share net of tax) which brings the total dividend for 2018 to 5.8 cents (3.8 cents net of tax). The final dividend will be paid on 25 April 2019 to shareholders who are on the bank's register of shareholders at 18 March 2019.

konservattiva. Għalhekk, fl-2017 kienet treġġgħet lura somma ta' €1.8 miljun. Fl-2018 sar treġġigħ lura addizzjonali ta' €2 miljun.

Ir-rata tat-taxxa effettiva kienet ta' 26%. Dan kien ifisser spiża ta' taxxa ta' €9.9 miljun, jiġifieri €9.1 miljun inqas mid-€19 miljun spiża tal-2017. Fl-2018 il-bank gawda minn trattament differenti għar-rigward tat-taxxa fuq tranżazzjoni waħda partikolari.

L-HSBC Life Assurance (Malta) Limited irrapportat profitt qabel it-taxxa ta' €3.7 miljun, €3.6 miljun inqas mis-sena ta' qabel. It-tnaqqis kien dovut l-aktar għal ċaqliq pożittiv fis-suq fl-2017 (+€2 miljun) li ma reġgħux seħħu fl-2018 (-€0.2 miljun). F'Diċembru 2018 ġie mniedi b'suċċess Pjan ta' Pensjoni Unit-Linked għall-Impjegati kollha tal-HSBC Bank Malta.

Is-self nett lill-klijenti niżel b'1% għal €3,110 miljun. Dan ġara għax kien hemm tnaqqis fis-self lill-kumpaniji minħabba miżuri li ttieħdu biex jikkontrollaw ir-riskju u wkoll minħabba self li ma baqax jirrendi. Ir-reġistru tas-self personali kiber bi 2% meta mqabbel mas-sena ta' qabel, u patta parzjalment għat-tnaqqis fis-self lill-kumpaniji. Il-bank kompla jtejjeb il-kwalità tal-assi billi l-ammont li bih kien espost għal self li ma jirrendix tniżżel b'aktar minn 19% taħt dak li kien fil-31 ta' Diċembru 2017.

Id-depożiti tal-klijenti kibru bi 3% għal €4,887 miljun, fejn iż-żieda ta' 4% fil-qasam personali pattiet sew għat-tnaqqis ta' 3% fid-depożiti kummerċjali. Il-bank żamm relazzjoni sana bejn is-self u d-depożiti ta' 64%, u kellu relazzjonijiet ta' likwidità li kienu jaqbżu sew dawk rikjesti b'regolament.

Il-portafoll tal-investimenti finanzjarji ċkien bi 2% għal €905 miljun. Id-dispożizzjoni tal-bank għal investimenti ta' kwalità ma nbidlitx. Dan il-portafoll huwa ġestit bħala lqugħ ta' kwalità għolja għal daqqiet fil-likwidità u jikkonsisti minn titoli ta' emittenti sovrani u supranazzjonali kklassifikati A- (S&P) jew aħjar. Waqt li l-bank xtara bonds ġodda minflok uħud li għalqulu matul is-sena, l-opportunitajiet ta' investiment attraenti f'ambjent fejn ir-rati tal-imgħax niżlu f'livell baxx rekord kienu limitati immens.

Il-bank kellu relazzjonijiet ta' kapital li komplew imorru għall-aħjar, bis-CET1 jitla' minn 13.9% għal 14.6% u r-relazzjoni tal-kapital totali minn 14.4% għal 17.0%. Is-self subordinat addizzjonali maħruġ f'Diċembru kien il-fattur ewlieni li għen biex togħla r-relazzjoni tal-kapital totali. Il-bank baqa' jżomm bażi kapitali soda u huwa totalment konformi mar-rekwiżiti regolatorji dwar il-kapital.

Il-Bank Ċentrali Ewropew m'ilux daħħal regoli ġodda li jirrikjedu li l-bank iżomm kapital addizzjonali għal self bla sigurtà li mhuwiex jirrendi li ilu 'l fuq minn sentejn, u għal self b'sigurtà li mhuwiex jirrendi li ilu 'l fuq minn 7 snin li għalih ma jkunx sar provvediment 100% permezz tal-mekkaniżmu tat-Telf Mistenni ta' Kreditu tal-IFRS 9, irrispettivament mis-sigurtà miżmuma. Biex ikun ċert li l-bank jkollu biżżejjed kapital biex isostni t-tkabbir futur u biex jissodisfa dawn ir-rekwiżiti ġodda, il-Bord irrakkomanda proporzjon ta' ħlas ta' dividend finali ta' 30% tal-profitt nett. B'dan, il-proporzjon totali ta' ħlas ta' dividend għas-sena sħiħa 2018 ikun ta' 47%. Id-dividend finali gross ikun ta' 1.8 ċenteżmi għal kull sehem (1.2 ċenteżmi għal kull sehem wara t-taxxa), li jtella' d-dividend totali għall-2018 għal 5.8 ċenteżmi (3.8 ċenteżmi wara t-taxxa). Id-dividend finali jitħallas fil-25 ta' April 2019 lill-azzjonisti li jkunu mniżżla fir-reġistru tal-azzjonisti tal-bank fit-18 ta' Marzu 2019.

HSBC Bank Malta p.l.c. introduced a number of banking innovations.

Retail Banking and Wealth Management ('RBWM')

2018 has been a year of positive strategic change for RBWM and we are pleased with the year-on-year improvements in core trading activity and increased customer focus whilst continuing to embed Financial Crime Compliance standards as part of day-today operations.

Our support to customers by way of mortgages and unsecured lending experienced strong growth which continues to place HSBC as one of the leading financial institutions in Malta and Gozo. We continued to increase the net number of retail customers that trust us with their day-to-day banking relationship, evidenced through strong growth in customer acquisition, thanks to process improvements, upgraded digital channels and best-in-market propositions, namely HSBC Premier and HSBC Advance.

Furthermore, our commitment to support the growing small business community continued with the roll out of HSBC Fusion to also serve companies and partnerships who have turnovers of less than €1m.

A VIP Premier proposition was launched in July to provide best in class service to our top commercial Premier customers. The launch was also combined with a review of HSBC Premier to ensure that the service continues to meet the needs of our high value customers who choose to hold their main banking relationship with HSBC.

Significant transformational investment on digital platforms was made in 2018 to make it easier for our customers to bank with us. We have launched a new public website making it more intuitive and easier for customers to navigate and we were the first bank to launch biometric technology, enabling our customers to access their Mobile Banking on iPhones securely via fingerprint. Substantial progress was also made in introducing new online services. Customers are now able to update their personal information, apply for a banking relationship, request a personal loan and undertake financial risk tolerance assessment all from the comfort of their home without the need of visiting a branch.

Is-Servizzi Bankarji Personali u l-Amministrazzjoni tal-Ġid (l-RBWM)

L-2018 kienet sena ta' bidla strateġika pożittiva għall-RBWM. Aħna kuntenti bit-titjib li sar minn sena għall-oħra fl-attività tan-negozju ċentrali u bil-mira aktar ikkonċentrata li qed inpoġġu fuq il-klijent, waqt li fl-istess ħin nibqgħu ndaħħlu l-istandards ta' Konformità Kontra Reati Finanzjarji bħala parti mill-operat ta' kuljum tagħna.

L-appoġġ li nagħtu lill-klijenti bis-self għad-djar u bis-self bla sigurtà kellu tkabbir qawwi, u dan ikompli jippjazza lill-HSBC bħala waħda mill-istituzzjonijiet finanzjarji ta' quddiem nett f'Malta u Għawdex. Għadna qed inżidu l-għadd nett ta' klijenti personali li jafdawna bir-relazzjoni bankarja ta' kuljum tagħhom, kif juri t-tkabbir qawwi fil-kisba ta' klijenti, grazzi għat-titjib fil-proċessi, il-kanali diġitali ta' livell ogħla, u l-propożizzjonijiet best-in-market, jiġifieri l-HSBC Premier u l-HSBC Advance.

Barra minn dan, komplejna bl-impenn tagħna li nsostnu l-komunità li qed tikber ta' negozji żgħar, billi varajna l-HSBC Fusion biex naqdu kumpaniji u anke negozji bi sħab li l-fatturat tagħhom ma jaqbiżx il-€1m.

F'Lulju inawgurajna wkoll il-propożizzjoni VIP Premier biex nagħtu servizz tal-ogħla klassi lill-klijenti kummerċjali tal-Premier l-aktar preġjati. L-inawgurazzjoni kienet ikkombinata ma' reviżjoni tal-HSBC Premier li kienet intenzjonata biex tassigura li s-servizz jibqa' jaqdi l-ħtiġijiet tal-klijenti b'valur għoli li jagħżlu li jżommu r-relazzjoni bankarja ewlenija tagħhom mal-HSBC.

Fl-2018 sar ukoll investiment għal trasformazzjoni sostanzjali fil-pjattaformi diġitali biex nagħmluha eħfef għall-klijenti biex jaqdu l-ħtiġijiet bankarji tagħhom magħna. Varajna sit elettroniku ġdid għall-pubbliku u għamilnieh aktar intelliġenti u eħfef biex taħdem bih, u konna l-ewwel bank li bdejna bit-teknoloġija bijometrika, li tippermetti lill-klijenti li jaċċessaw il-Mobile Banking fuq l-iPhones b'sigurtà sħiħa permezz tal-marki tas-swaba'. Sar ukoll progress sostanzjali lejn l-introduzzjoni ta' servizzi 'online' ġodda. Il-klijenti issa jistgħu jaġġornaw l-informazzjoni personali tagħhom, japplikaw biex jiftħu relazzjoni bankarja, jitolbu self personali u joqogħdu għal evalwazzjoni tat-tolleranza tar-riskju finanzjarju, kollha mill-kumdità ta' darhom mingħajr il-ħtieġa li jmorru personalment fil-fergħa.

Service improvements were delivered to in-branch processes, with enhancements to our account opening experience for new customers where we have introduced single signature verification, introduction of electronic signature and introduction of digitally assisted services.

2018 was an intense year of transformational regulatory change with a number of new and amended legislations coming into force. The bank has successfully implemented these necessary changes, safeguarding the interest of our customers.

As we look ahead to 2019, we intend to accelerate the transformation agenda through continued investment in best-in-class digital channels, upgrades to major technological platforms, investment in people training and process simplification for the benefit of our people and customers.

Commercial Banking ('CMB')

In 2018, our CMB business continued with its strategic objective of being Malta's leading international bank by offering an excellent customer experience that will enable us to work, succeed and grow together. While revenue and profits in the current challenging environment were down on last year, these were in line with expectations as we managed to strengthen our loan book by considerably reducing NPLs. Future business potential remains healthy.

During the year, work continued on repositioning our customer portfolio to ensure we adhere to the highest compliance standards. While not always easy, having built a safer and stronger bank, the focus is now on reconnecting with our customers and strengthening our commercial banking relationships. This would also complement our selective CMB growth strategy. We are not after just any growth but sustainable growth in economic areas which are compliant, in line with our beliefs, and of value added and beneficial to the economy.

CMB Malta is also using HSBC global expertise to assist clients in receiving the right commercial solutions. We are very much focused on helping our business customers engage in commercial activity overseas. Global connectivity is a unique competitive advantage we can offer. We can

Daħħalna titjib tas-servizz fil-proċessi li nħaddmu ġol-fergħat, fejn issa qed nagħtu esperjenza aħjar lill-klijenti li jridu jiftħu kont magħna, billi introduċejna l-verifika b'firma waħda, kif ukoll firma elettronika u servizzi b'assistenza diġitali.

L-2018 kienet sena intensa għall-bidliet ta' trasformazzjoni regolatorja, fejn bdew iseħħu għadd ta' liġijiet ġodda jew emendati. Il-bank irnexxielu jdaħħal b'suċċess dawn il-bidliet kollha, u baqa' jipproteġi l-interessi tal-klijenti.

Għall-2019, għandna l-ħsieb li ngħaġġlu aktar l-aġenda ta' trasformazzjoni billi nkomplu ninvestu f'kanali diġitali tal-ogħla klassi, intejbu l-livell tal-pjattaformi teknoloġiċi ewlenin, u ninvestu fit-taħriġ tal-ħaddiema u fis-simplifikazzjoni tal-proċessi, għall-benefiċċju tal-impjegati u l-klijenti tagħna.

Is-Servizzi Bankarji Kummerċjali (is-CMB)

Fl-2018, in-negozju tas-CMB kompla jaħdem bil-għan strateġiku li jkun il-bank internazzjonali ta' quddiem nett billi joffri esperjenza eċċellenti lill-klijent li tagħti l-opportunità li naħdmu, nirnexxu u nikbru flimkien. Għalkemm id-dħul u l-profitti fl-ambjent ta' sfida attwali kienu inqas minn tas-sena l-oħra, dawn kienu fil-livell mistenni, peress li rnexxielna nsaħħu r-reġistru tas-self billi naqqasna sew is-self li ma jirrendix. Il-potenzjal tan-negozju għall-futur għadu b'saħħtu.

Matul is-sena, kompliet il-ħidma biex il-portafoll tal-klijenti tagħna nġibuh f'pożizzjoni fejn nassiguraw li nkunu qed naderixxu mal-ogħla standards ta' konformità. Dan ma kienx dejjem faċli, imma wara li ġibna l-bank aktar sod u sigur, issa qed niffokaw biex nerġgħu noqorbu lejn il-klijenti u nsaħħu r-relazzjonijiet bankarji kummerċjali tagħna. Dan isir bħala ħaġa waħda sħiħa mal-istrateġija selettiva tagħna għat-tkabbir tas-CMB. Aħna m'aħniex infittxu tkabbir ikun x'ikun, imma tkabbir sostenibbli f'oqsma ekonomiċi li huma konformi, skont dak li nemmnu aħna, u li joffru valur miżjud u huma ta' benefiċċju għall-ekonomija.

Is-CMB Malta qiegħda wkoll tagħmel użu minn esperti globali tal-HSBC biex tgħin lill-klijenti jsibu soluzzjonijet kummerċjali tajbin. Aħna naħdmu ħafna biex ngħinu l-klijenti kummerċjali tagħna jidħlu f'attività kummerċjali barra minn Malta. Il-konnettività globali hija vantaġġ kompetittiv uniku tagħna. Nistgħu wkoll ningaġġaw

Commercial Banking is greatly positioned to support the growth of the Maltese economy.

also leverage world class capabilities for Maltese business in such areas as project finance, foreign exchange, hedging, trade finance and global payments.

We actively listen to our customers in an ongoing manner to identify key areas which need to be addressed. This insight is then used to make it easier and more convenient to bank with us and improve the overall customer experience. Such initiatives as shortening transaction times, offering efficient online solutions, making it easier to contact us, reducing bureaucracy and unnecessary delays, and investing in HSBC Group systems and the latest advances in technology to offer a better service have all been undertaken. Investment in raising service standards is also ongoing.

We also continued to invest in our people, as it is only through them that we can deliver an excellent customer experience. Our commercial team is constantly undergoing training and continuous professional development to ensure we deliver the best quality service to our customers. Such initiatives include technical training on such topics as cyber security threats, GDPR and personal developments skills in the areas of leadership and presentations. We are also discussing how to create the 'healthiest human system' within the bank, which is refreshing and exciting.

Our commitment to the local business community is also evident through our ongoing cooperation with the Malta Chamber of Commerce, Industry and Enterprise and Trade Malta. We once again supported the EY Malta Attractiveness Conference and organised various thought leadership and networking events and activities that showcase our international expertise and global reach for the benefit of the local business community.

Ultimately, we are here to serve our customers. By placing them at the heart of everything we do we will be fulfilling our aspiration of helping our clients realise their plans and ambitions and supporting the Maltese economy to grow.

Global Markets ('GM')

2018 has been a challenging year for Global Markets as the business continued to face tough external market factors. Balance sheet management (Corporate Centre), which manages cash, liquidity, funding and interest rate risk for the entity, continues to experience challenges from the prevailing negative interest rate environment. The Hold to Collect and Sell portfolio is mainly invested in very high quality liquid assets rated A- or higher, reflecting our conservative risk appetite which is delivering very low to negative revenue performance.

However trading profits were slightly above those earned in 2017. Underlying foreign exchange sales were strong notwithstanding increased competition. Collaboration with CMB remained an important source of revenue growth and on top of GM's strategic priorities. CMB clients continue to benefit from the technical expertise and digital solutions of HSBC Group.

During the year GM together with CMB organised various client events during which industry leading specialists interacted with our clients directly.

kapaċitajiet ta' klassi dinjija għan-negozji Maltin f'oqsma bħall-finanzjament ta' proġetti, kambju, 'hedging', finanzjament għall-kummerċ u pagamenti globali.

Aħna nisimgħu lill-klijenti tagħna attentament u kontinwament biex inkunu nistgħu nidentifikaw punti li għandhom bżonn jiġu indirizzati. Dak li nitgħallmu mbagħad nużawh biex nirrendu l-esperjenza ġenerali tal-klijent aħjar u nagħmluha aktar faċli u aktar konvenjenti. Bosta inizjattivi, pereżempju li nqassru l-ħin tat-tranżazzjonijiet, li noffru soluzzjonijiet effiċjenti 'online', li nagħmluha eħfef biex tikkuntattjawna, li nnaqqsu l-burokrazija u d-dewmien żejjed, u li ninvestu fis-sistemi tal-Grupp HSBC u fl-aħħar avvanzi fit-teknoloġija biex nagħtu servizz aħjar – dawn kollha adottajniehom. U għaddejjin ukoll b'investiment biex ngħollu l-istandards tas-servizz.

Komplejna wkoll ninvestu fin-nies tagħna, għax wara kollox hu permezz tagħhom li nistgħu nagħtu esperjenza eċċellenti lill-klijenti tagħna. It-tim kummerċjali tagħna jirċievi kontinwament programmi ta' taħriġ u ta' żvilupp professjonali kontinwu biex naraw li noffru servizz tal-aqwa kwalità lill-klijenti tagħna. Dawn l-inizjattivi jinkludu taħriġ tekniku dwar suġġetti bħal theddid għas-sigurtà tas-sistemi elettroniċi, GDPR u ħiliet fl-iżvilupp personali fl-oqsma tat-tmexxija u l-preżentazzjoni. Qed niddiskutu wkoll kif nistgħu noħolqu 'l-Aktar Sistema Umana Sana' fi ħdan il-bank, idea tassew friska u eċċitanti.

L-impenn tagħna lejn il-komunità kummerċjali lokali jidher ċar ukoll mill-kooperazzjoni li għandna għaddejja mal-Kamra tal-Kummerċ, Industrija u Intrapriża u ma' Trade Malta. Erġajna tajna l-appoġġ tagħna fl-EY Malta Attractiveness Conference u organizzajna diversi attivitajiet ta' 'thought leadership' u 'networking' fejn joħroġ l-għarfien espert internazzjonali tagħna u l-firxa globali li nilħqu għall-benefiċċju tal-komunità kummerċjali lokali.

Fl-aħħar mill-aħħar aħna qegħdin hawn biex naqdu lill-klijenti tagħna. Meta nqegħduhom fil-qalba ta' dak kollu li nagħmlu nkunu qed inwettqu l-aspirazzjoni tagħna li nassistu lill-kijenti biex jirrealizzaw il-pjani u l-ambizzjonijiet tagħhom u ngħinu fl-espansjoni tal-ekonomija Maltija.

Is-Swieq Globali (GM)

Is-sena 2018 kienet sena ta' sfida għall-GM, hekk kif in-negozju kompla jħabbatha ma' fatturi esterni diffiċli fis-suq. Dawk li jamministraw il-karta tal-bilanċ (fil-Corporate Centre), li jieħdu ħsieb il-flus, il-likwidità, il-finanzjament u r-riskju marbut mar-rati tal-imgħax għall-entità, komplew jiffaċċaw sfidi mill-ambjent prevalenti ta' rati ta' mgħax negattivi. Il-portafoll Miżmum għad-Dħul u l-Bejgħ huwa investit prinċipalment f'assi likwidi ta' kwalita' għolja ħafna kklassifkati A- jew ogħla, li jirrifletti d-dispożizzjoni konservattiva tagħna għar-riskju li iżda jirrendi introjtu baxx ħafna jew saħansitra negattiv.

Madankollu il-profitti min-negozju kienu ogħla minn dawk tal-2017. Fil-bażi kien hemm bejgħ ta' kambju mhux ħażin minkejja li żdiedet il-kompetizzjoni. Il-kollaborazzjoni mas-CMB baqgħet sors importanti biex jikber id-dħul u kienet fuq nett fil-prijoritajiet strateġiċi tal-GM. Il-klijenti tas-CMB jibqgħu dejjem igawdu mill-għarfien tekniku u s-soluzzjonijiet diġitali tal-Grupp HSBC.

Matul is-sena l-GM u s-CMB flimkien organizzaw diversi attivitajiet għall-klijenti fejn speċjalisti ewlenin fl-industrija setgħu jitkellmu direttament mal-klijenti tagħna.

HSBC Operations, Services & Technology ('HOST')

HOST run customer operations for the businesses, such as processing our clients' loans, mortgages and investments, and help manage change in the bank, deliver and manage technology and provide professional services to the bank like Procurement and Real Estate Management.

In 2018 we supported our business lines to implement the Fusion proposition and to provide a streamlined customer onboarding process. Furthermore, we completed the transformation of our flagship corporate banking centre. This included a new VIP lounge and meeting rooms complete with a host of amenities.

Managing Operational Risk remained high on our agenda and this year we adopted a cash handling model that poses less risk to our employees and improves operational efficiencies. We have also upgraded our Banking and ATM infrastructure in order to keep abreast with the latest technology updates and security features. We have also delivered a number of Regulatory projects such as GDPR, Consumer Protection Regulation (MiFID II, IDD, PRIIPS), Global Liquidity Reporting System (GLRS), Basel Committee on Banking Supervision (BCBS) and IFRS 9.

Furthermore, as part of our on-going cyber risk management programme, 113 employees in high risk roles received training with the aim to improve cyber security awareness within business environments. This was an industry accredited course, providing delegates with a formal qualification in cyber security.

Another focus area is ensuring that we operate in environments of the highest health and safety standards whilst increasing awareness amongst our staff. For the second consecutive year, we organised a health and safety day for the staff which included sessions led by speakers from the Richmond Foundation, ISTC and Mater Dei Hospital.

This year, HOST was also the key driver to raise awareness across the bank on paper usage. This led to a reduction of c. 1.5 million sheets of paper which translates into a 25% reduction when compared to the previous year. Other sustainability initiatives are aimed at reducing plastic by eliminating disposables from our canteen and introducing waste separation and recycling in Head Office in Qormi.

Our people

People are at the centre of everything we do. As an organisation, we strive to create the Healthiest Human System where our main concern is to serve our customers and each other. We want our people to be authentic and showing concern for those around us in everything we do.

We are very proud to have launched our People Strategy 2018-2020 during 2018. This three year plan focuses on creating the Healthiest Human System and a High Performing Organisation whereby becoming the best is not an option but a mission.

This past year we have continued to drive our diversity and inclusion agenda through the launch of the National Business Woman of the Year Award under the patronage of Her Excellency, the President of Malta, Marie Louise Coleiro Preca. This makes HSBC the first private company to launch such an initiative in Malta to continue promoting women leaders in business.

L-Operazzjonijiet, is-Servizzi u t-Teknoloġija tal-HSBC ('HOST')

Il-HOST jaqdu t-taqsimiet tan-negozju billi jaħdmulhom l-operazzjonijiet tal-klijenti, pereżempju jipproċessaw is-self u l-investiment tal-klijenti, u jgħinu fil-ġestjoni tal-bidla fil-bank; jinstallaw u jamministraw it-teknoloġija u jagħtu servizzi professjonali lill-bank, pereżempju l-akkwist tal-bżonnijiet u l-amministrazzjoni tal-proprjetà.

Fl-2018 assistejna t-taqsimiet tan-negozju fl-implimentazzjoni tal-proposta Fusion, u fil-provvista ta' proċess razjonalizzat għad-dħul ta' klijenti ġodda. Barra minn hekk, lestejna t-trasformazzjoni taċ-ċentru bankarju korporattiv ewlieni tagħna. Dan kien jinkludi sala ġdida għall-VIPs u kmamar għal-laqgħat attrezzati bil-ħtiġijiet kollha.

L-immaniġġjar tar-Riskju mill-Operat baqa' fuq quddiem fl-aġenda tagħna, u dis-sena adottajna mudell għall-flus kontanti f'idejn il-kaxxiera li jtaffi r-riskju għall-impjegati u jżid l-effiċjenza fl-operazzjoni. Għollejna l-livell tal-infrastruttura tal-ambjent bankarju u tal-ATMs sabiex inżommu aġġornati mal-aħħar xejriet fit-teknoloġija u s-sigurtà. U implimentajna wkoll għadd ta' proġetti regolatorji bħall-GDPR, regolamenti ta' protezzjoni tal-konsumatur (MiFID II, IDD, PRIIPS), GLRS, BCBS u l-IFRS 9.

Barra minn hekk, bħala parti mill-programm kontinwu tagħna għall-immaniġġjar tar-riskju fis-sistemi teknoloġiċi, 113-il impjegat li jaħdmu fi rwol ta' riskju għoli ngħataw taħriġ bil-għan li titjieb il-kuxjenza ta' sigurtà fl-ambjenti tan-negozju. Dan kien kors akkreditat mill-industrija, li wassal lid-delegati li jieħdu kwalifika formali fis-sigurtà tas-sistemi teknoloġiċi.

Qasam ieħor ta' attenzjoni huwa li nassiguraw li noperaw f'ambjenti tal-ogħla standards ta' saħħa u sigurtà waqt li nkabbru l-għarfien fost il-ħaddiema. Għat-tieni sena wara l-oħra organizzajna jum ta' saħħa u sigurtà għall-ħaddiema li kien jinkludi taħditiet minn kelliema ġejjin mir-Richmond Foundation, l-ISTC u l-Isptar Mater Dei.

Dis-sena wkoll, il-HOST kien strumentali biex iqajjem kuxjenza dwar l-użu tal-karta fil-bank. Dan wassal għal konsum inqas ta' miljun u nofs folja karti, li jfisser 25% inqas mis-sena l-oħra. Inizjattivi oħra ta' sostenibilità għandhom l-għan li jirriduċu l-użu tal-plastik billi fil-'canteen' ma jintużawx materjali li jintremew u billi jiddaħħlu s-separazzjoni u r-riċiklaġġ tal-iskart fis-sede ta' Ħal Qormi.

In-nies tagħna

In-nies huma fiċ-ċentru ta' kull ma nagħmlu. Bħala organizzazzjoni qed nistinkaw biex noħolqu l-Aktar Sistema Umana Sana, fejn l-ewwel interess ikun li nservu lill-klijenti tagħna u lil xulxin. Irridu li n-nies tagħna jkunu awtentiċi u li f'kull ma jagħmlu jieħdu interess f'dawk ta' madwarhom.

Aħna kburin li fl-2018 varajna l-Istrateġija għan-Nies għall-2018-2020. Dan il-pjan ta' tliet snin jiffoka fuq il-ħolqien tal-Aktar Sistema Umana Sana u ta' Organizzazzjoni ta' Prestazzjoni Għolja, fejn il-mira li nkunu l-aqwa mhijiex sempliċi għażla imma missjoni.

Din l-aħħar sena komplejna nimbuttaw l-aġenda ta' diversità u inklużjoni permezz tat-tnedija tal-Premju Nazzjonali Business Woman of the Year taħt il-patroċinju tal-Eċċelenza Tagħha il-President ta' Malta Marie Louise Coleiro Preca. B'dan l-HSBC saret l-ewwel kumpanija privata f'Malta li varat inizjattiva bħal din biex tkompli tinkoraġġixxi lin-nisa jieħdu post ta' quddiem fin-negozju.

HSBC Bank Malta p.l.c. launched the Employee Pension Plan which was a success.

We have launched numerous sessions on performance management for all our line managers to increase their capabilities and support our people strategy. We continued to invest in the development of our people with a focus on personal development planning to enable them to perform at their best. The aim was to encourage our employees to drive their development and growth opportunities within the organisation. One of the milestones achieved was the launch of our new HR Information System (HRIS). This system is a state of the art platform which enables our employees to access information that helps them perform their job better. All our people data and processes sit in this HRIS platform which provides details of the whole employee life cycle. Through extensive people insights and different reporting tools, we can understand our strengths and areas of improvement.

2018 closed with another big achievement as we launched the Employee Pension Plan. The employee pension plan is a true sign of the commitment HSBC has in its people as we invest today to safeguard their future. The pension plan was a joint success between the bank and the Malta Union of Bank Employees (MUBE).

We are all very proud to end the year once again as winners, recognised by the Financial Times as Malta's Best Bank. This is indeed a recognition that goes to all our people who have continued to uphold the highest standards in the banking sector.

Compliance

HSBC continued to demonstrate its commitment to the highest global standards of financial crime compliance in 2018. HSBC appreciates that our high standards have at times caused inconvenience for clients as we seek to understand our customers and their interaction with the bank, and we take this opportunity to thank them for their patience and understanding. We believe that this important work provides security to the financial system and to all those who use it. High compliance standards in the banking system continue to be a source of strength and competitive advantage not only for our customers but also for the country, as we work diligently to support growth in Malta's economy by facilitating new business and cross-border trade.

Nedejna għadd ta' sessjonijiet fuq it-tmexxija għar-riżultati, indirizzati għal-'line managers' tagħna biex iżidu l-kapaċitajiet tagħhom u nsostnu l-istrateġija tagħna għall-ħaddiema. Investejna aktar fl-iżvilupp tan-nies tagħna u ffokajna fuq l-ippjanar tal-iżvilupp personali biex ngħinuhom jaslu għall-aħjar riżultati f'xogħolhom. Il-mira kienet li nħeġġu 'l-impjegati jisfruttaw l-opportunitajiet ta' żvilupp u avvanz li jkollhom fl-organizzazzjoni.

Waħda mill-kisbiet li għamilna kienet l-inawgurazzjoni tas-Sistema Informatika ġdida għall-HR (HRIS). Din is-sistema hija pjattaforma tal-aħħar teknoloġija li fiha l-impjegati jistgħu jaċċessaw informazzjoni li tgħinhom jagħmlu xogħolhom aħjar. L-informazzjoni u l-proċessi kollha li jirrigwardaw in-nies tagħna jinstabu fl-HRIS, li tipprovdi dettalji taż-żmien kollu tal-impjieg tal-impjegat. Bl-intuwizzjoni estensiva tan-nies tagħna u b'għodod differenti ta' rappurtaġġ nistgħu naslu biex nifhmu fejn aħna b'saħħitna u fejn hemm bżonn ta' titjib.

Għalaqna l-2018 b'kisba oħra sinjifikanti, meta varajna l-Pjan ta' Pensjoni għall-Impjegati. Il-pjan ta' pensjoni għall-impjegati huwa sinjal li juri verament l-impenn li l-HSBC għandu lejn l-impjegati hekk kif ninvestu llum biex inħarsu l-futur tagħhom. Il-pjan ta' pensjoni kien suċċess li nkiseb flimkien bejn il-bank u l-Malta Union of Bank Employees (l-MUBE).

Aħna kollha kburin li nagħlqu s-sena bħala rebbieħa, b'rikonoxximent mill-Financial Times bħala l-aħjar bank f'Malta. Dan huwa tassew rikonoxximent għan-nies kollha tagħna li baqgħu dejjem iżommu l-ogħla standards fis-settur bankarju.

L-osservanza tar-regolamenti

L-HSBC kompla matul l-2018 juri kemm hu impenjat li jżomm l-ogħla standards globali ta' osservanza kontra r-reati finanzjarji. L-HSBC japprezza li dawn l-istandards għoljin setgħu xi drabi ġabu inkonvenjenza lill-klijenti tagħna, hekk kif nagħmlu l-aħjar tagħna biex nifhmu lill-klijenti u l-interazzjoni tagħhom mal-bank. Nieħdu din l-opportunità biex nirringrazzjawhom għall-paċenzja u l-mogħdrija tagħhom. Aħna nemmnu li dan ix-xogħol importanti joffri sigurtà lis-sistema finanzjarja u lil kull min jużaha. L-eżiġenzi għolja tal-osservanza tar-regolamenti fis-sistema bankarja jibqgħu jkunu għajn ta' saħħa u vantaġġ kompetittiv mhux biss għall-klijenti tagħna imma wkoll għall-pajjiż,

Executive Committee (EXCO)

The bank's Executive Committee during 2018 was comprised of the following team members:

Andrew Beane	Chief Executive Officer
Nikolaos Fertakis	Chief Operating Officer
Emma Nuttall	Chief Financial Officer
Daniel Robinson	Head of RBWM
Michel Cordina	Head of CMB
Irina Seylanyan	Head of GM
Joyce Grech	Chief Risk Officer
Caroline Buhagiar Klass	Head of Human Resources
Anna Camilleri	Head of Internal Audit
Joseph Sammut	General Counsel
Jane Estey	Head of Financial Crime Compliance
Anthony P. Abela	Head of Regulatory Compliance
Franco Aloisio	Head of Communications
George Brancaleone	Company Secretary

Outlook

Looking to the future, the outlook for the local economy remains favourable with strong GDP growth, low unemployment and inflation and government finances forecast to remain in surplus.

As I have commented earlier in this report, amidst this positive economic landscape, it is essential to ensure sustainable and measured growth. That is our primary focus during 2019.

I would like to thank my colleagues for their outstanding commitment to HSBC in 2018 and our customers and shareholders for their continued trust.

Andrew Beane, Chief Executive Officer
19 February 2019

speċjalment fil-ħidma li nagħmlu bil-għaqal biex insostnu t-tkabbir tal-ekonomija Maltija billi niffaċilitaw in-negozju ġdid u l-kummerċ ma' barra minn Malta.

Il-Kumitat Eżekuttiv (EXCO)

Il-Kumitat Eżekuttiv tal-bank matul l-2018 kien magħmul minn dawn il-membri:

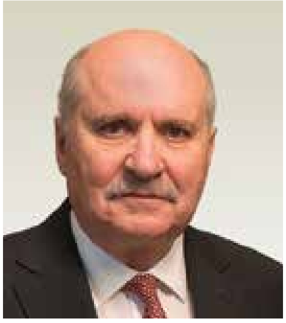
Andrew Beane	Kap Eżekuttiv
Nikolaos Fertakis	Kap Operattiv
Emma Nuttall	Kap tal-Finanzi
Daniel Robinson	Kap tal-RBWM
Michel Cordina	Kap tas-CMB
Irina Seylanyan	Kap tal-GM
Joyce Grech	Kap tar-Riskju
Caroline Buhagiar Klass	Kap tar-Riżorsi Umani
Anna Camilleri	Kap tal-Verifika Interna
Joseph Sammut	Kunsill Ġenerali
Jane Estey	Kap tal-Konformità dwar Reati Finanzjarji
Anthony P. Abela	Kap tal-Osservanza Regolatorja
Franco Aloisio	Kap tal-Komunikazzjoni
George Brancaleone	Segretarju tal-Kumpanija

Ħarsa 'l quddiem

Għall-quddiem, il-prospettiva tal-ekonomija lokali għadha ottimista, bi tkabbir sod fil-GDP, qgħad u inflazzjoni baxxi u tbassir għal bilanċ favorevoli fil-finanzi tal-gvern.

Kif diġà kkummentajt f'dan ir-rapport, f'din ix-xena ekonomika pożittiva huwa essenzjali li nassiguraw li t-tkabbir ikun sostenibbli u meqjus. Dan hu li se nikkonċentraw primarjament l-attenzjoni tagħna fuqu fl-2019.

Nixtieq nirringrazzja lill-kollegi tiegħi għall-impenn straordinarju tagħhom lejn l-HSBC fl-2018 u lill-klijenti u l-azzjonisti għall-fiduċja li dejjem jagħtuna.



Saviour sive Sonny Portelli, NON-EXECUTIVE CHAIRMAN

Appointed Chairman of HSBC Bank Malta p.l.c. on 31 May 2013 after having served as Director on the Board since 9 October 2006. Has a background in tourism, the hospitality industry, telecoms and general management, with significant international experience. In connection with these roles, Mr Portelli served on a number of Boards and trade organisations. His previous roles included being Chairman of the Board and of the Executive Committee of GO p.l.c., Executive Chairman of Air Malta p.l.c., Director of Forthnet SA (Greece), and Chairman of the Malta Council for Economic and Social Development. Mr Portelli is also former Chairman of the bank's Audit and Risk Committee and is presently Chairman of the bank's Remuneration and Nomination Committee.

Andrew Beane, DIRECTOR AND CHIEF EXECUTIVE OFFICER

Appointed Chief Executive Officer on 2 November 2015 and Director on 31 March 2016. Prior to taking up his appointment in Malta, Mr Beane was Chief of Staff to the CEO of HSBC Europe, Middle East and Africa in which capacity he served as a member of the Executive and Risk Committees of HSBC Bank plc. Mr Beane has been with the HSBC Group since 2002 and his previous roles include assignments in the United Kingdom, United Arab Emirates, Hong Kong and the United States, principally in the areas of Commercial Banking and Strategy & Planning.

Christopher Davies, NON-EXECUTIVE DIRECTOR

Appointed Director of the bank on 9 May 2014. Holds the roles of Group General Manager, Chief Executive Officer International Europe, HSBC Bank p.l.c. and Deputy Chief Executive Officer, HSBC France. Mr Davies also has directorships in companies forming part of the HSBC Group. Former Deputy Chief Executive Officer and Executive Director, HSBC Bank (China) Company Limited. Prior to moving to China, Mr Davies ran HSBC's Commercial Banking business in North America, following a series of senior appointments across all of HSBC's major business lines, principally in the UK and the Americas.

Michel Cordina, DESIGNATE EXECUTIVE DIRECTOR

Appointed Executive Director subject to regulatory approval. Mr Cordina started his banking career in 1981 with Mid-Med Bank Ltd and then joined HSBC in 1999. He has worked in various areas of banking in both Personal Banking and Commercial Banking. He has also led a number of operational and support Functions of the bank. He has occupied various executive roles within HSBC Bank Malta including: Deputy Head of Operations, Head of Business Transformation and was also the programme manager responsible for bringing the HBEU Contact Centre to Malta. In 2010, he was seconded to HSBC Commercial Banking in London where he performed the role of Head of Sales Performance. Mr Cordina is presently the Head of Commercial Banking where he has the responsibility for all aspects of the Bank's commercial banking activities in Malta. He is an Associate of the Chartered Institute of Bankers (ACIB).

Yiannos Michaelides, NON-EXECUTIVE DIRECTOR

Appointed Director of the bank on 26 May 2017. Presently Member of the bank's Risk Committee. Mr Michaelides has over 26 years of international business experience involving telecoms and media. Till 31 March 2017, Mr Michaelides occupied the post of Group CEO of GO p.l.c. Before joining GO p.l.c. he was Senior Executive at EITL Dubai, GO p.l.c.'s prior main shareholder, with responsibilities including portfolio management and value creation at EITL portfolio companies. Prior to that, he worked as Vice-president of Strategic Marketing at du in Dubai, the new integrated telecoms operator in the UAE and Areeba, the second mobile operator in Cyprus. Mr Michaelides holds a B. Eng. (Honours), M. Eng. from McGill University (Montreal, Canada) and an M.B.A. with distinction from Warwick Business School (UK).

John Bonello, NON-EXECUTIVE DIRECTOR

Appointed Director of the bank on 15 July 2013. Chairman of the bank's Audit Committee and Member of the bank's Risk Committee and former Chairman of the bank's Remuneration and Nomination Committee. Mr Bonello is a Chartered Accountant and a Certified Public Accountant. He was formerly the Chairman and Senior Partner of PricewaterhouseCoopers in Malta from where he retired in December 2009. He is a Fellow of the Malta Institute of Accountants and Chairman of the Disciplinary Committee of the Institute and a Member of the Joint Disciplinary Board of the Accountancy Board.

Maryanne sive Sue Vella, NON-EXECUTIVE DIRECTOR

Appointed Director of the bank on 27 May 2016. Presently Senior Lecturer at the University of Malta on Social Policy and a member of the National Centre for Family Research within the President's Foundation for Social Wellbeing. Former Chief Executive Officer of Malta Enterprise Corporation and of the Employment and Training Corporation respectively, and former Vice-President of the EU's Employment Committee. Doctor of Philosophy in Social Policy & Social Work, Master of Science in Social Policy & Planning and Bachelor of Arts in Psychology. Dr Vella is a Member of the bank's Remuneration and Nomination Committee.

Andrew Muscat, NON-EXECUTIVE DIRECTOR

Appointed Director of the bank on 16 January 2014. Partner at Mamo TCV Advocates where he heads the Corporate & Banking Department. Professor at the Faculty of Laws of the University of Malta. Professor Muscat also has two directorships in two different groups of companies and two other directorships in other companies. Former Director of Mid-Med Bank p.l.c. and also former member of the Board of Governors of the Malta Financial Services Authority. Presently Member of the bank's Audit Committee and of the bank's Remuneration and Nomination Committee.

Gordon Cordina, NON-EXECUTIVE DIRECTOR

Appointed Director of the bank on 1 February 2017. Presently operates as a consultant on economic matters at E-Cubed Consultants Ltd, where he is an Executive Director. Dr Cordina also holds a visiting position at the Department of Economics at the University of Malta. Dr Cordina formerly held the following roles: Economist/Head of the Economic Research Department at the Central Bank of Malta, Director General of the National Statistics Office, Head of the Economics Department of the University of Malta and Economic Advisor to the Malta Council for Economic and Social Development. Dr Cordina also occupied the role of Non- Executive Director at Bank of Valletta p.l.c. up to 2013. Holds a B.Com (Honours) and a doctorate in Economics from the University of Malta and read a Masters in Economics at University of Cambridge.

George Brancaleone, COMPANY SECRETARY

Company Secretary of HSBC Bank Malta p.l.c. since 1 June 2004. Joined the bank in 1980, graduated LL.D. in 1988 and read an MA Degree in Contemporary European Studies (Sussex University 1993). Company Secretary of various HSBC subsidiaries in Malta since 2001.

Andrew Beane, DIRECTOR AND CHIEF EXECUTIVE OFFICER

Appointed Chief Executive Officer on 2 November 2015 and Director on 31 March 2016. Prior to taking up his appointment in Malta, Mr Beane was Chief of Staff to the CEO of HSBC Europe, Middle East and Africa in which capacity he served as a Member of the Executive and Risk Committees of HSBC Bank plc. Mr Beane has been with the HSBC Group since 2002 and his previous roles include assignments in the United Kingdom, United Arab Emirates, Hong Kong and the United States, principally in the areas of Commercial Banking and Strategy & Planning.

Nikolaos Fertakis, CHIEF OPERATING OFFICER

Appointed Chief Operating Officer in April 2016. Mr Fertakis has over 24 years of experience in the banking sector with specialisation in Information Systems and Operations. He joined HSBC in Greece in 2011 initially assuming the duties of IT Director and two years later was promoted to the role of Head of IT Operations International Europe. Since early 2014 Mr Fertakis was appointed Chief Operating Officer of the HSBC's operations in Greece. He holds a Degree in Mechanical Engineering, an MSc in Information Systems from Kingston University and an MBA with specialisation in Banking and Finance from Kingston University - ICBS Athens Business School.

Emma Nuttall, CHIEF FINANCIAL OFFICER

Appointed Chief Financial Officer on 27 June 2018. Mrs Nuttall has over 20 years international experience in Banking & Finance. She joined the HSBC Group in 2013 and has worked across senior finance roles in Global Commercial Banking (UK) and most recently as Head of Commercial Banking Finance, Global Finance Operations, India. Mrs Nuttall was previously employed with Barclays Bank where she joined in 1998 as part of the Finance Graduate Scheme and worked in a number of senior finance roles across various geographies including UK, South Africa and Seychelles. She is a professionally qualified Chartered Management Accountant and holds a Bachelor of Science Honours Degree in Mathematics and Management Studies from the University of Nottingham.

Daniel Robinson, HEAD OF RETAIL BANKING AND WEALTH MANAGEMENT

Appointed to the current role in April 2016. Mr Robinson has extensive experience in a range of Senior RBWM leadership roles in the HSBC Group, including Programme Director, Head of Business Management and Performance Director at HSBC UK RBWM. Mr Robinson holds a Bachelor of Engineering in Automotive Engineering from Oxford Brookes University.

Michel Cordina, DESIGNATE EXECUTIVE DIRECTOR AND HEAD OF COMMERCIAL BANKING

Recently appointed as Executive Director, subject to regulatory approval. Was appointed Head of Commercial Banking on 1 June 2011. Prior to taking up this appointment, Mr Cordina was Deputy Head of CMB. Mr Cordina is a banking professional and has over 37 years' experience with HSBC. He has worked in the United Kingdom as the Head of Sales Performance for CMB, in the branch network in Malta for both retail and commercial banking and in a number of Head Office departments, where he was Deputy Head of Operations and Head of Business Transformation.

Irina Seylanyan, HEAD OF GLOBAL MARKETS

Appointed Head of the then Global Banking & Markets in May 2016. Ms Seylanyan has extensive background in Global Markets, most notably as Deputy CEO and Head of Global Markets of HSBC Bank Armenia. Prior to taking up her appointment in Malta, Ms Seylanyan held a senior managerial role with HSBC Global Commercial Banking in London, where she was responsible for regulatory change. Ms Seylanyan is an Automated Systems engineer and a fellow of the Association of Chartered Certified Accountants.

Caroline Buhagiar Klass, HEAD OF HUMAN RESOURCES

Appointed as Head of Human Resources in April 2018. Ms Buhagiar Klass began her HR career with ST Microelectronics in Malta in the 1990s before moving overseas in 2004 to work for ST in both France and then Italy. In 2010 she moved to Singapore, initially with ST before becoming the Head of Talent and Leadership Development for AXA. In 2015 she returned to Malta and established her own HR consultancy working with a range of local businesses.

Joyce Grech, CHIEF RISK OFFICER

Appointed Chief Risk Officer in April 2013. Ms Grech has worked with HSBC for 22 years. During her career, Ms Grech has undertaken a number of roles, principally in Malta. Ms Grech started her career in Trade Finance and Commercial Banking before moving to the bank's Credit department where she spent over five years, the last three of which she was the Deputy Head of Credit. Before taking up her role as Chief Risk Officer she worked in the bank's Retail Banking and Wealth Management division where she headed the Customer Value Management department.

Anna Camilleri, HEAD OF INTERNAL AUDIT

Appointed as Head of Internal Audit on 16 November 2015. Prior to joining the bank Ms Camilleri held the post of Senior Manager - Governance, Risk & Compliance Services at PwC. Ms Camilleri is a fellow of the Association of Chartered Certified Accountants, holds a Maltese Practising Certificate in Auditing and is a retired Information Systems and Controls specialist. She has a strong auditing background and has managed numerous complex internal audit and business process re-engineering assignments both in Malta and internationally.

Joseph Sammut, GENERAL COUNSEL

Appointed General Counsel in July 2016. Joined the bank in 1981, then Mid-Med Bank, and subsequently read law at the University of Malta, where he graduated in 1988. He obtained his postgraduate degree in European Law at the College of Europe in Bruges in 1989. At the bank's Legal Office he worked for some years as a contracts lawyer and subsequently focused mainly on financial services. Since 1999 he was entrusted with leading the legal advice team and in 2010 worked at HSBC Head Office in London on a short-term legal assignment. He was appointed Deputy General Counsel in 2012.

Anthony P. Abela, HEAD OF REGULATORY COMPLIANCE

Appointed as Head of Regulatory Compliance for HSBC Bank Malta p.l.c. in March 2014. With 23 years' experience in banking and financial services at HSBC, Mr Abela held senior management positions in fund management, securities services, internal audit and compliance. He holds a Bachelor's Degree in Economics and Psychology, and a Master's Degree in Business Administration.

Jane E. Estey, HEAD OF FINANCIAL CRIME COMPLIANCE

Appointed as Head of Financial Crime Compliance in September 2018. Ms Estey joined HSBC Group in 1989. After working in HSBC Canada for a number of years she moved to Hyderabad in India, leading large customer facing and operations teams within HOST before returning to Canada as Chief Operating Officer for FCC and RC. In 2016 she joined HSBC Bermuda as Head of Financial Crime Compliance Transformation.

Carine Arpa, HEAD OF COMMUNICATIONS

Ms Arpa was appointed Head of Communications in January 2019, bringing over 15 years of experience in the fields of communications, marketing and media relations. Ms Arpa undertook a number of different roles in the course of her career, including leading communications and marketing campaigns for the National Euro Changeover Committee, the European Commission Representation in Malta, KPMG and most recently EY. She holds a degree in Psychology and a Master's in European Studies. She is currently reading for an MBA at Henley Business School, University of Reading.

George Brancaleone, COMPANY SECRETARY

Company Secretary of HSBC Bank Malta p.l.c. since 1 June 2004. Joined the bank in 1980, graduated LL.D. in 1988 and read an MA Degree in Contemporary European Studies (Sussex University 1993). Company Secretary of various HSBC subsidiaries in Malta since 2001.

The bank provides a comprehensive range of banking and financial related services. The bank is authorised to carry on the business of banking, under the Banking Act, 1994 as a credit institution. It is also a licensed financial intermediary in terms of the Financial Markets Act, 1990. The bank also holds Category 3 and Category 4 Investment Services licences issued by the Malta Financial Services Authority in terms of the Investment Services Act, 1994. These licences authorise the bank to provide investment services to third parties and custodian services for collective investment schemes respectively. As at 31 December 2018 the bank had 22 branches and agencies in Malta, one of which is located in Gozo.

The local group comprised the following subsidiaries at 31 December 2018: HSBC Life Assurance (Malta) Limited and HSBC Global Asset Management (Malta) Limited.

Principal activities of subsidiaries

HSBC Life Assurance (Malta) Limited is authorised by the Malta Financial Services Authority to carry on business of insurance in Malta under the Insurance Business Act (chapter 403, Laws of Malta). It offers a range of protection and investment life assurance products distributed mainly through HSBC Bank Malta p.l.c. which is enrolled as a tied insurance intermediary for HSBC Life Assurance (Malta) Limited under the Insurance Intermediaries Act, 2006.

HSBC Global Asset Management (Malta) Limited is the investment solutions provider of the HSBC Group in Malta. It manages an array of funds which have exposure to both Maltese and international financial markets. HSBC Global Asset Management (Malta) Limited specialises in the provision of tailor-made discretionary portfolio management services for institutions and family offices.

Business and strategy

The purpose of the local group is to connect customers to opportunities, enable businesses to thrive and ultimately help people to fulfil their hopes and realise their ambitions. The group is part of HSBC, which has an average of 243,000 employees working across the world to provide more than 39 million customers with a broad range of banking products and services to meet their financial needs.

In this respect, the local group conducts its business through supporting the sustained success of its people, customers and communities. The local group sees investment in capabilities, employees and processes as a source of long-term competitive advantage. The way the local group carries out its business strengthens the durability of its earnings and its ability to return value to shareholders.

HSBC values underpin how the local group carries out business. It is open to differences and believes diversity makes it stronger. The bank is connected, and deems personal relationships are essential to the way of doing business. The bank is dependable in fulfilling its responsibilities in society and delivering on commitments.

Consequently, the local group's strategy and strategic direction is embedded in HSBC's strategy, which aims to capture value from its international network. It is built around long-term trends, which is reinforced by increasing global connectivity through increased international flow of goods, services and finance, aided by the development of technology and data in personal and commercial exchanges. The unrivalled global presence of HSBC reflects the local group's distinctive advantages.

In line with HSBC's global banking model, the local group manages its products and services to serve its customers, from individual savers to large multinational corporations, through three businesses: RBWM, CMB and GM.

This banking model enables the local group to effectively meet clients' diverse financial needs, support a strong capital and funding base, reduce risk profile and volatility, and generate stable returns for shareholders.

Conduct

The local Group continued to build on the strong Conduct foundations laid down in prior years and it can be said that Conduct is well embedded in the bank's wider risk management activities with a strong focus on outcomes, which are evidence-based. The local group continued to take a pro-active approach to manage conduct risk in order to ensure that customer detriment is avoided rather than just remediated. The conduct framework adopted is not just one aimed at meeting regulatory requirements but is embedded in the fabric of the organisation and acts as a prime driver underpinning the sustainability of the bank's growth strategy.

During this reporting year the Conduct activities culminated in a vibrant 'Conduct Week'. Through various events and exchange sessions a meaningful bank-wide discussion was created highlighting how poor conduct can impact our clients and damage the reputation of our business; interactive discussions were held to help staff understand the key risks which the businesses face and how these are to be managed effectively in order to deliver sustainable growth; the bank was also actively involved in similar Group European-wide Conduct activities, where the bank's CEO shared his thoughts and insights on Conduct and Culture with other regional top management; the bank's internal processes and procedures also continued to be strengthened and updated to reflect new regulatory requirements emanating from the introduction of heightened consumer protection and markets regulations.

Throughout the year the standing and engagement with the local group's regulators has remained consistently positive, proactive and transparent, reflective also of the solid governance and oversight culture, which is well established within the organisation.

Results for 2018

HSBC Bank Malta p.l.c. (the bank) and its subsidiaries (collectively referred to as the local group) reported a profit before tax of €38.6m for the year under review. The local group's profit attributable to shareholders was €28.7m.

A gross interim ordinary dividend of 4.0 cent per share was paid on 18 September 2018. The Directors have proposed a gross final dividend of 1.8 cent per ordinary share. The final dividend will be payable to shareholders on the bank's register as at 18 March 2019.

Further information about the results of the local group is provided in the Income Statements and the Statements of Comprehensive Income on pages 52 and 53 respectively.

A detailed review of the financial performance including important events affecting the local group's results and an indication of future developments are included in the Chief Executive Officer's Review.

Key performance indicators

The Board of Directors tracks the local group's progress in implementing its strategy with a range of financial measures or Key Performance Indicators (KPIs). Progress is assessed by comparison with the local group strategic priorities, operating plan targets and historical performance. The local group reviews its KPIs regularly in light of its strategic objectives and may adopt new or refined measures to better align the KPIs to HSBC's strategy and strategic priorities.

	2018	2017
Profit before tax (reported) (€m)	**38.6**	49.8
Profit before tax (adjusted) (€m)	**36.5**	55.6
Cost efficiency ratio (reported) (%)	**73.0**	70.9
Cost efficiency ratio (adjusted) (%)	**73.0**	66.2
Post-tax return on equity (reported) (%)	**6.1**	6.5
Post-tax return on equity (adjusted) (%)	**5.8**	7.3
Common Equity Tier 1 ratio (%)	**14.6**	13.9

Profit before tax (reported/adjusted): Reported profit before tax is the profit as reported under IFRS. Adjusted profit before tax excludes the impact of notable items as detailed in the Chief Executive Officer's Review.

Outcome (reported): Reported profit before tax was lower year-on-year as the bank completed the final phase of the de-risking strategy and managed the ongoing impact of negative interest rates. Operating expenses were lower compared to prior year. 2017 included a provision of €7.6m relating to the collective agreement, excluding this, adjusted operating expenses increased by €1.9m driven by continued investments in regulatory programmes, financial crime compliance and business growth.

Outcome (adjusted): Apart from the reason cited in the reported profit before tax, the adjusted profit before tax excludes the effect of the movement in the brokerage remediation provision.

Cost efficiency ratio (adjusted): is measured as total operating expenses divided by net operating income before changes in expected credit losses and provisions.

Outcome: The cost efficiency ratio increased from 66% to 73% largely due to the drop in interest and non-interest income.

Post-tax return on equity (reported/adjusted): is measured as post-tax profit divided by average equity. The local group targets a return in the medium term of 10%.

Outcome (reported): The reported return on equity was below the target range and prior year due to lower revenue as a result of the de-risking and ongoing impact of negative interest rates.

Outcome (adjusted): Apart from the reason cited in the reported return on equity, the adjusted return on equity excludes the effect of the notable items referred to earlier.

Common Equity Tier 1 capital ratio ('CET 1'): represents the ratio of Common Equity Tier 1 capital comprising shareholders' equity less regulatory deductions and adjustments, to total risk-weighted assets. The group seeks to maintain a strong capital base to support the development of its business and meet regulatory capital requirements at all times.

Outcome: The Common Equity Tier 1 ratio increased compared to 2017 due to retained profits, dividends received from subsidiaries and a reclassification of revaluation reserves from Tier2 to CET1, in line with capital regulations.

The Board of Directors does not monitor any specific non-financial KPIs. However, Directors evaluate the outcomes of surveys and reviews undertaken on a regular basis in respect of customers, people, culture and values including customer service satisfaction, employee involvement and engagement, and diversity and sustainability.

Employees

Building a more diverse and inclusive workforce is critical to developing a sustainable and successful business. The local group aims to increase and leverage diversity of thought to improve workforce agility, enhance risk management capability, drive innovation and grow markets. The local group's diversity and inclusion ambitions are focused on attracting, developing and retaining talent and deploying that talent effectively to anticipate and address expectations.

The local group supports this strategy and focuses on gender, age, working parents/carers and ability. Particularly, there is increased focus on improving gender balance within senior leadership and all global businesses and functions are progressing actions to support those aspirations and embed more inclusive processes throughout the employee life cycle.

There are also training programmes that reinforce a culture grounded in HSBC's values, called 'At Our Best' and 'Managing at Our Best' which are offered to all employees. Furthermore the 'At Our Best' online recognition tool allows all employees to recognise colleagues' actions by awarding points that are redeemed for gifts and benefits.

Our continued focus on Global Standards and Financial Crime Risk remained a priority locally. We are now renewing our emphasis on improving leadership development and learning for our line managers. In this respect we have launched the HSBC University which offers new leadership programmes, specifically designed to support our leaders at all levels, from new people managers to leaders of businesses and functions.

Whistleblowing

The local group has a whistleblowing policy based on a global whistleblowing platform, HSBC Confidential, which allows employees to report matters of concern confidentially. Common themes of cases raised concern matters regarding staff behaviour and recruitment practices, allegations of fraud perpetrated by staff, and weaknesses in incentive arrangements and information security.

The stewardship of the policy is entrusted to one of the non-executive Directors.

Diversity and inclusion

Diversity and inclusion are core components at HSBC. We aim to promote and embed diversity and inclusion into our culture, values and practices both within HSBC as well as in the communities in which we operate.

Health and safety

The maintenance of a safe place of work and business for our employees, customers and visitors is a key responsibility for all managers. The local group is committed to proactively manage health and safety risk through the identification, assessment and mitigation of hazards that may otherwise result in injury, fire events and operational failure.

Group policies, standards and guidance for the management of health and safety are set by the Global Corporate Real Estate function. Achieving these in the local group is the responsibility of the Chief Operating Officer with support and coordination provided by the Health and Safety Coordinator together with Global and Regional Corporate Real Estate.

Group Security Risk continuously monitors potential threats from terrorism and violent crime and ensure that HSBC maintains effective measures to protect its staff, buildings, assets and information.

The local group remains committed to maintaining its preparedness for emerging and foreseeable risks in ensuring health and safety compliance.

Sustainability

We continue to play an active role in the community we serve. Through the HSBC Malta Foundation, we have assisted various sectors of the community throughout 2018 via a number of key projects and initiatives. Sustainability and our role as a good corporate citizen remain a core focus of HSBC. The three pillars of the HSBC Malta Foundation are to improve the quality of life and education for children; especially those disadvantaged, to promote and work towards a more sustainable environment, and to preserve Malta's rich and unique historical heritage.

For the first time in 2018 in line with the Group's strategy, the Foundation also supported projects which focus on Future Skills. The objective of Future Skills is on helping people develop their employability and financial skills in order to thrive in the modern world.

Voluntary work is highly encouraged and pride is taken in our colleagues who contribute to the charities and causes that they feel passionate about. Our employees are encouraged to take an active role in initiatives supported by the HSBC Malta Foundation with an extra day's leave granted for voluntary work to support a range of projects around the country.

The HSBC Malta Water Programme – Catch the Drop Campaign, a nationwide environmental and educational water conservation campaign, continued to reach every student in Malta and Gozo, as well as various local councils. The main emphasis of this programme is to raise awareness on water shortage, encourage water consumption reduction, and water harvesting. This campaign was supported by a €540k grant from the HSBC Group. Bank employees are at the heart of this campaign with over 500 staff members volunteering to deliver the information sessions in all 172 schools around the country. Additionally, the HSBC Malta Foundation is supporting the international 'Water Explorer' programme, delivered locally by Nature Trust – FEE Malta through its Eco-Schools (EkoSkola) programme. In this programme participating schools are encouraged to link up with schools from other countries and share their ideas and top water-saving tips. In 2018 the HSBC Malta's CSR Institute was also launched, with the aim of training up to 500 members of public and business organisations on the values and ideals of corporate social responsibility as well as sustainability.

Meanwhile, a youth opportunity programme 'Achieve' introduced in Malta by HSBC Malta Foundation in cooperation with the Ministry for Education and Employment and the Prince's Trust International (PTI), is enabling scores of young persons to succeed and secure a strong future for themselves and Malta. Achieve supports young people to re-engage with education; improving attendance, behaviour and attainment. At the time of the launch of the Achieve programme in Malta in 2015, HSBC Malta Foundation became the first organisation outside of the UK to introduce one of The Prince's Trust's longstanding educational programmes in secondary schools. It was initially introduced in seven schools during the 2015/16 scholastic year across all of Malta and Gozo. However, with effect from the 2018/19 scholastic year, the number of schools/centres following this programme amounts to 40.

Our community commitment extends also to the field of environmental awareness. HSBC Malta had installed 678 photovoltaic panels which during 2018, generated 169,126 kWh of green energy, avoiding 76.4 tonnes of CO_2 emissions.

We had also commissioned seven electric vehicles including six charging points at the bank's Operations Centre in Qormi.

Financial Crime Compliance

In 2018 the bank began to transition from a period of intensive transformation in financial crime risk management to the creation of an effective risk management discipline. We have made significant progress towards achieving our highest or most effective standards and now turn our focus to sustainability. To achieve this, an operational effectiveness framework, made up of 12 core capability work streams was created. The work to implement the detailed 'end states' has been substantially completed.

Going forward, financial crime risk management capabilities are being embedded across the business and within the financial crime risk function. Ongoing oversight and training will be required as the risks in this area continue to evolve. In particular, the development of our proactive analytical capabilities will be a continued area of focus.

Anti-bribery and corruption

Along with money laundering and sanctions monitoring, bribery and corruption are among the key financial crime risks that we face. In 2018, focus to achieve a more robust framework continued with the creation of a specific transformation programme and the implementation of four key pillars: third party, strategic, customer and employee risks. Significant training was provided to ensure that new policies and procedures to mitigate these risks were clearly understood and embedded.

Risk management

The local group is exposed to a mixed blend of risks and hence operates a risk management strategy with the objective of controlling and minimising their impact on the financial performance and position of the local group.

An established risk governance framework and ownership structure ensures oversight of accountability for the effective management of risk. The local group's risk management framework fosters the continuous monitoring of the risk environment and an integrated evaluation of risks and their interactions. The local group's risk management framework is designed to provide appropriate risk monitoring and assessment. The Board sets the local group's strategy risk appetite, operating plans and performance targets, thereby playing an essential role in embedding a risk culture within the organisation. Specifically, the local group's banking risks are credit risk, operational risk, market risk, liquidity and funding risk, regulatory, compliance risk, strategic risk, sustainability risk and reputational risk. Owing to the group's insurance operation in Malta, the local group is also exposed to insurance risk. The Board delegates the day to day risk management responsibilities to individuals within the senior management team. These individuals are accountable for their assigned risks, and report and escalate as necessary through the risk governance structures. A detailed review of the risk management policies employed by the local group together with the exposures to credit risk, liquidity risk, market risk and insurance risk is included in Note 4 of the Financial Statements.

Branches and offices

A list of branches and offices is found on page 181.

Additional regulatory disclosures

Banking Rule 07 (Publication of Annual Report and Audited Financial Statements of Credit Institutions Authorised under the Banking Act 1994) partly repealed by certain provisions in the Capital Requirements Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (CRR) is related to market discipline and aims to make credit institutions more transparent by requiring them to publish specific disclosures on the credit institution's risk and capital management under the Basel III framework. However the local group is considered as a significant subsidiary of HSBC Holdings plc and therefore exempt, in terms of Article 24 of the revised BR 07 and Article 13 of the CRR, from certain risk disclosure requirements under Pillar 3, on the basis that such disclosures are required at the consolidated level which is HSBC Holdings plc level. HSBC Holdings plc publishes full Pillar 3 disclosures as a separate document on the HSBC Group Investor Relations website.

Shareholder register information pursuant to Listing Rule 5.64

The bank's authorised share capital is €141,000,000. The issued and fully paid up capital is €108,091,829 divided into 360,306,099 ordinary shares of a nominal value of 30 cent each. The issued share capital consists of one class of ordinary shares with equal voting rights attached and are freely transferable.

The largest single shareholder of the bank, provided it holds at least thirty three per cent (33%) of the ordinary issued share capital of the bank, shall be entitled to appoint the Chairman from amongst the Directors appointed or elected to the Board.

Every shareholder owning eleven per cent (11%) of the ordinary issued share capital, shall be entitled to appoint one Director for each and every eleven per cent (11%) of the ordinary issued share capital of the bank owned by such shareholder. Any fractional shareholding not so utilised in the appointment of Director(s) shall be entitled to participate in the voting for the election of further Directors.

There is a Restricted Share Awards scheme in existence whereby employees in the GCB3 grade and higher can be awarded shares in HSBC Holdings plc. Share awards will be released to the individual staggered over three years, provided the participant remains continuously employed within the Group. Vesting of these awards are generally not subject to performance conditions. During the 3-year period the employee has no voting rights whatsoever.

The rules governing the appointment of Board members are contained in Articles 77 to 80 of the bank's Articles of Association. An extraordinary resolution approved by the shareholders in the general meeting is required to amend the Articles of Association.

The powers of the Directors are outlined in Articles 73, 74 and 85 of the bank's Articles of Association. In terms of Article 12 of the said Articles of Association, the bank may, subject to the provisions of the Companies Act, 1995, acquire or hold any of its shares.

The Collective Agreement regulates redundancies, early retirement, resignation or termination of employment of employees. There are no contracts between the bank and the Directors on the bank's Board providing for compensation on resignation or termination of directorship.

It is hereby declared that the requirements pursuant to Listing Rules 5.64.7 and 5.64.10 that deal with agreements pertaining to changes in control of the bank did not apply to the bank as at 31 December 2018.

Shareholder register information

Directors' interest in the share capital of the bank

	At 31 December 2018 No. of shares
Saviour sive Sonny Portelli	**5,804**
John Bonello	**40,742**

None of the shares in the bank's subsidiary companies were held by Directors.

There were no changes to Directors' interest from 31 December 2018 to 31 January 2019.

Shareholders holding five per cent (5%) or more of the equity capital at 31 January 2019:

HSBC Europe B.V. 70.03%

Number of shareholders at 31 January 2019: One class of shares 9,408 shareholders (All shares have equal voting rights)

Number of shareholders analysed by range

	At 31 January 2019	
	Total shareholders	Shares
Range of shareholding		
1 – 500	**1,482**	**453,814**
501 – 1,000	**1,195**	**903,085**
1,001 – 5,000	**3,944**	**10,013,602**
5,001 and over	**2,787**	**348,935,598**
Total shareholding	**9,408**	**360,306,099**

Standard licence conditions applicable under the Investment Services Act, 1994

In accordance with the Malta Financial Services Authority (MFSA) Investment Services Rules (ISRs) Rule R4-5.3.5 for Investment Services Providers and the Standard Licence Conditions (SLCs) SLC 2.30 of the Investment Services Rules applicable to Investment Services Licence Holders which qualify as Custodians, and regulated by the Malta Financial Services Authority, licence holders are required to include breaches of Rules and Standard Licence Conditions applicable under the Investment Services Act, 1994, in the Report of the Directors.

Accordingly, the Directors report that during 2017 the Malta Financial Services Authority (MFSA) imposed an administrative fine of €10,000 on the bank as former Custodian of The Property Fund, a sub-fund of Global Capital Funds Sicav plc (the Scheme), due to a failure by the bank to exercise appropriate monitoring and oversight of the Scheme and the supervision of its Manager during the period 2006 - 2010. The bank was not involved in the sales process of the Fund and had no direct contact with individual investors. Throughout the resolution process the bank consistently upheld good governance standards, and demonstrated its goodwill by making a payment contribution in 2013 to the fund for the losses incurred. When deciding on the amount of the administrative penalty imposed on the bank, the MFSA considered the payment contribution made and also took into account the bank's transparent and fair approach to resolve this matter.

Apart from the above, the Directors confirm that there were no other breaches of the MFSA's Investment Services Rules, the Standard Licence Conditions and regulatory requirements.

Board of Directors

The Directors who served during the year and up till the date of this report are as follows:

Saviour sive Sonny Portelli

Andrew Beane

John Bonello

Andrew Muscat

Christopher Davies

Gordon Cordina

Maryanne sive Sue Vella

Yiannos Michaelides

Alison Hewitt (resigned 21 February 2018)

Michel Cordina (Designate Executive Director)

Executive Committee

As at 31 December 2018, the bank's Executive Committee of the local group was composed of the following:

Andrew Beane	Chief Executive Officer
Nikolaos Fertakis	Chief Operating Officer
Emma Nuttall	Chief Financial Officer
Daniel Robinson	Head of RBWM
Michel Cordina	Head of CMB
Irina Seylanyan	Head of GM
Caroline Buhagiar Klass	Head of Human Resources
Joyce Grech	Chief Risk Officer
Anna Camilleri	Head of Internal Audit
Joseph Sammut	General Counsel
Jane E. Estey	Head of Financial Crime Compliance
Anthony P. Abela	Head of Regulatory Compliance
Franco Aloisio	Head of Communications
George Brancaleone	Company Secretary

Auditors

PricewaterhouseCoopers have expressed their willingness to continue in office as auditors of the bank and the local group and a resolution proposing their reappointment will be put at the forthcoming Annual General Meeting.

Going concern

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

Statement by the Directors Pursuant to Listing Rule 5.70.1

Pursuant to Listing Rule 5.70.1 there were no material contracts to which the bank, or anyone of its subsidiary undertakings, was party to and in which anyone of the Directors was directly or indirectly interested.

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 requirements of International Financial Reporting Standards as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the bank and its subsidiaries and that this report includes a fair review of the development and 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.

Signed on behalf of the Board on 19 February 2019 by:

Sonny Portelli
Chairman

Andrew Beane
Chief Executive Officer

Directors' Responsibilities Statement

The Companies Act, 1995 requires the Directors of HSBC Bank Malta p.l.c. to prepare financial statements which give a true and fair view of the financial position of the local group and the bank as at the end of each period and of the profit or loss for that period. In preparing the financial statements, the Directors are responsible for:

- ensuring that the financial statements have been drawn up in accordance with the requirements of International Financial Reporting Standards as adopted by the EU;
- ensuring that the financial statements have been properly prepared in accordance with the provisions of the Companies Act, 1995 and the Banking Act, 1994;
- selecting and applying consistently suitable accounting policies;
- making accounting judgements and estimates that are reasonable; and
- ensuring that the financial statements are prepared on the going concern basis unless it is inappropriate to presume that the local group and the bank will continue in business as a going concern.

The Directors also assume responsibility for publishing Additional Regulatory Disclosure prepared in accordance with Pillar 3 quantitative and qualitative disclosure requirements as governed by Banking Rule 07 (Publication of Annual Report and Audited Financial Statements of Credit Institutions Authorised under the Banking Act 1994) and Regulation (EU) No 575/2013 (Capital Requirements Regulation). The local group is exempt from full regulatory disclosure requirements on the basis that such disclosures are required on a consolidated basis at the level of HSBC Holdings plc.

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

Through oversight of management, the Directors are responsible for ensuring that the bank and the local group establish and maintain internal control to provide reasonable assurance with regard to reliability of financial reporting, effectiveness and efficiency of operations, compliance with applicable laws and regulations, and as far as possible, the orderly and efficient conduct of the local group's business. This responsibility includes establishing and maintaining controls pertaining to the preparation of financial statements and for managing risks that may give rise to material misstatements in those financial statements, whether due to fraud or error.

The financial statements of HSBC Bank Malta p.l.c. for the year ended 31 December 2018 are included in the Annual Report 2018, which is being published in printed form and made available on the bank's website. The Directors are responsible for the maintenance and integrity of the Annual Report on the website in view of their responsibility for the controls over, and the security of, the website. Access to information published on the bank's website is available in other countries and jurisdictions, where legislation governing the preparation and dissemination of financial statements may differ from requirements or practice in Malta.

Signed on behalf of the Board on 19 February 2019 by:

Sonny Portelli
Chairman

Andrew Beane
Chief Executive Officer

The Board of Directors (the 'Board') of HSBC Bank Malta p.l.c. is committed to the HSBC global values of dependability, openness to different ideas and cultures, and connection with customers, communities, regulators and each other. The Board ensures that each employee, through ongoing training, is aware of the obligation to ensure that his or her conduct consistently matches the bank values so as to serve positively the customers who entrust their financial needs to HSBC.

The Board is proud of the fact that the bank and its subsidiaries (the 'local group') has a solid corporate governance framework that is built around the principles of control and accountability. This culture stems from a philosophy that puts the protection of investors and the interest of customers at the forefront.

Corporate governance is subject to regulation by the Malta Financial Services Authority Listing Rules. As a company whose equity securities are listed on a regulated market, HSBC Bank Malta p.l.c. endeavours to adopt the Code of Principles of Good Corporate Governance (the 'Code' or 'Principles') embodied in Appendix 5.1 to Chapter 5 of the Listing Rules. In terms of Listing Rule 5.94, the bank is obliged to disclose compliance and non-compliance with the provisions of the said Code. The bank strives to maintain the highest standards of disclosure in reporting the effective measures adopted to ensure compliance with the Principles, and to explain the instances of non-compliance.

Compliance with the Code

Principle 1: The Board

The bank is headed by an effective Board that leads and controls the business. The Board is composed of members who are honest, competent and solvent, and thus fit and proper to direct the business of the bank. Directors, individually and collectively, are of the appropriate calibre, having the necessary skills and experience to provide leadership, integrity and judgement in directing the bank. The courageous integrity, honesty and diligence of the Directors guarantee that the bank adheres to HSBC Group's (the 'Group') highly ethical business values and this is reflected in the bank's decision and policy-making process. Through their effective contribution Directors enhance shareholders value, protect the bank's assets and safeguard the interest of third parties.

Board members are accountable for their performance and that of their delegates to shareholders and other relevant stakeholders. Besides having a broad knowledge of the bank's business they are also conversant with the statutory and regulatory requirements regulating this business. Directors regularly attend Board meetings and allocate sufficient time to perform their duties.

The Board determines the bank's strategic aims and organisational structures and regularly reviews management performance. It ensures that the bank has the appropriate financial and human resources to meet its objectives. Moreover, it exercises prudent and effective controls which enable risk to be assessed and managed in order to achieve the short and long term sustainability of the business.

As part of a larger international group the Board assesses the compatibility of Group policy with local legal and regulatory requirements, and where appropriate, amends those policies.

During the year the Board delegated specific responsibilities to a number of committees, namely the Audit Committee, the Risk Committee, the Remuneration and Nomination Committee and the Executive Committee. Further detail in relation to the committees and their responsibilities can be found under principle 4 of this statement.

The process of appointment of Directors is conducted in terms of the Memorandum and Articles of Association of the company which state that the Board is to consist of not more than nine Directors who are appointed/elected by the shareholders. Every shareholder owning 11 per cent of the ordinary share capital is entitled to appoint one Director for each 11 per cent shareholding. The majority shareholder therefore has the right to appoint six Directors. Furthermore, any excess fractional shareholding not so utilised may be used to participate in the voting for the election of further Directors. Shareholders who own less than 11 per cent of the ordinary share capital participate in the election of the remaining three Directors. The largest single shareholder (subject to a minimum 33 per cent holding of the ordinary issued share capital of the bank) is entitled to appoint a Chairman from amongst the Directors appointed or elected to the Board.

Principle 2: Chairman and Chief Executive Officer

The position of the Chairman and that of the Chief Executive Officer are occupied by different individuals. There is a clear division of responsibilities between the running of the Board and the Chief Executive Officer's responsibility in managing the bank's business. This separation of roles of the Chairman and Chief Executive Officer avoids concentration of authority and power in one individual and differentiates the function of leadership of the Board from that of running the business.

The Chairman leads the Board, sets the agenda and ensures that the Directors receive precise, timely and objective information and at the same time ensures effective communication with shareholders. During Board meetings, he encourages active engagement by all Board members and ensures that Directors constructively challenge senior management. The Chairman also facilitates the effective contribution of non-executive Directors and ensures constructive relations between executive and non-executive Directors.

The Chief Executive Officer develops, drives and delivers performance within strategic goals, commercial objectives and business plans agreed by the Board. He effectively leads the senior management in the day-to-day running of the bank, ensures compliance with appropriate policies and procedures and maintains an effective framework of internal controls over risk in relation to the business. He makes decisions in all matters affecting the operations, performance and strategy of the business, with the exception of those matters reserved for the Board or specifically delegated by the Board to its Committees. He is also responsible for the recruitment and appointment of senior management, after consultation with the Remuneration and Nomination Committee.

Principle 3: Composition of the Board

Experience has shown that the size of the Board is appropriate to facilitate the effective oversight over the bank's operations. Each of the Directors is skilful, competent, knowledgeable and experienced to fulfil one's role diligently. The Directors who held office during the year possess the requisite ability to assess business risk, to identify key performance indicators and participate in critical debate in the decision-making process.

Ethnicity, age, culture, and gender diversity, underpinned by meritocracy, are areas of strategic focus for the employee base and the same principle is applied to the composition of the Board in accordance with the Board Diversity Policy reviewed and approved in May 2018. The reviewed policy established a target for 33% of directors to be female by 2020 (presently there is one female director on the Board), together with an aspiration to target gender parity on the Board over the long term while abiding by the principle of meritocracy. Indeed the bank remains committed to meritocracy in the Boardroom, which requires a diverse and inclusive culture where Directors believe that their views are heard, their concerns are attended to and they serve in an environment where bias, discrimination and harassment on any matter are not tolerated. The benefits of diversity, including that in educational and professional backgrounds, continue to influence the Remuneration and Nomination Committee's Board succession planning and Board candidates' selection process. This has resulted in a diverse Board composition with meets the diversity criteria in its widest aspect of ethnicity, age, culture, gender and educational and professional backgrounds.

As at 31 December 2018 the Board was composed of a non- executive Chairman, an executive Director, a designate executive Director and six non-executive Directors, five of whom are deemed to be independent. The non-executive Directors bring an external perspective to the Board when they constructively challenge and help develop proposals on strategy, scrutinise the performance of management, and monitor the risk profile and the reporting of performance. They are proactive in ensuring that financial controls and risk management systems are well established and in satisfying themselves with the integrity of financial information.

Following the appropriate due diligence, the European Central Bank had given its non-objection to all the bank's Directors. The letter of appointment issued to non-executive Directors stipulates the minimum time commitment expected to be dedicated to the bank. Non-executive Directors undertake that they will have sufficient time to meet what is expected of them. Any other significant commitments are disclosed to the Board before their appointment and subsequent changes are notified as they arise.

In accordance with the Code Provision 3.2, the independent non- executive Directors as at 31 December 2018 were the following:

John Bonello

Gordon Cordina

Yiannos Michaelides

Andrew Muscat

Sue Vella

In determining the independence or otherwise of its Directors, the Board has considered, inter alia, the principles relating to independence embodied in the Code, the local group's own practice as well as general principles of good practice.

The Board has determined that the fact that Professor Muscat is a partner in a Law firm which provides legal services to the bank and the fact that an economic consultancy firm in which Dr Gordon Cordina is executive director, provides consultancy services to the bank, do not influence these Directors' objective and balanced judgement or in any way reduce their ability to take decisions independently. On the other hand, in accordance with Code Provision 3.2.1, the Board believes that the employment of Chris Davies with the Group renders him non-independent from the bank. This should not however, in any manner, detract from the non-independent Director's ability to maintain independence of free judgement and character at all times and is able to make his own sound, objective, judgment and independent decisions and judgments when performing his functions and responsibilities.

In terms of Principle 3.4, each non-executive Director has confirmed in writing to the Board that he/she undertook:

- to maintain in all circumstances his/her independence of analysis, decision and action;
- not to seek or accept any unreasonable advantages that could be considered as compromising his/her independence; and
- to clearly express his/her opposition in the event that he/she finds that a decision of the Board may harm the bank.

Principle 4: The Responsibilities of the Board

The Board sets the bank's strategy, policies and business plans. The Board met informally twice during 2018 specifically to focus on strategy review and development. The Board of Directors monitors the implementation of strategy and policy by management within the parameters of all relevant laws, regulations and codes of best practice. The Board ensures that a balance is maintained between enterprise and control. The Board recognizes and supports innovation within the management of the bank. The Board remains accountable to the shareholders for its performance and also ensures effective communication with the different groups of stakeholders.

The Board actively oversees the affairs of the bank and keeps up with material changes in the bank's business and the external environment as well as acts in a timely manner to protect the long- term interests of the bank. It plays a leading role in establishing the bank's corporate culture and values. The Board, together with senior management and the Chief Risk Officer establishes the bank's risk appetite, taking into account the commercial and regulatory landscape and the bank's long-term interests, risk exposure and ability to manage risk effectively. It also oversees the bank's adherence to the Risk Appetite Statement, risk policy and risk limits. The Board is also responsible for approving the approach and overseeing the implementation of key policies pertaining to the bank's capital adequacy assessment process, capital and liquidity plans, compliance policies and obligations and the internal control system. The Board, through one of its Directors who reports to the Board, oversees the integrity, independence and effectiveness, of the bank's policies and procedures for whistleblowing.

The regular evaluation of management's implementation of corporate strategy and financial obligations is based on the use of key performance indicators enabling the bank to adopt expedient corrective measures. These key business risk and performance indicators are benchmarked against industry norms so as to ensure that the bank's performance is effectively evaluated.

The Board ensures that the bank has appropriate policies and procedures in place that guarantee that the bank and its employees adhere to the highest standards of corporate conduct and comply with the applicable laws, regulations, business and ethical standards.

An effective reporting system that enables the Directors to have relevant and timely information such that the Board can discharge its duties, exercise objective judgement and take pertinent decisions is implemented through:

- presentations during Board meetings delivered by senior management;
- updates provided by the CEO and senior management during intervals between Board / Committees' meetings; and
- accessibility to a common electronic platform hosting bank information, including Board / Committees' documentation and minutes of meetings.

The Board makes certain that its level of power is known by all Directors and the senior management of the bank. Any delegation of responsibility and functions is clearly documented in the Terms of Reference (TOR) embodied in the corporate governance framework.

The Board delegates specific responsibilities to Committees, which operate under their respective formal TOR:

Audit Committee

The terms of reference of this Committee are compliant with the Listing Rules and Banking Rule 12, the European Banking Authority and are modelled on the recommendations in the Cadbury Report and the UK Walker Review.

The Committee protects the interests of the bank's shareholders and assists Directors in conducting their role effectively so that the bank's decision-making capability and the accuracy of its reporting and financial results are maintained at the highest level at all times. It ensures that the bank maintains a robust finance function responsible for accounting and financial data. This Committee has non-executive responsibility for oversight of, and advice to, the Board on matters relating to financial reporting. Hence, it monitors the integrity of the bank's financial statements, and any formal announcements relating to the bank's financial performance or supplementary, regulatory information, reviewing significant financial reporting judgements contained in them.

An important function of the Audit Committee is to monitor and review the effectiveness of the Internal Audit function, consider major findings of internal investigations and management's response, and ensure that the Internal Audit Function is adequately resourced and is free from constraint by management.

This Committee approves the internal audit work plan, which will include assessment of controls relating to financial reporting, conduct financial crime and other risks as appropriate.

The Audit Committee also has the responsibility to review and monitor the external auditor's independence and the effectiveness of the audit process. In this regard the Committee has also to satisfy itself that there is the appropriate co-ordination between the internal and external auditors.

This Committee scrutinises and approves related party transactions. It 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 and that business resources are not misapplied.

The Committee met seven times during 2018 and was composed of Mr John Bonello as Chairman, and Dr Gordon Cordina and Professor Andrew Muscat as Members.

Attendance at Audit Committee meetings

	Attended
John Bonello	**7 out of 7**
Gordon Cordina	**7 out of 7**
Andrew Muscat	**7 out of 7**

During the year regular informal meetings were held between the Chairman of this Committee and Members of Senior Management especially the Chief Executive Officer, the Head of Internal Audit and the Chief Financial Officer. Moreover, a number of informal meetings were held to discuss inter alia IFRS 9, General Data Protection Regulation and related party transactions.

Senior Managers of the bank are invited to attend any of the Audit Committee's meetings as directed by the Committee.

The Chief Executive Officer, the Chief Risk Officer, the Chief Financial Officer and representatives of the external auditors attend all the meetings. In line with Listing Rule 5.131, the Head of Internal Audit is also always present for its meetings and has a right of direct access to the Chairman of the Committee at all times.

Mr Bonello was appointed by the Board as the Director who is independent and competent in accounting and/ or auditing in terms of Listing Rule 5.117 on the basis that he is a Fellow of the Institute of Chartered Accountants in England and Wales and is also a Certified Public Accountant, Auditor and Fellow of the Malta Institute of Accountants. He was formerly the Chairman and Senior Partner of PricewaterhouseCoopers in Malta from where he retired in 2009.

In terms of Listing Rule 5.127.7, the Audit Committee is responsible for developing and implementing policy on the engagement of the external auditor to supply non-audit services. The provision of non-audit services to EU Public Interest Entities (PIEs) and to parent and controlled undertakings in the EU are regulated in terms of EU rules. Under the regulations there are also certain prohibitions to controlled entities outside the EU.

In addition, since HSBC Holdings plc is a Securities Exchange Commission (SEC) registered company, non-audit services provided by the external auditor are also regulated in terms of the SEC rules.

Risk Committee

This Committee is responsible for advising the Board on high level risk related matters. In providing such oversight and advice to the Board, the Committee oversees: current and forward looking risk exposures, the bank's risk appetite and future risk strategy, including capital and liquidity management strategy, and management of risk within the bank.

In undertaking its responsibility to review the effectiveness of the bank's risk management framework and internal controls it has to inter alia satisfy itself that there are adequate procedures and internal controls for monitoring in a sufficiently timely and accurate manner, large exposures or risk types whose relevance may become of critical importance. It also has to consider any material findings from regulatory reviews and interactions with regulators in relation to risk governance or risk assessment or management process.

The Committee met six times during 2018 and was composed of Dr Gordon Cordina as Chairman, and Mr John Bonello and Mr Yiannos Michaelides as Members.

Attendance at Risk Committee meetings

	Attended
Gordon Cordina	**6 out of 6**
John Bonello	**6 out of 6**
Yiannos Michaelides	**5 out of 6**

Senior Managers of the bank are invited to attend any of the meetings as directed by the Committee.

The Chief Executive Officer, the Chief Risk Officer, the Chief Financial Officer, the Head of Financial Crime Compliance and the Head of Regulatory Compliance and representatives of the external auditors are invited to attend the meetings. During the year Dr Manfred Galdes was appointed Advisor to the Committee on Financial Crime Compliance matters.

Remuneration and Nomination Committee ('REMNOM' Committee)

The remuneration aspect of this Committee is dealt with under the Remuneration Report, which also includes the Remuneration Statement in terms of Code Provision 8.A.4.

In its nomination function, the Committee is primarily tasked with identifying and nominating new Board and Board Committees' candidates for the approval of the Board and to periodically assess the structure, size, composition and performance of the Board and make recommendations to the Board with regard to any changes. It is also tasked with considering issues related to succession planning and reviewing the policy of the Board for selection and appointment of senior management. This Committee is also responsible to periodically assess the skills, knowledge and experience of individual Directors and report on this to the Board.

During 2018 REMNOM met eight times and it continued to perform its role regarding 'fit and proper' assessments of present and prospective Board Members. The results of these assessments are then submitted to the Regulator as an integral part of the Regulator's due diligence exercise.

The members of the REMNOM were Mr Sonny Portelli (Chairman), Professor Andrew Muscat and Dr Sue Vella.

Executive Committee ('EXCO')

EXCO meets on a monthly basis to oversee the overall day-to-day management of the bank in accordance with such policies and directions as the Board may from time to time determine. The Chief Executive Officer chairs this Committee which is composed of members of the senior management of the bank. EXCO is empowered by its terms of reference to delegate its powers to sub-committees:

- **The Risk Management Meeting (RMM)**

  This Committee meets on a monthly basis and is chaired by the Chief Risk Officer, with the Chief Executive Officer as alternate chairman. Membership also includes the Chief Operating Officer, the Chief Financial Officer, the Head of Retail Banking and Wealth Management, the Head of Commercial Banking, the Head of Global Banking and Markets, the Head of Wholesale and Markets Risk, the Head of Internal Audit, General Counsel, Head of Regulatory Compliance and Head of Financial Crime Compliance. Other regular attendees are the Head of Credit Risk Management, Analytics and Systems, the Head of Security and Fraud Risk, Senior Manager Assurance and Oversight and Head of Communications.

  The objective of this Committee is to exercise oversight of the risk/ reward framework for the bank and its subsidiaries.

  This Committee is responsible for all risks in all businesses, functions and subsidiaries under the ownership of HSBC Bank Malta p.l.c., including inter alia Credit Risk, Market Risk, Operational Risk, Concentration Risk, Legal and Regulatory Risk, Security and Fraud Risk and Reputational Risk. The Risk Management Committee is also responsible for the setting and monitoring of a Risk Appetite Framework for EXCO and Board approval, signing off on material credit risk models, and consideration of top and emerging risks and scenario analysis. Individual risk acceptance and approval is not within the TOR of the Committee, and continues to be approved under existing delegated authorities within the management structure of the bank.

  Minutes of meetings of this Committee are circulated to the members of the Board. The Chief Risk Officer is also invited to attend Board meetings and meetings of the Audit and Risk Committees in which representations are made about the overall risk profile associated with the business including a comprehensive assessment of the bank's management of risk.

- **The Asset and Liability Management Meeting (ALCO)**

  ALCO is responsible for managing the balance sheet with a view to achieve efficient allocation and utilisation of all resources.

  This Committee reviews the financial risks of the local group and oversees the prudent management of interest rate risk, liquidity and funding risk, capital, foreign exchange risk, solvency risk, market sector risk and country risk. Furthermore, ALCO monitors the external environment and measures the impact on profitability of factors such as interest rate volatility, market liquidity, exchange rate volatility, monetary and fiscal policies and competitor banks' activity. ALCO monitors the liquidity and capital adequacy, making use of capital forecasts to ensure that enough capital is readily available at all times to meet the demand arising from business expansion and regulation. ALCO monitors and reviews the duration and cash flow matching of insurance assets and liabilities.

The Chief Executive Officer has primary responsibility for ensuring efficient development of Asset and Liability Management. Membership consists of senior executives with responsibility for the following functions: commercial banking, retail banking and wealth management, global banking and markets, finance, insurance services, asset and liability capital management, customer value management and payments and cash management. ALCO, which is chaired by the Chief Financial Officer and deputised by the Chief Executive Officer, meets once a month. The Chief Accounting Officer is also a member of this Committee.

- **Financial Crime Risk Management Committee ('FCRMC')**

  This Committee provides on-going oversight, management and communication of Financial Crime Compliance (FCC) risks, issues and changes impacting the business lines. FCC includes Anti-Money Laundering (AML), Sanctions, Anti-Bribery and Corruption, and Fraud. The membership of this Committee, which is chaired by the bank's Chief Executive Officer, is composed of most of the bank's EXCO team and the Money Laundering Reporting Officer.

In the selection of the above Committees' chairmanship and membership, there is recognition of the value in refreshing said appointments and in ensuring that no undue reliance is placed on particular individuals.

Principle 5: Board meetings

The Board meets as often and as frequently required to discharge its duties effectively. During the period under review the Board held seven meetings and another two informal meetings.

The Chairman ensures that all relevant issues are on the agenda and supported by all the available information. The agenda strikes a balance between long-term strategic objectives and short term performance issues. Notice of the dates of Board meetings together with supporting materials are circulated to the Directors well in advance of the meetings.

During the meetings Board Members have ample opportunity to discuss issues set on the board agenda, convey their opinions and challenge management. The Chairman facilitates presentation of views pertinent to the relevant issues on the agenda by promoting a culture of openness and debate. Moreover, Directors are encouraged to discuss any issue which they deem appropriate.

Minutes are taken during Board meetings that record faithfully attendance, discussed matters and decisions. These minutes are subsequently circulated to all the Directors as soon as practicable after the meeting. Besides attending formal Board meetings and Committee meetings of which they form part, Directors attend on frequent and regular basis meetings where their presence is required for the proper discharge of their duties. All the Directors dedicate the necessary time and attention to their duties as Directors of the bank. The holding of other directorships in other companies is in line with regulatory provisions.

Directors' attendance at Board Meetings

	Attended
Saviour sive Sonny Portelli	**7 out of 7**
Andrew Beane	**7 out of 7**
John Bonello	**7 out of 7**
Gordon Cordina	**7 out of 7**
Christopher Davies	**4 out of 7**
Alison Hewitt (resigned on 21 February 2018)	**1 out of 2**
Yiannos Michaelides	**6 out of 7**
Andrew Muscat	**6 out of 7**
Maryanne sive Sue Vella	**6 out of 7**

Principle 6: Information and professional development

The Board appoints the Chief Executive Officer of the bank upon guidance and recommendation by the HSBC Group and by the REMNOM Committee. The Board, through the REMNOM Committee, is actively involved in the appointment of other members of senior management. In this regard the bank benefits from the vast wealth of competence, talent and experience found across the Group.

Full, formal and tailored induction programmes, with particular emphasis on the systems of risk management and internal controls are arranged for newly appointed Directors.

The programmes consist of a series of meetings with senior executives to enable new Directors to familiarise themselves with the bank's strategy, risk appetite, operations and internal controls. Directors also receive comprehensive guidance on Directors' duties and liabilities.

A structured Board training and development programme is organised for the Directors and facilitated by an External Accounting Firm. The key objective of the programme is to improve the Board's awareness in risk, regulation, and compliance developments in the financial services sector. Topics covered during these awareness sessions range from the new regulatory environment to managing risk. Directors also participate in the Group's mandatory training which covers Financial Crime Compliance topics, regulatory matters, data privacy and cyber security. Additional training is also held for individual Directors sitting on Board committees.

Directors are given opportunities to update and develop their skills and knowledge, through briefings by senior executives and externally-run seminars throughout their directorship. Moreover, Directors have access to independent professional advice, at the bank's expense.

Directors also have access to the advice and services of the Company Secretary who is responsible for adherence to Board procedures as well as for effective information flows within the Board, its Committees and with senior management.

The Chairmen of the Audit and Risk Committees attend on an annual basis the Group Audit / Risk Committee Chairmen Forum where they are updated on the latest topical issues from an Audit / Risk Committees' perspective.

As part of succession planning and talent management, the Board and the Chief Executive Officer ensure that the bank implements appropriate schemes to recruit, retain and motivate high quality executive officers. They also encourage members of management to move to the higher ranks within the organisation and seek to maintain high morale amongst the bank's personnel.

Principle 7: Evaluation of the Board performance

During the year the Board undertook an evaluation of its own performance, the Chairman's performance and that of its Committees through a Board Effectiveness Questionnaire modelled on a questionnaire adopted by Group. This process was conducted by the REMNOM Committee through the support of the Company Secretary. No material changes in the governance structures and organisation resulted from this Board evaluation exercise.

Principle 8: Committees

The Remuneration and Nomination Committee is covered under Principle 4 and in the Remuneration Report, which also includes the Remuneration Statement in terms of Code provisions 8.A.4.

Principles 9 and 10: Relations with the shareholders, with the market and with institutional shareholders

The bank maintains on-going communication with its shareholders and the market on its strategy and performance in order to enhance trust and confidence in the bank. During the period under review the bank issued various company announcements and media releases to explain ongoing corporate developments and material events and transactions which have taken place and their impact on the financial position of the bank.

The bank communicates with shareholders in the following ways:

- through the 'Annual Report and Accounts' which is mailed to every shareholder and is available on the bank's website;
- through the publication of company announcements and media releases; and
- at the Annual General Meeting and Extraordinary General Meetings (further detail is provided under the section 'General Meetings').

The bank also holds meetings for stockbrokers, financial intermediaries and the media to explain the salient features of the interim and annual financial results.

The bank maintains an open channel of communication with its shareholders through the Company Secretarial Office and through the Head of Communications. Meetings have also been held between the Chief Executive Officer and the Malta Association of Small Shareholders.

As the Board always endeavours to protect the interests of both the bank and its shareholders, present and future, the Board takes into account the fact that shareholders are constantly changing. This is reflected in the Board's decisions on long term sustainability objectives to safeguard the interests of future shareholders. The Chairman ensures that the views of shareholders are communicated to the Board. Moreover, the Chairmen of the Audit Committee, of the Risk Committee and of the REMNOM Committee are available to answer questions during the Annual General Meeting. The conduct of the meeting is conducive to valid discussion and appropriate decision making.

In terms of the bank's Articles of Association, the Directors shall, on the request of members of the company holding not less than one-tenth of the paid up share capital, proceed duly to convene an Extraordinary General Meeting of the bank.

Principle 11: Conflicts of interests

Directors are aware that their primary responsibility is always to act in the interest of the bank and its shareholders as a whole, irrespective of who appointed them to the Board. This requires that they avoid conflicts of interest at all times and that their personal interests never take precedence over those of the bank and its shareholders.

In line with HSBC Group best practice, the Board operates a Conflicts Policy. In terms of this policy a Director is to avoid situations in which he or she has, or could have, a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the bank. Without prejudice to Articles 136A (3)(C) and 143 of the Companies Act, this policy stipulates that a director must obtain an authorisation from the Board before a situational conflict arises. Notably, in accordance with this policy, all directorships and other non-HSBC appointments should be authorised by the Board.

By virtue of the bank's Articles of Association, a Director is bound not to vote at a Board meeting on any contract or arrangement or any other proposal in which he has a material interest, either directly or indirectly. Moreover, in terms of the Board's Conflicts Policy, a Director having a continuing material interest that conflicts with the interests of the Bank, should take effective steps to eliminate the grounds for conflict. In the event that such steps do not eliminate the grounds for conflict then the Director should consider resigning.

On joining the Board and regularly thereafter, Directors are informed and reminded of their obligations on dealing in securities of the bank within the parameters of law and the Listing Rules. A proper procedure of reporting advance notices to the Chairman by a Director who intends to deal in the bank's shares has been endorsed by the Board in line with the Principles, the Listing Rules and the internal Code of Dealing.

Principle 12: Corporate sustainability

HSBC's Corporate Sustainability (CS) activities take place within the context of the Group wide strategy. The Board continues to recognise that the bank has a role within, and responsibility towards, the community it serves. To discharge these roles and responsibilities, during 2018, the bank continued to utilise its resources in order to carry out a series of initiatives and projects designed to provide value to various sectors within the community.

In Malta, the bank fulfils the Group's CS strategy primarily through the HSBC Malta Foundation (the 'Foundation'). The pillars of the HSBC Malta Foundation, with a yearly budget of more than €390,000, aim to improve the quality of life and education for children, especially the disadvantaged, to promote and work towards a more sustainable environment, to preserve Malta's rich and unique historical heritage, and in the area of medical research. In addition during 2018, in line with the Group's strategy, the Foundation also supported projects which focus on Future Skills. The objective of Future Skills is on helping people develop their employability and financial skills in order to thrive in the modern world.

Voluntary work is highly encouraged and HSBC staff who contribute to the charities and causes that they feel passionate about are encouraged to take an active role in initiatives supported by the Foundation, with an extra day's leave granted for voluntary work. During 2018, 306 HSBC colleagues volunteered on a range of projects around the country.

The HSBC Malta Water Programme - Catch the Drop Campaign, a nationwide environmental and educational water conservation campaign, continued to reach every student in Malta and Gozo, as well as various Local Councils. The main emphasis of this programme is to raise awareness on water shortage, encourage water consumption reduction, and water harvesting. This campaign was supported by a €540,000 grant from the HSBC Group. Bank employees are at the heart of this campaign with over 500 staff members volunteering to deliver the information sessions in all 172 schools around the country. Additionally, the HSBC Malta Foundation is supporting the international 'Water Explorer' programme, delivered locally by Nature Trust - FEE Malta through its Eco-Schools (EkoSkola) programme. In 2018 the HSBC Malta's CSR Institute was also launched, with the aim of training up to 500 members of public and business organisations on the values and ideals of corporate social responsibility as well as sustainability.

With the support of the HSBC Malta Foundation, Malta became the first country outside of the UK to introduce one of The Prince's Trust's long-standing educational programmes in its secondary schools. To date, 549 students were participating in the Achieve Programme which is helping these young people in Malta to develop the skills and confidence they need to reach a positive future through relevant, engaging and informal learning.

To raise the bank's commitment to support a sustainable environment for Malta and Gozo, the bank took several possible measures to ban single-use plastics within the organisation. Further, action was taken to introduce new recycling standards across the business.

Non-compliance with the Code

Principle 4 (Code Provision 4.2.7)

Code Provision 4.2.7 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'. The bank discloses that it has not formalised a Board succession policy. However, in practice the REMNOM Committee is actively involved in the board succession, specifically in recommending the appointment of new members and also by evaluating any newly proposed appointees.

Principle 9 (Code Provision 9.3)

This Code Provision recommends the bank to have in place a mechanism to resolve conflicts between minority shareholders and controlling shareholders. Although the bank does not have such mechanism in place there is ongoing open dialogue between the bank's senior management and the non-executive Directors to ensure that no such conflicts arise.

In terms of Code Provision 9.4 minority shareholders should be allowed to formally present an issue to the Board of Directors. The bank discloses that it does not have a policy in terms of this code provision.

Internal control

The Board is ultimately responsible for the bank's system of internal control and for reviewing its effectiveness. Such procedures are designed to manage and mitigate rather than to eliminate the risk of failure, to achieve business objectives and can only provide reasonable and not absolute assurance against material error, losses or fraud. The Group has reviewed the risk management and internal control structure referred to as the 'three lines of defence' to ensure we achieve our commercial aims while meeting regulatory, legal as well as Group requirements. It is a key part of our operational risk management framework.

- First line - The First Line of Defence consists of 'Risk Owners' and 'Control Owners'. The bank's Global Business employees are the 'Risk Owners'. They own the risk, set the risk appetite and are accountable for managing the risk associated with their commercial activities. In managing the risk they are responsible to both manage their own controls and work closely with other Control Owners who sit outside of their area. 'Control Owners' exist in Global Businesses, Global Functions and HOST (HSBC Operations, Services and Technology). They are accountable for the controls required to manage the risk associated with our commercial activities. They are required to monitor and provide an opinion on the effectiveness of the controls relied upon by the Risk Owners to manage their risk(s).
- Second line - The Second Line of Defence consists of 'Risk Stewards' and their teams. It is made up in part (but not exclusively) by leaders within Global Risk and other Global Functions. They set policy, give advice and provide independent challenge. In doing this, they oversee and assess the risk management activities carried out by the First Line. The Risk Stewards set the overall maximum risk appetite for their particular risk type (e.g. financial crime risk, regulatory compliance risk, legal risk, tax risk, accounting risk, people risk, fraud risk) and support the Risk Owners with setting their risk appetite within Group's overall risk appetite.
- Third line - The Third Line of Defence is Global Internal Audit, and it independently assures that the design and operating effectiveness of Group's framework of risk management, governance and internal control are adequate.

The local group's key risk management and internal control procedures include the following:

- Global standards. Functional, operating, financial reporting and certain management reporting standards are established by global function management committees, for application throughout HSBC globally. These are supplemented by operating standards set by functional and local management as required for the type of business and geographical location of each subsidiary.
- Delegation of authority within limits set by the Board. The Board has delegated specific, clear and unequivocal authority to the Chief Executive Officer to manage the day-to-day affairs of the business for which he is accountable within limits set by the Board. Delegation of authority from the Board requires the CEO to maintain appropriate apportionment of significant responsibilities and to oversee the establishment and maintenance of systems of control that are appropriate to the business.

- Risk identification and monitoring. Systems and procedures are in place to identify, control and report on the major risks facing the bank including credit, market, liquidity, capital, financial management, model, reputational, strategic, sustainability and operational (including accounting, tax, legal, compliance, fiduciary, information, external fraud, internal fraud, political, physical, business continuity, systems operations, project and people risk). Exposure to these risks is monitored by the Risk Management Meeting, Asset and Liability Committee and Executive Committee.
- Changes in market conditions/practices. Processes are in place to identify new risks arising from changes in market conditions/ practices or customer behaviours, which could expose the bank to heightened risk of loss or reputational damage. Further improvements have been, and will continue to be, implemented to combat the inherent challenges posed by financial crime. In addition attention remained focused on regulatory developments and engagement, including the ongoing supervisory review and evaluation process under the ECB's Single Supervisory Mechanism; regulatory commitments and consent orders that culminated in meeting the obligations under the Deferred Prosecution Agreement; challenges to balance business growth and risk management imperatives; internet crime and fraud; level of change creating operational complexity and heightened execution risk; and information security risk.
- IT operations. Centralised functional control is exercised over all IT developments and operations. In order to ensure consistency and benefit from economies of scale Common Group systems are employed for similar business processes wherever practicable.
- Comprehensive annual financial plans are prepared, reviewed and approved by the Board. Results are monitored and progress reports are prepared on a monthly basis to enable comparisons with plan. Financial accounting and management reporting standards have been established.
- Responsibilities for financial performance against plans and for capital expenditure, credit exposures and market risk exposures are delegated with limits to executive management. In addition, functional management in the bank has been given the responsibility to implement HSBC policies, procedures and standards for business and product lines; finance; legal and regulatory compliance; internal audit; human resources; credit risk; market risk; operational risk; computer systems and operations and property management.
- The Chief Risk Officer is responsible for the management of specific risks within the bank including credit risk in the wholesale and retail portfolios, markets risk and operational risk. Risks are monitored via Risk Management Meeting which meets regularly and via reporting to the Executive Committee, the Risk Committee and to the Board.
- Internal Audit. The establishment and maintenance of appropriate systems of risk management and internal control is primarily the responsibility of business management. The Internal Audit function reports to the Board. It provides independent and objective assurance in respect of adequacy of the design and operating effectiveness of the bank's framework of risk management, control and governance processes focusing on the areas of greatest risk to the bank using a risk- based approach. The Head of Internal Audit also reports to the Head of Global Internal Audit in so far as independence and resourcing are concerned.
- Internal Audit issues. Executive management is responsible for ensuring that any issues raised by the Internal Audit function are remediated within an appropriate and agreed timetable. Confirmation to this effect must be provided to Internal Audit who subsequently validate the remediation.
- The bank's Regulatory Compliance Department ensures that the local group maintains the highest standards of corporate conduct including compliance with all the local and international regulatory obligations and HSBC Group ethical standards and regulations.
- The bank's Financial Crime Compliance Department is responsible for the oversight of Anti Money Laundering and Terrorist Financing, Sanctions, Anti-Bribery and corruption and Fraud risks. Particular attention is given to the proactive management of identified Financial Crime Compliance issues. Routine governance is managed via the entity wide Financial Crime Risk Management Committee, and material matters reported to the Executive Committee, the Risk Committee and to the Board.
- Through the Audit Committee and Risk Committee, the Board reviews the processes and procedures to ensure the effectiveness of the system of internal control of the bank and its subsidiaries, which are subject to third line of defence review by Internal Audit.

Listing Rule 5.97.5

- The information relating to the Shareholder register required by this Listing rule is found in the Directors' Report.

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 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 and remuneration of the Board (which may or may not involve an election), the appointment of the external auditors and the grant of the authority to the Board to fix the external auditors' emoluments. Other business which may be transacted at a General Meeting 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 is unable to 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 such persons as the Directors may delegate for that purpose.

Governance

Role of the Remuneration Committee

The bank's Remuneration and Nomination Committee (the Committee) within its remuneration oversight responsibilities is primarily responsible for making recommendations on the reward policy, on fixed and variable pay, and for ensuring their implementation.

The Committee is responsible for recommending to the HSBC Bank Malta p.l.c. Board of Directors ('Board') the approvals of the total compensation spend within an annual operating plan.

The Chief Risk Officer regularly informs the Committee of risk related issues across the bank to ensure that such matters are considered by the Committee in applying the Policy and making remuneration decisions for the recommendation to the Board. The Chief Risk Officer also updates the Board on the bank's performance against the Risk Appetite Statement, which describes and measures the amount and types of risk that the bank is prepared to take in executing its strategy. The Board uses these updates in applying the Policy and considering the risk related adjustments made to the variable pay pool, to ensure that return, risk and remuneration are aligned.

The Committee works in conjunction with the HSBC Group Remuneration Committee (the 'Group's Committee'). However, it has its own Terms of Reference, which sets out its key responsibilities in relation to HSBC Bank Malta p.l.c.

Membership and meetings

The Committee was composed of Mr Sonny Portelli as Chairman, Dr Sue Vella and Professor Andrew Muscat as Members of the Committee.

Eight meetings were held by the Committee during 2018.

Attendance at Remuneration Committee meetings

	Attended
Sonny Portelli	**8 out of 8**
Andrew Muscat	**8 out of 8**
Sue Vella	**8 out of 8**

During the year, the Chief Executive Officer attended seven Committee meetings. The Head of HR and the Chief Risk Officer attended some of the meetings of the Committee when deemed appropriate. None of the executives participated in the discussion regarding their own remuneration.

In 2018, the Committee did not engage any external adviser. It will only seek specific legal and/or remuneration advice independently as and when it considers this to be necessary.

Remuneration strategy and policy, and the link to performance and risk

HSBC Bank Malta p.l.c. remuneration policy

The bank's remuneration strategy is designed to reward competitively the achievement of long-term sustainable performance and attract and motivate the very best people who are committed to a long-term career with the HSBC Group in the long-term interests of our shareholders.

In 2014, new regulatory requirements were introduced under the EU's Capital Requirements Directive ('CRD') IV. The consequential changes to the remuneration rules have influenced the bank's remuneration policy, particularly with respect to those employees identified as having a material impact on the bank's risk profile, being termed as Material Risk Takers ('MRTs').

During 2018 the remuneration policy has been updated to include that:

- the Board shall approve the remuneration policy, after taking advice from the compliance function.
- the Chief Risk Officer would need to consult with the Compliance function for identified risks.
- the spirit of the Policy is to remunerate employees, while at the same time still acting in the best interest of the customers.

In determining remuneration levels for 2018, the Committee applied the bank's remuneration strategy and policy, which takes into account the interests of shareholders, HSBC Group and the broader external context.

Key principles of the remuneration framework include:

- assessment of performance with reference to clear and relevant objectives set within a performance scorecard framework;
- a focus on total compensation (fixed plus variable pay) with variable pay (namely annual bonus) differentiated by performance and adherence to HSBC values;
- the use of discretion to assess the extent to which performance has been achieved; and
- deferral of a significant proportion of variable pay (where appropriate) to tie recipients to the future performance of the bank and align the relationship between risk and reward.

Within this framework, risk alignment of the remuneration structure is achieved through the following measures:

- Risk and Compliance is a critical part of the assessment process in determining the performance of all employees, especially senior executives and material risk takers.
- Adherence to HSBC values is a pre-requisite for any employee to be considered for variable pay. HSBC values are key to the running of a sound, sustainable bank. Employees have a separate HSBC Values rating which directly influences their overall performance rating, and is therefore considered for their variable pay determinations.
- For senior executives and certain MRTs, part of their variable pay is deferred (where appropriate) and thereby subject to malus, which allows unvested/unpaid deferred awards to be reduced or cancelled if warranted.
- Employees must not use personal hedging strategies or remuneration or liability related contracts of insurance in connection with any unvested deferred remuneration awards or any vested awards subject to a retention period.
- Instances of non-compliance with risk procedures and expected behaviour are escalated for consideration in variable pay decisions, including variable pay adjustments for that performance year and malus of unpaid awards granted in prior years. For MRTs, the Committee and the Board has oversight of such decisions and can make recommendations to the HSBC Group Remuneration Committee to reduce or cancel all or part of any unpaid deferred award.

The bank's reward strategy

The quality and long-term commitment of all employees is fundamental to the bank's success. The bank therefore aims to attract, retain and motivate the very best people who are committed to maintaining a long-term career with the bank, and who will perform their role in the long-term interests of the shareholders. HSBC's reward package comprises three key elements:

- Fixed Pay,
- Benefits, and
- Variable Pay.

These elements support the achievement of the bank's objectives through balancing reward for both short-term and long-term sustainable performance. This strategy is designed to reward success, and aligns employees' remuneration with the bank's risk framework and risk outcomes.

For senior employees, where appropriate, part of their reward is deferred, and thereby subject to malus, that is, it can be cancelled if warranted by events. In order to ensure alignment between what the bank pays its employees and the bank's business strategy, individual performance is assessed against annual and long-term financial and non-financial objectives summarised in performance scorecards. This assessment also takes into account adherence to the HSBC Values of being 'open, connected and dependable' and acting with 'courageous integrity'. Altogether, performance is therefore judged not only on what is achieved over the short and long term but also importantly on how it is achieved, as the bank believes the latter contributes to the long term sustainability of the business.

Structure of remuneration

The following table shows the purpose and relevant features of each of the three key elements of the HSBC's reward package. For the purposes of the Annual Variable Pay element, Material Risk Takers represent those members of staff whose professional activities have a material impact on the risk profile of the bank.

Description	Purpose, relevant features and link to strategy	Senior management	Non-executive Directors
Fixed Pay	Fixed pay reflects the individual's role, experience and responsibility. It comprises the base salary and in some cases a fixed pay allowance and/or a pension.		
	Base salary Base salaries are paid in cash on a monthly basis and are benchmarked on an annual basis against relevant comparator groups.	Y	
	Fixed pay allowance This is typically paid in cash on a monthly basis.	Y	
	Pensions These consist of cash allowances in lieu of personal/occupational pension arrangements of international assignees appointed to Senior Executive position. In December 2018, the bank launched the Employees' Pension Plan Scheme for all HBMT Employees. The bank is committed to help employees improve their financial future and contributes to the Personal Pension Plan.	Y	
	Non-executive Directors' fees These refer to fees payable to non-executive Directors and reflect the time commitment and responsibilities required of them. Fees are determined by benchmark against other companies and banks.		Y
Benefits	Benefits take account of local market practice and include the provision of medical insurance, health assessment, life assurance, car cash/lease allowance and tax assistance where appropriate.	Y	
Variable Pay – annual incentive	Variable Pay award is discretionary, and is determined and paid in line with internal bank policies and procedures. Variable pay awards are made to drive and reward performance against annual financial and non-financial measures and adherence to HSBC Values which are consistent with the medium to long-term strategy and aligns to shareholder interests. Performance targets are set taking into account the economic environment, strategic priorities and risk appetite. Variable pay is delivered in the form of cash and shares. Where variable pay for Material Risk Takers is more than €100,000 or for lower values more than 100% of fixed pay, a minimum of 50% of awards are made in shares. Total awards are subject to deferral and vest over a period of three years or five years in case of Senior Management or such other period as determined by the Committee, and hence subject to malus or clawback provisions. The award is non-pensionable.	Y	

Variable pay funding

Funding of the bank's annual variable pay pool is determined in the context of profitability and affordability. The Committee considers many factors in approving the overall variable pay pool. These include, but are not limited to, the performance of the bank and the performance of the HSBC Group, considered within the context of the bank's risk appetite. The variable pay pool is also shaped by risk considerations and factors that may arise from any local or Group-wide notable events. The commercial requirement to remain competitive in the market is also taken into account.

Performance measurement and risk adjustment

Under the bank's remuneration framework, decisions relating to remuneration of individuals are made based on a combination of: performance against objectives, general individual performance of the role, and adherence to the HSBC values, business principles, Group risk-related policies and procedures and Global Standards.

In order to reward genuine performance, individual awards are made on the basis of a risk adjusted view of both financial and non-financial performance. In light of this, the bank has discretion to reduce an employee's current year variable pay to reflect detrimental conduct or involvement in Group-wide notable events or local issues.

The Committee can also seek advice from the Group Remuneration Committee, at the level of HSBC Holdings plc, to reduce or cancel all or part of any unvested deferred award under the applicable malus and clawback provision. Appropriate circumstances include (but are not limited to) conduct detrimental to the business; past performance being materially worse than originally understood; restatement, correction or amendment of any financial statements; or improper or inadequate risk management. The Group Remuneration Committee can also recommend the forfeiture of unvested awards granted in prior years.

Adjustments would generally be made to the current year variable pay before application of malus and clawback is considered. Details of the circumstances where an adjustment, malus and/or clawback will be considered are set out below:

Type of action	Type of variable pay awared affected	Circumstances where it may apply (including, but not limited to):
Adjustment	Current year variable pay	• Detrimental conduct or conduct which brings the business into disrepute. • Involvement in Group-wide events resulting in significant operational losses, including events which have caused or have the potential to cause significant harm to HSBC. • Non-compliance with HSBC Values and other mandatory requirements. • For specified individuals, insufficient yearly progress in developing an effective AML and sanctions compliance programme or non-compliance with the DPA and other relevant orders.
Malus	Unvested deferred awards granted in prior years	• Detrimental conduct or conduct which brings the business into disrepute. • Past performance being materially worse than originally reported. • Restatement, correction or amendment of any financial statements. • Improper or inadequate risk management.
Clawback	Vested or paid awards	• Participation in or responsibility for conduct which results in significant losses. • Failing to meet appropriate standards of fitness and propriety. • Reasonable evidence of misconduct or material error that would justify, or would have justified, summary termination of a contract of employment. • HSBC or a business unit suffers a material failure of risk management within the context of Group risk management standards, policies and procedures.

Remuneration policy – non-executive Directors

Non-executive Directors are not employees and receive a fee for their services as Directors. In addition, it is common practice for non-executive Directors to be reimbursed expenses incurred in performing their role and any related tax. They are not eligible to receive a base salary, fixed pay allowance, benefits, pension or any variable pay.

The fee levels payable reflect the time commitment and responsibilities required of a non-executive Director. Fees are determined by reference to other Maltese companies and comparable entities within the HSBC Group.

The Board reviews each component of the fees periodically to assess whether, individually and in aggregate, they remain competitive and appropriate in light of changes in roles, responsibilities, and/or the time commitment required for the non-executive Directors and to ensure that individuals of the appropriate calibre are retained or can be appointed. The Board may approve changes to the fees within the aggregate amount approved by Shareholders at the Annual General Meeting. The Board may also introduce any new component of fee for non-executive Directors subject to the principles, parameters and other requirements set out in the remuneration policy.

The Directors' fees are approved in aggregate by the shareholders at the Annual General Meeting.

Remuneration amounts – non-executive Directors

Details of non-executive directors' fees for the financial year under review were as follows:

	2018 Fees €
Saviour sive Sonny Portelli	**75,600**
John Bonello	**59,700**
Andrew Muscat	**45,600**
Maryanne sive Sue Vella	**36,300**
Gordon Cordina	**59,700**
Yiannos Michaelides	**39,600**
Total	**316,500**

Directors who are employed with the bank or with HSBC Group are not paid any fees for their directorship.

Remuneration policy – Material Risk Takers including Executive Directors and Senior Management

Individuals have been identified as MRTs based on qualitative and quantitative criteria set out in the Regulatory Technical Standard EU 604/2014 that came into force in June 2014. Amongst others, MRTs include all Executive Committee members, members of the ALCO and the Risk Management Meeting as well as staff that have the authority to approve or veto a decision on any credit transaction representing 0.5% of the bank's CET 1 capital.

Standard contracts for Senior Executives and other Material Risk Takers employed locally would generally be indefinite. Normal retirement from the bank would be in line with local legislation. A three month notice period is required for Senior Executives, who would similarly be entitled to a notice of a minimum of three months in the event that the bank terminates the employment on grounds of redundancy.

International assignees appointed to Senior Executive positions are covered by the standard Group contracts policy. The period of notice required to be given to terminate by either party can be up to six months.

For the purposes of information provided hereunder 'Senior Executives'/'Senior Management' shall mean Executive Committee members.

Remuneration amounts – MRTs

The aggregate remuneration expenditure in the table below includes salary and incentives awarded in respect of performance in the year 2018 (including deferred component) and any pension or benefits outside of policy.

Remuneration amounts – MRTs

	Global business aligned					
	Retail Banking and Wealth Management	Commercial Banking	Global Markets	Non-global business aligned	**2018 Total**	2017 Total
	€000	€000	€000	€000	**€000**	€000
Aggregate remuneration expenditure	1,147	419	394	4,015	**5,975**	5,753

Remuneration – fixed and variable amounts

	2018			2017
	Senior management	**MRTs (non-senior management)**	**Total**	Total
Number of MRTs	**24**	**26**	**50**	48
	€000	**€000**	**€000**	€000
Fixed pay				
Cash-based remuneration	**2,476**	**1,607**	**4,083**	3,754
Other remuneration				
– pensions	**63**	**19**	**82**	104
– benefits	**532**	**194**	**726**	829
Total fixed pay	**3,071**	**1,820**	**4,891**	4,687
Variable pay				
Cash	**622**	**302**	**924**	904
Non-deferred shares	**65**	**–**	**65**	63
Deferred cash	**43**	**–**	**43**	42
Deferred shares	**52**	**–**	**52**	57
Total variable pay	**782**	**302**	**1,084**	1,066
Total remuneration	**3,853**	**2,122**	**5,975**	5,753

The bank continued with its strategy to develop and promote local talent. Whilst proactively managing the international assignee population downwards, there remains a need to attract resources with specialist skills which are not readily available in Malta. The associated average total compensation of this population also decreased during the period.

All international assignees are employed on a time specific contract and as such, do not benefit from the collective agreement which provides significant benefits such as security of employment and other financial/ non-financial benefits.

The regulatory environment continues to change and the requirements to manage the associated risk have increased in complexity together with the focus of the remediation of the business. The focus of the bank still remains on ensuring that the bank creates the right culture to mitigate Financial Crime. To this effect, the bank has continued to develop the skills of its employees with extensive training and development. This will ensure that the employees will continue to protect the bank and its customers for ongoing sustainability in the future as regulation continue to grow and evolve.

All MRTs are remunerated less than €1m per annum.

For the purposes of remuneration, MRTs have been aggregated and split between senior and non-senior management. The table above includes the total fixed and variable remuneration and the number of MRTs. In 2018, on average, the ratio of variable to fixed remuneration for MRTs was 22.2% (2017: 22.7%).

Deferred remuneration

	2018			2017
	Senior management €000	**MRTs (non-senior management) €000**	**Total €000**	Total €000
Cash				
Total outstanding deferred remuneration	**102**	**–**	**102**	102
– of which				
total amount of deferred remuneration paid out in the financial year	**51**	**–**	**51**	27
Shares				
Total outstanding deferred remuneration	**186**	**–**	**186**	178
– of which				
total amount of amendment during the year due to ex-post explicit adjustment	**(27)**	**–**	**(27)**	26
total amount of deferred remuneration paid out in the financial year	**139**	**–**	**139**	150

Deferred remuneration is typically granted through a Restricted Share Awards scheme, whereby MRTs are awarded ordinary shares in HSBC Holdings plc to which the employee will become entitled, generally between one and five years from the date of the award, and normally subject to the individual remaining in employment.

Sign-on and severance payments

During 2018, no severance payments were made. No sign-on payments were made during the year.

Payments to past Directors

During 2018, no payments were made to past Directors.

Report on the audit of the financial statements

Our opinion

In our opinion:

- HSBC Bank Malta p.l.c.'s consolidated and stand-alone parent company financial statements (the "financial statements") give a true and fair view of the financial position of the local group and bank as at 31 December 2018, and of their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU; and
- The financial statements have been prepared in accordance with the requirements of the Banking Act (Cap. 371) and the Maltese Companies Act (Cap. 386).

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

What we have audited

HSBC Bank Malta p.l.c.'s financial statements, set out on pages 52 to 148, comprise:

- the consolidated and parent company income statements and statements of comprehensive income for the year ended 31 December 2018;
- the consolidated and parent company statements of financial position as at 31 December 2018;
- the consolidated and parent company statements of changes in equity for the year then ended;
- the consolidated and parent company statements of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report.

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

Independence

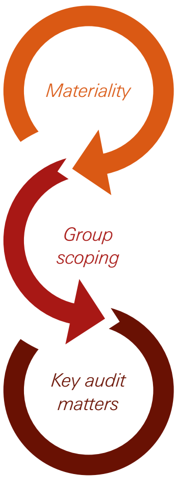
We are independent of the local group and the bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements of the Accountancy Profession (Code of Ethics for Warrant Holders) Directive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

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

The non-audit services that we have provided to the local group and its subsidiaries, in the period from 1 January 2018 to 31 December 2018 are disclosed in Note 19 to the financial statements. During the period starting 1 January 2018 to 31 December 2018, no non-audit services have been provided to the bank.

Our audit approach

Overview



– Overall group materiality: €1.8 million, which represents 5% of profit before tax adjusted for one-time item.

– The audit carried out by the group engagement team covered all the components within the local group as at and for the year ended 31 December 2018 comprising HSBC Bank Malta p.l.c. and its subsidiaries HSBC Life Assurance (Malta) Limited and HSBC Global Asset Management (Malta) Limited, which are all based in Malta.

– Impairment of loans and advances to customers

– Measurement of life insurance contract liabilities and of the Present Value of in-force Business (PVIF).

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

Materiality

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

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

Overall group materiality	€1,826,000 (2017: €2,885,000)
How we determined it	5% of profit before tax adjusted for one-time items
Rationale for the materiality benchmark applied	We chose profit before tax adjusted for one-time item as the benchmark because, in our view, it is the benchmark against which the performance of the local group is most commonly measured by users, and is a generally accepted benchmark. We chose 5% which is within the range of acceptable quantitative materiality thresholds in auditing standards.

In the audit of HSBC Life Assurance (Malta) Limited, we have applied a higher materiality of €2,839,000 solely for the purpose of identifying and evaluating the effect of misstatements that are likely only to lead to a reclassification between line items within assets and liabilities.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above €91,000 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Key audit matters

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

Key audit matter

Credit loss allowances in respect of loans and advances to customers of the local group and bank

Credit loss allowances in respect of loans and advances to customers represent management's best estimate of expected credit losses ('ECLs') within the loan portfolios at the balance sheet date.

On 1 January 2018, the group transitioned to IFRS 9, a new and complex accounting standard which introduced the measurement of impairment allowances based on an expected loss model rather than an incurred loss model previously applied under IAS 39.

A considerable level of judgement is required in the development of the models designed to estimate ECLs on loans measured at amortised cost in accordance with the requirements of IFRS 9. In general the group calculates ECL by using the following key inputs: probability of default (PD), loss given default (LGD) and exposure at default (EAD). The maximum period considered when measuring ECL is the maximum period over which the local group is exposed to credit risk.

Credit loss allowances relating to all loans and advances within the Wholesale portfolio are determined at an instrument level. For non-defaulted (Stages 1 and 2) exposures, the Bank uses an ECL model that relies on risk parameters, specifically proxy PDs determined at Group level attributable to another country/portfolio with similar credit risk characteristics. The output proxy PD is then

How our audit addressed the key audit matter

As IFRS 9 was adopted at the start of the year, we performed audit procedures on the opening balances to gain assurance on the transition from IAS 39. This included evaluating the accounting interpretations to apply the requirements of IFRS 9 and testing the adjustments and disclosures made on transition. Discussions with the Audit Committee included:

- the policies and methodologies used by the bank in respect of computing ECLs on loans and advances;
- inputs, assumptions and adjustments to ECL, in particular changes to risk factors and other inputs within the bank's models;
- individually significant loan impairments.

For ECL models the appropriateness of the modelling policy and methodology used was independently assessed by reference to the requirements of IFRS 9.

The more judgemental interpretations of IFRS 9 made by management continued to be discussed during the year, in particular the application of forward economic guidance, including the severity and magnitude of modelled downside scenarios, and considerations of post model adjustments.

Key audit matter

Credit loss allowances in respect of loans and advances to customers of the local group and bank

adjusted using a scalar to reflect local macro economic conditions. The LGD used for the Wholesale portfolio is driven by the loan-to-value ratio of the individual facilities and takes into account other assumptions, including market value haircut (which includes costs to sell), time to sell and the impact of discounting the collateral from the date of realisation back to the date of default.

Management also applies overlays where their view is that the calculated assumptions based on historical experience are not appropriate or that ECLs estimated by the models do not capture the risks in the portfolio.

For defaulted (Stage 3) exposures within the Wholesale portfolio, discounted cash flow models are utilised in order to estimate ECLs. Judgement is required to determine when a default has occurred and then to estimate the expected future cash flows related to that loan which are dependent on parameters or assumptions such as the valuation of collateral (including forced sale discounts and assumed realisation period) or forecasted operating cash flows. The bank is required to assess multiple scenarios in this respect, which scenarios will have probabilities attached.

Credit loss allowances relating to all loans and advances within the Retail portfolio (Stages 1, 2 and 3), comprising mortgages, personal loans and overdrafts as well as credit cards are determined on a collective basis through the use of ECL models.

The models are used to calculate ECLs based on key assumptions, such as loss rates (reflecting a combined impact of PDs and EADs) and loss severities (including the impact of implied cure rates) together with valuation of collateral (including forced sale discounts for mortgages) or recoveries. Loss rates and LGDs are estimated using internally developed statistical models and historical model development data based on the Bank's own experience as available at the reporting date. The LGD for the mortgages portfolio is also driven by the loan-to-value ratio of exposures, taking into account similar assumptions as those applied for the Corporate portfolio. The LGD for the remaining Retail portfolios is based on the local group's recovery history.

Under the new expected credit loss model, the bank is required to formulate and incorporate multiple forward-looking economic conditions, reflecting management's view of potential future economic variables and environments, into the ECL estimates. A number of macro-economic scenarios based on the selected macro-economic variables are considered to capture non-linearity across credit portfolios. The complexity attributable to this factor requires management to develop multiple macro-economic scenarios involving the use of significant judgements. The bank utilises a methodology to generate the economic inputs applied within the ECL models.

In order to meet the requirements of the new standard, significant changes have been made to systems, processes and controls with effect from 1 January 2018. There is also a significant increase in the number of data inputs required for the impairment calculation.

How our audit addressed the key audit matter

As the control environment for the calculation of ECL under IFRS 9 continued to be strengthened following initial adoption, we provided updates on the changes being made and the results of our testing procedures.

ECL calculation for non-defaulted Wholesale exposures and for all Retail exposures

We understood and critically assessed the models used for ECL estimation in both Wholesale and Retail portfolios. Since modelling assumptions and parameters are also based on historic data, we assessed whether historic experience was representative of current circumstances and of the recent losses incurred within the portfolios. The appropriateness of management's judgements was also independently considered in respect of calculation methodologies, calibration of PDs/loss rates and LGDs, segmentation, selection of macroeconomic variables and post-model overlays. Model calculations were also tested independently.

The design and operating effectiveness of key controls management has established across the processes relevant to the ECL models were tested as follows:

- Model performance monitoring and validation, including back testing of performance and approval of model changes.
- Review and challenge of multiple economic scenarios by an expert panel and internal governance committee.
- Inputs of critical data, into source systems, and the flow and transformation of data between source systems to the impairment calculation engine.
- User acceptance testing over the automated calculation of ECLs to ensure it is performed in line with business requirements.
- Review and challenge to assess ECL output and approval of overlays.
- Independent testing of model calculations.

We determined that we could rely on these controls for the purposes of our audit.

Substantive procedures were performed as follows:

- Performed an overall assessment of the ECL provision levels by stage to determine if they were reasonable considering the bank's portfolio, risk profile, credit risk management practices and the macroeconomic environment.
- Tested a sample of loans to independently review the borrower's financial performance and ability to meet loan repayments and assess the appropriateness of the credit rating assigned by management.
- Challenged the criteria used to allocate an asset to stage 1, 2 or 3 in accordance with IFRS 9 and tested assets in stage 1, 2 and 3 to verify that they were allocated to the appropriate stage.
- Tested the completeness and accuracy of the critical data, extracted from the underlying systems, that is utilised within the models for the purposes of the year end ECL calculation.

Key audit matter	How our audit addressed the key audit matter

Credit loss allowances in respect of loans and advances to customers of the local group and bank

The data is sourced from a number of systems that have not been used previously for the preparation of the accounting records. This increases risk around completeness and accuracy of certain data used to create assumptions and operate the models. In some cases, data is unavailable and reasonable alternatives have been applied to allow calculations to be performed.

As this is the first year of adoption of IFRS 9, there is limited experience available to back-test the ECL income statement charge with actual results.

The credit environment has remained relatively benign for an extended period of time, in part due to low interest rates and relative strength of the local economy. Whilst the current level of delinquencies and defaults remains low, the risk of misstatement in credit loss allowances remains significant.

Since the estimation of ECLs is subjective in nature and inherently judgemental, the bank's application of the IFRS 9 impairment requirements is deemed to be an area of focus. We focused on credit loss allowances due to the subjective nature of the calculations and the subjective judgements involved in both timing of recognition of impairment and the estimation of the size of any such impairment.

Accordingly, summarising the key areas relevant to the bank's measurement of expected credit losses (ECLs) would include:

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

Relevant references in the Annual Report and Financial Statements:

- Accounting policy: Note 3(b);
- Credit risk management: Note 4;
- Note on Changes in expected credit losses and other impairment charges: Note 15;
- Note on Loans and advances to customers: Note 26; and
- Critical accounting judgements and estimates: Note 61(a).

How our audit addressed the key audit matter

- Reviewed the SAS script codes for the impairment engine against business requirements and our expectations of how the calculation should operate.
- Risk based testing of models, including independent re-build of certain assumptions. We tested the assumptions, inputs and formulas used in ECL models on a sample basis. This included assessing the appropriateness of model design and formulas used, and recalculating PDs, LGDs and EADs on a sample basis.
- Tested the multiple macro-economic scenarios and variables using our experts to assess their reasonableness. We assessed the base case and alternative economic scenarios, including challenging probability weights. We assessed whether forecasted macroeconomic variables were appropriate and we challenged the correlation and impact of the macroeconomic factors on the ECL.
- Assessed the completeness and appropriateness of post model adjustments including through the recalculation of a sample.

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

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

ECL calculation for defaulted Wholesale exposures

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

In respect of defaulted exposures the design and operating effectiveness of key controls management has established were tested over:

- The compilation and review of the credit watch list and the credit file review processes.
- The determination of which loans and advances are credit-impaired, including the timely identification of such defaulted exposures.
- The perfection of security and revaluation of collateral in line with the Bank's policy.

We determined that we could rely on these controls for the purposes of our audit.

Key audit matter	How our audit addressed the key audit matter
Credit loss allowances in respect of loans and advances to customers of the local group and bank	
	Substantive procedures were performed in respect of identification of defaults as follows: • Assessed critically the criteria used for determining whether a default event had occurred by testing a sample of loans with characteristics that might imply a default event had occurred (for example a customer experiencing financial difficulty) to challenge whether default events had actually occurred and to assess whether default events had been identified by management in a timely manner. • Selected a sample of performing loans, which had not been identified by management as potentially defaulted, to form our own judgement as to whether that was appropriate and to further challenge whether all relevant events had been identified by management. Substantive procedures were performed on defaulted exposures as follows: • Reviewed the credit files of a selected sample of corporate loans to understand the latest developments at the level of the borrower and the basis of measuring the ECL provisions and considered whether key judgements were appropriate given the borrowers' circumstances.
Measurement of life insurance contract liabilities and of the present value of in-force business (PVIF) of the local group	
Management's valuation of provisions for the settlement of future claims attributable to life insurance contracts, and the PVIF, involves complex and subjective judgements about future events, both internal and external to the business, for which small changes in assumptions can result in material impacts to the valuation of these items. We focused on this area due to the materiality and subjectivity of the judgements made. Economic assumptions (investment return and associated discount rates) and non-economic assumptions (mortality, lapse rates and expenses associated with servicing policies), including the respective margins applied, are the key inputs to which the carrying amounts of these long-term liabilities and intangible asset are highly sensitive. Relevant references in Annual Report and Financial Statements: • Accounting policy: Note 3(m) and Note 3(h); • Note on Liabilities under insurance contracts: Note 42; • Note on Intangible assets: Note 35; and • Critical accounting judgements and estimates: Note 61(c).	Our audit procedures addressing the valuation of the local group's life insurance contract liabilities and the local group's PVIF included the following procedures, using our actuarial specialist team members: • we tested the accuracy of the underlying data utilised for the purposes of measurement by reference to its source; • we applied our industry knowledge and experience in comparing the methodology, models and assumptions used to recognised actuarial practices; and • we tested management's controls in respect of the valuation and assumption setting processes, and we assessed management's key judgements throughout the processes. In respect of the assumptions underlying the measurement of the life insurance contract liabilities, we performed the following procedures using our actuarial specialist team members: • we assessed the assumptions for investment mix and projected investment returns by reference to company-specific and market observable data (euro swap curve); • we considered the appropriateness of the mortality assumptions by reference to company and industry data on historical mortality experience and expectations of future mortality; and

Key audit matter	How our audit addressed the key audit matter
Measurement of life insurance contract liabilities and of the present value of in-force business (PVIF) of the local group	
	• we tested the future expense assumption by understanding and challenging the basis on which expenses are allocated between new business and renewals and by reference to market observable data (inflation curve). The following procedures addressing the assumptions underlying the valuation of the local group's PVIF were performed, also through the involvement of our actuarial specialist team members: • we leveraged the testing performed in relation to those assumptions that are aligned with the insurance contract liability valuation, reviewing the differences in margins applied between the two; and • we considered the appropriateness of the lapse rate assumptions by reference to company data, considering the results of management's analysis of recent lapse experience. In respect of all the assumptions referred to above, we have reviewed management's approach to setting the assumptions, assessed the assumptions' appropriateness based on internal and external data, and tested management's governance and controls over the assumption basis review. We also reviewed the modelled results and manual adjustments, and we assessed the reasonableness of management's analysis of the changes in the carrying amounts. Based on the results of our work we concluded that the data and assumptions used by management were reasonable.

How we tailored our group audit scope

The local group is composed of three components: HSBC Bank Malta p.l.c. (the parent company), and its subsidiaries HSBC Life Assurance (Malta) Limited, which is determined to be a financially significant entity, and HSBC Global Asset Management (Malta) Limited.

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

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

Other information

The Directors are responsible for the other information. The other information comprises the Report of the Directors (but does not include the financial statements and our auditor's report thereon), which we obtained prior to the date of this auditor's report, and the Chairman's Statement, the Chief Executive Officer's Review, the Directors' Responsibilities Statement, the Remuneration Report, the Additional Regulatory Disclosures and the the Five-year comparisons, which are expected to be made available to us after that date.

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

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

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

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

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

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

When we read the Chairman's Statement, the Chief Executive Officer's Review, the Directors' Responsibilities Statement, the Remuneration Report, the Additional Regulatory Disclosures and the Five-year comparisons, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance in accordance with International Standards on Auditing.

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

The Directors are responsible for the preparation of financial statements that give a true and fair view in accordance with IFRSs as adopted by the EU and the requirements of the Banking Act (Cap. 371) and the Maltese Companies Act (Cap. 386), and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Those charged with governance are responsible for overseeing the local group's and the bank's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the local group's and the bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors.
- Conclude on the appropriateness of the Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the local group's or the bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the local group or the bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the local group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

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

Report on other legal and regulatory requirements

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

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

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

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

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

In our opinion, the Statement of Compliance set out on pages 29 to 37 has been properly prepared in accordance with the requirements of the Listing Rules issued by the Malta Listing Authority.

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

In our opinion:

- we have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;
- proper books of account have been kept by the bank, so far as appears from our examination of those books;
- the bank's financial statements are in agreement with the books of account; and
- to the best of our knowledge and according to the explanations given to us, the financial statements give the information required by any law in force in the manner so required.

Other matters on which we are required to report by exception

We also have responsibilities under:

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

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

Appointment

We were first appointed as auditors of the local group and the bank on 22 April 2015. Our appointment has been renewed annually by shareholder resolution representing a total period of uninterrupted engagement appointment of 4 years. The engagement partner on the audit resulting in this independent auditor's report is Fabio Axisa.

F Axisa

Fabio Axisa (Partner) for and on behalf of

PricewaterhouseCoopers
Registered Auditors
78 Mill Street, Qormi, Malta

19 February 2019

Income statements

for the year ended 31 December

		Group		Bank	
		2018	2017	**2018**	2017
	Notes	**€000**	€000	**€000**	€000
Interest and similar income					
– on loans and advances, balances with Central Bank of Malta and Treasury Bills	7	**109,272**	120,309	**109,272**	120,310
– on debt and other fixed income instruments	7	**9,671**	12,541	**9,659**	12,378
Interest expense	8	**(10,321)**	(12,190)	**(10,321)**	(12,190)
Net interest income		**108,622**	120,660	**108,610**	120,498
Fee income		**24,114**	25,061	**19,695**	20,039
Fee expense		**(1,338)**	(2,326)	**(1,134)**	(1,361)
Net fee income	9	**22,776**	22,735	**18,561**	18,678
Net trading income	10	**5,386**	5,273	**5,386**	5,273
Net income from assets and liabilities of insurance operations, including related derivatives, designated at fair value through profit and loss		**N/A**	15,480	**N/A**	–
Net income from financial instruments of insurance operations measured at fair value through profit and loss		**(20,289)**	N/A	**–**	N/A
Dividend income	11	**18**	–	**11,425**	–
Net insurance premium income	12	**58,500**	73,502	**–**	–
Movement in present value of in-force long-term insurance business		**(5,774)**	(1,675)	**–**	–
Other operating income/(expense)	13	**3,307**	(723)	**2,976**	(681)
Total operating income		**172,546**	235,252	**146,958**	143,768
Net insurance claims, benefits paid and movement in liabilities to policyholders	14	**(24,173)**	(74,363)	**–**	–
Net operating income before changes in expected credit losses and provisions/ loan impairment charges and provisions		**148,373**	160,889	**146,958**	143,768
Change in expected credit losses and other credit impairment charges	15	**(3,488)**	N/A	**(3,488)**	N/A
Net reversal of loan impairment charges	16	**N/A**	1,168	**N/A**	1,168
Movement in provision for brokerage remediation costs	17	**2,028**	1,800	**2,028**	1,800
Net operating income		**146,913**	163,857	**145,498**	146,736
Employee compensation and benefits	18	**(50,158)**	(56,192)	**(47,506)**	(53,510)
General and administrative expenses	19	**(53,024)**	(52,278)	**(48,171)**	(46,856)
Depreciation of property, plant and equipment	34	**(3,401)**	(3,632)	**(3,401)**	(3,630)
Amortisation of intangible assets	35	**(1,774)**	(1,932)	**(1,681)**	(1,861)
Profit before tax	19	**38,556**	49,823	**44,739**	40,879
Tax expense	20	**(9,860)**	(18,968)	**(12,148)**	(15,894)
Profit for the year		**28,696**	30,855	**32,591**	24,985
Earnings per share	21	**8.0c**	8.6c		

The notes on pages 58 to 148 are an integral part of these financial statements.

Statements of comprehensive income

for the year ended 31 December

		Group		Bank	
		2018	2017	**2018**	2017
	Notes	**€000**	€000	**€000**	€000
Profit for the year		**28,696**	30,855	**32,591**	24,985
Other comprehensive income					
Items that will be reclassified subsequently to profit or loss when specific conditions are met:					
Debt instruments at fair value through other comprehensive income/available-for-sale investments:		**(3,592)**	(4,739)	**(3,582)**	(4,640)
– fair value losses	*48*	**(5,527)**	(7,290)	**(5,511)**	(7,139)
– income taxes	*48*	**1,935**	2,551	**1,929**	2,499
Items that will not be reclassified subsequently to profit or loss:					
Properties:		**382**	–	**382**	–
– surplus arising on revaluation	*48*	**424**	–	**424**	–
– income taxes	*48*	**(42)**	–	**(42)**	–
Defined benefit obligation:		**(334)**	–	**(334)**	–
– remeasurement of defined benefit obligation	*43*	**(514)**	–	**(514)**	–
– income taxes		**180**	–	**180**	–
Equity instruments designated at fair value through other comprehensive income:		**1,045**	N/A	**1,045**	N/A
– fair value gains	*48*	**1,608**	N/A	**1,608**	N/A
– income taxes	*48*	**(563)**	N/A	**(563)**	N/A
Other comprehensive income for the year, net of tax		**(2,499)**	(4,739)	**(2,489)**	(4,640)
Total comprehensive income for the year		**26,197**	26,116	**30,102**	20,345

The notes on pages 58 to 148 are an integral part of these financial statements.

Statements of financial position

for the year ended 31 December

	Notes	Group 2018 €000	Group 2017 €000	Bank 2018 €000	Bank 2017 €000
Assets					
Balances with Central Bank of Malta, Treasury Bills and cash	*22*	**190,768**	164,059	**190,768**	164,059
Items in the course of collection from other banks		**5,404**	18,158	**5,404**	18,158
Financial investments designated at fair value attributable to insurance operations	*23*	**N/A**	727,270	**N/A**	—
Financial investments mandatorily measured at fair value through profit or loss attributable to insurance operations	*23*	**694,081**	N/A	**—**	N/A
Held for trading derivatives	*24*	**4,956**	5,175	**4,956**	5,175
Loans and advances to banks	*25*	**1,097,714**	1,059,308	**1,092,773**	1,045,699
Loans and advances to customers	*26*	**3,110,412**	3,128,833	**3,110,412**	3,128,833
Financial investments	*27*	**904,920**	926,096	**904,918**	924,881
Prepayments and accrued income	*28*	**27,312**	24,236	**22,760**	20,199
Current tax assets		**16,728**	13,911	**15,960**	13,440
Reinsurance assets	*29*	**85,205**	85,887	**—**	—
Assets attributable to disposal group held for sale	*30*	**—**	473,797	**—**	—
Other non-current assets held for sale	*31*	**5,908**	7,411	**5,908**	7,411
Investments in subsidiaries	*32*	**—**	—	**30,859**	30,859
Investment property	*33*	**9,714**	10,600	**7,515**	7,500
Property, plant and equipment	*34*	**55,413**	56,308	**55,520**	56,415
Intangible assets	*35*	**59,136**	64,062	**5,831**	4,575
Deferred tax assets	*36*	**21,509**	16,488	**21,509**	16,488
Other assets	*37*	**21,814**	16,384	**20,531**	15,686
Total assets		**6,310,994**	6,797,983	**5,495,624**	5,459,378
Liabilities					
Deposits by banks	*38*	**2,542**	54,703	**2,542**	54,703
Customer accounts	*39*	**4,887,473**	4,765,995	**4,940,980**	4,850,931
Held for trading derivatives	*24*	**4,991**	5,228	**4,991**	5,228
Accruals and deferred income	*40*	**19,151**	17,838	**17,063**	15,303
Current tax liabilities		**538**	—	**538**	—
Liabilities under investment contracts	*41*	**166,347**	203,136	**—**	—
Liabilities under insurance contracts	*42*	**620,781**	658,792	**—**	—
Provisions for liabilities and other charges	*43*	**20,689**	20,099	**19,752**	19,410
Deferred tax liabilities	*36*	**23,427**	26,295	**5,119**	5,578
Subordinated liabilities	*44*	**62,000**	29,277	**62,000**	30,000
Liabilities attributable to disposal group held for sale	*45*	**—**	473,797	**—**	—
Other liabilities	*46*	**44,277**	63,785	**38,857**	58,088
Total liabilities		**5,852,216**	6,318,945	**5,091,842**	5,039,241
Equity					
Called up share capital	*47*	**108,092**	108,092	**108,092**	108,092
Revaluation reserve	*48*	**34,265**	36,430	**34,265**	36,420
Retained earnings	*48*	**316,421**	334,516	**261,425**	275,625
Total equity		**458,778**	479,038	**403,782**	420,137
Total liabilities and equity		**6,310,994**	6,797,983	**5,495,624**	5,459,378
Memorandum items					
Contingent liabilities	*49*	**149,783**	122,959	**149,785**	122,961
Commitments	*50*	**1,433,773**	1,215,457	**1,434,634**	1,215,501

The notes on pages 58 to 148 are an integral part of these financial statements.

The financial statements on pages 52 to 148 were approved and authorised for issue by the Board of Directors on 19 February 2019 and signed on its behalf by:

Sonny Portelli
Chairman

Andrew Beane
Chief Executive Officer

Statements of changes in equity

for the year ended 31 December

	Notes	Group			
		Share capital	Revaluation reserve	Retained earnings	Total equity
		€000	€000	€000	€000
At 31 December 2017		**108,092**	**36,430**	**334,516**	**479,038**
Impact of transition to IFRS 9	56	**—**	**—**	**(8,048)**	**(8,048)**
At 1 January 2018		**108,092**	**36,430**	**326,468**	**470,990**
Profit for the year		**—**	**—**	**28,696**	**28,696**
Other comprehensive income					
Financial investments at fair value through other comprehensive income:					
– fair value losses, net of tax	48	**—**	**(2,547)**	**—**	**(2,547)**
Properties:					
– surplus arising on revaluation, net of tax	48	**—**	**382**	**—**	**382**
Defined benefit obligation:					
– remeasurement of defined benefit obligation, net of tax		**—**	**—**	**(334)**	**(334)**
Total other comprehensive income		**—**	**(2,165)**	**(334)**	**(2,499)**
Total comprehensive income for the year		**—**	**(2,165)**	**28,362**	**26,197**
Transactions with owners, recognised directly in equity					
Contributions by and distributions to owners:					
– dividends	52	**—**	**—**	**(38,409)**	**(38,409)**
Total contributions by and distributions to owners		**—**	**—**	**(38,409)**	**(38,409)**
At 31 December 2018		**108,092**	**34,265**	**316,421**	**458,778**
At 1 January 2017		108,092	41,333	324,099	473,524
Profit for the year		—	—	30,855	30,855
Other comprehensive income					
Available-for-sale investments:					
– fair value losses, net of tax	48	—	(4,739)	—	(4,739)
Properties:					
– transfer to retained earnings upon realisation through disposal, net of tax	48	—	(164)	164	—
Total other comprehensive income		—	(4,903)	164	(4,739)
Total comprehensive income for the year		—	(4,903)	31,019	26,116
Transactions with owners, recognised directly in equity					
Contributions by and distributions to owners:					
– share-based payments		—	—	8	8
– dividends	52	—	—	(20,610)	(20,610)
Total contributions by and distributions to owners		—	—	(20,602)	(20,602)
At 31 December 2017		108,092	36,430	334,516	479,038

The notes on pages 58 to 148 are an integral part of these financial statements.

Statements of changes in equity (continued)

for the year ended 31 December

	Notes	Bank			
		Share capital	Revaluation reserve	Retained earnings	Total equity
		€000	€000	€000	€000
At 31 December 2017		**108,092**	**36,420**	**275,625**	**420,137**
Impact of transition to IFRS 9	56	**–**	**–**	**(8,048)**	**(8,048)**
At 1 January 2018		**108,092**	**36,420**	**267,577**	**412,089**
Profit for the year		**–**	**–**	**32,591**	**32,591**
Other comprehensive income					
Financial investments at fair value through other comprehensive income:					
– fair value losses, net of tax	48	**–**	**(2,537)**	**–**	**(2,537)**
Properties:					
– surplus arising on revaluation, net of tax	48	**–**	**382**	**–**	**382**
Defined benefit obligation:					
– remeasurement of defined benefit obligation, net of tax		**–**	**–**	**(334)**	**(334)**
Total other comprehensive income		**–**	**(2,155)**	**(334)**	**(2,489)**
Total comprehensive income for the year		**–**	**(2,155)**	**32,257**	**30,102**
Transactions with owners, recognised directly in equity					
Contributions by and distributions to owners:					
– dividends	52	**–**	**–**	**(38,409)**	**(38,409)**
Total contributions by and distributions to owners		**–**	**–**	**(38,409)**	**(38,409)**
At 31 December 2018		**108,092**	**34,265**	**261,425**	**403,782**
At 1 January 2017		108,092	41,224	271,078	420,394
Profit for the year		–	–	24,985	24,985
Other comprehensive income					
Available-for-sale investments:					
– fair value losses, net of tax	48	–	(4,640)	–	(4,640)
Properties:					
– transfer to retained earnings upon realisation through disposal, net of tax	48	–	(164)	164	–
Total other comprehensive income		–	(4,804)	164	(4,640)
Total comprehensive income for the year		–	(4,804)	25,149	20,345
Transactions with owners, recognised directly in equity					
Contributions by and distributions to owners:					
– share-based payments		–	–	8	8
– dividends	52	–	–	(20,610)	(20,610)
Total contributions by and distributions to owners		–	–	(20,602)	(20,602)
At 31 December 2017		108,092	36,420	275,625	420,137

The notes on pages 58 to 148 are an integral part of these financial statements.

Statements of cash flows

for the year ended 31 December

		Group		Bank	
		2018	2017	**2018**	2017
	Notes	**€000**	€000	**€000**	€000
Cash flows from operating activities					
Interest, fees and premium receipts		**193,161**	234,213	**127,123**	149,039
Interest, fees and claims payments		**(75,222)**	(296,742)	**(12,049)**	(14,745)
Payments to employees and suppliers		**(100,533)**	(106,740)	**(92,660)**	(99,585)
Cash flows from/(used in) operating activities before changes in operating assets/liabilities		**17,406**	(169,269)	**22,414**	34,709
(Increase)/decrease in operating assets:					
– financial investments designated at fair value attributable to insurance operations		**N/A**	189,207	**N/A**	–
– financial investments mandatorily measured at fair value through profit or loss attributable to insurance operations		**11,372**	N/A	**–**	N/A
– reserve deposit with Central Bank of Malta		**(1,176)**	290	**(1,176)**	290
– loans and advances to customers and banks		**(89,233)**	60,397	**(89,216)**	60,428
– Treasury Bills		**(15,527)**	(18,214)	**(15,527)**	(18,214)
– other receivables		**(5,543)**	8,997	**(4,339)**	4,570
(Decrease)/increase in operating liabilities:					
– customer accounts and deposits by banks		**66,657**	(172,436)	**35,209**	(146,746)
– other payables		**(40,880)**	(43,580)	**(2,616)**	3,282
Net cash used in operating activities before tax		**(56,924)**	(144,608)	**(55,251)**	(61,681)
– tax paid		**(14,452)**	(12,086)	**(10,183)**	(13,609)
Net cash used in operating activities		**(71,376)**	(156,694)	**(65,434)**	(75,290)
Cash flows from investing activities					
Dividends received		**18**	–	**7,618**	–
Interest received from financial investments		**20,091**	32,305	**18,282**	21,724
Purchase of financial investments		**(242,523)**	(139,115)	**(242,523)**	(139,115)
Proceeds from sale and maturity of financial investments		**254,972**	231,950	**253,759**	228,515
Purchase of property, plant and equipment and intangible assets		**(5,194)**	(2,999)	**(5,018)**	(2,219)
Proceeds from disposal of investment property		**1,300**	–	**–**	–
Net cash from investing activities		**28,664**	122,141	**32,118**	108,905
Cash flows from financing activities					
Dividends paid		**(38,409)**	(20,610)	**(38,409)**	(20,610)
Issue of subordinated liabilities		**62,000**	–	**62,000**	–
Repayment of subordinated liabilities		**(29,277)**	(58,158)	**(30,000)**	(58,172)
Net cash used in financing activities		**(5,686)**	(78,768)	**(6,409)**	(78,782)
Net decrease in cash and cash equivalents		**(48,398)**	(113,321)	**(39,725)**	(45,167)
Cash and cash equivalents at beginning of year		**848,649**	949,504	**835,035**	867,736
Effect of exchange rate changes on cash and cash equivalents		**1,631**	12,466	**1,631**	12,466
Cash and cash equivalents at end of year	53	**801,882**	848,649	**796,941**	835,035

The notes on pages 58 to 148 are an integral part of these financial statements.

1 Reporting entity

HSBC Bank Malta p.l.c. (the 'local group') is a limited liability company domiciled and incorporated in Malta.

The consolidated financial statements of the local group as at and for the year ended 31 December 2018 comprise the bank and its subsidiaries. All amounts have been rounded to the nearest thousand, unless otherwise stated.

2 Basis of preparation

(a) Compliance with IFRSs as adopted by the EU

These consolidated financial statements have been prepared in accordance with the requirements of International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board ('IASB'), including interpretations issued by the IFRS Interpretations Committee, and as endorsed by the European Union ('EU'). At 31 December 2018, there were no unendorsed standards effective for the year ended 31 December 2018 affecting these consolidated and separate financial statements, and HSBC's application of IFRSs results in no differences between IFRSs as issued by the IASB and IFRSs as endorsed by the EU.

These financial statements have also been drawn up in accordance with the provisions of the Banking Act (Cap. 371) and the Maltese Companies Act (Cap. 386), enacted in Malta.

(b) Historical cost convention

These financial statements have been prepared on the historical cost basis, except for the intangible asset reflecting the present value of in-force long-term insurance business, and the following items that are measured at fair value:

- Held for trading derivatives;
- Financial investments designated at fair value attributable to insurance operations;
- Financial investments mandatorily measured at fair value through profit or loss attributable to insurance operations;
- Financial investments;
- Property within 'Property, plant and equipment' and 'Investment property'; and
- Liabilities under investment contracts.

(c) Interpretations and amendments to standards adopted by the local group

During 2018, the bank adopted a number of interpretations and amendments to standards in the consolidated financial statements of the local group and the separate financial statements of the bank.

Standards adopted during the year ended 31 December 2018

The bank has adopted the requirements of IFRS 9 'Financial Instruments' from 1 January 2018.

The classification and measurement, and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application. As permitted by IFRS 9, the local group has not restated comparatives. Adoption reduced net assets at 1 January 2018 by €8,048,000 as a result of the estimation of expected credit loss allowances (with the impact disclosed in Note 56), net of deferred income taxes.

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

IFRS 9 transitional requirements

The transitional requirements of IFRS 9 necessitated a review of the designation of financial instruments at fair value. IFRS 9 requires that the designation is revoked where there is no longer an accounting mismatch at 1 January 2018 and permits designations to be revoked or additional designations created at 1 January 2018 if there are accounting mismatches at that date.

The changes in the classification of financial instruments as a result of the transitional requirements are highlighted in Note 3(b)(ii) and set out in Note 56.

(d) New standards and interpretations not yet adopted

Minor amendments to IFRSs

The IASB has published a number of minor amendments to IFRSs which are effective from 1 January 2019, some of which have been endorsed for use in the EU. The local group expects they will have an insignificant effect, when adopted, on the consolidated financial statements of the local group and the separate financial statements of the bank. The local group has not early adopted any of the amendments effective after 31 December 2018.

Major new IFRSs

The IASB has published IFRS 16 'Leases' and IFRS 17 'Insurance Contracts'.

IFRS 16 'Leases'

IFRS 16 'Leases' has an effective date for annual periods beginning on or after 1 January 2019. IFRS 16 results in lessees accounting for most leases within the scope of the standard in a manner similar to the way in which finance leases are currently accounted for under International Accounting Standard ('IAS') 17 'Leases'. Lessees will recognise a right of use ('ROU') asset and a corresponding financial liability on the balance sheet. The asset will be amortised over the length of the lease, and the financial liability measured at amortised cost. Lessor accounting remains substantially the same as under IAS 17. At 1 January 2019, the local group expects to adopt the standard using a modified retrospective approach where the cumulative effect of initially applying it is recognised as an adjustment to the opening balance of retained earnings and comparatives are not restated. The implementation is expected to increase assets and increase financial liabilities by the same amount with no effect on net assets or retained earnings. The local group is currently assessing the impact of IFRS 16, and it is not practicable to quantify the effect at the date of the publication of these financial statements. Existing operating lease commitments are set out in Note 51.

IFRS 17 'Insurance Contracts'

IFRS 17 'Insurance Contracts' was issued in May 2017, and sets out the requirements that an entity should apply in accounting for insurance contracts it issues and reinsurance contracts it holds. IFRS 17 is currently effective from 1 January 2021. However, the IASB is considering delaying the mandatory implementation date by one year and may make additional changes to the standard. The local group is in the process of implementing IFRS 17. Industry practice and interpretation of the standard is still developing and there may be changes to it, therefore the likely impact of its implementation remains uncertain.

Amendment to IAS 12 'Income Taxes'

An amendment to IAS 12 was issued in December 2017 as part of the annual improvement cycle. The amendment clarifies that an entity should recognise the tax consequences of dividends where the transactions or events that generated the distributable profits are recognised. This amendment is effective for annual periods beginning on or after 1 January 2019 and is applied to the income tax consequences of distributions recognised on or after the beginning of the earliest comparative period. As a result of its application, the income tax consequences of distributions on certain capital securities classified as equity will be presented in profit or loss rather than directly in equity. The implementation of this standard is not expected to have a material impact on the local group results.

(e) Functional and presentation currency

The functional currency of the bank is Euro, which is also the presentation currency of the consolidated financial statements of the local group.

(f) Critical accounting estimates and judgements

The preparation of financial information in accordance with the requirements of IFRSs as adopted by the EU requires the use of estimates and judgements about future conditions. In view of the inherent uncertainties and the high level of subjectivity involved in the recognition or measurement of items listed below, it is possible that the outcomes in the next financial year could differ from those on which management's estimates are based, resulting in materially different conclusions from those reached by management for the purposes of the 2018 Financial Statements. Management's selection of the local group's accounting policies which contain critical estimates and judgements is listed below; it reflects the materiality of the items to which the policies are applied, the high degree of judgement and estimation of uncertainty involved:

- Expected credit losses on loans and advances: Note 3(b) and Note 15;
- Valuation of financial instruments: Note 5;
- Policyholder claims and benefits: Note 3(m)(ii) and Note 14;
- Present value of in-force long-term assurance business (PVIF): Note 3(m)(iv) and Note 35.

Further information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment, related to the matters highlighted above, is included in Note 61.

In management's view, apart from judgements involving estimations as reflected above, there are no significant or critical judgements made in the process of applying the local group's accounting policies that have a more significant effect on the amounts recognised in the financial statements.

(g) Going concern

The financial statements are prepared on a going concern basis, as the Directors are satisfied that the local group have the resources to continue in business for the foreseeable future. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including future projections of profitability, cash flows and capital resources.

3 Significant accounting policies

This note provides a list of the significant accounting policies adopted in the preparation of these consolidated financial statements. These policies have been consistently applied to all the years presented, unless otherwise stated.

(a) Basis of consolidation

i Consolidation

HSBC Bank Malta p.l.c. controls and consequently consolidates an entity when it is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Control is initially assessed based on consideration of all facts and circumstances, and is subsequently reassessed when there are significant changes to the initial setup. The local group is considered to have power over an entity when it has existing rights that give it the current ability to direct the relevant activities. For the local group to have power over an entity, it must have the practical ability to exercise those rights.

Where an entity is governed by voting rights, the group would consolidate when it holds, directly or indirectly, the necessary voting rights to pass resolutions by the governing body. In all other cases, the assessment of control is more complex and requires judgement of other factors, including having exposure to variability of returns, power over the relevant activities or holding the power as agent or principal. The local group may have power over an entity even though it holds less than a majority of the voting rights, if it holds additional rights arising through other contractual arrangements or substantive potential voting rights which give it power.

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured at the fair value of the consideration, including contingent consideration, given at the date of exchange. Acquisition-related costs are recognised as an expense in profit or loss in the period in which they are incurred. The acquired identifiable assets, liabilities and contingent liabilities are generally measured at their fair values at the date of acquisition. Goodwill is measured as the excess of the aggregate of the consideration transferred, the amount of non-controlling interest and the fair value of the local group's previously held equity interest, if any, over the net of the amounts of the identifiable assets acquired and the liabilities assumed. On an acquisition-by-acquisition basis, the amount of non-controlling interest is measured either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. For acquisitions achieved in stages, the previously held equity interest is remeasured at the acquisition-date fair value with the resulting gain or loss recognised in profit or loss.

Changes in the parent's ownership interest in a subsidiary that do not result in a loss of control are treated as transactions between equity owners of the local group and the net impact is reported within equity.

Subsidiaries are fully consolidated from the date on which control is transferred to the local group. They are deconsolidated from the date that control ceases.

ii Structured entities

A structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, for example when any voting rights relate to administrative tasks only, and key activities are directed by contractual arrangements. Structured entities often have restricted activities and a narrow and well defined objective.

Structured entities are assessed for consolidation in accordance with the local group's accounting policy set out above.

When assessing whether to consolidate HSBC managed investment funds, the local group reviews all facts and circumstances to determine whether the local group, as fund manager, is acting as agent or principal. The local group may be deemed to be a principal, and hence would control and consolidate the funds, i) when it acts as fund manager and cannot be removed without cause, ii) has variable returns through significant unit holdings and/or a guarantee provided, and iii) is able to influence the returns of the funds by exercising its power.

iii Transactions eliminated on consolidation

All intra-group balances and income and expenses arising from intra-group transactions, are eliminated on consolidation. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment of the transferred asset.

(b) Financial assets

i Initial recognition

The local group recognises a financial asset in its statement of financial position when it becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of financial assets are recognised on the trade date, which is the date on which the local group commits to purchase or sell the asset. Accordingly, the local group uses trade date accounting for regular way contracts when recording financial asset transactions. All financial assets are initially recognised at fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the financial asset.

ii Classification and measurement

The classification and measurement of financial assets will depend on how these are managed (the entity's business model) and their contractual cash flow characteristics.

If a financial asset is held within a business model other than 'hold to collect' or 'hold to collect and sell' then the financial asset is required to be measured at fair value through profit or loss (FVTPL) without further analysis. For those financial assets where the contractual cash flows arising on specified dates are solely payments of principal and interest (SPPI) on the principal amount outstanding, classification at amortised cost or fair value through other comprehensive income (FVOCI) will depend on whether the business model is to hold financial assets for the collection of contractual cash flows or whether the objective of the business model is achieved by both the collection of contractual cash flows and selling financial assets. If an instrument contains contractual cash flows which do not represent solely payments of principal and interest, then the classification to be used is FVTPL even if it is held in a business model that is either hold to collect or hold to collect and sell.

The local group's business model is determined by key management personnel and reflects the strategic purpose and intention for the portfolio and how the performance of the portfolio is assessed. Since the business model is set at a portfolio level, the classification assessment for this criterion is accordingly performed at that level. Because the key distinction between the two business models identified in IFRS 9 is whether or not 'sales' are intrinsic to achieving the desired objectives, it is important to identify what is meant by 'sales'. For the purposes of the business model assessment, these are transfers which would result in derecognition.

For those assets where the intention of the business model is to hold the financial assets to collect the contractual cash flows or to hold to collect and to sell, the local group assesses whether the cash flow characteristics of these assets meet the SPPI requirements of IFRS 9. 'Principal' is the fair value of the financial asset at initial recognition. It is not the amount that is due under the contractual terms of an instrument. 'Interest' is the compensation for time value of money and credit risk of a basic lending-type return. A basic lending-type return could also include consideration for other basic lending risks (for example, liquidity risk) and consideration for costs associated with holding the financial asset for a particular period of time (for example, servicing or administrative costs) and/or a profit margin.

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

- variable interest rates and modified relationships with the time value of money;
- leverage, being a contractual cash flow characteristic of some financial assets that increases the variability of the contractual cash flows with the result that they do not have economic characteristics of interest;
- contractual terms that allow the issuer to prepay (or the holder to put a debt instrument back to the issuer) before maturity and the prepayment amount substantially represents unpaid amounts of principal and interest, which may include reasonable compensation for early termination of the contract;
- contractual terms that allow the issuer or holder to extend the contractual term and the terms of the extension option result in contractual cash flows during the extension period that are solely payments of principal and interest, which may include reasonable compensation for the extension of the contract;
- contractual cash flows may be caused by an underlying contingent event (a trigger) such as contractual term resetting interest to a higher amount in the event of a missed payment; and
- contractual changes in interest rates.

Financial assets measured at amortised cost

Financial assets that are held to collect the contractual cash flows and which contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest are measured at amortised cost. Such financial assets comprise primarily loans and advances to banks and customers.

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

Financial assets measured at fair value through other comprehensive income

Financial assets held for a business model that is achieved by both collecting contractual cash flows and selling and which contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest are measured at fair value through other comprehensive income ('FVOCI'). These comprise primarily financial investments as debt securities.

They are subsequently remeasured at fair value and changes therein (except for those relating to impairment, interest income and foreign currency exchange gains and losses) are recognised in other comprehensive income until the assets are sold. Upon disposal, the cumulative gains or losses in other comprehensive income are recognised in the income statement. Financial assets measured at FVOCI are included in the impairment calculations set out below and impairment is recognised in profit or loss.

The local group's debt securities and Treasury Bills classified as available-for-sale under IAS 39 are classified at FVOCI under IFRS 9 given that the objective of the business model is achieved by both the collection of contractual cash flows and selling of the financial assets.

Equity securities measured at fair value with fair value movements presented in other comprehensive income

The equity securities for which fair value movements are shown in other comprehensive income are business facilitation and other similar investments where HSBC holds the investments other than to generate a capital return. Gains or losses on the derecognition of these equity securities are not transferred to profit or loss (dividend income is recognised in profit or loss). Otherwise, equity securities are measured at fair value through profit or loss.

The local group's equity securities remain measured at fair value, with fair value movements recognised in other comprehensive income under IFRS 9, since the equity securities currently held by the local group are held for reasons other than to generate a capital return.

Financial assets measured at fair value through profit or loss

Financial assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value through profit or loss. Financial assets held for trading are held principally for the purpose of selling in the near term or are part of a portfolio of financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. These assets are classified in the 'other' business model and measured at FVTPL.

The portfolios of all financial assets attributable to the local group's insurance operations are managed and performance is evaluated on a fair value basis. The insurance subsidiary is primarily focused on fair value information and uses that information to assess the assets' performance and to make decisions. The contractual cash flows of the debt securities are solely principal and interest, however, these securities are neither held for the purpose of collecting contractual cash flows nor held both for collecting contractual cash flows and for sale. The collection of contractual cash flows is only incidental to achieving the business model's objective. The subsidiary has not taken the option to irrevocably designate any equity securities as fair value through other comprehensive income. Consequently, all investments attributable to insurance operations are mandatorily measured at fair value through profit or loss. In the comparative period, most of the subsidiary's financial assets were subsequently measured at fair value due to fair value through profit or loss designation at initial recognition.

Financial instruments designated at fair value through profit or loss

Financial instruments, other than those held for trading, are classified in this category if they meet one or more of the criteria set out below and are so designated irrevocably at inception:

- the use of the designation removes or significantly reduces an accounting mismatch;
- a group of financial assets and liabilities or a group of financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; and
- the financial liability contains one or more non-closely related embedded derivatives.

Under this criterion, the financial instruments designated by the local group comprise financial liabilities under unit-linked investment contracts.

Liabilities to customers under unit-linked contracts are determined based on the fair value of the assets held in the linked funds, with changes recognised in profit or loss. Designation at fair value of the financial liabilities under investment contracts allows the changes in fair values of these financial liabilities to be recorded in profit or loss and presented in the same line as the changes in fair value of the assets held in the linked funds. As outlined previously, these financial assets are mandatorily measured at fair value through profit or loss. If no fair value designation was made for the customer liabilities, an accounting mismatch would arise. The related financial assets and financial liabilities are managed and reported to management on a fair value basis.

Subsequent changes in fair values are recognised in the income statement in 'Net trading income' or 'Net income from financial instruments of insurance operations measured at fair value through profit and loss' (2017: 'Net income from assets and liabilities of insurance operations, including related derivatives, designated at fair value through profit and loss').

iii Derecognition of financial assets

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

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

iv Impairment of amortised cost and FVOCI financial assets

Expected credit losses ('ECL') are recognised for loans and advances to banks and customers, other financial assets measured at amortised cost, debt instruments measured at FVOCI, and certain loan commitments and financial guarantee contracts. HSBC may commit to underwriting loans on fixed contractual terms for specified periods of time. When HSBC intends to hold the loan, the loan commitment is included in the impairment calculations set out below.

At initial recognition, an allowance (or provision in the case of loan commitments and financial guarantees) is required for ECL resulting from default events that are possible within the next 12 months, or less, where the remaining life is less than 12 months (12-month ECL).

In the event of a significant increase in credit risk, an allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument (lifetime ECL). Financial assets where 12-month ECL is recognised are considered to be 'stage 1'; financial assets which are considered to have experienced a significant increase in credit risk would be classified as 'stage 2'; and financial assets for which there is objective evidence of impairment, and which are so considered to be in default or otherwise credit impaired, would be classified as 'stage 3'. Purchased or originated credit-impaired financial assets ('POCI') are treated differently, as set out below.

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

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

Significant increase in credit risk (SICR or Stage 2)

The general principle of IFRS 9 ECL accounting requires that the credit risk of financial instruments within the scope of impairment to be assessed for significant increase since initial recognition at each balance sheet date. If there is a significant increase in credit risk, the financial instruments are transferred into Stage 2 and lifetime ECL is recognised. The principle of SICR is achieved by performing an assessment to compare the risk of default occurring at the reporting date with the risk of default occurring at the date of initial recognition.

Accordingly, an assessment of whether credit risk has increased significantly since initial recognition is performed at each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument. The assessment explicitly or implicitly compares the risk of default occurring at the reporting date compared with that at initial recognition, taking into account reasonable and supportable information, including information about past events, current conditions and future economic conditions. The assessment is unbiased, probability-weighted, and to the extent relevant, uses forward-looking information consistent with that used in the measurement of ECL. The analysis of credit risk is multifactor. The determination of whether a specific factor is relevant and its weight compared with other factors depends on the type of product, the characteristics of the financial instrument and the borrower. Therefore, it is not possible to provide a single set of criteria that will determine what is considered to be a significant increase in credit risk, and these criteria will differ for different types of lending, particularly between retail and wholesale. However, unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when 30 days past due. In addition, wholesale loans that are individually assessed, typically corporate and commercial customers, and included on a watch or worry list, are included in stage 2.

Wholesale exposures are usually managed on an individual basis for credit purposes, through relationship managers who have access to the customers and their financial information. A Customer Risk Rating (CRR) is assigned to each customer and is reviewed at least annually.

Although the CRR is assigned on an obligor/counterparty level rather than at the financial instrument level, it can still be used to assess significant increase in credit risk as long as it meets the underlying principles.

In applying the above, the CRR of the counterparty is inferred onto the outstanding financial instruments. For example, if a customer has a CRR of 3 when a loan is underwritten, the loan will have an initial recognition CRR of 3. If at the subsequent period end, the customer's CRR has deteriorated to 5 and a second loan is being granted to the customer, both loans will have CRR of 5 on that day. For the first loan, the CRR has increased from 3 to 5. If this is considered significant, it will be transferred to Stage 2. For the second loan, the initial recognition CRR is 5. It will remain in Stage 1 until the CRR has increased significantly in subsequent periods. While all outstanding loans to the same obligor/counterparty will have the same CRR at the reporting date, the respective loans might be in different stages depending on the initial recognition CRR, unless the obligor is in the 'Watch or Worry Status' and/or past due by more than 30 days, in which case all associated facilities (excluding those cases on the list for non-credit related reasons) will be transferred to Stage 2 immediately.

A CRR on its own is not a measure that meets all the requirements of IFRS 9 (e.g. it does not incorporate forward looking information). However, within the HSBC Group, CRRs are used to determine regulatory Probabilities of Default (PDs), and with appropriate adjustments, these PDs are used for IFRS 9 purposes. Each CRR is associated with an external rating grade by reference to long-run default rates for that grade, represented by the average of issuer-weighted historical default rates. This mapping between internal and external ratings is indicative and may vary over time. Therefore regulatory PD models calibrated at the level of HSBC Group are leveraged to derive a measure that is appropriate to assess significant increase in credit risk under IFRS 9.

As regulatory PDs are generally calculated over 12 months, one of the adjustments required is to incorporate the term structure into the PD to obtain the lifetime PD. The lifetime PD is determined by calculating the PD for each year over the life of the financial instrument. For example, for a five-year loan, PDs are calculated for each of the five years. The year-1 PD is calculated as the probability of the loan defaulting within the first year of it being issued. The year-2 PD is calculated as the probability of the loan surviving the first year but defaulting in the second year. The same principle of survival applies to the PDs of years 3 - 5. These yearly PDs are added together to arrive at the cumulative lifetime PD. As each year passes, the cumulative lifetime PD reduces in line with the reduction in the residual life of the loan. Albeit, significant increase in credit risk is measured by comparing the average PD for the remaining term estimated at origination with the equivalent estimation at reporting date.

For wholesale portfolios, the quantitative comparison assesses default risk using a lifetime PD which encompasses a wide range of information including the obligor's CRR, macroeconomic condition forecasts and credit transition probabilities. For origination CRRs up to 3.3, significant increase in credit risk is measured by comparing the average PD for the remaining term estimated at origination with the equivalent estimation at the reporting date. The quantitative measure of significance varies depending on the credit quality at origination as follows:

Origination CRR	Significance trigger - PD to increase by
0.1-1.2	15bps
2.1-3.3	30bps

For CRRs greater than 3.3 that are not impaired, a significant increase in credit risk is considered to have occurred when the origination PD has doubled. The significance of changes in PD was informed by expert credit risk judgement, referenced to historical credit migrations and to relative changes in external market rates.

For loans originated prior to the implementation of IFRS 9, the origination PD does not include adjustments to reflect expectations of future macroeconomic conditions since these are not available without the use of hindsight. In the absence of this data, origination PDs must be approximated assuming through-the-cycle ('TTC') PDs and TTC migration probabilities, consistent with the instrument's underlying modelling approach and the CRR at origination. For these loans, the quantitative comparison is supplemented with additional CRR deterioration-based thresholds, as set out in the table below:

Origination CRR	Additional significance criteria - number of CRR grade notches deterioration required to identify as significant credit deterioration (stage2) (>or equal to)
0.1	5 notches
1.1-4.2	4 notches
4.3-5.1	3 notches
5.2-7.1	2 notches
7.2-8.1	1 notch
8.3	0 notch

Retail exposures, unlike Wholesale exposures, are not managed on a credit by credit basis (e.g. through relationship managers), due to the high volume of relatively low value and homogeneous exposures. As a result, it is not feasible to replicate the Wholesale approach for Retail exposures. The Retail methodology takes into account the nature of the Retail exposures and the underlying credit risk management practices. The Retail portfolio comprises mortgages, personal loans and overdrafts, as well as credit cards.

Utilisation of the Retail methodology to determine whether a significant increase in credit risk has occurred is based on meeting the following three criteria:

- the credit risks of exposures within the portfolio are similar;
- any increase in the credit risk below the threshold is not considered significant; and
- the risk measure used (e.g. PD) includes all available information, including forward looking information.

Given how Retail customers are accepted and managed for credit risk, Retail customers within a particular segment will have similar credit risk at initial recognition. The measure, or threshold, used to assess significant increase in credit risk for the Retail portfolios is the average PD twelve months prior to exposures falling more than 30 days past due. Portfolio segments whose 12-month default rate is higher than this threshold would be classified as Stage 2 (the look back method). Within each portfolio, the stage 2 accounts are defined as accounts with an adjusted 12-month PD greater than the average 12-month PD of loans in that portfolio 12 months before they become 30 days past due. The expert credit risk judgement is that no prior increase in credit risk is significant. This portfolio-specific threshold identifies loans with a PD higher than would be expected from loans that are performing as originally expected, and higher than what would have been acceptable at origination. It therefore approximates a comparison of origination to reporting date PDs.

With respect to mortgages, through the look back method, it has been determined that all exposures that are one day past due would require such exposures to be classified as Stage 2. In this respect, the transfer criterion for the mortgages portfolio is assessed on the instrument's delinquency period.

For portfolios of debt securities where external market ratings are available and internal credit ratings are not used in credit risk management, the debt securities will be in Stage 2 if their credit risk increases to the extent they are no longer considered investment grade. Investment grade is where the financial instrument has a low risk of incurring losses, the structure has a strong capacity to meet its contractual cashflow obligations in the near term, and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil their contractual cashflow obligations.

Credit impaired (Stage 3)

IFRS 9 requires an assessment of the extent of increase in credit risk of a financial instrument since initial recognition. This assessment is performed by considering the change in the risk of default occurring over the remaining life of the financial instrument. As a result, the definition of default is important.

IFRS 9 does not specifically define default, but requires it to be applied on a consistent basis with internal credit risk management practice for the relevant instruments and requires consideration of qualitative factors where appropriate. In addition, IFRS 9 also introduces a rebuttable presumption that default does not occur later than when a financial asset is 90 days past due unless there is reasonable and supportable information to demonstrate that a more lagging criterion is more appropriate.

In this respect, the local group determines that a financial instrument is credit-impaired and in Stage 3 by considering relevant objective evidence, primarily whether:

- contractual payments of either principal or interest are past due for more than 90 days;
- there are other indications that the borrower is unlikely to pay such as that a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition; and
- the loan is otherwise considered to be in default.

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

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

With respect to Wholesale exposures the local group has incorporated evidence of credit impairment/default into the internal CRR used to rate Wholesale exposures. A defaulted or credit-impaired financial asset is assigned CRR 9 or 10. These exposures are usually managed by the local group's loan management unit (LMU).

With respect to Retail exposures, evidence of credit impairment/default is also incorporated into the PD model. A retail exposure with a PD of 1 i.e. 100% probability is considered defaulted and credit-impaired.

Interest income is recognised by applying the effective interest rate to the amortised cost amount, i.e. gross carrying amount less ECL allowance.

Write-off

Financial assets (and the related impairment allowances) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realisation of security. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write-off may be earlier.

Renegotiated loans

A 'renegotiated loan' is a loan where the contractual payment terms have been renegotiated or otherwise modified because the local group has significant concerns about the borrower's ability to meet contractual payments when due. In general, renegotiated loans are regarded as credit-impaired upon renegotiation unless the concession is insignificant and there are no other indicators of impairment. Moreover, loans are considered renegotiated irrespective of whether the modification is significant or not. Thus, de-recognition or otherwise of the financial asset would not have a bearing on whether the financial asset remains classified in the respective stage allocation. A range of forbearance strategies are employed upon the renegotiation of a loan in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid default, foreclosure or repossession. They include extended payment terms, a reduction in interest or principal repayments, approved external debt management plans, debt consolidations, the deferral of foreclosures, and other forms of loan modifications and re-ageing (re-ageing is an account action where the customer account is reclassified as being up to date without the customer having paid the arrears in full).

The local group's policies and practices are based on criteria which enable local management to judge whether repayment is likely to continue. Forbearance measures typically provide a customer with terms and conditions that are more favourable than those provided initially. Forbearance/renegotiation is only granted in situations where the customer has showed a willingness to repay the borrowing and is expected to be able to meet the revised obligations.

Accordingly, loans are identified as renegotiated and classified as credit-impaired when we modify the contractual payment terms due to significant credit distress of the borrower. Renegotiated loans remain classified as credit impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows and retain the designation of renegotiated until maturity or derecognition.

A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement is made on substantially different terms, or if the terms of an existing agreement are modified such that the renegotiated loan is a substantially different financial instrument. Any new loans that arise following derecognition events in these circumstances are considered to be POCI and will continue to be disclosed as renegotiated loans.

Other than originated credit-impaired loans, all other modified loans could be transferred out of stage 3 if they no longer exhibit any evidence of being credit impaired and, in the case of renegotiated loans, there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows over the minimum observation period, and there are no other indicators of impairment. These loans could be transferred to stage 1 or 2 based on the mechanism as described below by comparing the risk of a default occurring at the reporting date (based on the modified contractual terms) and the risk of a default occurring at initial recognition (based on the original, unmodified contractual terms). Any amount written off as a result of the modification of contractual terms would not be reversed.

As suggested previously, Wholesale renegotiated loans are considered credit-impaired and accordingly classified as Stage 3 assets. They can be cured out of the credit impaired status subsequently. When evidence suggests that the renegotiated asset is no longer credit-impaired, the asset is transferred out of Stage 3. This is assessed on the basis on historical and forward looking information and an assessment of the credit risk over the expected life of the asset, including information about the circumstances that led to the renegotiation.

Similarly, Retail renegotiated loans are also classified as Stage 3 assets. Retail renegotiated loans cure out of the credit impaired status if the customers meet the new payment requirements for 12 months following the date on which the loan was renegotiated.

Purchased or originated credit impaired

Financial assets that are purchased or originated at a deep discount that reflects the incurred credit losses are considered to be POCI. This population includes the recognition of a new financial instrument following a renegotiation where concessions have been granted for economic or contractual reasons relating to the borrower's financial difficulty that otherwise would not have been considered. The amount of change-in-lifetime ECL is recognised in profit or loss until the POCI is derecognised, even if the lifetime ECL are less than the amount of ECL included in the estimated cash flows on initial recognition.

Movement between stages

Financial assets can be transferred between the different categories (other than POCI) depending on their relative increase in credit risk since initial recognition. Financial instruments are transferred out of stage 2 if their credit risk is no longer considered to be significantly increased since initial recognition based on the assessments described above. Except for renegotiated loans, financial instruments are transferred out of stage 3 when they no longer exhibit any evidence of credit impairment as described above. Renegotiated loans that are not POCI will continue to be in stage 3 until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, observed over a minimum one-year period and there are no other indicators of impairment. For loans that are assessed for impairment on a portfolio basis, the evidence typically comprises a history of payment performance against the original or revised terms, as appropriate to the circumstances. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case-by-case basis.

Measurement of ECL

The assessment of credit risk and the estimation of ECL are unbiased and probability-weighted, and incorporate all available information that is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money.

In general, the local group calculates ECL using three main components: PD, loss given default (LGD), and exposure at default (EAD). The local group calculates the ECL for the Wholesale portfolio at an instrument level, whilst the ECL for Retail portfolios is calculated on a collective basis.

The 12-month ECL is calculated by multiplying the 12-month PD, LGD, and EAD. Lifetime ECL is calculated on a similar basis for the residual life of the exposure using the lifetime PD instead. The 12-month and lifetime PDs represent the probability of default occurring over the next 12 months and the remaining maturity of the instrument, respectively. PDs are point in time (based on current conditions, adjusted to take into account estimates of future conditions that will impact PD). The lifetime PDs are determined by projecting the 12-month PD using a term structure.

With respect to the Wholesale portfolio, given the local group's inherent lack of history of defaults to derive coherent PDs, proxy PDs are used as part of a Smaller Site Methodology. These proxy PDs are derived from regulatory PDs determined at HSBC Group level, and are adjusted for a scalar and a management overlay to reflect the economic realities of the market the local group operates in. The scalar denotes a risk parameter that helps translate the regulatory PDs into PDs relevant to the local scenario. For the wholesale methodology, the lifetime PD also takes into account credit migration, i.e. a customer migrating through the CRR bands over its life. In contrast, PDs for the Retail portfolio are based on internally developed statistical models using the local group's historical model development data based on the local group's own experience.

The LGD represents expected losses on the EAD given the event of default, taking into account, among other attributes, the mitigating effect of collateral value at the time it is expected to be realised and the time value of money. Expected LGD is based on estimate of loss given default including the expected impact of future economic conditions. It incorporates the impact of discounting back from point of default to balance sheet date using the original effective interest rate of the loan. Costs associated with obtaining / selling collateral are reflected.

The LGD used for the Wholesale portfolio is driven by the loan-to-value ratio of the individual facilities, and takes into account other assumptions, including market value haircut (which includes costs to sell), time to sell and discounting the collateral from the date of realisation back to the date of default. Similarly, the LGD for the Mortgages portfolio is also driven by the loan-to-value ratio of exposures, taking into account similar assumptions as those in the Wholesale portfolio. In contrast, the LGD for the remaining Retail portfolios (personal loans, overdrafts and credit cards), is based on the local group's recovery history.

The EAD represents the expected balance at default, taking into account the repayment of principal and interest from the balance sheet date to the default event together with any expected drawdowns of committed facilities.

The ECL for wholesale stage 3 is determined on an individual basis using a discounted cash flow ('DCF') methodology. The expected future cash flows are based on the credit risk officer's estimates as at the reporting date, reflecting reasonable and supportable assumptions and projections of future recoveries and expected future receipts of interest. Collateral is taken into account if it is likely that the recovery of the outstanding amount will include realisation of collateral based on the estimated fair value of collateral at the time of expected realisation, less costs for obtaining and selling the collateral. The cash flows are discounted at a reasonable approximation of the original effective interest rate. For significant cases, cash flows under different scenarios are probability-weighted by reference to the three economic scenarios applied more generally by the local group and the judgement of the credit risk officer in relation to the likelihood of the workout strategy succeeding or receivership being required. For less significant cases, the effect of different economic scenarios and work-out strategies is approximated and applied as an adjustment to the most likely outcome.

Period over which ECL is measured

The ECL is measured from the initial recognition of the financial asset. The maximum period considered when measuring ECL (be it 12-month or lifetime ECL) is the maximum contractual period over which the local group is exposed to credit risk. With respect to non-revolving credit facilities, the contractual life of the facility is considered. In contrast, in respect of revolving credit facilities, the local group distinguishes between individually managed exposures and collectively managed exposures. For individually managed exposures, which mostly form part of the Wholesale portfolio, credit risk management actions are taken no less frequently than on an annual basis and therefore this period is to the expected date of the next substantive credit review. The date of the substantive credit review also represents the initial recognition of the new facility. In contrast, with respect to the remaining revolving credit facilities, the lifetime of such exposures is defined as the point where 95% of the defaults have materialised - thus, the lifetime of such assets may be longer than 12 months.

Where the financial instrument includes both a drawn and undrawn commitment and the contractual ability to demand repayment and cancel the undrawn commitment does not serve to limit the local group's exposure to credit risk to the contractual notice period, the contractual period does not determine the maximum period considered. Instead, ECL is measured over the period the local group remains exposed to credit risk that is not mitigated by credit risk management actions. This applies to retail overdrafts and credit cards, where the period is the average time taken for stage 2 exposures to default or close as performing accounts, determined on a portfolio basis and ranging from between three and four years. In addition, for these facilities it is not possible to identify the ECL on the loan commitment component separately from the financial asset component. As a result, the total ECL is recognised in the loss allowance for the financial asset unless the total ECL exceeds the gross carrying amount of the financial asset, in which case the ECL is recognised as a provision.

Forward looking economic inputs

The recognition and measurement of ECL is highly complex and involves the use of significant judgement and estimation, including in the formulation and incorporation of multiple forward-looking economic conditions into the ECL estimates to meet the measurement objective of IFRS 9.

The local group will in general apply three forward-looking economic scenarios determined with reference to external forecast distributions representative of the group's view of forecast economic conditions. Three scenarios are considered to capture non-linearity across credit portfolios. If the economic environment is considered to be particularly adverse and results in a more pronounced non-linearity impact, senior management will exercise judgement, request additional analysis, recommend overlays and/or commission the production of additional scenarios. This approach on the whole is operationally feasible and will result in transparent outcomes. If conditions warrant, this could result in alternative scenarios and probability weightings being applied in arriving at the ECL.

The three scenarios will include a central or baseline view (most likely outcome) driven by a consensus among professional industry forecasts. The Central scenario is the basis for the annual operating planning process. Two additional outer scenarios - an 'upside' and a 'downside' - will be constructed using a 'rules-based' system supported by a scenario narrative that will reflect the current top and emergent risks. The relationship between the outer scenarios and Central scenario will generally be fixed with the Central scenario being assigned a weighting of 80% and the Upside and Downside scenarios 10% each, with the difference between the Central and outer scenarios in terms of economic severity being informed by the spread of external forecast distributions among professional industry forecasts. The key point to note is that the 'outer' scenarios will be economically plausible states of the world and will not necessarily be as severe as scenarios used in stress testing. The period of forecast is five years for the Central scenario after which the forecasts will revert to a more 'through the cycle' view.

Upside and Downside scenarios use distributional forecasts for the first two years, after which they converge to the Central forecasts. The economic factors include, but are not limited to, gross domestic product, unemployment, interest rates, inflation and property prices.

A Forward Economic Guidance (FEG) methodology has been developed to generate the economic inputs to help drive the IFRS 9 ECL models used for credit risk. The scenarios will have probabilities attached, based on a mixture of quantitative analysis and management judgement, with reference to an assessment of the economic risk landscape. In general, the consequences of the assessment of credit risk and the resulting ECL outputs will be probability-weighted using the standard probability weights. This probability weighting may be applied directly or the effect of the probability weighting determined on a periodic basis, at least annually, and then applied as an adjustment to the outcomes resulting from the central economic forecast. The scenarios will be enriched to produce the necessary variables that are required by the impairment models.

Presentation of ECL in statement of financial position

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

For financial assets measured at fair value through other comprehensive income, the loss allowance is presented within other comprehensive income and not against the carrying amount of the assets. The carrying amount of the asset is always the fair value.

(c) Derivative financial instruments

Derivatives are initially recognised and are subsequently re-measured at fair value. Fair values of exchange traded derivatives are obtained from quoted market prices. Fair values of over-the-counter derivatives are obtained using valuation techniques, including discounted cash flow models and option pricing models. Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative.

All the local group's derivative financial instruments are designated as held for trading as they are not designated as hedging instruments in accordance with the requirements of IAS 39.

Accordingly, all gains and losses from changes in the fair values of derivatives that do not qualify for hedge accounting are recognised immediately in profit or loss. These gains and losses are reported in Net trading income, except where derivatives are managed in conjunction with financial instruments measured at fair value through profit or loss in which case gains and losses are reported in 'Net income from financial instruments of insurance operations measured at fair value through profit and loss' (2017: 'Net income from assets and liabilities of insurance operations, including related derivatives, designated at fair value through profit and loss').

(d) Financial liabilities

The local group recognises a financial liability on its statement of financial position when it becomes a party to the contractual provisions of the instrument. The local group's financial liabilities are classified into two categories: i) financial liabilities which are designated at fair value through profit or loss and ii) financial liabilities measured at amortised cost. The criteria for designating financial liabilities at fair value and their measurement are described in Note 3(b)(ii).

Financial liabilities measured at amortised cost, i.e. not at fair value through profit or loss are recognised initially at fair value, being the fair value of consideration received, net of transaction costs that are directly attributable to the acquisition or the issue of the financial liability. These liabilities are subsequently measured at amortised cost using the effective interest rate method to amortise the difference between proceeds received, net of directly attributable transaction costs incurred, and the redemption amount over the expected life of the instrument.

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

Financial liabilities measured at amortised cost comprise principally subordinated liabilities, deposits by banks and customer accounts.

(e) Reverse repurchase and repurchase agreements

When debt securities are sold subject to a commitment to repurchase them at a predetermined price, they remain on the statement of financial position and a liability is recorded in respect of the consideration received. Securities purchased under commitments to resell are not recognised on the statement of financial position and an asset is recorded in respect of the initial consideration paid. In respect of the latter, the right to receive back the initial consideration paid is recorded in 'Loans and advances to banks' or 'Loans and advances to customers' as appropriate. The difference between the sale and repurchase price or between the purchase and resale price is treated as interest and recognised in net interest income over the life of the agreement, for loans and advances to banks and customers. Securities lending and borrowing transactions are generally secured against cash or non-cash collateral. Securities lent or borrowed do not normally result in derecognition or recognition on the statement of financial position. Cash collateral advanced or received is recorded as an asset or a liability respectively.

(f) Offsetting financial assets and financial liabilities

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

(g) Investments in subsidiaries

The local group classifies investments in entities which it controls as subsidiaries.

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

(h) Intangible assets

Intangible assets are recognised when they are separable or arise from contractual or other legal rights, and their fair value can be measured reliably.

Where intangible assets have a finite useful life, except for 'Present value of in-force long-term insurance business', they are stated at cost less accumulated amortisation and impairment losses.

Intangible assets with finite useful lives, such as purchased computer software, are amortised, on a straight line basis, over their estimated useful lives. Estimated useful life is the lower of legal duration and expected useful life. The estimated useful life of purchased software ranges between 3 - 5 years. Costs incurred in the ongoing maintenance of software are expensed immediately as incurred.

Intangible assets are subject to impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

The accounting policy in respect of the PVIF long-term insurance business is reflected within Note 3(m)(iv).

Deferred acquisition costs

Incremental costs that are incurred in acquiring investment management contracts and creditor protection business are deferred and amortised as the related revenue is recognised. All deferred acquisition costs are reviewed regularly to determine if they are recoverable from future cash flows on the associated contracts.

Deferred acquisition costs that are not deemed to be recoverable are charged to profit or loss. The test for recoverability is performed at a portfolio level, on portfolios of relatively homogeneous contracts. Deferred acquisition costs are amortised in profit or loss on a straight line basis over the estimated useful life of the contract.

(i) Property, plant and equipment

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

Freehold and long leasehold properties (land and buildings) are subsequently measured at fair value based on periodic valuations by external professionally qualified and independent valuers, less subsequent depreciation for buildings. Valuations are carried out on a regular basis such that the carrying amount of property does not differ materially from that which would be determined using fair values at the end of the reporting period. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset, and the net amount is restated to the revalued amount of the asset.

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

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

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

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

- long leaseholds, freehold buildings and improvements 50 years;
- short leaseholds and improvements to rented property over term of lease; and
- equipment, furniture and fittings 3–10 years.

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

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see Note 3(k)).

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

(j) Investment property

Property held for long-term rental yields or for capital appreciation or both that is not occupied by the local group is classified as investment property.

Investment properties are measured initially at historical cost, including transaction costs. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent to initial recognition, investment properties are stated at fair value, representing open market value determined annually, which reflects market conditions at the end of the reporting period.

Gains or losses arising from changes in the fair value of investment properties are included in profit or loss in the year in which they arise. Subsequent expenditure is capitalised to the asset's carrying amount only when it is probable that future economic benefits associated with the item will flow to the local group and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to the profit or loss during the financial period in which they are incurred.

The fair value of investment properties is based on the nature, location and condition of the specific asset. Fair values are determined by external professionally qualified and independent valuers who apply recognised valuation techniques. Any gain or loss on the disposal of an investment property is recognised in profit or loss. When the use of property changes such that it is reclassified as property, plant and equipment, its fair value at the date of reclassification becomes its carrying amount for subsequent accounting.

(k) Impairment of non-financial assets

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

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separate identifiable cash inflows (cash-generating units). An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in profit or loss, unless the asset is carried at a revalued amount.

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

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss on non-financial assets is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(l) Non-current assets (or disposal groups) held for sale

Non-current assets (or disposal groups i.e. assets and liabilities forming part of disposal groups) are classified as held for sale when their carrying amounts will be recovered principally through sale rather than through continuing use, they are available for sale in their present condition and their sale is highly probable. Immediately before the initial classification as held for sale, the carrying amount of the assets and liabilities is measured in accordance with the local group's accounting policies. Non-current assets (or disposal groups) classified as held for sale are generally measured at the lower of their carrying amount and fair value less cost to sell except for those assets and liabilities that are not within the scope of the measurement requirements of IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', such as those measured in accordance with IFRS 9.

On subsequent remeasurement of a disposal group, the carrying amounts of any assets and liabilities that are not within the scope of the measurement requirements of IFRS 5, but are included in a disposal group classified as held for sale, are remeasured under applicable IFRSs before the fair value less costs to sell of the disposal group is determined.

(m) Insurance and investment contracts

Through its insurance subsidiary, the local group issues contracts to customers that contain insurance risk, financial risk or a combination thereof. A contract under which the local group accepts significant insurance risk from another party by agreeing to compensate that party on the occurrence of a specified uncertain future event, is classified as an insurance contract. An insurance contract may also transfer financial risk, but is accounted for as an insurance contract if the insurance risk is significant.

i Net insurance premium income

Premiums for life insurance contracts are accounted for when receivable, except in unit-linked business where premiums are accounted for when liabilities are established.

Reinsurance premiums are accounted for in the same accounting period as the premiums for the direct insurance contracts to which they relate.

ii Net insurance claims, benefits paid and movement in liabilities to policyholders

Gross insurance claims for life insurance contracts reflect the total cost of claims arising during the year, including claim handling costs and any policyholder bonuses allocated in anticipation of a bonus declaration. Claims arising during the year include maturities, surrenders and death claims. Maturity claims are recognised when due for payment. Surrenders are recognised when paid or at an earlier date on which, following notification, the policy ceases to be included within the calculation of the related insurance liabilities. Death claims are recognised when notified.

Reinsurance recoveries are accounted for in the same period as the related claims.

iii Liabilities under insurance contracts

Liabilities under non-linked life insurance contracts are calculated based on actuarial principles.

Liabilities under unit-linked life insurance contracts are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices.

A liability adequacy test is carried out on insurance liabilities to ensure that the carrying amount of the liabilities is sufficient in the light of current estimates of future cash flows. When performing the liability adequacy test, all contractual cash flows are discounted and compared with the carrying value of the liability. When a shortfall is identified it is charged immediately to profit or loss.

iv Present value of in-force (PVIF) long-term insurance business

The value placed on insurance contracts that are classified as long-term insurance business and are in force at the reporting date, is recognised as an asset.

The asset represents the present value of the equity holders' interest in the issuing insurance company's profits expected to emerge from these contracts written at the reporting date. The PVIF is determined by discounting the equity holders' interest in future profits expected to emerge from business currently in force using appropriate assumptions in assessing factors such as future mortality, lapse rates and levels of expenses, and a risk discount rate that reflects the risk premium attributable to the respective contracts. The PVIF asset is presented gross of attributable tax in the balance sheet and movements in the PVIF asset are included in 'Movement in present value of in-force long-term insurance business' on a gross of tax basis.

v Investment contracts

Investment contracts are those contracts where there is no significant insurance risk. A contract under which the local group accepts insignificant insurance risk from another party is not classified as an insurance contract, but is accounted for as a financial liability.

Customer liabilities under unit-linked investment contracts are designated at fair value through profit or loss, and the movements in fair value are recognised in profit or loss in 'Net income from financial instruments of insurance operations measured at fair value through profit and loss' (2017: 'Net income from assets and liabilities of insurance operations, including related derivatives, designated at fair value through profit and loss'). Liabilities under unit-linked investment contracts are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices.

Premiums receivable and amounts withdrawn are accounted for as increases or decreases in the liability recorded in respect of investment contracts.

Investment management fees receivable are recognised in profit or loss over the period of the provision of the investment management services in 'Net fee and commission income'.

(n) Provisions for legal proceedings and regulatory matters

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a current legal or constructive obligation which has arisen as a result of past events, and for which a reliable estimate can be made. A provision for restructuring is recognised when the local group has approved a detailed and formal restructuring plan and the restructuring either has commenced or has been announced publicly. Future operating losses are not provided for.

(o) Contingent liabilities

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security, as well as contingent liabilities related to legal proceedings or regulatory matters, are possible obligations that arise from past events 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 local group; or are present obligations that have arisen from past events but are not recognised because it is not probable that settlement will require the outflow of economic benefits, or because the amount of the obligations cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

(p) Financial guarantee contracts and loan commitments

Financial guarantees are contracts that require the local group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Liabilities under financial guarantee contracts are recorded initially at their fair value, which is generally the fee received or present value of the fee receivable. Financial guarantee contracts are subsequently measured at the higher of:

- the amount of the loss allowance (calculated as described in Note 3(b)(iv)); and
- the premium received on initial recognition less income recognised in accordance with the principles of IFRS 15.

Loan commitments provided by the local group are measured as the amount of the loss allowance (calculated as described in Note 3(b)(iv)).

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

(q) Interest income and expense

Interest income and expense for all interest-bearing financial instruments, except those measured at fair value through profit or loss, are recognised in 'Net interest income' in profit or loss, using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability (and groups of financial assets or financial liabilities) and of allocating the net interest income over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period, to the gross carrying amount of the financial asset or financial liability (i.e. amortised cost before any impairment allowance for a financial asset). When calculating the effective interest rate, the local group estimates cash flows considering all contractual terms of the financial instrument but excluding expected credit losses. The calculation includes transaction costs, premiums or discounts and all fees and points paid or received by the local group that are an integral part of the effective interest rate of a financial instrument.

For POCI financial assets - assets that are credit impaired at initial recognition - the local group calculates the credit-adjusted effective interest rate, which is calculated based on the amortised cost of the financial asset instead of its gross carrying amount and incorporates the impact of expected credit losses in estimated future cash flows.

Interest on credit impaired financial assets is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

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

(r) Non-interest income

i Net fee and commission income

The local group generates fee income from services provided at a fixed price over time, such as account service and card fees, or when the local group delivers a specific transaction at a point in time, such as broking services and import/export services. With the exception of certain fund management and performance fees, all other fees are generated at a fixed price. Fund management and performance fees can be variable depending on the size of the customer portfolio and the local group's performance as fund manager. Variable fees are recognised when all uncertainties are resolved. Fee income is generally earned from short-term contracts with payment terms that do not include a significant financing component.

The local group acts as principal in the majority of contracts with customers, with the exception of broking services. For brokerage trades, the local group acts as agent in the transaction and recognises broking income net of fees payable to other parties in the arrangement.

The local group recognises fees earned on transaction-based arrangements at a point in time when it would have fully provided the service to the customer. Where the contract requires services to be provided over time, income is recognised on a systematic basis over the life of the agreement.

ii Dividend income

Dividend income is recognised when the right to receive payment is established. This is the ex-dividend date for listed equity securities, and usually the date when shareholders have approved the dividend for unlisted equity securities.

iii Net income from financial instruments of insurance operations measured at fair value through profit and loss / Net income from assets and liabilities of insurance operations, including related derivatives, designated at fair value through profit and loss

Net income from financial instruments designated or otherwise mandatorily measured at fair value includes:

- all gains and losses from changes in the fair value of financial assets and financial liabilities designated or otherwise mandatorily measured at fair value through profit or loss, including all financial investments attributable to insurance operations and financial liabilities under investment contracts; and
- interest income and expense and dividend income in respect of financial assets and financial liabilities designated or otherwise mandatorily measured at fair value through profit or loss.

(s) Employee benefits

i Contributions to defined contribution pension plan

The local group contributes towards the State defined contribution pension plan in accordance with local legislation in exchange for services rendered by employees and to which it has no commitment beyond the payment of fixed contributions. The group also contributes towards a Unit Linked Employee Pension Plan with no commitment beyond the payment of fixed contributions. Obligations for contributions are recognised as an employee benefit in profit or loss in the periods during which services are rendered by employees.

ii Long-term employee benefit obligations

The local group's liabilities for long service bonuses, retirement bonuses and benefits upon retirement on medical grounds, emanating from obligations within the collective agreement, are not expected to be settled wholly within 12 months after the end of the period in which the employees render the related service. They are therefore measured as the present value of expected future payments to be made in respect of services provided by employees up to the end of the reporting period using the projected unit credit method. The projected unit credit method considers each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build the final obligation. Consideration is given to expected future salary levels, experience of employee departures and periods of service.

The liability recognised in the balance sheet is the present value of the defined benefit obligation at the end of the reporting period. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The projected unit credit method requires the local group to attribute benefit to the current period in order to determine current service cost and to the current and prior periods in order to determine the present value of the defined benefit obligations.

The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms approximating to the terms of the related obligation.

The net interest cost is calculated by applying the discount rate to the net balance of the defined benefit obligation. This cost is reflected in profit or loss. Actuarial gains and losses, comprising remeasurement gains and losses arising from experience adjustments and changes in actuarial assumptions, are recognised in profit or loss in the period in which they occur. Amounts recognised in profit or loss in respect of these long-term employee benefit obligations are presented within 'Employee compensation and benefits'.

iii Termination benefits

The local group recognises a liability and expense for termination benefits when the local group can no longer withdraw the offer of those benefits. For termination benefits payable as a result of an employee's decision to accept an offer of benefits in exchange for the termination of employment, the time when the group can no longer withdraw the offer of termination benefits is the earlier of:

- when the employee accepts the offer; and
- when a restriction on the group's ability to withdraw the offer takes effect.

For termination benefits payable as a result of the local group's decision to terminate an employee's employment, the local group can no longer withdraw the offer when it has communicated to the affected employees a plan of termination meeting all of the following criteria:

- actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made;
- the plan identifies the number of employees whose employment is to be terminated, their job classifications or functions and the expected completion date; and
- the plan establishes the termination benefits that employees will receive in sufficient detail that employees can determine the type and amount of benefits they will receive when their employment is terminated.

iv Share-based payments

The local group enters into equity-settled share-based payment arrangements with its employees as compensation for services provided by employees.

The cost of share-based payment arrangements with employees is measured by reference to the fair value of equity instruments on the date they are granted and recognised as an expense on a straight-line basis over the vesting period, with a corresponding credit to retained earnings.

Fair value is determined by using appropriate valuation models. Vesting conditions include service conditions and performance conditions; any other features of the arrangement are non-vesting conditions. Market performance conditions and non-vesting conditions are taken into account when estimating the fair value of the award at the date of the award. Vesting conditions, other than market performance conditions, are not taken into account in the initial estimate of the fair value at the grant date. They are taken into account by adjusting the number of equity instruments included in the measurement of the transaction.

HSBC Holdings is the grantor of its equity instrument for all share awards and share options across the Group. The credit to retained earnings over the vesting period on expensing an award represents the effective capital contribution from HSBC Holdings. To the extent the local group will be, or has been, required to fund a share-based payment arrangement, this capital contribution is reduced and the fair value of shares expected to be released to employees is recorded within liabilities.

(t) Operating leases

All leases which do not transfer to the lessee substantially all the risks and rewards incidental to the ownership of assets are classified as operating leases. As a lessor, the local group presents assets subject to operating leases within the statement of financial position. Impairment losses are recognised to the extent that the carrying values are not fully recoverable. As a lessee, leased assets are not recognised on the statement of financial position with the exception of long leasehold interests.

Rentals payable and receivable under operating leases are spread on a straight-line basis over the lease periods and are recognised in 'General and administrative expenses' and in 'Net other operating income' respectively.

(u) Foreign currencies

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange at the reporting date. Any resulting exchange differences are recognised in profit or loss. Non-monetary assets and liabilities that are measured at historical cost in a foreign currency are translated into the functional currency using the rate of exchange at the date of the initial transaction. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined. Any foreign exchange component of a gain or loss on a non-monetary item is recognised either in other comprehensive income or in profit or loss depending where the gain or loss on the underlying non-monetary item is recognised.

(v) Income tax

Income tax comprises current tax and deferred tax. Income tax is recognised in profit or loss except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case it is recognised in the same statement in which the related item appears.

Current tax is the tax expected to be payable on the taxable profit for the year, calculated using tax rates enacted or substantively enacted by the reporting date, and any adjustment to tax payable in respect of previous years. Current tax assets and liabilities are offset when the local group intends to settle on a net basis and the legal right to offset exists.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the statement of financial position and the amounts attributed to such assets and liabilities for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences and unutilised tax losses can be utilised.

Deferred tax is calculated using the tax rates expected to apply in the periods in which the assets will be realised or the liabilities settled based on tax rates and laws enacted, or substantively enacted, by the reporting date. Deferred tax assets and liabilities are offset when they arise in the same tax reporting group and relate to income taxes levied by the same taxation authority, and when the local group has a legal right to offset.

(w) Cash and cash equivalents

Cash and cash equivalents comprise cash balances, highly liquid investments and deposits with contractual maturity of three months or less. Cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition. 'Loans and advances to banks' that are repayable on demand or have a contractual maturity of three months or less and which form an integral part of the local group's cash management are included as a component of cash and cash equivalents for the purpose of the Statements of Cash Flows.

(x) Segment analysis

Measurement of segmental assets, liabilities, income and expenses is in accordance with the local group's accounting policies. Segmental income and expenses include transfers between segments and these transfers are conducted on arm's length terms and conditions. Shared costs are included in segments on the basis of the actual recharges made.

(y) Equity instruments

Financial instruments issued are classified as equity when there is no contractual obligation to transfer cash, other financial assets or issue a variable number of own equity instruments. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

(z) Accounting policies applied to financial instruments prior to 1 January 2018

i Classification of financial assets

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

Financial assets at fair value through profit or loss

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

Held for trading

A financial instrument is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivatives are also categorised as held for trading unless they are designated and considered effective as hedging instruments.

Financial instruments designated at fair value through profit or loss

Financial instruments, other than those held for trading, are classified in this category if they meet one or more of the criteria set out below, and are so designated irrevocably at inception. The local group designates financial instruments at fair value when the designation:

- eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise from measuring financial instruments (financial assets or financial liabilities), or recognising gains and losses from related positions, on different bases. Under this criterion, the financial instruments designated by the local group comprise financial assets under unit-linked insurance contracts and unit-linked investment contracts and financial liabilities under unit-linked investment contracts.

  Liabilities to customers under unit-linked contracts are determined based on the fair value of the assets held in the linked funds, with changes recognised in profit or loss. If no fair value designation was made for the assets related to these customer liabilities, the assets would be classified as available-for-sale, with the changes in fair value recorded in other comprehensive income. The related financial assets and financial liabilities are managed and reported to management on a fair value basis. Designation at fair value of the financial assets and related liabilities under investment contracts allows the changes in fair values to be recorded in profit or loss and presented in the same line.

- applies to groups of financial instruments (financial assets, financial liabilities or combinations thereof) that are managed, and their performance evaluated, on a fair value basis in accordance with a documented risk management or investment strategy, and where information about the groups of financial instruments is reported to management on that basis. Certain financial assets held to meet liabilities under non-linked insurance contracts are the main class of financial instruments designated at fair value through profit or loss under this criterion. The local group has documented risk management and investment strategies designed to manage and monitor market risk of those assets on a net basis after considering non-linked liabilities.

  Financial instruments classified within this category are recognised initially at fair value; transaction costs are taken directly to profit or loss. Subsequent to initial recognition, changes in fair values are recognised in profit or loss within 'Net income from financial instruments designated at fair value attributable to insurance operations'.

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 the local group intends to sell immediately or in the short-term, which are classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss;
- those that the local group upon initial recognition designates as available-for-sale; or
- those for which the holders may not recover substantially all of their initial investment, other than because of credit deterioration.

The local group's loans and receivables principally comprise loans and advances to banks and customers. Loans and receivables are recognised when cash is advanced to a borrower or funds placed with a counterparty. They are initially recorded at fair value - which is the case consideration to originate or purchase the loan - plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less impairment allowance. Amortised cost is the initial measurement amount adjusted for the amortisation of any difference between the initial and maturity amounts using the effective interest method.

Available-for-sale financial investments

Available-for-sale investments are financial assets that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices, or that are not classified as loans and receivables or financial assets at fair value through profit or loss. Treasury Bills, debt securities and equity securities intended to be held on a continuing basis, other than those designated at fair value, are classified as available-for-sale.

Available-for-sale financial assets are initially measured at fair value plus direct and incremental transaction costs. They are subsequently re-measured at fair value, and changes therein are recognised in other comprehensive income until the financial assets are either sold or become impaired. When available-for-sale financial investments are sold, the cumulative gains or losses previously recognised in other comprehensive income are reclassified to profit or loss as 'Net gains on sale of available-for-sale financial investments'.

Interest income is recognised in profit or loss over the debt asset's expected life using the effective interest method. Premiums and/or discounts arising on the purchase of dated debt securities are included in the interest recognised. Dividends from equity assets are recognised in profit or loss when the right to receive payment is established. Foreign currency gains and losses arising on retranslation of monetary assets classified as available-for-sale are recognised in profit or loss.

Unquoted equity securities, the fair value of which cannot be reliably measured, are carried at cost less impairment.

ii Impairment of financial assets

Financial investments: Available-for-sale securities

Available-for-sale financial assets are assessed at each reporting date for objective evidence of impairment. If such evidence exists as a result of one or more events that occurred after the initial recognition of the financial asset (a 'loss event') and that loss event has an impact, which can be reliably measured, on the estimated future cash flows of the financial asset an impairment loss is recognised.

If the available-for-sale financial asset is impaired, the difference between the financial asset's acquisition cost (net of any principal repayments and amortisation) and the current fair value, less any previous impairment loss recognised in profit or loss, is reclassified from other comprehensive income and recognised in profit or loss as a reclassification adjustment.

In assessing objective evidence of impairment at the reporting date in relation to available-for-sale debt securities, the local group considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in recovery of future cash flows. Financial difficulties of the issuer, as well as other factors such as information about the issuers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees may be considered individually, or in combination, to determine if there is objective evidence of impairment.

The primary indicators of potential impairment are considered to be adverse fair value movements and the disappearance of an active market for a security, while changes in credit ratings are of secondary importance.

Objective evidence of impairment for available-for-sale equity securities may include specific information about the issuer as detailed above, but may also include information about significant changes in technology, markets, economics or the law that provides evidence that the cost of the equity securities may not be recovered.

A significant or prolonged decline in the fair value of the equity security classified as available-for-sale below its cost is also objective evidence of impairment. In assessing whether it is significant, the decline in fair value is evaluated against the original cost of the asset at initial recognition. In assessing whether it is prolonged, the decline is evaluated against the continuous period in which the fair value of the asset has been below its original cost at initial recognition.

Once an impairment loss has been recognised on an available-for-sale financial asset, the subsequent accounting treatment for changes in the fair value of that asset differs depending on the type of asset:

- for an available-for-sale debt security, a subsequent decline in the fair value of the instrument is recognised in profit or loss when there is further objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, or the instrument is no longer impaired, the impairment loss is reversed through profit or loss.
- for an available-for-sale equity security, all subsequent increases in the fair value of the instrument are treated as a revaluation and are recognised in other comprehensive income. Impairment losses recognised on the equity security are not reversed through profit or loss. Subsequent decreases in the fair value of the available-for-sale equity security are recognised in profit or loss, to the extent that further cumulative impairment losses have been incurred.

Loans and receivables

Losses for impaired loans are recognised promptly when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Impairment allowances are calculated on individual loans and on groups of loans assessed collectively, are recorded as charges in profit or loss, and are recorded against the carrying amount of impaired loans through the use of impairment allowance accounts. Losses which may arise from future events are not recognised.

Individually assessed loans and advances

The factors considered in determining whether a loan is individually significant for the purposes of assessing impairment include:

- the size of the loan;
- the number of loans in the portfolio; and
- the importance of the individual loan relationship, and how this is managed.

Loans that are determined to be individually assessed for impairment, except when volumes of defaults and losses are sufficient to justify treatment under a collective assessment methodology.

For all loans that are considered individually significant, the local group considers on a case-by-case basis at each reporting date whether there is any objective evidence that a loan is impaired. The criteria used by the local group to make this assessment include:

- known cash flow difficulties experienced by the borrower;
- contractual payments of either principal or interest being past due for more than 90 days;
- the probability that the borrower will enter bankruptcy or other financial realisation;
- a concession granted to the borrower for economic or legal reasons relating to the borrower's financial difficulty that results in forgiveness or postponement of principal, interest or fees, where the concession is not insignificant; and
- there has been deterioration in the financial condition or outlook of the borrower such that its ability to repay is considered doubtful.

For loans where objective evidence of impairment exists, impaired losses are determined considering the following factors:

- the local group's aggregate exposure to the customer;
- the viability of the customer's business model and their capability to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;
- the amount and timing of expected receipts and recoveries;
- the likely dividend available on liquidation or bankruptcy;

- the extent of other creditors' commitments ranking ahead of, or pari passu with, the local group and the likelihood of other creditors continuing to support the customer;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realisable value of security (or other credit risk mitigants) and likelihood of successful repossession; and
- the likely costs of obtaining and selling collateral as part of foreclosure.

Determination of the realisable value of security is based on the current market value when the impairment assessment is performed. The value is not adjusted for expected future changes in market prices, though adjustments are made to reflect local conditions, such as forced sale discounts.

Impairment losses are calculated by discounting the expected future cash flows of a loan, which includes expected future receipts of contractual interest, at the loan's original effective interest rate and comparing the resultant present value with the loan's current carrying amount. The impairment allowances on individually significant accounts are reviewed at least annually and more regularly when circumstances necessitate review. This normally encompasses re-assessment of the enforceability of any collateral held and the timing and amount of actual and anticipated receipts. Individually assessed impairment allowances are only released when there is reasonable and objective evidence of a reduction in the established loss estimate.

Collectively assessed loans and advances

Impairment is assessed on a collective basis:

- to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment; and
- for homogeneous groups of loans that are not considered individually significant.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for a collective impairment assessment. These credit risk characteristics may include type of business involved, type of products offered, security obtained or other relevant factors. This assessment captures impairment losses that the local group has incurred as a result of events occurring before the reporting date, which the local group is not able to identify on an individual loan basis, and that can be reliably estimated. These losses would only be identified individually in the future. When information becomes available which identifies losses on individual loans within the group, those loans are removed from the group and assessed on an individual basis.

The collective impairment allowance is determined after taking into account:

- historical loss experience in portfolios of similar risk characteristics (for example, by industry sector, loan grade or product);
- the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against the individual loan; and
- management's judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses at the reporting date is likely to be greater or less than that suggested by historical experience.

The period between a loss occurring and its identification is estimated by local management for each identified portfolio based on economic and market conditions, customer behaviour, portfolio management information, credit management techniques and collection and recovery experiences in the market. As it is assessed empirically on a periodic basis the estimated period between a loss occurring and its identification may vary over time as these factors change.

Homogeneous groups of loans and advances

For homogeneous groups of loans that are not considered individually significant, two alternative methods are used to calculate allowances on a portfolio basis:

- When appropriate empirical information is available, the local group utilises roll rate methodology. This methodology employs statistical analysis of historical data and experience of delinquency and default to estimate the amount of the loans that will eventually be written off as a result of the events occurring before the reporting date but which the group is not able to identify individually. Individual loans are grouped using ranges of past due days; statistical analysis is then used to estimate the likelihood that loans in each range will progress through the various stages of delinquency and become irrecoverable. In applying this methodology, adjustments are made to estimate the periods of time between a loss event occurring and its discovery, for example through a missed payment, (known as the emergence period) and the period of time between discovery and write-off (known as the outcome period). Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss.
- When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll rate methodology, the local group adopts a formulaic approach based on historical loss rate experience. Where a basic formulaic approach is undertaken, the period between a loss event occurring and its identification is explicitly estimated by local management.

The inherent loss within each portfolio is assessed on the basis of statistical models using historical data observations, which are updated periodically to reflect recent portfolio and economic trends. When the most recent trends arising from changes in economic, regulatory or behavioural conditions are not fully reflected in the statistical models, they are taken into account by adjusting the impairment allowances derived from the statistical models to reflect these changes as at the reporting date.

Write-off of loans and advances

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realisation of security. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write-off may be earlier.

Reversals of impairment

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. The reversal is recognised in profit or loss.

Assets acquired in exchange for loans

When non-financial assets acquired in exchange for loans as part of an orderly realisation are held for sale, these assets are recorded as 'Assets held for sale' and reported in 'Non-current assets held for sale'.

Renegotiated loans

Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired. The carrying amounts of loans that have been classified as renegotiated retain this classification until maturity or derecognition.

A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement made on substantially different terms, or if the terms of an existing agreement are modified, such that the renegotiated loan is substantially a different financial instrument. Any new agreements arising due to derecognition events will continue to be disclosed as renegotiated loans.

(iii) Financial guarantee contracts

Financial guarantees are contracts that require the local group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Liabilities under financial guarantee contracts are recorded initially at their fair value, which is generally the fee received or present value of the fee receivable. The initial fair value is amortised over the term of the financial guarantee contract. Subsequently, financial guarantee liabilities are measured at the higher of the initial fair value, less cumulative amortisation, and the best estimate of the expenditure required to settle the obligations.

4 Financial risk management

(a) Introduction

The nature of the local group's core banking operations implies that financial instruments are extensively used in the course of its routine business. The local group's financial instruments include loans and advances to banks, loans and advances to customers, securities and amounts due to banks and customers.

The local group is exposed to a mixed blend of risks and hence operates a risk management strategy with the objective of controlling and minimising their impact on local group financial performance and position.

All of the local group's activities involve to varying degrees, the analysis, evaluation, acceptance and management of risks or combination of risks.

An established risk governance framework and ownership structure ensures oversight of and accountability for the effective management of risk. The local group's risk management framework fosters the continuous monitoring of the risk environment and an integrated evaluation of risks and their interactions.

The local group's risk management framework is designed to provide appropriate risk monitoring and assessment. The bank's Risk Committee focuses on risk governance and provides a forward looking view of risks and their mitigation.

The Risk Committee is a committee of the Board and has responsibility for oversight and advice to the Board on, inter alia, the bank's risk appetite, tolerance and strategy, systems of risk management, internal control and compliance.

The Risk Committee maintains and develops a supportive culture in relation to the management of risk, appropriately embedded by executive management through procedures, training and leadership actions.

In carrying out its responsibilities, the Risk Committee is closely supported by the Chief Risk Officer, the Chief Financial Officer, the Head of Internal Audit and the Head of Compliance, together with other business functions on risks within their respective areas of responsibility.

The most important types of risk include financial risk, which comprises credit risk, market risk and liquidity risk. These categories of risk in relation to life insurance business are described in Note 4(f).

(b) Credit risk excluding Insurance credit risk which is reported under Note 4(f)

i Credit risk management

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from lending, trade finance and treasury business, mainly through the holdings of debt securities, but also from off-balance sheet products such as guarantees. The local group has standards, policies and procedures dedicated to control and monitor the risk arising from all such activities.

Within the overall framework of the local group policy, the local group has an established risk management process encompassing credit approvals, the control of exposures, credit policy direction to business units and the monitoring and reporting of exposures both on an individual and a portfolio basis which includes the management of adverse trends. Management is responsible for the quality of its credit portfolios and follows a credit process involving delegated approval authorities and credit procedures, the objective of which is to build and maintain risk assets of high quality. Regular reviews are undertaken to assess and evaluate levels of risk concentrations by market sector and product.

The bank's credit risk rating systems and processes differentiate exposures in order to highlight those with greater risk factors and higher potential severity of loss. In the case of individually significant accounts, risk ratings are reviewed regularly and any amendments are implemented promptly.

The principal objectives of the local group's credit risk management are:

- to maintain a strong culture of responsible lending and a robust risk policy and control framework;
- to both partner and challenge global businesses in defining, implementing, and continually re-evaluating risk appetite under actual and scenario conditions; and
- to ensure there is independent, expert scrutiny of credit risks.

Within the bank, the credit risk function's responsibilities include:

- formulating credit policy;
- guiding business on appetite for credit risk exposure to specified market sectors, activities and banking products and controlling exposures to certain higher-risk sectors;
- undertaking an independent review and objective assessment of risk and exposures over designated limits, prior to the facilities being committed to customers or transactions being undertaken;
- monitoring the performance and management of portfolios;
- controlling exposure to sovereign entities, banks and other financial institutions, as well as debt securities;
- setting policy on large credit exposures, ensuring that concentrations of exposure by counterparty, sector or geography do not become excessive in relation to the capital base, and remain within internal and regulatory limits;
- maintaining and developing the risk rating framework and systems and overseeing risk rating system governance for both wholesale and retail businesses; and
- reporting on retail portfolio performance, high risk portfolios, risk concentrations, large impaired accounts, impairment allowances and stress testing results.

Special attention is paid to problem exposures in order to accelerate remedial action. The local group uses specialist units to provide customers with support in order to help them avoid default wherever possible.

Internal approval limits are in place depending on the magnitude and particular risks attached to the respective facility. The bank has set limits of authority for the business and the credit risk functions, ensuring segregation of duties so as to maintain independence during the approval process. The local group structures the level of credit risk it undertakes by placing limits in relation to products, counterparties, sectors and other parameters. Certain actual exposures against limits are monitored at end of day and on a real-time basis too.

All figures and tables relating to credit risk presented in this note exclude the local group's exposure to insurance credit risk, which is disclosed separately in Note 4(f), as well as the credit risk relating to the asset management subsidiary, which is deemed to be insignificant. Accordingly, other than for insurance credit risk, the local group's credit risk is deemed to correspond to that of the bank.

Maximum exposure to credit risk

The following table presents the maximum exposure to credit risk from balance sheet and off-balance sheet financial instruments, before taking account of any collateral held or other credit enhancements. For financial assets recognised on the balance sheet, the maximum exposure to credit risk equals their carrying amount; for financial guarantees granted, it is the maximum amount that the bank would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments that are irrevocable over the life of the respective facilities, it is generally the full amount of the committed facilities.

	2018	2017
	€000	€000
Balances with Central Bank of Malta and Treasury Bills	**159,599**	129,053
Items in course of collection from other banks	**5,404**	18,158
Loans and advances to banks	**1,092,773**	1,045,699
Loans and advances to customers	**3,110,412**	3,128,833
Financial investments (excluding equity securities)	**902,215**	923,786
Accrued income and other assets	**28,564**	28,071
Off-balance sheet		
– financial guarantee and similar contracts	**147,579**	120,333
– loan and other credit related commitments	**1,434,634**	1,215,501
At 31 December	**6,881,180**	6,609,434

Summary of financial instruments to which the impairment requirements in IFRS 9 are applied

The following disclosure presents the gross carrying/nominal amount of financial instruments measured at amortised cost to which the impairment requirements in IFRS 9 are applied and the associated allowance for ECL, as well as the fair value of financial instruments measured at FVOCI and the associated allowance for ECL. Due to the forward-looking nature of IFRS 9, the scope of financial instruments on which ECL are recognised is greater than the scope of IAS 39.

	At 31 December 2018		At 1 January 2018	
	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL
	€000	€000	€000	€000
Loans and advances to customers at amortised cost:	3,155,180	(44,768)	3,169,474	(45,688)
– personal	2,140,547	(12,179)	2,098,841	(11,282)
– corporate and commercial	980,408	(31,837)	1,031,115	(33,459)
– non-bank financial institutions	34,225	(752)	39,518	(947)
Loans and advances to banks at amortised cost	1,092,776	(3)	1,045,699	(1)
Other financial assets measured at amortised cost:	89,474	(6,254)	94,770	(5,703)
– balances at central banks	49,253	(1)	48,541	(3)
– items in the course of collection from other banks	5,404	—	18,158	—
– accrued income and other assets	34,817	(6,253)	28,071	(5,700)
Total gross carrying amount on balance sheet	4,337,430	(51,025)	4,309,943	(51,392)
Loan and other credit-related commitments:	1,434,634	(1,575)	1,215,501	(1,307)
– personal	587,005	(30)	474,521	(71)
– corporate and commercial (including non-bank financial institutions)	847,629	(1,545)	740,980	(1,236)
Financial guarantee and similar contracts:	147,579	(238)	120,333	(322)
– personal	5,679	—	3,572	—
– corporate and commercial (including non-bank financial institutions)	141,900	(238)	116,761	(322)
Total nominal amount off balance sheet	1,582,213	(1,813)	1,335,834	(1,629)
Total	5,919,643	(52,838)	5,645,777	(53,021)
	Fair value	Allowance for ECL	Fair value	Allowance for ECL
	€000	€000	€000	€000
Financial investments (debt securities) measured at fair value through other comprehensive income	902,215	(20)	923,786	(37)
Treasury Bills measured at fair value through other comprehensive income	110,347	(1)	80,512	(2)
Total	1,012,562	(21)	1,004,298	(39)

The following table contains an analysis of the maximum credit risk exposure from financial assets not subject to impairment (i.e. FVTPL):

	2018	2017
	€000	€000
Held for trading derivatives	4,956	5,175

ii Concentration of credit risk exposure

Concentrations of credit risk arise when a number of counterparties or exposures have comparable economic characteristics, or such counterparties are engaged in similar activities, or operate in the same geographical areas or industry sectors, so that their collective ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions. The bank uses a number of controls and measures to minimise undue concentration of exposure in its portfolios across industry, country and customer groups. These include portfolio and counterparty limits, approval and review controls, and stress testing.

Financial investments measured at FVOCI (2017: Available-for-sale financial investments)

The bank's holdings of debt securities are spread across a range of issuers in both 2018 and 2017, with the exception of 54% (2017: 59%) invested in local government debt securities.

Derivatives

The bank participates in transactions exposing it to counterparty credit risk. Counterparty credit risk is the risk of financial loss if the counterparty to a transaction defaults before completing the satisfactory settlement of the transaction, which varies in value by reference to a market factor such as interest rate or exchange rate. It arises principally from OTC derivatives.

Derivative assets were €4,956,000 at 31 December 2018 (2017: €5,175,000).

Items in course of collection from other banks

Settlement risk arises in any situation where a payment in cash, securities or equities is made with the expectation of a corresponding receipt of cash, securities or equities. Daily settlement limits are established for counterparties to cover the aggregate amount of transactions with each counterparty on any single day.

The bank substantially mitigates settlement risk on many transactions, particularly those involving securities and equities, by settling through assured payment systems, or on a delivery-versus-payment basis.

Loans and advances to customers

The following table analyses the bank's loans and advances including credit impaired loans by business segment.

	Gross loans and advances to customers	Gross loans by business segment as a % of total gross loans	Credit impaired loans and advances to customers	Credit impaired loans by business segment as a % of sector gross loans
	€000	%	€000	%
At 31 December 2018				
Personal				
– first lien residential mortgages	**1,872,474**	**59.34**	**51,696**	**2.76**
– other personal lending	**268,073**	**8.50**	**13,399**	**5.00**
Corporate and commercial				
– commercial real estate and other property related	**246,310**	**7.81**	**49,735**	**20.19**
– state-owned entities	**228,470**	**7.24**	**—**	**—**
– other commercial	**539,853**	**17.11**	**21,431**	**3.97**
Total	**3,155,180**	**100.00**	**136,261**	**4.32**
At 31 December 2017				
Personal				
– residential mortgages	1,810,639	57.13	52,961	2.92
– other personal	288,202	9.09	14,530	5.04
Corporate and commercial				
– commercial real estate and other property related	259,994	8.20	63,628	24.47
– state-owned entities	125,217	3.95	—	—
– other commercial	685,422	21.63	36,801	5.37
Total	3,169,474	100.00	167,920	5.30

The amount of gross loans and advances to customers of the bank stood at €3,155,180,000 (2017: €3,169,474,000) at 31 December 2018. As at 31 December 2018, there were no loans and advances payable to the bank by any of its subsidiaries.

A detailed sectorial analysis of the bank's on-balance sheet loans and advances to customers, before and after taking into account collateral held or other credit enhancements is presented in the following page.

With respect to collateral values used within the table, in the case of exposure secured by mortgages on immovable property, the value is limited to 70% of the market value of the property in case of residential property and 50% of the market value of the property in the case of commercial property.

Collateral included under 'Securities/Cash' comprise euro and foreign denominated cash and sovereign debt securities. Euro denominated cash is included at its full value, whilst foreign denominated cash is included at 90% of the cash value. A 20-50% haircut is applied to the value of sovereign debt securities, depending on the external credit rating assigned to such collateral. Moreover, the bank holds the following collateral, included in the table as 'Other eligible collateral':

- guarantees from the Government of Malta to cover exposures of public entities and corporations, included at 100% of the guarantee amount;
- guarantees from the Housing Authority to cover mortgage lending as part of social housing schemes, included at 100% of the guarantee amount;
- prime bank guarantees, included at 100% of the guarantee amount; and
- saving and endowment policies included at 100% of the surrender value, and pension plans included at 50% of the net asset value.

		Collateral				
	Gross on-balance sheet exposure	Residential property	Commercial property	Securities/ cash	Other	Net maximum exposure
	€000	€000	€000	€000	€000	€000
As at 31 December 2018						
Electricity, gas, water supply and waste management	**166,817**	**10**	**57**	**250**	**118,975**	**47,525**
Accomodation and food service	**117,429**	**1,092**	**52,968**	**312**	**20**	**63,037**
Construction, real estate activities	**166,343**	**25,494**	**81,321**	**2,260**	**380**	**56,888**
Wholesale and retail trade and repairs	**188,792**	**14,560**	**55,727**	**7,683**	**86**	**110,736**
Services	**351,965**	**8,505**	**59,745**	**13,680**	**92,570**	**177,465**
Manufacturing, agriculture and fishing	**53,168**	**3,891**	**32,740**	**228**	**64**	**16,245**
Household and individuals	**2,110,666**	**1,925,600**	**1,395**	**20,611**	**56,227**	**106,833**
	3,155,180	**1,979,152**	**283,953**	**45,024**	**268,322**	**578,729**
As at 31 December 2017						
Electricity, gas, water supply and waste management	73,479	—	326	292	22,179	50,682
Construction, real estate activities and accommodation	270,458	32,397	112,746	42,363	813	82,139
Wholesale and retail trade and repairs	288,828	6,833	66,407	24,464	2,640	188,484
Services	375,314	6,928	64,695	39,878	103,336	160,477
Manufacturing, agriculture and fishing	62,554	972	31,443	10,428	155	19,556
Household and individuals	2,098,841	1,842,079	20,736	30,413	46,283	159,330
	3,169,474	1,889,209	296,353	147,838	175,406	660,668

iii Credit quality of financial assets

As outlined previously, the bank's credit risk rating processes are designed to highlight exposures which require closer management attention because of their greater probability of default and potential loss. The credit quality of unimpaired loans is assessed by reference to the bank's standard credit rating system.

The five credit quality classifications below describe the credit quality of the bank's lending, debt securities and derivatives.

Quality classification definitions

'Strong' exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss. Personal accounts operate within product parameters and only exceptionally show any period of delinquency.

'Good' exposures require closer monitoring and demonstrate good capacity to meet financial commitments, with low to moderate default risk. Personal accounts typically show only short periods of delinquency, with any losses expected to be minimal following the adoption of recovery processes.

'Satisfactory' exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk. Personal accounts typically show only short periods of delinquency, with any losses expected to be minor following the adoption of recovery processes.

'Sub-standard' exposures require varying degrees of special attention and default risk is of greater concern. Personal portfolio segments show longer delinquency periods of generally up to 90 days past due and/or expected losses are higher due to a reduced ability to mitigate these through security realisation or other recovery processes.

'Impaired' exposures have been assessed, individually or collectively, as impaired.

As illustrated in the table below, these classifications each encompass a range of more granular, internal credit rating grades assigned to corporate and personal lending business as well as external rating grades, attributed by external agencies to debt securities. There is no direct correlation between the internal and external ratings at granular level, except to the extent each falls within a single quality classification.

	Debt securities and other bills – External credit rating	Wholesale and retail lending – Internal credit rating
Quality classification		
Strong	**A- and above**	**CRR1 to CRR2**
Good	**BBB+ to BBB-**	**CRR3**
Satisfactory	**BB+ to B and unrated**	**CRR4 to CRR5**
Sub-standard	**B- and below**	**CRR6 to CRR8**
Impaired	**Impaired**	**CRR9 to CRR10**

The Customer Risk Rating (CRR) 10-grade scale assigned to corporate and personal lending business summarises a more granular underlying CRR scale for these customer segments; this combines obligor and facility/product risk factors in a composite measure.

For debt securities and certain other financial instruments, external ratings have been aligned to the five quality classifications.

Distribution of financial instruments by credit quality

	As at 31 December 2018							
	Gross carrying/nominal amount							
	Strong	Good	Satisfactory	Sub-standard	Credit impaired	Total	Allowance for ECL	Net
	€000	€000	€000	€000	€000	€000	€000	€000
In scope for IFRS 9								
Loans and advances to customers held at amortised cost:	**1,118,062**	**406,869**	**1,415,310**	**78,678**	**136,261**	**3,155,180**	**(44,768)**	**3,110,412**
– personal	**900,093**	**356,704**	**808,110**	**10,545**	**65,095**	**2,140,547**	**(12,179)**	**2,128,368**
– corporate and commercial	**217,632**	**50,009**	**575,238**	**68,133**	**69,396**	**980,408**	**(31,837)**	**948,571**
– non-bank financial institutions	**337**	**156**	**31,962**	**–**	**1,770**	**34,225**	**(752)**	**33,473**
Loans and advances to banks held at amortised cost	**1,092,776**	**–**	**–**	**–**	**–**	**1,092,776**	**(3)**	**1,092,773**
Other financial assets held at amortised cost:								
Balances at central banks	**49,253**	**–**	**–**	**–**	**–**	**49,253**	**(1)**	**49,252**
Items in the course of collection from other banks	**5,404**	**–**	**–**	**–**	**–**	**5,404**	**–**	**5,404**
Other assets	**2,866**	**2,412**	**8,800**	**787**	**19,952**	**34,817**	**(6,253)**	**28,564**
– endorsements and acceptances	**285**	**1,639**	**5,000**	**–**	**–**	**6,924**	**(14)**	**6,910**
– accrued income	**2,581**	**773**	**3,800**	**787**	**19,952**	**27,893**	**(6,239)**	**21,654**
Total gross carrying amount on balance sheet	**2,268,361**	**409,281**	**1,424,110**	**79,465**	**156,213**	**4,337,430**	**(51,025)**	**4,286,405**
Percentage of total credit quality	**52.3%**	**9.4%**	**32.8%**	**1.8%**	**3.7%**	**100%**		
Loan and other credit-related commitments	**134,839**	**182,560**	**1,085,600**	**25,984**	**5,651**	**1,434,634**	**(1,575)**	**1,433,059**
Financial guarantees and similar contracts	**5,167**	**9,425**	**116,506**	**16,076**	**405**	**147,579**	**(238)**	**147,341**
Total nominal amount off balance sheet	**140,006**	**191,985**	**1,202,106**	**42,060**	**6,056**	**1,582,213**	**(1,813)**	**1,580,400**
At 31 December 2018	**2,408,367**	**601,266**	**2,626,216**	**121,525**	**162,269**	**5,919,643**	**(52,838)**	**5,866,805**

	Fair value						
	Strong	Good	Satisfactory	Sub-standard	Credit impaired	Total	Allowance for ECL
	€000	€000	€000	€000	€000	€000	€000
Debt instruments at fair value through other comprehensive income	**902,215**	**–**	**–**	**–**	**–**	**902,215**	**(20)**
Treasury Bills measured at fair value through other comprehensive income	**110,347**	**–**	**–**	**–**	**–**	**110,347**	**(1)**
At 31 December 2018	**1,012,562**	**–**	**–**	**–**	**–**	**1,012,562**	**(21)**

Distribution of financial instruments by credit quality

	Performing					Non-performing		
	Strong	Good	Satisfactory	Sub- Standard	Past due not impaired	Impaired	Impairment allowances	Total
	€000	€000	€000	€000	€000	€000	€000	€000
Balances with Central Bank of Malta and Treasury Bills	129,053	—	—	—	—	—	—	129,053
Items in course of collection from other banks	18,158	—	—	—	—	—	—	18,158
Held for trading derivatives	991	—	4,184	—	—	—	—	5,175
Loans and advances to banks	1,045,699	—	—	—	—	—	—	1,045,699
Loans and advances to customers								
– personal	894,264	355,419	745,112	2,287	34,268	67,491	(6,375)	2,092,466
– corporate and commercial	201,889	69,351	570,487	75,734	52,743	100,429	(34,266)	1,036,367
Available-for-sale financial investments (excluding equities)	923,786	—	—	—	—	—	—	923,786
Accrued income	7,945	232	2,862	968	—	7,113	—	19,120
Other assets	—	32	8,901	—	18	—	—	8,951
At 31 December 2017	3,221,785	425,034	1,331,546	78,989	87,029	175,033	(40,641)	5,278,775

The amount of past due but not impaired financial instruments as at 31 December 2017 reported in the table above of €87,029,000 consists of an amount of €66,529,000 which have a 'Satisfactory' credit quality classification and an amount of €20,500,000 which have a 'Sub-standard' credit quality classification.

Past due but not impaired gross loans and advances to customers

Past due but not impaired loans and advances to customers are those loans where although customers have failed to make payments in accordance with the contractual terms of their facilities, they have not met the impaired loan criteria described below.

Ageing analysis of days past due but not impaired gross loans and advances to customers

	2017 €000
Personal	
Past due by up to 29 days	26,000
Past due by up to 59 days	5,062
Past due by up to 89 days	3,206
Corporate and commercial	
Past due by up to 29 days	48,337
Past due by up to 59 days	3,175
Past due by up to 89 days	1,231
	87,011

Summary of credit quality of loans and advances to customers

The following table provides an overview of the bank's credit risk by stage and business segment, and the associated ECL coverage. The financial assets recorded in each stage have the following characteristics:

- Stage 1: Unimpaired and without significant increase in credit risk on which a 12-month allowance for ECL is recognised.
- Stage 2: A significant increase in credit risk has been experienced since initial recognition on which a lifetime ECL is recognised.
- Stage 3: Objective evidence of impairment, and are therefore considered to be in default or otherwise credit impaired on which a lifetime ECL is recognised.

The bank determines that a financial instrument is credit impaired and in stage 3 by considering relevant objective evidence, primarily whether:

- contractual payments of either principal or interest are past due for more than 90 days;
- there are other indications that the borrower is unlikely to pay, such as when a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition; and
- the loan is otherwise considered to be in default.

If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due. Therefore the definitions of credit-impaired and default are aligned as far as possible so that stage 3 represents all loans that are considered defaulted or otherwise credit impaired.

Impaired loans and advances are those that are classified as CRR 9 or CRR 10. These grades are assigned when the bank considers that either the customer is unlikely to pay its credit obligations in full, without recourse to security, or when the customer is more than 90 days past due on any material credit obligation to the bank.

Impaired loans and advances also include renegotiated loans and advances that have been subject to a change in contractual cash flows as a result of a concession which the bank would not otherwise consider, and where it is probable that without the concession the borrower would be unable to meet the contractual payment obligations in full, unless the concession is insignificant and there are no other indicators of impairment. Renegotiated loans remain classified as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment.

Summary of credit risk (excluding debt instruments measured at FVOCI) by stage distribution and ECL coverage by business segment

	Gross carrying/nominal amount				Allowance for ECL				ECL coverage %			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
	€000	€000	€000	€000	€000	€000	€000	€000	%	%	%	%
Loans and advances to customers at amortised cost:	2,833,200	185,719	136,261	3,155,180	(7,829)	(7,060)	(29,879)	(44,768)	0.3	3.8	21.9	1.4
– personal	2,007,777	67,675	65,095	2,140,547	(2,974)	(3,802)	(5,403)	(12,179)	0.1	5.6	8.3	0.6
– corporate and commercial	796,043	114,969	69,396	980,408	(4,644)	(3,204)	(23,989)	(31,837)	0.6	2.8	34.6	3.2
– non-bank financial institutions	29,380	3,075	1,770	34,225	(211)	(54)	(487)	(752)	0.7	1.8	27.5	2.2
Loans and advances to banks at amortised cost	1,092,776	–	–	1,092,776	(3)	–	–	(3)	–	–	–	–
Other financial assets measured at amortised cost	62,744	6,778	19,952	89,474	(3)	(12)	(6,239)	(6,254)	–	0.2	31.3	7.0
Loan and other credit-related commitments	1,359,077	69,906	5,651	1,434,634	(1,191)	(295)	(89)	(1,575)	0.1	0.4	1.6	0.1
– personal	580,593	2,566	3,846	587,005	(30)	–	–	(30)	–	–	–	–
– corporate and commercial (including non-bank financial institutions)	778,484	67,340	1,805	847,629	(1,161)	(295)	(89)	(1,545)	0.1	0.4	4.9	0.2
Financial guarantee and similar contracts:	130,635	16,539	405	147,579	(143)	(95)	–	(238)	0.1	0.6	–	0.2
– personal	5,417	5	257	5,679	–	–	–	–	–	–	–	–
– corporate and commercial (including non-bank financial institutions)	125,218	16,534	148	141,900	(143)	(95)	–	(238)	0.1	0.6	–	0.2
At 31 December 2018	5,478,432	278,942	162,269	5,919,643	(9,169)	(7,462)	(36,207)	(52,838)	0.2	2.7	22.3	0.9

Unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when they are 30 days past due ('DPD') and are transferred from stage 1 to stage 2. The following disclosure presents the ageing of stage 2 financial assets. It distinguishes those assets that are classified as stage 2 when they are less than 30 days past due (1-29 DPD) from those that are due to ageing and are more than 30 DPD (30 and >DPD). Past due financial instruments are those loans where customers have failed to make payments in accordance with the contractual terms of their facilities.

Stage 2 days past due analysis at 31 December 2018

	Gross exposure			Allowance for ECL			ECL coverage %		
	Stage 2	Of which: <30 DPD	Of which: >30 DPD	Stage 2	Of which: <30 DPD	Of which: >30 DPD	Stage 2	Of which: <30 DPD	Of which: >30 DPD
	€000	€000	€000	€000	€000	€000	%	%	%
Loans and advances to customers at amortised cost:	185,719	177,300	8,419	(7,060)	(6,204)	(856)	3.8	3.5	10.2
– Personal	67,675	59,468	8,207	(3,802)	(3,046)	(756)	5.6	5.1	9.2
– Corporate and commercial	114,969	114,757	212	(3,204)	(3,104)	(100)	2.8	2.7	47.2
– Non-bank financial institutions	3,075	3,075	–	(54)	(54)	–	1.8	1.8	–
Other financial assets measured at amortised cost	6,778	6,778	–	(12)	(12)	–	0.2	0.2	–

Summary of credit risk (excluding debt instruments measured at FVOCI) by stage distribution and ECL coverage by business segment

	Gross carrying/nominal amount				Allowance for ECL				ECL coverage %			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
	€000	€000	€000	€000	€000	€000	€000	€000	%	%	%	%
Loans and advances to customers at amortised cost:	2,789,841	211,713	167,920	3,169,474	(9,323)	(9,296)	(27,069)	(45,688)	0.3	4.4	16.1	1.4
– personal	1,959,863	71,487	67,491	2,098,841	(4,443)	(3,798)	(3,041)	(11,282)	0.2	5.3	4.5	0.5
– corporate and commercial	798,266	134,619	98,230	1,031,115	(4,580)	(5,297)	(23,582)	(33,459)	0.6	3.9	24.0	3.2
– non-bank financial institutions	31,712	5,607	2,199	39,518	(300)	(201)	(446)	(947)	0.9	3.6	20.3	2.4
Loans and advances to banks at amortised cost	1,045,699	—	—	1,045,699	(1)	—	—	(1)	—	—	—	—
Other financial assets measured at amortised cost	86,242	1,415	7,113	94,770	(64)	—	(5,639)	(5,703)	0.1	—	79.3	6.0
Loan and other credit-related commitments	1,110,877	100,626	3,998	1,215,501	(775)	(382)	(150)	(1,307)	0.1	0.4	3.8	0.1
– personal	468,736	5,119	666	474,521	(43)	—	(28)	(71)	—	—	4.2	—
– corporate and commercial	642,141	95,507	3,332	740,980	(732)	(382)	(122)	(1,236)	0.1	0.4	3.7	0.2
Financial guarantee and similar contracts:	108,247	11,339	747	120,333	(133)	(186)	(3)	(322)	0.1	1.6	0.4	0.3
– personal	3,375	27	170	3,572	—	—	—	—	—	—	—	—
– corporate and commercial	104,872	11,312	577	116,761	(133)	(186)	(3)	(322)	0.1	1.6	0.5	0.3
At 1 January 2018	5,140,906	325,093	179,778	5,645,777	(10,296)	(9,864)	(32,861)	(53,021)	0.2	3.0	18.3	0.9

Stage 2 days past due analysis at 1 January 2018

	Gross exposure			Allowance for ECL			ECL coverage %		
	Stage 2	Of which: <30 DPD	Of which: >30 DPD	Stage 2	Of which: <30 DPD	Of which: >30 DPD	Stage 2	Of which: <30 DPD	Of which: >30 DPD
	€000	€000	€000	€000	€000	€000	%	%	%
Loans and advances to customers at amortised cost:	211,713	199,056	12,657	(9,296)	(8,609)	(687)	4.4	4.3	5.4
– Personal	71,487	63,236	8,251	(3,798)	(3,231)	(567)	5.3	5.1	6.9
– Corporate and commercial	134,619	130,213	4,406	(5,297)	(5,177)	(120)	3.9	4.0	2.7
– Non-bank financial institutions	5,607	5,607	—	(201)	(201)	—	3.6	3.6	—
Other financial assets measured at amortised cost	1,415	1,415	—	—	—	—	—	—	—

The credit quality of all financial instruments that are subject to credit risk is a point-in-time assessment of the probability of default of financial instruments, whereas IFRS 9 stages 1 and 2 are determined based on relative deterioration of credit quality since initial recognition. Accordingly, for non-credit-impaired financial instruments, there is no direct relationship between the credit quality assessment and IFRS 9 stages 1 and 2, though typically the lower credit quality bands exhibit a higher proportion in stage 2.

Distribution of financial instruments to which the impairment requirements in IFRS 9 are applied, by credit quality and stage distribution

	Gross carrying/nominal amount							
	Strong	Good	Satisfactory	Sub-standard	Credit impaired	Total	Allowance for ECL	Net
	€000	€000	€000	€000	€000	€000	€000	€000
Loans and advances to customers at amortised cost	1,118,062	406,869	1,415,310	78,678	136,261	3,155,180	(44,768)	3,110,412
– stage 1	1,109,897	404,052	1,319,251	–	–	2,833,200	(7,829)	2,825,371
– stage 2	8,165	2,817	96,059	78,678	–	185,719	(7,060)	178,659
– stage 3	–	–	–	–	136,261	136,261	(29,879)	106,382
Loans and advances to banks at amortised cost	1,092,776	–	–	–	–	1,092,776	(3)	1,092,773
– stage 1	1,092,776	–	–	–	–	1,092,776	(3)	1,092,773
– stage 2	–	–	–	–	–	–	–	–
– stage 3	–	–	–	–	–	–	–	–
Other financial assets measured at amortised cost	57,523	2,412	8,800	787	19,952	89,474	(6,254)	83,220
– stage 1	57,225	1,914	3,420	185		62,744	(3)	62,741
– stage 2	298	498	5,380	602	–	6,778	(12)	6,766
– stage 3	–	–	–	–	19,952	19,952	(6,239)	13,713
Loan and other credit-related commitments	134,839	182,560	1,085,600	25,984	5,651	1,434,634	(1,575)	1,433,059
– stage 1	134,831	182,422	1,035,323	6,501	–	1,359,077	(1,191)	1,357,886
– stage 2	8	138	50,277	19,483	–	69,906	(295)	69,611
– stage 3	–	–	–	–	5,651	5,651	(89)	5,562
Financial guarantees and similar contracts	5,167	9,425	116,506	16,076	405	147,579	(238)	147,341
– stage 1	5,148	9,332	112,817	3,338	–	130,635	(143)	130,492
– stage 2	19	93	3,689	12,738	–	16,539	(95)	16,444
– stage 3	–	–	–	–	405	405	–	405
At 31 December 2018	2,408,367	601,266	2,626,216	121,525	162,269	5,919,643	(52,838)	5,866,805

	Fair value						
	Strong	Good	Satisfactory	Sub-standard	Credit impaired	Total	Allowance for ECL
	€000	€000	€000	€000	€000	€000	€000
Debt instruments at fair value through other comprehensive income	902,215	–	–	–	–	902,215	(20)
– stage 1	902,215	–	–	–	–	902,215	(20)
– stage 2	–	–	–	–	–	–	–
– stage 3	–	–	–	–	–	–	–
Treasury Bills at fair value through other comprehensive income	110,347	–	–	–	–	110,347	(1)
– stage 1	110,347	–	–	–	–	110,347	(1)
– stage 2	–	–	–	–	–	–	–
– stage 3	–	–	–	–	–	–	–

Distribution of financial instruments to which the impairment requirements in IFRS 9 are applied, by credit quality and stage distribution (continued)

	Gross carrying/nominal amount						Allowance for ECL	Net
	Strong	Good	Satisfactory	Sub-standard	Credit impaired	Total		
	€000	€000	€000	€000	€000	€000	€000	€000
Loans and advances to customers at amortised cost	1,096,491	425,841	1,382,582	96,640	167,920	3,169,474	(45,688)	3,123,786
– stage 1	1,080,428	421,910	1,287,503	—	—	2,789,841	(9,323)	2,780,518
– stage 2	16,063	3,931	95,079	96,640	—	211,713	(9,296)	202,417
– stage 3	—	—	—	—	167,920	167,920	(27,069)	140,851
Loans and advances to banks at amortised cost	1,045,699	—	—	—	—	1,045,699	(1)	1,045,698
– stage 1	1,045,699	—	—	—	—	1,045,699	(1)	1,045,698
– stage 2	—	—	—	—	—	—	—	—
– stage 3	—	—	—	—	—	—	—	—
Other financial assets measured at amortised cost	74,662	232	11,795	968	7,113	94,770	(5,703)	89,067
– stage 1	74,632	197	11,212	201	—	86,242	(76)	86,166
– stage 2	30	35	583	767	—	1,415	—	1,415
– stage 3	—	—	—	—	7,113	7,113	(5,627)	1,486
Loan and other credit-related commitments	142,043	185,030	851,709	33,648	3,071	1,215,501	(1,307)	1,214,194
– stage 1	138,423	181,628	783,502	7,324	—	1,110,877	(775)	1,110,102
– stage 2	3,620	3,396	67,290	26,320	—	100,626	(382)	100,244
– stage 3	—	6	917	4	3,071	3,998	(150)	3,848
Financial guarantees and similar contracts	2,799	14,559	88,047	14,494	434	120,333	(322)	120,011
– stage 1	2,661	14,549	85,363	5,602	72	108,247	(133)	108,114
– stage 2	90	—	2,349	8,891	9	11,339	(186)	11,153
– stage 3	48	10	335	1	353	747	(3)	744
At 1 January 2018	2,361,694	625,662	2,334,133	145,750	178,538	5,645,777	(53,021)	5,592,756

	Fair value						Allowance for ECL
	Strong	Good	Satisfactory	Sub-standard	Credit impaired	Total	
	€000	€000	€000	€000	€000	€000	€000
Debt instruments at fair value through other comprehensive income	923,786	—	—	—	—	923,786	(37)
– stage 1	923,786	—	—	—	—	923,786	(37)
– stage 2	—	—	—	—	—	—	—
– stage 3	—	—	—	—	—	—	—
Treasury Bills at fair value through other comprehensive income	80,512	—	—	—	—	80,512	(2)
– stage 1	80,512	—	—	—	—	80,512	(2)
– stage 2	—	—	—	—	—	—	—
– stage 3	—	—	—	—	—	—	—

Reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to customers, including loan and other credit-related commitments, acceptances, accrued income and financial guarantees and similar contracts

The following disclosure provides a reconciliation by stage of the bank's gross carrying/nominal amount and allowances for loans and advances to customers, including loan and other credit-related commitments.

The transfers of financial instruments represents the impact of stage transfers upon the gross carrying/nominal amount and associated allowance for ECL. The 'Net remeasurement of ECL arising from stage transfers' represents the increase or decrease due to these transfers, for example, moving from a 12-month (stage 1) to a lifetime (stage 2) ECL measurement basis. Net remeasurement excludes the underlying CRR movements of the financial instruments transferring stage. This is captured, along with other credit quality movements in the 'Changes in risk parameters' line item.

The 'Net new and further lending/repayments' represent the gross carrying/nominal amount and associated allowance ECL impact from volume movements within the bank's lending portfolio.

	Non-credit impaired				Credit impaired		Total	
	Stage 1		Stage 2		Stage 3			
	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL
	€000	€000	€000	€000	€000	€000	€000	€000
As at 1 January 2018	4,028,508	(10,292)	325,093	(9,864)	179,778	(32,861)	4,533,379	(53,017)
Transfers of financial instruments:	(37,755)	(1,233)	30,374	1,478	7,383	(246)	–	–
– transfers from Stage 1 to Stage 2	(90,609)	461	90,609	(461)	–	–	–	–
– transfers from Stage 2 to Stage 1	58,159	(1,701)	(58,159)	1,701	–	–	–	–
– transfers from Stage 3	2,327	(23)	3,393	(68)	(5,719)	90	–	–
– transfers to Stage 3	(7,632)	30	(5,469)	306	13,102	(336)	–	–
Net remeasurement of ECL arising from stage transfers	–	1,420	–	(1,202)	–	(258)	–	(40)
Changes in risk parameters	–	(564)	–	(918)	–	(8,234)	–	(9,716)
Net new and further lending/repayments	340,246	1,504	(76,525)	3,044	(19,035)	(465)	244,688	4,082
Assets written off	–	–	–	–	(5,857)	5,857	(5,857)	5,857
As at 31 December 2018	**4,330,999**	**(9,165)**	**278,942**	**(7,462)**	**162,269**	**(36,207)**	**4,772,210**	**(52,834)**
ECL release for the period								183
Recoveries								1,095
Other								1,073
Change in expected credit losses for the period								**2,351**
Assets written off								(5,857)
Change in expected credit losses and other credit impairment charges								**(3,506)**

	At 31 December 2018		12 months ended 31 December 2018
	Gross carrying/ nominal amount	Allowance for ECL	ECL (charge)/ release
	€000	€000	€000
As above	**4,772,210**	**(52,834)**	**(3,506)**
Balances at central banks	49,253	(1)	2
Loans and advances to banks measured at amortised cost	1,092,776	(3)	(2)
Summary of financial instruments to which the impairment requirements in IFRS 9 are applied through the Income Statement	**5,914,239**	**(52,838)**	**(3,506)**
Debt instruments and Treasury Bills measured at fair value through other comprehensive income	1,012,562	(21)	18
Total allowance for ECL/total income statement ECL charge for the year	**N/A**	**(52,859)**	**(3,488)**

Credit loss allowances attributable to loans and advances to customers

The following tables show the impairment allowances on loans and advances to customers recognised as at 31 December 2018 analysed by stage distribution and the impairment allowances on loans and advances to customers as at 31 December 2017 analysed between exposures which were individually assessed or collectively assessed for impairment.

Impairment allowances on loans and advances to customers by business segment

	Stage 1	Stage 2	Stage 3	Total
	€000	€000	€000	€000
Personal	2,974	3,802	5,403	12,179
Corporate and commercial	4,855	3,258	24,476	32,589
At 31 December 2018	**7,829**	**7,060**	**29,879**	**44,768**

Impairment allowances on loans and advances to customers by business segment

	Individually assessed	Collectively assessed	Total
	€000	€000	€000
Personal	4,080	2,295	6,375
Corporate and commercial	30,044	4,222	34,266
At 31 December 2017	34,124	6,517	40,641

The measurement in allowances for ECL and the ECL charge for 2018 are analysed in detail in the tables presented in the previous section. In addition, these movements are further analysed by business segment in the tables presented on pages 90 and 92 within the sections entitled 'Wholesale lending to customers' and 'Personal lending to customers' respectively.

The following tables analyse the loan impairment charges for 2017 and the impairment allowances recognised as at 31 December 2017 for impaired loans and advances that were either individually assessed or collectively assessed, and collective impairment allowances on loans and advances classified as not impaired.

Movement in impairment allowances accounts for loans and advances to customers

	2017	
	Individually assessed	Collectively assessed
	€000	€000
At 1 January	43,966	7,395
Amounts written off	(8,938)	—
Recoveries of amounts written off in previous years	1,918	—
Discount unwind	(2,232)	—
Exchange differences	(335)	—
Loan impairment (reversal)/charge	(255)	(878)
At 31 December	34,124	6,517
Personal	4,080	2,295
Corporate and commercial	30,044	4,222
At 31 December	34,124	6,517

Loan impairment charge to income statement by business segment

	2017	
	Individually assessed	Collectively assessed
	€000	€000
New allowance	29,394	608
Release of allowance no longer required	(27,731)	(1,486)
Recoveries of amounts previously written off	(1,918)	—
Total loan impairment reversal at 31 December	(255)	(878)
Personal		
– residential mortgages	(3,395)	(10)
– other personal lending	288	(481)
Corporate and commercial		
– commercial real estate	(2,135)	(136)
– other corporate lending	4,987	(251)
Total loan impairment reversal at 31 December	(255)	(878)

Renegotiated loans and advances to customers and forbearance

The contractual terms of a loan may be modified for a number of reasons including changing market conditions, customer retention and other factors not related to the current or potential credit deterioration of a customer. 'Forbearance' describes concessions made on the contractual terms of a loan in response to an obligor's financial difficulties. The bank classifies and reports loans on which concessions have been granted under conditions of credit distress as 'renegotiated loans' when their contractual payment terms have been modified, because the bank has significant concerns about the borrowers' ability to meet contractual payments when due.

On renegotiation, where the existing agreement is cancelled and a new agreement is made on substantially different terms, or if the terms of an existing agreement are modified, such that the renegotiated loan is substantially a different financial instrument, the loan would be derecognised and recognised as a new loan, for accounting purposes. However, newly recognised loans retain the 'renegotiated loans' classification.

A range of forbearance strategies is employed in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid default, foreclosure or repossession. They include extended payment terms, a reduction in interest or principal repayments, approved external debt management plans, debt consolidations, the deferral of foreclosures, and other forms of loan modifications and re-ageing.

The bank's policies and practices are based on criteria which enable management to judge whether repayment is likely to continue. These typically provide a customer with terms and conditions that are more favourable than those provided initially. Loan forbearance is only granted in situations where the customer has showed a willingness to repay the borrowing and is expected to be able to meet the revised obligations.

For retail lending, unsecured renegotiated loans are generally segmented from other parts of the loan portfolio. Renegotiated expected credit loss assessments reflect the higher rates of losses typically encountered with renegotiated loans. For wholesale lending, renegotiated loans are typically assessed individually. Credit risk ratings are intrinsic to the impairment assessments. The individual impairment assessment takes into account the higher risk of the future non-payment inherent in renegotiated loans.

For personal lending the bank's credit risk management policy sets out restrictions on the number and frequency of renegotiations, the minimum period an account must have been opened before any renegotiation can be considered and the number of qualifying payments that must be received.

When the bank grants a concession to a customer that the bank would not otherwise consider, as a result of their financial difficulty, this is objective evidence of impairment and impairment losses are measured accordingly. A renegotiated loan is presented as impaired when there has been a change in contractual cash flows as a result of a concession which the lender would otherwise not consider; and it is probable that without the concession, the borrower would be unable to meet contractual payment obligations in full. Accordingly, where the customer is not meeting contractual repayments or it is evident that they will be unable to do so without the renegotiation, there will be a significant concern regarding their ability to meet contractual payments, and the loan will be disclosed as impaired, unless the concession granted is insignificant. The renegotiated loan will continue to be disclosed as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment.

Renegotiated loans are classified as unimpaired where the renegotiation has resulted from significant concern about a borrower's ability to meet their contractual payment terms but the renegotiated terms are based on current market rates and contractual cash flows are expected to be collected in full following the renegotiation.

Unimpaired renegotiated loans also include previously impaired renegotiated loans that have demonstrated satisfactory performance over a period of time or have been assessed based on all available evidence as having no remaining indicators of impairment.

Loans that have been identified as renegotiated retain this designation until maturity or derecognition. When a loan is restructured as part of a forbearance strategy and the restructuring results in a derecognition of the existing loan, the new loan is disclosed as renegotiated. A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement made on substantially different terms, or if the terms of an existing agreement are modified, such that the renegotiated loan is substantially a different financial instrument as outlined previously.

When determining whether a loan that is restructured should be derecognised and a new loan recognised, the bank considers the extent to which the changes to the original contractual terms result in the renegotiated loan, considered as a whole, being a substantially different financial instrument.

The following table shows the gross carrying amounts of the bank's holdings of renegotiated loans and advances to customers by industry sector and by stage. Renegotiated loans are classified as stage 3 until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, observed over a minimum one-year period, and there are no other indicators of impairment.

Renegotiated loans and advances to customers by business segment and credit quality classification

	Stage 1	Stage 2	Stage 3	Total
	€000	€000	€000	€000
Gross carrying amount				
Personal				
– first lien residential mortgages	**–**	**15,535**	**12,313**	**27,848**
– other personal lending	**–**	**2,306**	**3,138**	**5,444**
Wholesale				
– corporate and commercial	**789**	**3,131**	**59,575**	**63,495**
– non-bank financial institutions	**–**	**–**	**1,309**	**1,309**
At 31 December 2018	**789**	**20,972**	**76,335**	**98,096**
Allowance for ECL				
Personal				
– first lien residential mortgages	**–**	**(707)**	**(667)**	**(1,374)**
– other personal lending	**–**	**(311)**	**(440)**	**(751)**
Wholesale				
– corporate and commercial	**(48)**	**(157)**	**(18,754)**	**(18,959)**
– non-bank financial institutions	**–**	**–**	**(263)**	**(263)**
At 31 December 2018	**(48)**	**(1,175)**	**(20,124)**	**(21,347)**

	Neither past due nor impaired	Past due but not impaired	Impaired	Total
Personal				
– residential mortgages	14,409	803	15,207	30,419
– other personal lending	3,017	105	3,487	6,609
Corporate and commercial				
– commercial real estate and other property-related	819	514	55,013	56,346
– other commercial	17,537	573	33,632	51,742
At 31 December 2017	35,782	1,995	107,339	145,116
% of loans and advances				4.58%
Total impairment allowances for renegotiated loans				
– individually assessed	–	–	24,598	24,598
– collectively assessed	74	4	220	298
	74	4	24,818	24,896
Collateral held	25,331	1,106	82,383	108,820

The table as at 31 December 2017 above shows the amounts net of suspended interest of the bank's holdings of renegotiated loans and advances to customers by business segment and credit quality classification.

	2018	2017
	€000	€000
Total renegotiated loans and advances to customers as a percentage of total gross loans and advances to customers	**3.11%**	4.58%
Interest income recognised in respect of forborne assets	**4,275**	6,122
Movement in forbearance activity during the year:		
At 1 January	**145,116**	196,260
Loans renegotiated without derecognition	**33,398**	4,618
Repayments	**(78,951)**	(50,491)
Amounts written off	**(1,467)**	(5,271)
At 31 December	**98,096**	145,116

Wholesale lending to customers

This section provides further detail on the distribution of allowances for ECL on wholesale loans and advances to customers, together with the respective gross carrying amounts, by industry and stage. Product granularity is also provided by stage with data presented for loans and advances to customers, banks, other credit commitments, financial guarantees and similar contracts. Additionally, this section provides a reconciliation of the opening 1 January 2018 to 31 December 2018 closing gross carrying / nominal amounts and the associated allowance for ECL.

Total wholesale lending for loans and advances to customers by stage distribution

	Gross carrying amount				Allowance for ECL			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
	€000	€000	€000	€000	€000	€000	€000	€000
Corporate and commercial	796,043	114,969	69,396	980,408	(4,644)	(3,204)	(23,989)	(31,837)
– agriculture, forestry and fishing	90	2	429	521	–	–	(23)	(23)
– manufacture	37,590	4,973	6,569	49,132	(227)	(104)	(2,563)	(2,894)
– electricity, gas, steam and air-conditioning supply	127,451	–	–	127,451	(201)	–	–	(201)
– water supply, sewerage,waste management and remediation	39,012	259	–	39,271	(2)	(5)	–	(7)
– construction	39,266	4,907	18,781	62,954	(371)	(149)	(1,434)	(1,954)
– wholesale and retail trade,repair of motor vehicles and motorcycles	145,679	29,959	6,161	181,799	(1,139)	(800)	(2,064)	(4,003)
– transportation and storage	10,731	13,114	12	23,857	(135)	(49)	–	(184)
– accommodation and food	105,528	5,556	4,452	115,536	(912)	(147)	(1,825)	(2,884)
– information and communication	32,922	18,844	68	51,834	(413)	(799)	–	(1,212)
– real estate	46,761	16,172	26,502	89,435	(551)	(460)	(12,657)	(13,668)
– professional, scientific and technical activities	71,400	7,650	406	79,456	(364)	(290)	–	(654)
– administrative and support services	9,367	3,371	551	13,289	(65)	(90)	(26)	(181)
– education	812	12	3	827	(7)	–	–	(7)
– health and care	14,877	9,703	4,914	29,494	(89)	(296)	(3,348)	(3,733)
– arts, entertainment and recreation	1,964	41	130	2,135	(21)	–	(40)	(61)
– other services	17,053	106	2	17,161	(116)	(3)	–	(119)
– activities of households	3,132	300	416	3,848	(26)	(12)	(9)	(47)
– public administration and defence, compulsory social security	92,408	–	–	92,408	(5)	–	–	(5)
Non-bank financial institutions	29,380	3,075	1,770	34,225	(211)	(54)	(487)	(752)
At 31 December 2018	825,423	118,044	71,166	1,014,633	(4,855)	(3,258)	(24,476)	(32,589)
Other financial assets measured at amortised cost								
– endorsements and acceptances	1,166	5,758	–	6,924	(2)	(12)	–	(14)
– accrued income	3,893	678	15,178	19,749	–	–	(5,694)	(5,694)
At 31 December 2018	5,059	6,436	15,178	26,673	(2)	(12)	(5,694)	(5,708)

Total wholesale lending for loan and other credit-related commitments and financial guarantee and similar contracts by stage distribution

	Nominal amount				Allowance for ECL			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
	€000	€000	€000	€000	€000	€000	€000	€000
Corporate and commercial	900,704	83,835	1,953	986,492	(1,304)	(386)	(89)	(1,779)
Non-bank financial institutions	2,998	39	–	3,037	–	(4)	–	(4)
At 31 December 2018	903,702	83,874	1,953	989,529	(1,304)	(390)	(89)	(1,783)

Wholesale lending - reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to customers including loan and other credit-related commitments, acceptances, accrued income and financial guarantees and similar contracts

	Non - credit impaired				Credit impaired			
	Stage 1		Stage 2		Stage 3		Total	
	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL
	€000	€000	€000	€000	€000	€000	€000	€000
As at 1 January 2018	1,595,073	(5,806)	248,267	(6,066)	108,187	(29,417)	1,951,527	(41,289)
Transfers of financial instruments :	(22,697)	(594)	20,881	656	1,818	(63)	–	–
– transfers from Stage 1 to Stage 2	(67,687)	395	67,687	(395)	–	–	–	–
– transfers from Stage 2 to Stage 1	45,670	(1,005)	(45,670)	1,005	–	–	–	–
– transfers from Stage 3	676	(1)	407	(1)	(1,082)	1	–	–
– transfers to Stage 3	(1,356)	17	(1,543)	47	2,900	(64)	–	–
Net remeasurement of ECL arising from stage transfers	–	755	–	(464)	–	64	–	355
Changes in risk parameters	–	(815)	–	(950)	–	(5,754)	–	(7,519)
Net new and further lending/ repayments	161,808	299	(60,794)	3,164	(16,065)	(732)	84,951	2,730
Assets written off	–	–	–	–	(5,643)	5,643	(5,643)	5,643
As at 31 December 2018	1,734,184	(6,161)	208,354	(3,660)	88,297	(30,259)	2,030,835	(40,080)
ECL release for the period								1,209
Recoveries								858
Other								1,821
Change in expected credit losses for the period								3,888
Assets written off								(5,643)
Change in expected credit losses and other credit impairment charges								(1,755)

Total wholesale lending for loan and other credit-related commitments and financial guarantee and similar contracts by credit quality

	Gross exposure/nominal amount						Allowance for ECL	Net
	Strong	Good	Satisfactory	Sub-standard	Credit Impaired	Total		
	€000	€000	€000	€000	€000	€000	€000	€000
Corporate and commercial	120,325	180,377	644,490	39,348	1,952	986,492	(1,779)	984,713
Non-bank financial institutions	2	–	2,996	39	–	3,037	(4)	3,033
At 31 December 2018	120,327	180,377	647,486	39,387	1,952	989,529	(1,783)	987,746

All corporate customers are rated using a 10-grade scale, with each CRR band being associated with an external rating grade by reference to long-run default rates for that grade, represented by the average of issuer-weighted historical default rates. This mapping between internal and external ratings is indicative and may vary over time. The table below shows the distribution of Wholesale loans and advances to customers as at 1 January 2018 and 31 December 2018, together with their associated ECL allowance by CRR.

Wholesale lending – credit risk profile by obligor grade for loans and advances to customers

	Gross carrying amount				Allowance for ECL				
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total	ECL Coverage
	€000	€000	€000	€000	€000	€000	€000	€000	%
Corporate and Commercial	**796,043**	**114,969**	**69,396**	**980,408**	**(4,644)**	**(3,204)**	**(23,989)**	**(31,837)**	**3.2**
CRR1	**39,300**	**10**	**–**	**39,310**	**(2)**	**–**	**–**	**(2)**	**–**
CRR2	**178,323**	**–**	**–**	**178,323**	**(50)**	**–**	**–**	**(50)**	**–**
CRR3	**50,009**	**–**	**–**	**50,009**	**(162)**	**–**	**–**	**(162)**	**0.3**
CRR4	**242,940**	**26,203**	**–**	**269,143**	**(1,321)**	**(129)**	**–**	**(1,450)**	**0.5**
CRR5	**285,471**	**20,623**	**–**	**306,094**	**(3,109)**	**(324)**	**–**	**(3,433)**	**1.1**
CRR6	**–**	**37,155**	**–**	**37,155**	**–**	**(975)**	**–**	**(975)**	**2.6**
CRR7	**–**	**21,174**	**–**	**21,174**	**–**	**(607)**	**–**	**(607)**	**2.9**
CRR8	**–**	**9,804**	**–**	**9,804**	**–**	**(1,169)**	**–**	**(1,169)**	**11.9**
CRR9/10	**–**	**–**	**69,396**	**69,396**	**–**	**–**	**(23,989)**	**(23,989)**	**34.6**
Non-bank financial institutions	**29,380**	**3,075**	**1,770**	**34,225**	**(211)**	**(54)**	**(487)**	**(752)**	**2.2**
CRR1	**337**	**–**	**–**	**337**	**–**	**–**	**–**	**–**	**–**
CRR2	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
CRR3	**156**	**–**	**–**	**156**	**–**	**–**	**–**	**–**	**–**
CRR4	**23,357**	**2,500**	**–**	**25,857**	**(147)**	**(51)**	**–**	**(198)**	**0.8**
CRR5	**5,530**	**575**	**–**	**6,105**	**(64)**	**(3)**	**–**	**(67)**	**1.1**
CRR6	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
CRR7	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
CRR8	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
CRR9/10	**–**	**–**	**1,770**	**1,770**	**–**	**–**	**(487)**	**(487)**	**27.5**
At 31 December 2018	**825,423**	**118,044**	**71,166**	**1,014,633**	**(4,855)**	**(3,258)**	**(24,476)**	**(32,589)**	**3.2**
Corporate and Commercial	798,266	134,619	98,230	1,031,115	(4,580)	(5,297)	(23,582)	(33,459)	3.2
CRR1	25,946	–	–	25,946	(14)	–	–	(14)	0.1
CRR2	176,155	–	–	176,155	(60)	–	–	(60)	–
CRR3	69,180	173	–	69,353	(256)	(9)	–	(265)	0.4
CRR4	173,656	1,482	–	175,138	(713)	(8)	–	(721)	0.4
CRR5	353,329	47,048	–	400,377	(3,537)	(968)	–	(4,505)	1.1
CRR6	–	43,135	–	43,135	–	(733)	–	(733)	1.7
CRR7	–	29,466	–	29,466	–	(1,238)	–	(1,238)	4.2
CRR8	–	13,315	–	13,315	–	(2,341)	–	(2,341)	17.6
CRR9/10	–	–	98,230	98,230	–	–	(23,582)	(23,582)	24.0
Non-bank financial institutions	31,712	5,607	2,199	39,518	(300)	(201)	(446)	(947)	2.4
CRR1	5	–	–	5	–	–	–	–	–
CRR2	–	–	–	–	–	–	–	–	–
CRR3	–	–	–	–	–	–	–	–	–
CRR4	22,640	5,485	–	28,125	(231)	(196)	–	(427)	1.5
CRR5	9,067	80	–	9,147	(69)	(4)	–	(73)	0.8
CRR6	–	–	–	–	–	–	–	–	–
CRR7	–	42	–	42	–	(1)	–	(1)	2.4
CRR8	–	–	–	–	–	–	–	–	–
CRR9/10	–	–	2,199	2,199	–	–	(446)	(446)	20.3
At 1 January 2018	829,978	140,226	100,429	1,070,633	(4,880)	(5,498)	(24,028)	(34,406)	3.2

Personal lending to customers

This section presents further disclosures related to personal lending. It provides details of the products which are driving the change observed in personal loans and advances to customers. This section also provides a reconciliation of the opening 1 January 2018 to 31 December 2018 closing gross carrying / nominal amounts and associated allowance for ECL. Further product granularity is also provided by stage, with data presented for loans and advances to customers, loan and other credit-related commitments and financial guarantees.

Total personal lending for loans and advances to customers by stage distribution

	Gross carrying amount				Allowance for ECL			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
	€000	€000	€000	€000	€000	€000	€000	€000
By portfolio								
First lien residential mortgages	1,776,287	44,491	51,696	1,872,474	(2,497)	(2,049)	(3,348)	(7,894)
Other personal lending	231,490	23,184	13,399	268,073	(477)	(1,753)	(2,055)	(4,285)
– other	75,547	13,270	2,743	91,560	(178)	(840)	(1,505)	(2,523)
– credit cards	33,513	3,265	454	37,232	(193)	(764)	(168)	(1,125)
– second lien residential mortgages	122,430	6,649	10,202	139,281	(106)	(149)	(382)	(637)
At 31 December 2018	2,007,777	67,675	65,095	2,140,547	(2,974)	(3,802)	(5,403)	(12,179)
Other financial assets measured at amortised cost								
– accrued income	3,028	342	4,774	8,144	–	–	(545)	(545)
At 31 December 2018	3,028	342	4,774	8,144	–	–	(545)	(545)

Total personal lending for loan and other credit-related commitments and financial guarantee and similar contracts by stage distribution

	Nominal amount				Allowance for ECL			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
	€000	€000	€000	€000	€000	€000	€000	€000
Personal	586,010	2,571	4,103	592,684	(30)	–	–	(30)
At 31 December 2018	586,010	2,571	4,103	592,684	(30)	–	–	(30)

Personal lending - reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to customers including loan and other credit-related commitments, accrued income and financial guarantees and similar contracts

	Non-credit impaired				Credit impaired		Total	
	Stage 1		Stage 2		Stage 3			
	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL
	€000	€000	€000	€000	€000	€000	€000	€000
As at 1 January 2018	2,433,435	(4,486)	76,826	(3,798)	71,591	(3,444)	2,581,852	(11,728)
Transfers of financial instruments :	(15,058)	(639)	9,493	822	5,565	(183)	–	–
– transfers from Stage 1 to Stage 2	(22,922)	66	22,922	(66)	–	–	–	–
– transfers from Stage 2 to Stage 1	12,489	(696)	(12,489)	696	–	–	–	–
– transfers from Stage 3	1,651	(22)	2,986	(67)	(4,637)	89	–	–
– transfers to Stage 3	(6,276)	13	(3,926)	259	10,202	(272)	–	–
Net remeasurement of ECL arising from stage transfers	–	665	–	(738)	–	(322)	–	(395)
Changes in risk parameters	–	251	–	32	–	(2,480)	–	(2,197)
Net new and further lending repayments	178,438	1,205	(15,731)	(120)	(2,970)	267	159,737	1,352
Assets written off	–	–	–	–	(214)	214	(214)	214
As at 31 December 2018	2,596,815	(3,004)	70,588	(3,802)	73,972	(5,948)	2,741,375	(12,754)
ECL release for the period								(1,026)
Recoveries								237
Other								(748)
Change in expected credit losses								(1,537)
Assets written off								(214)
Change in expected credit losses and other credit impairment charges								(1,751)

Personal lending – credit risk profile by obligor grade for loans and advances to customers

	Gross carrying amount				Allowance for ECL				
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total	ECL Coverage
	€000	€000	€000	€000	€000	€000	€000	€000	%
First lien residential mortgages	**1,776,287**	**44,491**	**51,696**	**1,872,474**	**(2,497)**	**(2,049)**	**(3,348)**	**(7,894)**	**0.4**
CRR 1 - 5	**1,776,287**	**38,992**	**—**	**1,815,279**	**(2,497)**	**(1,534)**	**—**	**(4,031)**	**0.2**
CRR 6	**—**	**2,855**	**—**	**2,855**	**—**	**(181)**	**—**	**(181)**	**6.3**
CRR 7	**—**	**2,644**	**—**	**2,644**	**—**	**(334)**	**—**	**(334)**	**12.6**
CRR 8	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
CRR 9	**—**	**—**	**51,696**	**51,696**	**—**	**—**	**(3,348)**	**(3,348)**	**6.5**
Other personal lending	**231,490**	**23,184**	**13,399**	**268,073**	**(477)**	**(1,753)**	**(2,055)**	**(4,285)**	**1.6**
CRR 1 - 5	**231,490**	**18,138**	**—**	**249,628**	**(477)**	**(1,062)**	**—**	**(1,539)**	**0.6**
CRR 6	**—**	**4,069**	**—**	**4,069**	**—**	**(574)**	**—**	**(574)**	**14.1**
CRR 7	**—**	**977**	**—**	**977**	**—**	**(117)**	**—**	**(117)**	**12.0**
CRR 8	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
CRR 9	**—**	**—**	**13,399**	**13,399**	**—**	**—**	**(2,055)**	**(2,055)**	**15.3**
At 31 December 2018	**2,007,777**	**67,675**	**65,095**	**2,140,547**	**(2,974)**	**(3,802)**	**(5,403)**	**(12,179)**	**0.6**
First lien residential mortgages	1,716,599	41,079	52,961	1,810,639	(3,766)	(1,570)	(927)	(6,263)	0.3
CRR 1 - 5	1,716,599	34,246	—	1,750,845	(3,766)	(1,245)	—	(5,011)	0.3
CRR 6	—	4,069	—	4,069	—	(238)	—	(238)	5.8
CRR 7	—	2,764	—	2,764	—	(87)	—	(87)	3.1
CRR 8	—	—	—	—	—	—	—	—	—
CRR 9	—	—	52,961	52,961	—	—	(927)	(927)	1.8
Other personal lending	243,264	30,408	14,530	288,202	(677)	(2,228)	(2,114)	(5,019)	1.7
CRR 1 - 5	243,264	26,559	—	269,823	(677)	(1,430)	—	(2,107)	0.8
CRR 6	—	2,930	—	2,930	—	(667)	—	(667)	22.8
CRR 7	—	812	—	812	—	(118)	—	(118)	14.5
CRR 8	—	107	—	107	—	(13)	—	(13)	12.1
CRR 9	—	—	14,530	14,530	—	—	(2,114)	(2,114)	14.5
At 1 January 2018	1,959,863	71,487	67,491	2,098,841	(4,443)	(3,798)	(3,041)	(11,282)	0.5

Collateral and other credit enhancements

It is the bank's practice to lend on the basis of the customer's ability to meet their obligations out of their cash flow resources rather than rely on the value of security offered. Depending on the customer's standing and the type of product, facilities may be provided unsecured. For other lending a charge over collateral is obtained and considered in determining the credit decision and pricing. In the event of a default, the bank may utilise the collateral as a source of repayment. Depending on its form, collateral can have a significant financial effect in mitigating exposure to credit risk.

The principal collateral types are as follows:

- In the personal sector, mortgages over residential properties, cash and securities; and
- In the commercial real estate sector, charges over the properties being financed;

The bank is required to implement guidelines on the acceptability of specific classes of collateral or credit risk mitigation, and determine suitable valuation parameters. Such parameters are expected to be conservative, reviewed regularly and supported by empirical evidence. Security structures and legal covenants are required to be subject to regular review to ensure that they continue to fulfil their intended purpose and remain in line with local market practice.

The tables in following pages show loans and advances to customers by level of collateral. The collateral measured in the tables below consists of fixed first charges on real estate and charges over cash and marketable financial instruments. The values in the tables represent the expected market value on an open market basis; no adjustment has been made to the collateral for any expected costs of recovery. Cash is valued at its nominal value and marketable securities at their fair value.

The LTV ratios presented are calculated by directly associating loans and advances with the collateral that individually and uniquely supports each facility.

Where collateral assets are shared by multiple loans and advances, the collateral value is pro-rated across the loans and advances protected by the collateral.

Wholesale lending to customers

Wholesale lending includes the financing of corporate, institutional and high net worth individuals investing primarily in income producing assets and, to a lesser extent construction and development of the same. The business focuses mainly on traditional core asset classes such as retail, offices, light industrial and residential building projects.

The collateral measured in the table in following pages consists of fixed first charges on real estate. The values in the table represent the expected market value on an open market basis. Loans shown as not collateralised or partially collateralised may also benefit from other forms of credit mitigants.

Other types of collateral which are commonly taken for corporate and commercial lending such as unsupported guarantees and floating charges over the assets of a customer's business are not measured in the tables below. While such mitigants have value, often providing rights in insolvency, their assignable value is not sufficiently certain and they are therefore assigned no value for disclosure purposes.

The value of commercial real estate collateral is determined by using a combination of professional and internal valuations and physical inspections. Due to the complexity of valuing collateral for commercial real estate, local valuation policies determine the frequency of review on the basis of local market conditions. Revaluations are sought with greater frequency as concerns over the performance of the collateral or the direct obligor increase.

Wholesale lending - corporate and commercial loans and advances by level of collateral by stage distribution

	Gross carrying amount	Allowance for ECL	ECL coverage
	€000	€000	%
Stage 1			
Not collateralised	373,720	(2,542)	0.7
Fully collateralised			
– less than 50%	30	(1)	3.3
– 51% to 75%	181	(4)	2.2
– 76% to 90%	1,620	(8)	0.5
– 91% to 100%	416,365	(2,002)	0.5
Partially collateralised			
– greater than 100% LTV	33,507	(298)	0.9
– *of which: Collateral value*	*18,728*		
Total	825,423	(4,855)	0.6
Stage 2			
Not collateralised	42,197	(710)	1.7
Fully collateralised			
– less than 50%	–	–	
– 51% to 75%	6	–	–
– 76% to 90%	152	(4)	2.6
– 91% to 100%	69,982	(2,382)	3.4
Partially collateralised			
– greater than 100% LTV	5,707	(162)	2.8
– *of which: Collateral value*	*3,915*		
Total	118,044	(3,258)	2.8
Stage 3			
Not collateralised	23,325	(8,261)	35.4
Fully collateralised			
– 91% to 100%	24,294	(2,539)	10.5
Partially collateralised			
– greater than 100% LTV	23,547	(13,676)	58.1
– *of which: Collateral value*	*11,265*		
Total	71,166	(24,476)	34.4
At 31 December 2018	1,014,633	(32,589)	3.2

Wholesale lending - corporate and commercial loans and advances by level of collateral by obligor grade

	Gross carrying amount	Allowance for ECL	ECL coverage
	€000	€000	%
CRR 1 to 8			
Not collateralised	**415,917**	**(3,252)**	**0.8**
Fully collateralised			
– less than 50%	**30**	**(1)**	**3.3**
– 51% to 75%	**187**	**(4)**	**2.1**
– 76% to 90%	**1,772**	**(12)**	**0.7**
– 91% to 100%	**486,347**	**(4,384)**	**0.9**
Partially collateralised			
– greater than 100% LTV	**39,214**	**(460)**	**1.2**
– of which: Collateral value	***22,643***		
Total	**943,467**	**(8,113)**	**0.9**
CRR 9 to 10			
Not collateralised	**23,325**	**(8,261)**	**35.4**
Fully collateralised			
– 91% to 100%	**24,294**	**(2,539)**	**10.5**
Partially collateralised			
– greater than 100% LTV	**23,547**	**(13,676)**	**58.1**
– of which: Collateral value	***11,265***		
Total	**71,166**	**(24,476)**	**34.4**
At 31 December 2018	**1,014,633**	**(32,589)**	**3.2**

	2017
	€000
Non-impaired loans and advances (CRR 1 to 8)	
Not collateralised	464,947
Fully collateralised	447,340
– 51% to 75% LTV	314,051
– 76% to 90% LTV	8,076
– 91% to 100% LTV	125,213
Partially collateralised	
– greater than100% LTV	57,917
– of which: Collateral value	*30,270*
Impaired loans and advances (CRR 9 to 10)	
Not collateralised	35,409
Fully collateralised	52,537
– 51% to 75% LTV	40,934
– 76% to 90% LTV	1,141
– 91% to 100% LTV	10,462
Partially collateralised	
– greater than100% LTV	12,483
– of which: Collateral value	*5,106*
At 31 December 2017	1,070,633

Personal lending to customers

The bank provides a broad range of secured and unsecured personal lending products to meet customer needs. Personal lending includes advances to customers for asset purchases such as residential property where the loans are secured by the assets acquired. The bank also offers loans secured on existing assets, such as first charges on residential property, and unsecured lending products such as overdrafts, credit cards and card loans.

The collateral measured in the following table consists of fixed charges held over borrowers' real estate. The value of collateral is determined using professional valuations and excludes any adjustment for obtaining and selling the collateral. Loans shown as not collateralised or partially collateralised may also benefit from other forms of credit mitigants.

Personal Lending - residential mortgages, loans and advances by level of collateral by stage distribution

	Gross carrying amount €000	Allowance for ECL €000	ECL coverage %
Stage 1			
Not collateralised	98,252	(359)	0.4
Fully collateralised	1,905,253	(2,605)	0.1
– less than 50%	716,232	(436)	0.1
– 51% to 75%	663,512	(661)	0.1
– 76% to 90%	478,544	(1,393)	0.3
– 91% to 100%	46,965	(115)	0.2
Partially collateralised :			
– greater than 100% LTV	4,272	(10)	0.2
– *of which: Collateral value*	*1,739*		
Total	2,007,777	(2,974)	0.1
Stage 2			
Not collateralised	13,113	(1,332)	10.2
Fully collateralised	53,082	(2,422)	4.6
– less than 50%	28,474	(747)	2.7
– 51% to 75%	15,395	(550)	3.6
– 76% to 90%	6,926	(854)	12.3
– 91% to 100%	2,287	(271)	11.8
Partially collateralised:			
– greater than 100% LTV	1,480	(48)	3.2
– *of which: Collateral value*	*923*		
Total	67,675	(3,802)	5.6
Stage 3			
Not collateralised	2,750	(1,287)	46.8
Fully collateralised	62,124	(4,069)	6.6
– less than 50%	34,223	(1,408)	4.1
– 51% to 75%	21,959	(1,206)	5.5
– 76% to 90%	4,291	(824)	19.2
– 91% to 100%	1,651	(631)	38.2
Partially collateralised:			
– greater than 100% LTV	221	(47)	21.2
– *of which: Collateral value*	*148*		
Total	65,095	(5,403)	8.3
At 31 December 2018	2,140,547	(12,179)	0.6

Personal Lending - residential mortgages, loans and advances by level of collateral by obligor grade

	Gross carrying amount €000	Allowance for ECL €000	ECL coverage %
CRR 1 to 8			
Not collateralised	111,365	(1,691)	1.5
Fully collateralised	1,958,335	(5,027)	0.3
– less than 50%	744,706	(1,183)	0.2
– 51% to 75%	678,907	(1,211)	0.2
– 76% to 90%	485,470	(2,247)	0.5
– 91% to 100%	49,252	(386)	0.8
Partially collateralised :			
– greater than 100% LTV	5,752	(58)	1.0
– *of which: Collateral Value*	*2,662*		
Total	2,075,452	(6,776)	0.3
CRR 9 to 10			
Not collateralised	2,750	(1,287)	46.8
Fully collateralised	62,124	(4,069)	6.6
– less than 50%	34,223	(1,408)	4.1
– 51% to 75%	21,959	(1,206)	5.5
– 76% to 90%	4,291	(824)	19.2
– 91% to 100%	1,651	(631)	38.3
Partially collateralised	–	–	–
– greater than 100% LTV	221	(47)	21.3
– *of which: Collateral Value*	*148*		
Total	65,095	(5,403)	8.3
At 31 December 2018	2,140,547	(12,179)	0.6

	2017
	€000
Non-impaired loans and advances (CRR 1 to 8)	
Not collateralised	119,345
Fully collateralised	1,906,649
– Less than 50% LTV	772,866
– 51% to 75% LTV	636,789
– 76% to 90% LTV	446,311
– 91% to 100% LTV	50,683
Partially collateralised	
– greater than100% LTV	5,417
– of which: collateral value	*2,480*
Impaired loans and advances (CRR 9 to 10)	
Not collateralised	800
Fully collateralised	53,269
– Less than 50% LTV	33,716
– 51% to 75% LTV	16,423
– 76% to 90% LTV	2,414
– 91% to 100% LTV	716
Partially collateralised	
– greater than100% LTV	13,361
– of which: collateral value	*8,795*
At 31 December 2017	2,098,841

The bank typically does not hold collateral against financial assets measured at fair value through profit or loss, financial investments and loans to banks, and no such collateral was held at 31 December 2018 and 2017.

Forward-looking information incorporated in the ECL model

Expected credit loss impairment allowances recognised in the financial statements reflect the effect of a range of possible economic outcomes, calculated on a probability-weighted basis. The recognition and measurement of expected credit losses ('ECL') involves the use of significant judgement and estimation. It is necessary to formulate multiple forward-looking economic forecasts and incorporate them into the ECL estimates. The bank uses a standard framework to form economic scenarios to reflect assumptions about future economic conditions, supplemented with the use of management judgement, which may result in using alternative or additional economic scenarios and/or management adjustments.

Methodology

HSBC has developed a globally consistent methodology for the application of forward economic guidance ('FEG') into the calculation of ECL by incorporating macroeconomic variables into the estimation of the term structure of probability of default ('PD') and loss given default ('LGD').

The bank has adopted the use of three scenarios, representative of forecast economic conditions, sufficient to calculate unbiased expected losses. They represent a 'most likely outcome' (the Central scenario), and two, less likely 'outer' scenarios, referred to as the Upside and Downside scenarios. Each outer scenario is consistent with a probability of 10%, while the Central scenario is assigned the remaining 80%, according to the decision of the bank's senior management. This weighting scheme is deemed appropriate for the unbiased estimation of ECL. Key scenario assumptions are set using external forecasts, helping to ensure that the IFRS 9 scenarios are unbiased and maximise the use of independent information. The Central, Upside and Downside scenarios selected with reference to external forecast distributions using the above approach are termed the 'consensus economic scenarios'.

For the Central scenario, key assumptions such as GDP growth, inflation, unemployment and policy interest rates are calibrated using external forecasts (commonly referred to as consensus forecasts). The Upside and Downside scenarios are designed to be cyclical, in that the forecasted macroeconomic variables usually revert back to the Central scenario after the first three years. The approach centres on GDP growth rate forecasts. The remaining variables are then forecasted subject to restrictions to enable consistency with GDP forecasts. The maximum divergence of GDP growth from the Central scenario is calibrated using the 10^{th} and the 90^{th} percentile of the entire distribution of forecast outcomes.

To generate the three economic scenarios, a shortlist of the most relevant upside and downside economic and political risks is developed. This is known as the 'economic risk assessment'. For the Central scenario, a predefined set of economic paths is taken as the average of different forecast distributions. Paths for the two outer scenarios are benchmarked to the Central scenario and reflect the economic risk assessment. Scenarios are representative of the probability weighting scheme, informed by the current economic outlook, data analysis of past recessions, and transitions in and out of recession. The key assumptions made, and the accompanying paths, represent the 'best estimate' of a scenario at a specified probability.

The Upside and Downside scenarios are generated at the year-end and are only updated during the year if economic conditions change significantly. The Central scenario is generated every quarter.

How economic scenarios are reflected in the wholesale calculation of ECL

In line with HSBC's methodology, for the wholesale portfolio, FEG is incorporated into the calculation of ECLs through the estimation of the term structure of PD and LGD.

For PDs, the correlation of FEG to default rates is considered. In this respect, forward-looking PDs are approximated by using a proxy country's PDs and macroeconomic paths, shifted by a scalar. A suitable proxy is selected using the Bhattacharyya methodology which compares various proxy sites' principal component macroeconomic variables to local variables to determine the most suitable site. The scalar is then calculated, which is intended to capture the difference between the proxy and local sensitivities to economic shocks.

For the LGD calculation, the correlation of FEG, derived from the assumed macroeconomic paths of the proxy site, to collateral values, which are in turn derived from the bank's data, is taken into account.

For credit impaired loans, LGD estimates take into account independent recovery valuations provided by external consultants, or internal forecasts corresponding to anticipated economic conditions and individual company conditions. In estimating the ECL on credit impaired loans that are individually considered not to be significant, the model incorporates forward economic guidance proportionate to the probability-weighted outcome and the Central scenario outcome for non-stage 3 populations.

The following table describes key macroeconomic variables, reflecting those used by the proxy site, and the probabilities assigned in the consensus Central, Upside and Downside scenarios.

Consensus scenarios (average 2019-2023)

	Wholesale lending		
	Central scenario	**Upside scenario**	**Downside scenario**
Real GDP Growth rate (%)	**1.7**	**2.2**	**1.1**
Consumer price index (%)	**2.1**	**2.3**	**1.7**
Unemployment (%)	**4.5**	**4.2**	**4.8**
Short-term interest rate (%)	**1.2**	**1.3**	**0.3**
House price index(%)	**2.9**	**4.1**	**1.0**
Probability (%)	**80.0**	**10.0**	**10.0**

How economic scenarios are reflected in the retail calculation of ECL

With respect to the retail portfolio, the impact of economic scenarios on PDs is modelled at a portfolio level. Historical relationships between observed default rates and macroeconomic variables are integrated into IFRS 9 ECL estimates by leveraging economic response models. The impact of these scenarios on PDs is modelled over a period equal to the remaining maturity of underlying assets.

For the mortgage portfolio, the impact on LGD is modelled by forecasting loan-to-value ('LTV') profiles up to the point of default. In this regard, LTV profiles are forecasted for the remaining maturity of the asset for exposures within stages 1 and 2 by leveraging national level forecasts of the house price index and applying the corresponding LGD expectation. However, no impact on LGD is modelled for stage 3 exposures to reflect the fact that these are already defaulted.

The key macroeconomic variables used for the retail portfolio are specific to Malta and have been calibrated in line with the methodology explained above. The following table describes key macroeconomic variables and the probabilities assigned in the consensus Central, Upside and Downside scenarios.

Consensus scenarios (average 2019-2023)

	Retail lending		
	Central scenario	**Upside scenario**	**Downside scenario**
Real GDP Growth rate (%)	**3.0**	**3.5**	**2.5**
House price index(%)	**3.6**	**3.9**	**3.1**
Probability (%)	**80.0**	**10.0**	**10.0**

Economic scenarios sensitivity analysis of ECL estimates

The ECL outcome is sensitive to judgement and estimations made with regards to the formulation and incorporation of multiple forward-looking economic conditions described above. As a result, management assessed and considered the sensitivity of the ECL outcome against the forward-looking economic conditions as part of the ECL governance process.

The sensitivity impact was not considered to be significant taking cognisance of the level of ECL allowances and the effects of the application of macroeconomic inputs to ECL calculations.

Treasury Bills and debt securities

Debt securities and other bills by rating agency (S&P Rating Agency) designation of the bank, are reported in the table below. Information relating to the HSBC Life insurance business is disclosed in Note 4(f)(iii).

Debt securities and other bills by rating agency

	At 31 December 2018		
	Treasury Bills	**Debt securities**	**Total**
	€000	**€000**	**€000**
AAA	**–**	**274,270**	**274,270**
AA- to AA+	**–**	**138,266**	**138,266**
A-	**110,347**	**489,679**	**600,026**
	110,347	**902,215**	**1,012,562**

	At 31 December 2017		
	Treasury Bills	Debt securities	Total
	€000	€000	€000
AAA	—	304,943	304,943
AA- to AA+	—	71,232	71,232
A- to BBB-	80,512	547,611	628,123
	80,512	923,786	1,004,298

Derivatives

The bank participates in transactions exposing it to counterparty credit risk. Counterparty credit risk is the risk of financial loss if the counterparty to a transaction defaults before satisfactorily settling it and it arises principally from over the counter (OTC) derivatives. Transactions vary in value by reference to a market factor such as interest rate, exchange rate or asset price. The bank manages its derivative market risk positions principally through back-to-back derivative transactions with HSBC Group entities. The counterparty risk from derivative transactions is taken into account when reporting the fair value of derivative positions. The adjustment to the fair value is known as the credit value adjustment ('CVA').

For transactions with HSBC Group entities, the bank has an International Swaps and Derivatives Association (ISDA) Master Agreement in place. It provides the contractual framework within which dealing activity across a full range of OTC products is conducted, and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement if either party defaults or other preagreed termination events occur. In this respect, gross derivative assets amounting to €927,000 (2017: €202,000) are subject to enforceable netting agreement, however, they are not offset in the balance sheet as they do not meet the on-balance sheet offsetting criteria for financial reporting purposes. Similarly, gross derivative liabilities amounting to €4,055,000 (2017: €4,814,000) are subject to enforceable netting agreement, however, they are not offset in the balance sheet as they do not meet the on-balance sheet offsetting criteria for financial reporting purposes.

(c) Liquidity risk

Liquidity risk is the risk that the local group does not have sufficient financial resources to meet its financial obligations when they fall due or will have to do so at excessive cost. This risk principally arises from mismatches in the timing of cash flows. Funding risk (a form of liquidity risk) arises when the liquidity needed to fund illiquid asset positions cannot be obtained on the expected terms and when required.

The objective of the local group's liquidity and funding management is to ensure that all foreseeable funding commitments and deposit withdrawals can be met when due. To this end, the local group maintains a diversified and stable funding base. The funding base comprises core personal and corporate customer deposits, wholesale funding and portfolios of highly liquid assets with the objective of enabling the local group to respond quickly and smoothly to unforeseen liquidity requirements.

The bank maintains strong liquidity positions and manages the liquidity profiles of assets, liabilities and commitments with the objective of ensuring that cash flows are balanced appropriately and that all anticipated obligations can be met when due.

The local group's liquidity and funding management processes include:

- projecting cash flows by major currency under various stress scenarios considering the level of liquid assets necessary in relation thereto;
- monitoring liquidity ratios against internal and regulatory requirements;
- maintaining a diverse range of funding sources with adequate back-up facilities;
- managing the concentration and profile of debt maturities;
- monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensure a satisfactory overall funding mix; and
- maintaining liquidity and funding contingency plans. These plans identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systematic or other crises while minimising adverse long-term implications for the business.

Primary sources of funding

Customer deposits in the form of current accounts and savings deposits payable on demand or at short notice form a significant part of the local group's funding, and thus considerable importance is placed on maintaining their stability. For deposits, stability depends upon maintaining depositor confidence in the local group's capital strength and liquidity, and on competitive and transparent pricing.

Management of liquidity and funding risk

The bank's liquidity and funding risk management framework employs two key measures to define, monitor and control the liquidity and funding risk. The Net Stable Funding Ratio (NSFR) ratio is used to monitor the structural long-term funding position of the bank, and the Liquidity Coverage Ratio (LCR) metric is used to gauge the short-term resilience of the bank's liquidity profile. The bank also monitors the contractual maturity ladder, which provides insight into the extent to which the bank relies on maturity transformation in respect of contractual cash flows. More precisely, the maturity ladder is used by the bank to determine the availability of liquid assets to meet the liquidity gaps for diverse time horizons.

The bank's ALCO focuses on the management process with respect to liquidity and funding risks. Compliance with established limits is monitored by the local ALCO.

i Liquidity Coverage Ratio

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

LCR year end levels for the bank

	31 December 2018	31 December 2017
	%	%
Actual LCR Ratio	**504**	456
Regulatory Minimum	**100**	100

During the years ended 31 December 2018 and 2017 the LCR ratio was within both the regulatory minimum and the risk appetite set by the bank.

ii Net stable funding ratio

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

The bank calculates NSFR in line with Basel Committee on Banking Supervision publication 295. This calculation requires various interpretations of the text, and therefore HSBC's NSFR may not be directly comparable with the ratios of other institutions.

Net stable funding ratio year end levels for the bank

	31 December 2018	31 December 2017
	%	%
Actual NSFR Ratio	**137**	135
Regulatory Minimum	**100**	100

During the years ended 31 December 2018 and 2017 the NSFR was within both the regulatory minimum and the risk appetite set by the bank.

iii Depositor concentration

The LCR and NSFR metrics assume a stressed outflow based on a portfolio of depositors within different depositor segments. The validity of these assumptions is challenged if the underlying depositors do not represent a large enough portfolio so that a depositor concentration exists. The bank is exposed to term re-financing concentration risk if the current maturity profile results in future maturities being overly concentrated in any defined period.

As at 31 December 2018 and 2017, the bank was within the risk appetite levels set for depositor concentration and term funding maturity concentration.

iv Contractual maturity ladder

The following is an analysis of financial assets and liabilities (excluding financial instruments relating to HSBC Life Assurance (Malta) Limited) by remaining contractual maturities at the reporting date. Information relating to HSBC Life insurance business is disclosed in Note 4(f)(iv):

Financial assets and liabilities (excluding financial instruments relating to HSBC Life Assurance (Malta) Limited) by remaining contractual maturities

	Group						
	At 31 December 2018						
	Not more than 3 months	Between 3 and 6 months	Between 6 months and 1 year	Between 1 year and 5 years	More than 5 years	No maturity date	Total
	€000	€000	€000	€000	€000	€000	€000
Assets							
Cash	31,169	—	—	—	—	—	31,169
Balances with Central Bank of Malta and Treasury Bills	69,364	38,025	3,003	—	—	49,207	159,599
Items in the course of collection from other banks	5,404	—	—	—	—	—	5,404
Held for trading derivatives	193	1,206	107	1,023	2,427	—	4,956
Loans and advances to banks	729,736	47,463	50,000	265,574	—	—	1,092,773
Loans and advances to customers	286,216	23,756	19,219	313,170	2,468,051	—	3,110,412
Financial investments measured at fair value through other comprehensive income	47,957	31,165	176,307	580,353	66,433	2,705	904,920
Other assets	33,016	—	77	—	—	—	33,093
Total assets	1,203,055	141,615	248,713	1,160,120	2,536,911	51,912	5,342,326
Liabilities							
Deposits by banks	2,542	—	—	—	—	—	2,542
Customer accounts	4,119,427	188,033	254,979	313,333	11,701	—	4,887,473
Held for trading derivatives	142	1,141	116	912	2,680	—	4,991
Other liabilities	38,479	671	617	1,159	—	—	40,926
Subordinated liabilities	—	—	—	—	62,000	—	62,000
Total liabilities	4,160,590	189,845	255,712	315,404	76,381	—	4,997,932
Liquidity gap	(2,957,535)	(48,230)	(6,999)	844,716	2,460,530		
Cumulative liquidity gap	(2,957,535)	(3,005,765)	(3,012,764)	(2,168,048)	292,482		
	At 31 December 2017						
Assets							
Cash	35,006	—	—	—	—	—	35,006
Balances with Central Bank of Malta and Treasury Bills	54,016	25,006	2,001	—	—	48,030	129,053
Items in the course of collection from other banks	18,158	—	—	—	—	—	18,158
Held for trading derivatives	260	1,037	178	1,310	2,390	—	5,175
Loans and advances to banks	758,358	—	81,710	155,635	50,000	—	1,045,703
Loans and advances to customers	354,832	4,943	29,608	360,340	2,379,110	—	3,128,833
Available-for-sale financial investments	61,213	45,423	148,980	568,087	100,083	1,097	924,883
Other assets	26,783	—	—	5,307	—	—	32,090
Total assets	1,308,626	76,409	262,477	1,090,679	2,531,583	49,127	5,318,901
Liabilities							
Deposits by banks	54,703	—	—	—	—	—	54,703
Customer accounts	3,834,332	94,483	513,705	304,439	19,036	—	4,765,995
Held for trading derivatives	190	630	571	1,179	2,658	—	5,228
Other liabilities	44,861	3,441	2,775	5,944			57,021
Subordinated liabilities	—	—	29,277	—	—	—	29,277
Total liabilities	3,934,086	98,554	546,328	311,562	21,694	—	4,912,224
Liquidity gap	(2,625,460)	(22,145)	(283,851)	779,117	2,509,889		
Cumulative liquidity gap	(2,625,460)	(2,647,605)	(2,931,456)	(2,152,339)	357,550		

Financial assets and liabilities (excluding financial instruments relating to HSBC Life Assurance (Malta) Limited) by remaining contractual maturities (continued)

	Bank						
	At 31 December 2018						
	Not more than 3 months	**Between 3 and 6 months**	**Between 6 months and 1 year**	**Between 1 year and 5 years**	**More than 5 years**	**No maturity date**	**Total**
	€000	**€000**	**€000**	**€000**	**€000**	**€000**	**€000**
Assets							
Cash	**31,169**	**—**	**—**	**—**	**—**	**—**	**31,169**
Balances with Central Bank of Malta and Treasury Bills	**69,364**	**38,025**	**3,003**	**—**	**—**	**49,207**	**159,599**
Items in the course of collection from other banks	**5,404**	**—**	**—**	**—**	**—**	**—**	**5,404**
Held for trading derivatives	**193**	**1,206**	**107**	**1,023**	**2,427**	**—**	**4,956**
Loans and advances to banks	**729,736**	**47,463**	**50,000**	**265,574**	**—**	**—**	**1,092,773**
Loans and advances to customers	**286,216**	**23,756**	**19,219**	**313,170**	**2,468,051**	**—**	**3,110,412**
Financial investment measured at fair value through other comprehensive income	**47,957**	**31,165**	**176,307**	**580,353**	**66,433**	**2,705**	**904,920**
Other assets	**28,487**	**—**	**77**	**—**	**—**	**—**	**28,564**
Total assets	**1,198,526**	**141,615**	**248,713**	**1,160,120**	**2,536,911**	**51,912**	**5,337,797**
Liabilities							
Deposits by banks	**2,542**	**—**	**—**	**—**	**—**	**—**	**2,542**
Customer accounts	**4,172,934**	**188,033**	**254,979**	**313,333**	**11,701**	**—**	**4,940,980**
Held for trading derivatives	**142**	**1,141**	**116**	**912**	**2,680**	**—**	**4,991**
Other liabilities	**36,530**	**671**	**617**	**1,159**	**—**	**—**	**38,977**
Subordinated liabilities	**—**	**—**	**—**	**—**	**62,000**	**—**	**62,000**
Total liabilities	**4,212,148**	**189,845**	**255,712**	**315,404**	**76,381**	**—**	**5,049,490**
Liquidity gap	**(3,013,622)**	**(48,230)**	**(6,999)**	**844,716**	**2,460,530**		
Cumulative liquidity gap	**(3,013,622)**	**(3,061,852)**	**(3,068,851)**	**(2,224,135)**	**236,395**		

	At 31 December 2017						
Assets							
Cash	35,006	—	—	—	—	—	35,006
Balances with Central Bank of Malta and Treasury Bills	54,016	25,006	2,001	—	—	48,030	129,053
Items in the course of collection from other banks	18,158	—	—	—	—	—	18,158
Held for trading derivatives	260	1,037	178	1,310	2,390	—	5,175
Loans and advances to banks	758,354	—	81,710	155,635	50,000	—	1,045,699
Loans and advances to customers	354,832	4,943	29,608	360,340	2,379,110	—	3,128,833
Available-for-sale financial investments	61,213	45,423	148,980	568,087	100,083	1,095	924,881
Other assets	22,764	—	—	5,307	—		28,071
Total assets	1,304,603	76,409	262,477	1,090,679	2,531,583	49,125	5,314,876
Liabilities							
Deposits by banks	54,703	—	—	—	—	—	54,703
Customer accounts	3,919,268	94,483	513,705	304,439	19,036	—	4,850,931
Held for trading derivatives	190	630	571	1,179	2,658	—	5,228
Other liabilities	42,326	3,441	2,775	5,944	—	—	54,486
Subordinated liabilities	—	—	30,000	—	—	—	30,000
Total liabilities	4,016,487	98,554	547,051	311,562	21,694	—	4,995,348
Liquidity gap	(2,711,884)	(22,145)	(284,574)	779,117	2,509,889		
Cumulative liquidity gap	(2,711,884)	(2,734,029)	(3,018,603)	(2,239,486)	270,403		

Current accounts and savings deposits payable on demand or at short notice amounted to €3,808 million at 31 December 2018 (2017: €3,560 million), for the local group and €3,861 million at 31 December 2018 (2017: €3,645 million) for the bank . This amount is disclosed within the 'Not more than three months' maturity grouping. However, in practice these deposits are maintained with the bank for longer periods; hence the effective date of repayment is later than the contractual date. This amount represents a significant part of the local group's funding. The local group places considerable importance on maintaining the stability of these deposits.

Overdraft and debt balances included within 'Loans and advances to customers' amounted to €261 million at 31 December 2018 (2017: €274 million), both for the local group and the bank. This amount is disclosed within the 'Not more than three months' maturity grouping.

v Cash flows payable by the local group under financial liabilities by remaining maturities

The following is an analysis by relevant maturity groupings of undiscounted cash flows payable under the principal non-derivative financial liabilities (excluding financial instruments relating to HSBC Life Assurance (Malta) Limited) by remaining contractual maturities at the reporting date. Information relating to HSBC Life insurance business is disclosed in Note 4(f)(iv):

Cash flows payable under non-derivative financial liabilities

	Group					
	At 31 December 2018					
	Due within 3 months	**Due between 3 and 12 months**	**Due between 1 and 5 years**	**Due after 5 years**	**Gross nominal outflow**	**Carrying amount**
	€000	**€000**	**€000**	**€000**	**€000**	**€000**
Financial liabilities						
Deposits by banks	**2,542**	**—**	**—**	**—**	**2,542**	**2,542**
Customer accounts	**4,127,403**	**446,192**	**322,684**	**12,688**	**4,908,967**	**4,887,473**
Subordinated liabilities	**271**	**542**	**4,335**	**67,690**	**72,838**	**62,000**
Other financial liabilities	**38,548**	**1,212**	**1,166**	**—**	**40,926**	**40,926**
	4,168,764	**447,946**	**328,185**	**80,378**	**5,025,273**	**4,992,941**
Commitments	**1,583,554**	**—**	**—**	**—**	**1,583,554**	**1,583,554**
	At 31 December 2017					
Financial liabilities						
Deposits by banks	54,931	—	—	—	54,931	54,703
Customer accounts	3,838,178	613,567	314,402	20,502	4,786,649	4,765,995
Subordinated liabilities	—	31,770	—	—	31,770	29,277
Other financial liabilities	51,498	217	5,306	—	57,021	57,021
	3,944,607	645,554	319,708	20,502	4,930,371	4,906,996
Commitments	1,215,457	—	—	—	1,215,457	1,215,457

	Bank					
	At 31 December 2018					
Financial liabilities						
Deposits by banks	**2,542**	**—**	**—**	**—**	**2,542**	**2,542**
Customer accounts	**4,180,909**	**446,192**	**322,684**	**12,688**	**4,962,473**	**4,940,980**
Subordinated liabilities	**271**	**542**	**4,335**	**67,690**	**72,838**	**62,000**
Other financial liabilities	**36,599**	**1,212**	**1,166**	**—**	**38,977**	**38,977**
	4,220,321	**447,946**	**328,185**	**80,378**	**5,076,830**	**5,044,499**
Commitments	**1,584,419**	**—**	**—**	**—**	**1,584,419**	**1,584,419**
	At 31 December 2017					
Financial liabilities						
Deposits by banks	54,931	—	—	—	54,931	54,703
Customer accounts	3,921,704	613,567	314,402	20,502	4,870,175	4,850,931
Subordinated liabilities	—	31,770	—	—	31,770	30,000
Other financial liabilities	48,963	217	5,306	—	54,486	54,486
	4,025,598	645,554	319,708	20,502	5,011,362	4,990,120
Commitments	1,215,501	—	—	—	1,215,501	1,215,501

Cash flows payable by the local group under investment contracts and insurance contracts issued are disclosed in Note 4(f)(iv).

The balances in the above table do not agree with the balances in the 'Statement of financial position' as the table incorporates all cash flows, on an undiscounted basis, related to principal as well as those associated with all future interest payments.

The following is an analysis by relevant maturity groupings of undiscounted cash flows relating to the local group's derivative financial instruments by remaining contractual maturities at the reporting date:

Contracted undiscounted cash flows

	Group/Bank				
	As at 31 December 2018				
	Less than 3 months	**Between 3 months and 1 year**	**Between 1 year and 5 years**	**Over 5 years**	**Total**
	€000	**€000**	**€000**	**€000**	**€000**
Inflows	**69,497**	**54,719**	**4,632**	**452**	**129,300**
Outflows	**(69,435)**	**(54,638)**	**(4,557)**	**(452)**	**(129,082)**
	62	**81**	**75**	**—**	**218**
	As at 31 December 2017				
Inflows	13,518	82,647	3,531	827	100,523
Outflows	(13,497)	(82,552)	(3,427)	(827)	(100,303)
	21	95	104	—	220

(d) Encumbered and unencumbered assets

The objective of this disclosure is to facilitate an understanding of available and unrestricted assets that could be used to support potential future funding and collateral needs.

An asset is defined as encumbered if it has been pledged as collateral against an existing liability, and as a result is no longer available to the group to secure funding, satisfy collateral needs or be sold to reduce the funding requirement. The disclosure is not designed to identify assets which would be available to meet the claims of creditors or to predict assets that would be available to creditors in the event of a resolution or bankruptcy.

Encumbered and unencumbered assets

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Total assets at 31 December	**6,310,994**	6,797,983	**5,495,624**	5,459,378
Less:				
Assets pledged against the provision of credit lines by Central Bank of Malta				
– debt securities	**61,893**	62,880	**61,893**	62,880
Less:				
Debt securities pledged in terms of Depositor Compensation Scheme	**24,043**	25,510	**24,043**	25,510
Less:				
Cash pledged in terms of the Recovery and Resolution Regulations	**710**	509	**710**	509
Less:				
Other assets that cannot be pledged as collateral	**979,868**	1,494,943	**173,993**	175,199
Assets available to support funding and collateral needs at 31 December	**5,244,480**	5,214,141	**5,234,985**	5,195,280

Out of the €5,244,000 assets available, €3,110,000 do not form part of the local group's and the bank's HQLA and are therefore not categorised as liquid assets.

(e) Market risk

Market risk is the risk that movements in market risk factors, including foreign exchange rates, interest rates and market prices will impact the local group's income or the value of its portfolios. Exposure to market risk arises from positions that primarily emanate from the interest rate management of the local group's retail and commercial banking assets and liabilities and financial investments measured at FVOCI (2017: designated as available-for-sale).

The objective of the local group's market risk management is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with the local group's status as a premier provider of financial products and services.

Market risk is managed and controlled through limits approved by HSBC Holdings and the global businesses. These limits are allocated across business lines and agreed with the Group's legal entities. The management of market risk is principally undertaken using risk limits allocated from the risk appetite. Limits are set for portfolios, products and risk types, with market liquidity being a principal factor in determining the level of limits set. Risk, as an independent function, is responsible for market risk management and measurement techniques. The bank has an independent market risk management and control function which is responsible for measuring market risk exposures in accordance with policies, and monitoring and reporting these exposures against the prescribed limits on a daily basis.

Each line of business is requested to assess the market risks which arise on each product in the business and, where there is a risk that can be hedged in the markets, this is transferred to the local Global Markets for management. Where market risk is identified but there is no viable hedge in the market then the risk is managed under the local ALCO.

Monitoring and limiting market risk exposure

The bank uses a range of tools to monitor and limit market risk exposures including sensitivity analysis, value at risk (VaR), and stress testing.

i Sensitivity analysis

Sensitivity analysis measures the impact of individual market factor movements on specific instruments or portfolios including interest rates, foreign exchange rates and equity prices such as the impact of a one basis point change in yield. The bank uses sensitivity measures to monitor the market risk positions within each risk type, for example, the present value of a basis point movement in interest rates for interest rate risk. Sensitivity limits are set for portfolios, products and risk types, with the depth of the market being one of the principal factors in determining the level of limits set.

ii Value at risk (VaR)

VaR is a technique that estimates the potential losses on risk positions in a portfolio as a result of movement in market rates and prices over a specified time horizon and to a given level of confidence. The use of VaR is integrated into market risk management.

The VaR model used by the local group is based predominantly on historical simulation. This model derives plausible future scenarios from past series of recorded market rates and prices, taking into account inter-relationships between different markets and rates such as interest rates and foreign exchange rates.

The historical simulation models used incorporate the following features:

- historical market rates and prices are calculated with reference to foreign exchange rates, interest rates, equity prices and the associated volatilities;
- potential market movements utilised for VaR are calculated with reference to data from the past two years; and
- VaR measures are calculated to a 99 per cent confidence level and use a one-day holding period.

The nature of VaR models means that an increase in observed market volatility will lead to an increase in VaR without any changes in the underlying positions. The local group routinely validates the accuracy of the VaR models by back-testing the hypothetical daily results.

Although a valuable guide to risk, VaR should always be viewed in the context of its limitations. For example:

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a holding period assumes that all positions can be liquidated or the risks offset during that period. This may not fully reflect the market risk arising at times of severe illiquidity, when the holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99 per cent confidence level, by definition does not take into account losses that might occur beyond this level of confidence;
- VaR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures; and
- VaR is unlikely to reflect loss potential on exposures that only arise under significant market movements.

The local group recognises these limitations and thus resorts to the use of other tools.

VaR for the bank

	2018	2017
	€000	€000
At 31 December	**803**	479
Average	**756**	667
Minimum	**557**	479
Maximum	**877**	759

iii Stress testing

Stress testing is an important tool that is integrated into the local group's market risk management to evaluate the potential impact on portfolio values of more extreme, although plausible, events or movements in a set of financial variables. In such abnormal scenarios, losses can be much greater than those predicted by VaR modelling. A standard set of scenarios is utilised consistently across the Group, which are however tailored in order to capture the relevant events or market movements happening locally. The risk appetite around potential stress losses is set and monitored against referral limits.

iv Interest rate risk

Interest rate risk in the bank's portfolios arises principally from mismatches between the future yield on assets and their funding cost, as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on embedded optionality within certain product areas such as the incidence of mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand such as current accounts.

Interest rate risk is assessed and managed according to 'business as usual' conditions. The bank's aim in this respect is to mitigate the effect of prospective interest rate movements which could reduce future net interest income. The bank's ALCO is responsible for oversight over the bank's interest rate risk management process and monitors actively the interest rate risk measures utilised.

Sensitivity of net interest income

A principal element of the local group's management of interest rate risk is monitoring the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling). The local group applies a combination of scenarios and assumptions which are required throughout the HSBC Group.

Projected net interest income sensitivity figures represent the effect of the pro forma movements in net interest income based on the projected yield curve scenarios and the current interest rate risk profile. This effect, however, does not incorporate actions which would probably be taken by the local group to mitigate the effect of interest rate risk. In reality, the local group seeks actively to change the interest rate risk profile to minimise losses and optimise net revenues.

The net interest income sensitivity calculations shown in the table below, assume that interest rates of all maturities move by the same amount in the 'up-shock' scenario and 'down-shock' scenario subject to an established response strategy set by the bank. The net interest income sensitivity calculations take account of the effect on net interest income of anticipated differences in changes between interbank interest rates and interest rates over which the bank has discretion in terms of the timing and extent of rate changes.

The table below sets out the impact on future one year net income of an incremental 100 basis points parallel fall or rise in the yield curves, based on current financial position/risk profiles and current managed interest rate policy.

Impact on future one year net income

	Group/Bank	
	Impact on profit for the year	Impact on profit for the year
	2018	2017
	€000	€000
+ 100 basis points	**10,233**	10,432
- 100 basis points	**(4,834)**	(3,145)

The table below discloses the mismatch of the dates on which interest on financial assets and financial liabilities (excluding financial instruments relating to HSBC Life Assurance (Malta) Limited) are next reset to market rates on a contractual basis or, if earlier, the dates on which the instruments mature as at 31 December. Information relating to HSBC Life insurance business is disclosed in Note 4(f)(ii). Actual reset dates may differ from contractual dates owing to prepayments and the exercise of options. In addition, contractual terms may not be representative of the behaviour of financial assets and liabilities.

	Group					
	At 31 December 2018					
	Not more than 3 months	**Between 3 and 6 months**	**Between 6 months and 1 year**	**Between 1 year and 5 years**	**More than 5 years**	**Total**
	€000	**€000**	**€000**	**€000**	**€000**	**€000**
Assets						
Treasury Bills	**69,319**	**38,025**	**3,003**	**–**	**–**	**110,347**
Loans and advances to banks	**729,736**	**47,463**	**50,000**	**265,574**	**–**	**1,092,773**
Loans and advances to customers	**2,074,844**	**306,756**	**486,093**	**217,405**	**25,314**	**3,110,412**
Financial investments measured at fair value through other comprehensive income (excluding equities)	**187,210**	**56,859**	**119,454**	**472,259**	**66,433**	**902,215**
Total assets	**3,061,109**	**449,103**	**658,550**	**955,238**	**91,747**	**5,215,747**
Liabilities						
Deposits by banks	**2,542**	**–**	**–**	**–**	**–**	**2,542**
Customer accounts	**4,114,113**	**188,033**	**421,107**	**158,905**	**5,315**	**4,887,473**
Subordinated liabilities	**62,000**	**–**	**–**	**–**	**–**	**62,000**
Total liabilities	**4,178,655**	**188,033**	**421,107**	**158,905**	**5,315**	**4,952,015**
Interest rate sensitivity gap	**(1,117,546)**	**261,070**	**237,443**	**796,333**	**86,432**	
Cumulative interest rate sensitivity gap	**(1,117,546)**	**(856,476)**	**(619,033)**	**177,300**	**263,732**	

	At 31 December 2017					
Assets						
Treasury Bills	53,505	25,006	2,001	–	–	80,512
Loans and advances to banks	758,358	–	81,710	155,635	50,000	1,045,703
Loans and advances to customers	2,317,919	183,538	393,405	204,505	29,466	3,128,833
Available-for-sale financial investments (excluding equities)	61,213	45,423	148,980	568,087	100,083	923,786
Total assets	3,190,995	253,967	626,096	928,227	179,549	5,178,834
Liabilities						
Deposits by banks	54,703	–	–	–	–	54,703
Customer accounts	3,834,332	94,483	513,705	304,439	19,036	4,765,995
Subordinated liabilities	–	–	29,277	–	–	29,277
Total liabilities	3,889,035	94,483	542,982	304,439	19,036	4,849,975
Interest rate sensitivity gap	(698,040)	159,484	83,114	623,788	160,513	
Cumulative interest rate sensitivity gap	(698,040)	(538,556)	(455,442)	168,346	328,859	

	Bank					
	At 31 December 2018					
Assets						
Treasury Bills	**69,319**	**38,025**	**3,003**	**–**	**–**	**110,347**
Loans and advances to banks	**729,736**	**47,463**	**50,000**	**265,574**	**–**	**1,092,773**
Loans and advances to customers	**2,074,844**	**306,756**	**486,093**	**217,405**	**25,314**	**3,110,412**
Financial investments measured at fair value through other comprehensive income (excluding equities)	**187,210**	**56,859**	**119,454**	**472,259**	**66,433**	**902,215**
Total assets	**3,061,109**	**449,103**	**658,550**	**955,238**	**91,747**	**5,215,747**
Liabilities						
Deposits by banks	**2,542**	**–**	**–**	**–**	**–**	**2,542**
Customer accounts	**4,167,620**	**188,033**	**421,107**	**158,905**	**5,315**	**4,940,980**
Subordinated liabilities	**62,000**	**–**	**–**	**–**	**–**	**62,000**
Total liabilities	**4,232,162**	**188,033**	**421,107**	**158,905**	**5,315**	**5,005,522**
Interest rate sensitivity gap	**(1,171,053)**	**261,070**	**237,443**	**796,333**	**86,432**	
Cumulative interest rate sensitivity gap	**(1,171,053)**	**(909,983)**	**(672,540)**	**123,793**	**210,225**	

	At 31 December 2017					
Bank						
Assets						
Treasury Bills	53,505	25,006	2,001	–	–	80,512
Loans and advances to banks	758,354	–	81,710	155,635	50,000	1,045,699
Loans and advances to customers	2,317,919	183,538	393,405	204,505	29,466	3,128,833
Available-for-sale financial investments (excluding equities)	61,213	45,423	148,980	568,087	100,083	923,786
Total assets	3,190,991	253,967	626,096	928,227	179,549	5,178,830
Liabilities						
Deposits by banks	54,703	–	–	–	–	54,703
Customer accounts	3,919,268	94,483	513,705	304,439	19,036	4,850,931
Subordinated liabilities	–	–	30,000	–	–	30,000
Total liabilities	3,973,971	94,483	543,705	304,439	19,036	4,935,634
Interest rate sensitivity gap	(782,980)	159,484	82,391	623,788	160,513	
Cumulative interest rate sensitivity gap	(782,980)	(623,496)	(541,105)	82,683	243,196	

A positive interest rate sensitivity gap exists where more assets than liabilities re-price during a given period. Although a positive gap position tends to benefit net interest income in a rising interest rate environment, the actual effect will depend on a number of factors, including the extent to which repayments are made earlier or later than the contracted date and variations in interest rates within re-pricing periods and among currencies. Similarly, a negative interest rate sensitivity gap exists where more liabilities than assets re-price during a given period. A negative gap position tends to benefit net interest income in a declining interest rate environment, but the actual effect will depend on the same factors as for positive interest rate gaps.

v Foreign exchange risk

Foreign exchange risk arises principally from the local group's exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

The table below shows an analysis of financial assets and liabilities (excluding financial instruments relating to HSBC Life Assurance (Malta) Limited) between balances denominated in euro and those denominated in other currencies. Information relating to HSBC Life insurance business is disclosed in Note 4(f)(ii).

	Group				
	2018				
	Reporting currency	**In USD**	**In GBP**	**Other currencies**	**Total**
	€000	**€000**	**€000**	**€000**	**€000**
Assets					
Balances with Central Bank of Malta, Treasury Bills and cash	**189,439**	**398**	**594**	**337**	**190,768**
Items in the course of collection from other banks	**5,166**	**47**	**177**	**14**	**5,404**
Held for trading derivatives	**4,016**	**904**	**35**	**1**	**4,956**
Financial investments measured at fair value through other comprehensive income	**708,679**	**80,208**	**105,257**	**10,776**	**904,920**
Loans and advances to banks	**955,869**	**57,304**	**27,363**	**52,237**	**1,092,773**
Loans and advances to customers	**3,086,101**	**23,139**	**677**	**495**	**3,110,412**
Other assets	**30,912**	**1,815**	**3**	**363**	**33,093**
Total assets	**4,980,182**	**163,815**	**134,106**	**64,223**	**5,342,326**
Liabilities					
Held for trading derivatives	**3,588**	**1,367**	**35**	**1**	**4,991**
Deposits by banks	**2,542**	**—**	**—**	**—**	**2,542**
Customer accounts	**4,535,180**	**157,384**	**131,319**	**63,590**	**4,887,473**
Subordinated liabilities	**62,000**	**—**	**—**	**—**	**62,000**
Other liabilities	**38,814**	**1,971**	**110**	**31**	**40,926**
Total liabilities	**4,642,124**	**160,722**	**131,464**	**63,622**	**4,997,932**
Net open position	**338,058**	**3,093**	**2,642**	**601**	
	2017				
Assets					
Balances with Central Bank of Malta, Treasury Bills and cash	162,541	670	649	199	164,059
Items in the course of collection from other banks	17,898	149	103	8	18,158
Held for trading derivatives	4,839	95	239	2	5,175
Available-for-sale financial investments	682,398	127,855	104,429	10,201	924,883
Loans and advances to banks	924,152	42,349	37,092	42,110	1,045,703
Loans and advances to customers	3,102,273	23,049	2,937	574	3,128,833
Other assets	27,734	3,987	295	74	32,090
Total assets	4,918,032	197,059	145,744	53,168	5,314,003
Liabilities					
Held for trading derivatives	4,043	948	235	2	5,228
Deposits by banks	25	54,678	—	—	54,703
Customer accounts	4,441,448	130,776	140,729	53,042	4,765,995
Subordinated liabilities	29,277	—	—	—	29,277
Other liabilities	53,432	3,544	14	31	57,021
Total liabilities	4,528,225	189,946	140,978	53,075	4,912,224
Net open position	389,807	7,113	4,766	93	

	Bank				
	2018				
	Reporting currency	In USD	In GBP	Other currencies	Total
	€000	€000	€000	€000	€000
Assets					
Balances with Central Bank of Malta, Treasury Bills and cash	**189,439**	**398**	**594**	**337**	**190,768**
Items in the course of collection from other banks	**5,166**	**47**	**177**	**14**	**5,404**
Held for trading derivatives	**4,016**	**904**	**35**	**1**	**4,956**
Financial investments measured at fair value through other comprehensive income	**708,677**	**80,208**	**105,257**	**10,776**	**904,918**
Loans and advances to banks	**955,869**	**57,304**	**27,363**	**52,237**	**1,092,773**
Loans and advances to customers	**3,086,101**	**23,139**	**677**	**495**	**3,110,412**
Other assets	**26,383**	**1,815**	**3**	**363**	**28,564**
Total assets	**4,975,651**	**163,815**	**134,106**	**64,223**	**5,337,795**
Liabilities					
Held for trading derivatives	**3,588**	**1,367**	**35**	**1**	**4,991**
Deposits by banks	**2,542**	**—**	**—**	**—**	**2,542**
Customer accounts	**4,585,134**	**159,097**	**133,135**	**63,614**	**4,940,980**
Subordinated liabilities	**62,000**	**—**	**—**	**—**	**62,000**
Other liabilities	**36,865**	**1,971**	**110**	**31**	**38,977**
Total liabilities	**4,690,129**	**162,435**	**133,280**	**63,646**	**5,049,490**
Net open position	**285,522**	**1,380**	**826**	**577**	
	2017				
Assets					
Balances with Central Bank of Malta, Treasury Bills and cash	162,541	670	649	199	164,059
Items in the course of collection from other banks	17,898	149	103	8	18,158
Held for trading derivatives	4,839	95	239	2	5,175
Available-for-sale financial investments	682,396	127,855	104,429	10,201	924,881
Loans and advances to banks	924,148	42,349	37,092	42,110	1,045,699
Loans and advances to customers	3,102,273	23,049	2,937	574	3,128,833
Other assets	23,715	3,987	295	74	28,071
Total assets	4,917,810	198,154	145,744	53,168	5,314,876
Liabilities					
Held for trading derivatives	4,043	948	235	2	5,228
Deposits by banks	25	54,678	—	—	54,703
Customer accounts	4,517,256	135,953	144,666	53,056	4,850,931
Subordinated liabilities	30,000	—	—	—	30,000
Other liabilities	50,897	3,544	14	31	54,486
Total liabilities	4,602,221	195,123	144,915	53,089	4,995,348
Net open position	315,589	1,936	829	79	

All derivatives are transacted primarily to create risk management solutions for clients. All positions entered into with clients are covered by back-to-back derivative transactions with HSBC Group entities. Accordingly, the group/bank does not use currency derivatives to close open currency positions.

The bank essentially manages this risk by matching asset and liability positions in each respective foreign currency, as much as is practicable. The bank maintains exposures to foreign currencies within prescribed limits. The bank's ALCO is responsible for oversight over the foreign currency risk management process, whereby overnight and intra-day net positions are monitored.

(f) Insurance risk

The local group operates an integrated bancassurance model which provides wealth and protection insurance products principally for customers with whom the local group has a banking relationship. Insurance products are sold predominantly by RBWM. The subsidiary also holds a portfolio of unit-linked investment products and non-linked insurance products that were transferred from HSBC Life (Europe) Limited during 2014.

The majority of the risk in the local group's insurance business derives from manufacturing activities and can be categorised as insurance risk and financial risk. Insurance risk is the risk, other than financial risk, of loss transferred from the holder of the insurance contract to the issuer, the local group's insurance subsidiary company.

The risk under any insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, this risk is random and therefore unpredictable.

For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the principal risk that the local group faces under its insurance contracts is that the actual claims and benefit payments exceed the carrying amount of the insurance liabilities. This could occur because the frequency or severity of claims and benefits are greater than estimated. Insurance events are random and the actual number and amount of claims and benefits will vary from year to year and from the estimate established using statistical techniques.

Experience shows that the larger the portfolio of similar insurance contracts, the smaller the relative variability about the expected outcome will be. The local group uses reinsurance appropriately to reduce variability of the expected outcome. Factors that aggravate insurance risk include lack of risk diversification in terms of type and amount of risk and geographical location. For contracts with Discretionary Participation Feature ('DPF'), the participating nature of these contracts results in a significant portion of the insurance risk being shared with the insured party.

Frequency and severity of claims

For contracts where death is the insured risk, the most significant factors that could increase the overall frequency of claims are epidemics or wide spread changes in lifestyle resulting in earlier or more claims than expected.

At present these risks do not vary significantly in relation to the location of the risk insured by the local group. However, undue concentration by amounts could have an impact on the severity of benefit payments on a portfolio basis.

For contracts with fixed and guaranteed benefits and fixed future premiums, there are no mitigating terms and conditions that reduce the insurance risk accepted. For contracts with DPF, the participating nature of the contracts results in a portion of the insurance risk being reduced over the term of the policy. Investment contracts with DPF carry negligible insurance risk.

The local group manages its insurance risk through strict underwriting limits and claims management; approval procedures for new products and pricing reviews; close monitoring of reinsurance arrangements and monitoring of emerging issues.

The local group's underwriting strategy is intended to ensure that the risks underwritten are well diversified in terms of type of risk and the level of insured benefits. For example, the local group balances death risk across its portfolio. Medical selection is also included in the local group's underwriting procedures, with premium varied to reflect the health condition and family medical history of the applicants.

Sources of uncertainty in the estimation of future benefit payments and premium receipts

Uncertainty in the estimation of future benefit payments and premium receipts for long-term insurance contracts arises from the unpredictability of long-term changes in overall levels of mortality, and the variability in contract holder behaviour. The local group uses appropriate base tables of standard mortality according to the type of contract being written. The local group does not take credit for future lapses in determining the liability of long-term contracts.

The technical provisions in respect of long-term life insurance contracts are subject to quarterly valuations by the Approved Actuary based on data and information provided by the local group.

The following table provides an analysis of the insurance risk exposures by type of business:

	2018	2017
	€000	€000
Life insurance (non-linked)		
Insurance contracts with discretionary participation feature	**292,494**	318,296
Term assurance and other long-term contracts	**116,988**	117,239
Total non-linked	**409,482**	435,535
Life insurance (linked)	**211,299**	223,257
Liabilities under insurance contracts	**620,781**	658,792

Financial Risk

The local group's insurance subsidiary company is exposed to financial risk through its financial assets, financial liabilities (investment contracts), reinsurance assets and insurance liabilities. In particular, the key financial risk is that the proceeds from its financial assets are not sufficient to fund the obligations arising from its insurance and investment contracts. The most important components of this financial risk are market risk, credit risk and liquidity risk.

For unit-linked insurance and investment contracts, the local group matches all the liabilities on which the unit prices are based with assets in the unit-linked portfolios. There is therefore no direct equity price, currency, credit or interest risk exposure for these contracts which is borne by the local group.

i General nature of participation feature and unit-linked contracts

The local group offers savings with-profit policies which participate in the investment returns of the with-profit funds. At least 90% of the eligible investment return is attributed to the contract holders. Policyholders receive regular (reversionary) bonus. A Regular bonus rate is declared yearly in advance. This rate may be reviewed upwards during the course of the year based on the performance of the fund. This provides a progressive build-up of guaranteed benefits over the lifetime of the policy. Regular bonuses are set by the Board on the recommendation of the Approved Actuary. Therefore, on assets held to back the with-profits portfolio, the local group's exposure to financial risk is limited to 10%.

ii Market risk

Interest rate risk

The insurance subsidiary's exposure to interest rate changes is concentrated in its non-linked investment portfolio. Changes in investment values attributable to interest rate changes are mitigated by partially offsetting changes in the economic value of insurance provisions. The local group monitors this exposure through periodic reviews of its asset and liability positions. Estimates of future cash flows, as well as the impact of interest rate fluctuations on its investment portfolio and insurance liabilities, are modelled and reviewed quarterly. Interest rate risk in the insurance subsidiary company is minimised primarily by matching estimated future cash outflows to be paid to policyholders with expected cash flows from assets. The pool of investments backing liabilities is managed to duration targets that aim to make the net effect of interest rate changes on assets and liabilities manageable.

Exchange risk

The insurance subsidiary company is exposed to currency risk on its investment portfolio and to 10% of the investments backing contracts with DPF. The net exposure amounts to €4,209,000 (2017: €4,761,000) and a sensitivity analysis is not deemed necessary on the basis of insignificance.

Equity price risk

The insurance subsidiary company manages the equity risk arising from its holdings of equity securities by setting limits on the maximum market value of equities that it may hold. Equity risk is also monitored by estimating the effect of predetermined movements in equity prices on the profit and total net assets of the insurance underwriting business.

Sensitivity analysis

The local group performs various sensitivity analysis as summarised below. An immediate and permanent movement in interest yield curves or equity prices as at the reporting date would have the following impact on the profit for the year and net assets at that date:

	Impact on profits for the year and net assets	
	2018	2017
	€000	€000
+100 basis points shift in yield curves	**895**	195
-100 basis points shift in yield curves	**(1,314)**	(1,030)
+10 per cent increase in equity prices	**712**	902
-10 per cent decrease in equity prices	**(720)**	(1,081)

The impact of the above sensitivity analysis on other comprehensive income for 2017 is negligible in light of the level of investments measured at FVOCI held by the insurance subsidiary company.

iii Credit risk

The main areas where the insurance subsidiary company is exposed to credit risk are:

- reinsurers' share of insurance liabilities;
- amounts due from reinsurers in respect of claims already paid;
- investment portfolios of debt securities;
- insurance and other receivables; and
- call and term deposits.

The insurance subsidiary company structures the levels of credit risk it accepts by placing limits on its exposure to investment grade single counterparty, or groups of counterparties, and to geographical and industry segments. Investment credit exposures positions are reviewed on a quarterly basis by the insurance subsidiary company's Asset Liability Committee.

The selection of reinsurers also includes restrictions designed to minimise the risk of credit exposure.

The insurance subsidiary company currently manages the majority of reinsurance risk by using reinsurers with a minimum rating of AA-. The creditworthiness of reinsurers is confirmed from public rating information and considered on an annual basis by reviewing their financial strength prior to finalisation of any contract.

The third party banks with whom cash and cash equivalents are held are rated A- and above. As from 2018, in line with IFRS 9, the insurance subsidiary company measures credit risk and expected credit losses using probability of default, exposure at default and loss given default. Management consider both historical analysis and forward looking information in determining any expected credit loss. At 31 December 2018 cash deposits are held with reputable counter parties and are due on demand. Management consider the probability of default to be closed to zero as the counter parties have a strong capacity to meet their contractual obligations in the near term. As a result, no loss allowance has been recognised based on 12-month expected credit losses as any such impairment would be wholly insignificant to the insurance subsidiary company.

Investments in bonds are made within the credit limits permitted within the investment credit risk mandate conferred by HSBC Group.

The following table presents the analysis of debt securities within the insurance business by rating agency (Standard and Poor's Rating Agency):

	Debt securities – Unit linked		Debt securities – Others		Total	
	2018	2017	**2018**	2017	**2018**	2017
	€000	€000	**€000**	€000	**€000**	€000
AAA	**–**	9,382	**10,218**	10,418	**10,218**	19,800
AA+ to AA-	**–**	5,646	**43,204**	58,456	**43,204**	64,102
A+ to A-	**–**	24,954	**151,906**	135,808	**151,906**	160,762
BBB+ to BBB-	**193**	45,001	**41,723**	42,674	**41,916**	87,675
BB+ to B-	**679**	165,485	**1,594**	1,721	**2,273**	167,206
Lower than B-	**–**	6,845	**–**	–	**–**	6,845
Unrated	**1,047**	26,055	**10,093**	12,215	**11,140**	38,270
Total	**1,919**	283,368	**258,738**	261,292	**260,657**	544,660

The insurance subsidiary company is not exposed to credit risk in respect of unit-linked business, although the relevant credit information is disclosed.

iv Liquidity risk

It is an inherent characteristic of almost all insurance contracts that there is uncertainty over the amount and the timing of settlement of claims liabilities that may arise, and this leads to liquidity risk. As part of the management of this exposure, estimates are prepared for most lines of insurance business of cash flows expected to arise from insurance funds at the reporting date. The insurance subsidiary company actively manages its assets in such a manner as to achieve a competitive rate of return within the prevailing risk objectives delineated by asset liquidity, credit quality and asset-liability matching.

The following table shows the cash flows expected to arise pertaining to insurance and investment liabilities as well as the contractual maturity of financial assets as at reporting date.

Expected maturity of financial assets and insurance and investment liabilities

	At 31 December 2018					
	No fixed maturity	Due within 3 months	Due between 3 and 12 months	Due between 1 year and 5 years	Due after 5 years	Total
	€000	€000	€000	€000	€000	€000
Financial investments	**433,533**	**4,421**	**2,602**	**100,560**	**153,079**	**694,195**
Reinsurance assets	**85,205**	**—**	**—**	**—**	**—**	**85,205**
Cash	**4,876**	**—**	**—**	**—**	**—**	**4,876**
	523,614	**4,421**	**2,602**	**100,560**	**153,079**	**784,276**

	At 31 December 2018					
	On demand	Due within 3 months	Due between 3 and 12 months	Due between 1 year and 5 years	Due after 5 years	Total
	€000	€000	€000	€000	€000	€000
Liabilities to customers:						
– insurance contracts	**—**	**19,749**	**46,181**	**189,752**	**404,059**	**659,741**
– investment contracts	**116,166**	**596**	**1,450**	**14,722**	**38,342**	**171,276**
	116,166	**20,345**	**47,631**	**204,474**	**442,401**	**831,017**

	At 31 December 2017					
	No fixed maturity	Due within 3 months	Due between 3 and 12 months	Due between 1 year and 5 years	Due after 5 years	Total
	€000	€000	€000	€000	€000	€000
Financial investments	466,829	1,011	9,929	90,826	160,850	729,445
Reinsurance assets	85,887	—	—	—	—	85,887
Cash	12,314	—	—	—	—	12,314
Asset held for sale:						
– financial investments	153,783	7,044	10,751	47,285	215,749	434,612
– cash	39,185	—	—	—	—	39,185
	757,998	8,055	20,680	138,111	376,599	1,301,443

	On demand	Due within 3 months	Due between 3 and 12 months	Due between 1 year and 5 years	Due after 5 years	Total
	€000	€000	€000	€000	€000	€000
Liabilities to customers:						
– insurance contracts	—	23,463	53,055	213,819	413,973	704,310
– investment contracts	167,697	237	653	7,027	33,113	208,727
Liabilities held for sale:						—
– investment contracts	473,797	—	—	—	—	473,797
	641,494	23,700	53,708	220,846	447,086	1,386,834

The insurance subsidiary company's Asset Liability Committee reviews and approves investment strategies on a periodic basis, ensuring that assets are managed efficiently within approved risk mandates.

For the comparative period, the assets pertaining to a disposal group have been analysed by contractual maturity in line with the requirements of IFRS 7.

The methodology used for estimating cash outflows on liabilities to customers can be found below:

- Linked Insurance Reserves: derived via undiscounted cash flows. No future premiums are assumed and investment returns are not included in the provisions. All decrements are considered.
- Linked Investment Reserves: derived via undiscounted cash flows but only considering contractual maturities and no other form of decrement. When there is no contractual maturity, the reserve is placed within the 'on demand' bucket.
- Non-Linked Reserve: derived via undiscounted reserves run-off on a reporting basis. All future premiums are considered and provisions based on all expected decrements. The timing of cash flows is based on the expected run-off of the reserves.

5 Fair value of financial and non-financial instruments

i Valuation of financial instruments

All financial instruments are recognised initially at 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. The fair value of a financial instrument on initial recognition is generally its transaction price (that is, the fair value of the consideration given or received). However, sometimes there is a difference between the transaction price and the fair value of the financial asset where fair value will be based on a quoted price in an active market (such as other observable current market transactions in the same instrument, without modification or repackaging), or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the local group recognises a trading gain or loss on day one, being the difference between the transaction price and the fair value. In all other cases (such as when significant unobservable parameters are used), the entire day one gain or loss is deferred and is recognised in the income statement over the life of the transaction until the transaction matures, is closed out, the valuation inputs become observable, or when the local group enters into an offsetting transaction.

The fair value of financial instruments is generally measured on an individual basis. However, in cases where HSBC manages a group of financial assets and liabilities according to its net market or credit risk exposure, the local group measures the fair value of the group of financial instruments on a net basis but presents the underlying financial assets and liabilities separately in the financial statements, unless they satisfy the IFRS offsetting criteria as described in Note 3(f).

ii 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.

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilised. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, the local group will source 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 that are considered in this regard are, inter alia:

- 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 reporting date; and
- the manner in which the data was sourced.

For fair values determined using a valuation model, the control framework may include, as applicable, development or validation by independent support functions of (i) the logic within valuation models; (ii) the inputs to those models; (iii) any adjustments required outside the valuation models; and, where possible, (iv) model outputs. Valuation models are subject to a process of due diligence and calibration before becoming operational and are calibrated against external market data on an ongoing basis.

iii Fair value hierarchy

Fair values are determined according to the following hierarchy:

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

iv Critical accounting estimates and judgements

The best evidence of fair value is a quoted price in an actively traded market. The fair values of financial instruments that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities issued. Where a financial instrument has a quoted price in an active market, the fair value of the total holding of the financial instrument is calculated as the product of the number of units and quoted price.

The judgement as to whether a market is active may include, but is not restricted to, the consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads. The bid/offer spread represents the difference in prices at which a market participant would be willing to buy compared with the price at which they would be willing to sell.

In the event that the market for a financial instrument is not active, a valuation technique is used. Valuation techniques may incorporate assumptions about factors that other market participants would use in their valuations, including:

- the likelihood and expected timing of future cash flows on the instrument. Judgement may be required to assess the counterparty's ability to service the instrument in accordance with its contractual terms. Future cash flows may be sensitive to changes in market rates;
- selecting an appropriate discount rate for the instrument. Judgement is required to assess what a market participant would regard as the appropriate spread of the rate for an instrument over the appropriate risk-free rate;
- judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivative products.

A range of valuation techniques is employed, dependent on the instrument type and available market data. Most valuation techniques are based upon discounted cash flow analyses, in which expected future cash flows are calculated and discounted to present value using a discounting curve. Prior to considering credit risk, the expected future cash flows may be known, as would be the case for the fixed leg of an interest rate swap, or may be uncertain and require projection, as would be the case for the floating leg of an interest rate swap. 'Projection' utilises market forward curves, if available. In option models, the probability of different potential future outcomes is considered. In addition, the value of some products are dependent on more than one market factor, and in these cases it is typically necessary to consider how movements in one market factor may affect the other market factors.

The model inputs necessary to perform such calculations include interest rate yield curves, exchange rates, volatilities, correlations, prepayment and default rates.

The majority of valuation techniques employ only observable market data. However certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are unobservable, and for them the derivation of fair value is more judgemental. An instrument in its entirety is classified as valued using significant unobservable inputs if, in the opinion of management, a significant proportion of the instrument's inception profit ('day 1 gain or loss') or greater than 5% of the instrument's carrying value is driven by unobservable inputs. 'Unobservable' in this context means that there is little or no current market data available from which to determine the price at which an arm's length transaction would be likely to occur. It generally does not mean that there is no data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used).

v Disclosures in respect of fair values of financial instruments carried at fair value

The following table sets out the financial instruments by fair value hierarchy:

Financial instruments by fair value

	Quoted market price	Using observable inputs	With significant unobservable inputs	
	Level 1	Level 2	Level 3	Total
	€000	€000	€000	€000
Group				
At 31 December 2018				
Valuation techniques				
Assets				
Treasury Bills	**–**	**110,347**	**–**	**110,347**
Held for trading derivatives	**–**	**4,956**	**–**	**4,956**
Financial investments mandatorily measured at fair value through profit or loss attributable to insurance operations	**678,293**	**7,635**	**8,153**	**694,081**
Financial investments	**902,217**	**–**	**2,703**	**904,920**
	1,580,510	**122,938**	**10,856**	**1,714,304**
Liabilities				
Held for trading derivatives	**–**	**4,991**	**–**	**4,991**
Liabilities under investment contracts	**163,359**	**2,408**	**580**	**166,347**
	163,359	**7,399**	**580**	**171,338**
At 31 December 2017				
Assets				
Treasury Bills	–	80,512	–	80,512
Held for trading derivatives	–	5,175	–	5,175
Financial investments designated at fair value attributable to insurance operations	719,385	411	7,474	727,270
Financial investments	925,001	–	1,095	926,096
Assets attributable to disposal group held for sale	325,077	139,792	2,734	467,603
	1,969,463	225,890	11,303	2,206,656
Liabilities				
Held for trading derivatives	–	5,228	–	5,228
Liabilities under investment contracts	202,725	411	–	203,136
Liabilities attributable to disposal group held for sale	331,271	139,792	2,734	473,797
	533,996	145,431	2,734	682,161
Bank				
At 31 December 2018				
Assets				
Treasury Bills	**–**	**110,347**	**–**	**110,347**
Held for trading derivatives	**–**	**4,956**	**–**	**4,956**
Financial investments	**902,215**	**–**	**2,703**	**904,918**
	902,215	**115,303**	**2,703**	**1,020,221**
Liabilities				
Held for trading derivatives	**–**	**4,991**	**–**	**4,991**
	–	**4,991**	**–**	**4,991**
At 31 December 2017				
Assets				
Treasury Bills	–	80,512	–	80,512
Held for trading derivatives	–	5,175	–	5,175
Financial investments	923,786	–	1,095	924,881
	923,786	85,687	1,095	1,010,568
Liabilities				
Held for trading derivatives	–	5,228	–	5,228
	–	5,228	–	5,228

The local group's and bank's assets categorised within Level 2 comprise debt securities, equity investments and units in collective investment schemes which are traded in inactive markets, with fair value determined on the basis of quoted prices in such inactive markets.

The local group's and bank's derivative instruments are categorised as Level 2, since they are fair valued principally using discounted cash flow models where all significant inputs are observable, such as exchange rates and interest rate yield curves.

Certain assets attributable to insurance operations, categorised as Level 2, are held to cover linked liabilities and accordingly, corresponding liabilities to customers under investment contracts are also categorised as Level 2.

No transfers of financial instruments between different levels of the fair value hierarchy have occurred during the financial years ended 31 December 2018 and 2017, other than transfers from Levels 1 and 2 to Level 3 referred to below. The following table shows a reconciliation of the fair value measurements in Level 3 of the fair value hierarchy:

Reconciliation of the fair value measurements in Level 3

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Level 3				
Financial investments mandatorily measured at fair value through profit or loss attributable to insurance operations / Financial investments designated at fair value attributable to insurance operations				
At 1 January	**7,474**	5,840	**–**	–
Disposal of assets	**(1,713)**	(282)	**–**	–
Purchases	**59**	2,787	**–**	–
Transferred from/(to) assets attributable to disposal group held for sale	**307**	(1,003)	**–**	–
Transfer from Level 2	**1,259**	–	**–**	–
Gains recognised in profit or loss - partially offset through loss on linked liabilities	**767**	132	–	–
At 31 December	**8,153**	7,474	**–**	–
Assets attributable to disposal group held for sale				
At 1 January	**2,734**	–	**–**	–
Disposal of assets	**(454)**	–	**–**	–
Purchases	**–**	250	–	–
Transfer (to)/from financial investments mandatorily measured at fair value through profit or loss attributable to insurance operations / financial investments designated at fair value attributable to insurance operations	**(307)**	1,003	**–**	–
Transfer from Level 1	**–**	1,646	**–**	–
Gains/(losses) recognised in profit or loss - partially offset through loss/gain on linked liabilities	**20**	(165)	**–**	–
Transfer to third party	**(1,993)**	–	**–**	–
At 31 December	**–**	2,734	**–**	–
Financial investments				
At 1 January	**1,095**	747	**1,095**	747
Change in fair value recognised in other comprehensive income	**1,608**	348	**1,608**	348
At 31 December	**2,703**	1,095	**2,703**	1,095

The financial investments mandatorily measured at fair value through profit or loss attributable to insurance operations/financial investments designated at fair value attributable to insurance operations and assets attributable to disposal group held for sale, categorised within Level 3, comprise holdings of units in collective investment schemes. These holdings consist of shares in alternative funds which are unlisted and have illiquid price sources. In view of the absence of quoted market prices or observable inputs for modelling value, the fair value of the shares held is derived using the net asset value as sourced from the respective custodians, which is not necessarily supported by audited financial statements.

On 7 December 2018 as part of the portfolio transfer to a third party, investments with a carrying amount of €1,993,000 were transferred out and investments with a carrying amount of €307,000 were reclassified from assets attributable to disposal group held for sale to financial investments mandatorily measured at fair value through profit or loss attributable to insurance operations, as the respective policies were excluded from the portfolio transfer. During 2018, two units of collective investment schemes with a carrying amount of €1,259,000 were transferred from Level 2 to Level 3. The price for these funds is no longer being quoted on the market. In 2017 units in collective investment schemes with a carrying amount of €1,646,000 have been transferred from Level 1 to Level 3 since the price for this fund was no longer being quoted on the market. Transfers between levels of the fair value hierarchy are deemed to have occurred on the date of the event or change in circumstances that caused the transfer.

A portion of the units in collective investment schemes categorised as Level 3 are held to cover linked liabilities and accordingly, corresponding liabilities to customers under investment contracts are also categorised as Level 3. Investment risk attributable to these Level 3 assets is borne by the policyholder in view of the policyholder's decision to invest in such assets. In view of this factor and the immateriality of the residual Level 3 assets, the disclosure of key unobservable inputs to Level 3 financial instruments and the sensitivity of Level 3 fair value to reasonably possible alternatives in respect of significant unobservable assumptions was not deemed necessary and relevant.

The remaining financial investments categorised within Level 3 relate predominantly to the local group's investment in the preferred stock of Visa Inc. acquired in 2016 as part of the consideration for the purchase of Visa Europe Limited by Visa Inc. (refer to Note 27).

The purpose of the preferred stock categorised as Level 3 is to provide protection to Visa Inc. against potential risk associated with multilateral interchange fees linked to the activity of Visa Europe Limited. The fair value of this stock is dependent on changes in the risk of litigation, in particular around the assumption on the percentage of successful claims that will be settled over time which will reduce the outstanding preferred stock. Based on the fair value of preferred stock the Directors deemed any changes to significant assumptions to have an immaterial impact and the sensitivity analysis in respect of significant unobservable assumptions is accordingly considered unnecessary.

vi Disclosures in respect of fair values of non-financial instruments carried at fair value

Fair valuation of property

The local group's land and buildings within property, plant and equipment and investment property, were revalued on 31 December 2018 by an independent firm of property valuers having appropriate recognised professional qualifications and experience in the location and category of the property being valued. The Directors have reviewed the carrying amounts of the properties as at 31 December 2018, on the basis of the valuations carried out by the independent property valuers.

Valuations were made on the basis of open market value taking cognisance of the specific location of the properties, the size of the sites together with their development potential, the availability of similar properties in the area, and whenever possible, having regard to recent market transactions for similar properties in the same location.

At 31 December 2018 the carrying amounts of the local group's land and buildings within property, plant and equipment, were adjusted to reflect the properties' estimated open market value. There were no adjustments required in 2017.

The carrying amount of investment property at 31 December 2017 was adjusted to reflect the properties' estimated open market value on an individual asset level. There were no adjustments deemed necessary for 2018.

The local group is required to analyse non-financial assets carried at fair value by level of the fair value hierarchy within which the recurring fair value measurements are categorised in their entirety (Level 1, 2 or 3). The different levels of the fair value hierarchy have been defined above as fair value measurements using:

- Quoted prices (unadjusted) in active markets for identical assets (Level 1);
- Inputs other than quoted prices included within Level 1 that are observable for the asset, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2);
- Inputs for the asset that are not based on observable market data (that is, unobservable inputs) (Level 3).

The local group's land and buildings, within property, plant and equipment, comprises commercial branches, bank offices and other operational premises. Investment property comprises commercial property leased out as offices to third parties including the local group's intermediate parent (Note 55). All the recurring property fair value measurements at 31 December 2018 and 2017 use significant unobservable inputs and are accordingly categorised within Level 3 of the fair valuation hierarchy.

The local group's policy is to recognise transfers into and out of fair value hierarchy levels on the date the event or change in circumstances that causes the transfer occurs. There were no transfers between different levels of the fair value hierarchy during the years ended 31 December 2018 and 2017.

A reconciliation from the opening balance to the closing balance of land and buildings for recurring fair value measurements categorised within Level 3 of the value hierarchy for both owner occupied and investment property is reflected in the tables in Notes 33 and 34 respectively.

Valuation processes

The valuations of the properties are performed regularly on the basis of valuation reports prepared by independent and qualified valuers. These reports are based on both:

- information provided by the local group which is derived from the bank's financial systems and is subject to the bank's overall control environment; and
- assumptions and valuation models used by the valuers - the assumptions are typically market-related. These are based on professional judgement and market observation.

The information provided to the valuers, together with the assumptions and the valuation models used by the valuers, are reviewed by the Chief Financial Officer (CFO). This includes a review of fair value movements over the period. When the CFO considers that the valuation report is appropriate, the valuation report is recommended to the Audit Committee. The Audit Committee considers the valuation report as part of its overall responsibilities.

At the end of every reporting period, the CFO assesses whether any significant changes or developments have been experienced since the last external valuation. This is supported by an assessment performed by the independent firm of property valuers.

Valuation techniques

The external valuations of the Level 3 property have been performed using predominantly the traditional investment method of valuation based on the capitalised rentals approach. In view of the limited market information available, the valuations have been performed using unobservable inputs. In relation to the capitalised rentals approach, the significant unobservable inputs include a capitalisation rate applied at 4.75% – 8.8% (2017: 5.0% – 8.0%), which is effectively the discount rate adjusted for anticipated growth, and the expected annual rental value (ERV) taking into account the rental rate per square metre for comparable properties located in proximity to the local group's property with adjustments for differences in the size, age, exact location and condition of the property. Effectively, the capitalisation rate indicates the return the investor expects to receive through annual rental value.

	At 31 December 2018			
	Fair value	**Valuation technique**	**Significant unobservable input**	**Range of unobservable inputs (weighted average)**
	€000	**€000**	**€000**	**€000**
Description by class based on highest and best use				
Current use as commercial branches, bank offices and other related premises	**43,752**	**Capitalised rental approach**	**Rental rate per square metre**	**40 – 220 (107)**
Current use as third party offices	**9,714**	**Capitalised rental approach**	**Rental rate per square metre**	**(143)**
	At 31 December 2017			
Current use as commercial branches, bank offices and other related premises	43,610	Capitalised rental approach	Rental rate per square metre	40 – 300 (155)
Current use as third party offices	10,600	Capitalised rental approach	Rental rate per square metre	(145)

The higher the rental rate per square metre, the higher the resultant fair valuation. Conversely, the lower the capitalisation rate the higher the fair value. The highest and best use of the properties reflected in the tables above is equivalent to their current use.

vii Disclosures in respect of fair values of financial instruments not carried at fair value

Certain financial instruments are carried at amortised cost. The fair values of these financial instruments are not disclosed given that the carrying amount is a reasonable approximation of fair value because these are either re-priced to current market rates frequently or are short-term in nature.

The following table sets out the carrying amounts of these financial instruments:

	Group		Bank	
	2018	2017	**2018**	2,017
	€000	€000	**€000**	€000
Assets				
Balances with Central Bank of Malta and cash	**80,421**	83,547	**80,421**	83,547
Items in course of collection from other banks	**5,404**	18,158	**5,404**	18,158
Loans and advance to banks	**1,097,714**	1,059,308	**1,092,773**	1,045,699
Loans and advance to customers	**3,110,412**	3,128,833	**3,110,412**	3,128,833
Accrued interest	**24,710**	17,901	**21,277**	17,901
Other assets	**6,910**	8,951	**6,910**	8,951
	4,334,057	4,321,936	**4,324,778**	4,304,308
Liabilities				
Deposits by banks	**2,542**	54,703	**2,542**	54,703
Customer accounts	**4,887,473**	4,765,995	**4,940,980**	4,850,931
Subordinated liabilities	**62,000**	29,277	**62,000**	30,000
Accrued interest	**3,702**	4,324	**3,478**	4,071
Other liabilities	**22,130**	39,446	**22,130**	39,446
	4,977,847	4,893,745	**5,031,130**	4,979,151

Loans and advances to banks and customers

Fair values are estimated using discounted cash flows, applying market rates, and are fairly close to carrying amounts principally in view of the local group's ability to reprice at its discretion. These estimates are considered Level 2 fair value estimates.

Deposits by banks and customer accounts

Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of a deposit repayable on demand is approximated by its carrying value. These are considered Level 2 fair value estimates.

Subordinated liabilities

The fair value of the new subordinated liabilities issued in December 2018 approximates the carrying amount and falls under Level 2 of the fair value hierarchy. The fair value of the matured subordinated liabilities was based on quoted market prices at the reporting date, without deduction for transaction costs. This amounted to €30,510,000 as at end December 2017 and was determined under Level 1 of the fair value hierarchy.

Other financial instruments

Other financial instruments not carried at fair value are typically short term in nature and reprice to current market rates frequently. Accordingly, their carrying amount is a reasonable approximation of fair value. They include balances with Central Bank of Malta and cash, items in the course of collection from and transmission to other banks, accrued interest, committed letters of credit and bills payable, all of which are measured at amortised cost.

6 Capital Risk Management

Our approach to capital management is driven by our strategic and organisational requirements, taking into account the regulatory, economic and commercial environment. We aim to maintain a strong capital base to support the risks inherent in our business, invest in accordance with our strategy and meeting both consolidated as well as local regulatory capital requirements at all times.

Our capital management process culminates in the annual local group capital plan, which is approved by the Board and which determines the optimal amount and mix of capital required to support planned business growth whilst at the same time meet regulatory capital requirements. Capital generated in excess of planned requirements is returned to shareholders in the form of dividends.

The impact of the local group's capital plan on shareholder returns is therefore recognised by the level of equity capital employed for which the local group seeks to maintain a prudent balance between the advantages and flexibility afforded by a strong capital position and the higher returns on equity from increased leverage.

The local group manages its capital requirements based on internal targets, which are set above the prescribed minimum levels established within the CRR.

For regulatory purposes, the local group's capital base is divided into two main categories, CET 1 (Common Equity Tier) capital and Tier 2 capital, as defined in Part Two of the Capital Requirement Regulation (CRR). CET 1 capital is the highest quality form of capital, comprising shareholders' equity. Under the CRR, various capital deductions and regulatory adjustments are made against these items – these include deductions for intangible assets and the depositor compensation scheme reserve. Tier 2 capital comprises eligible subordinated debt.

The local group's assessment and measurement of capital adequacy is aligned with regulatory requirements and with the bank's assessment of risk, including credit, market and operational risks.

To determine the capital required for Pillar 1 risks, the local group utilises the Standardised Approach for credit risk and operational risk and the Basic Method for foreign exchange risk in order to calculate the Pillar 1 minimum capital requirements.

For credit risk, under the Standardised Approach, risk weights are determined according to credit ratings provided by internationally recognised credit agencies such as S&P or their equivalents and by using the applicable regulatory risk weights for unrated exposures.

For operational risk, the group divides its activities into business lines set out in Article 317 of the CRR and multiplies the capital requirements by 12.5 to derive the risk-weighted assets.

For market risk, the basic method requires the bank to allocate 8% of its overall net foreign exchange position to calculate the capital requirement for foreign exchange risk.

Compliance with the capital plan as well as with regulatory capital measures is monitored by the Asset Liability and Capital Management team and reported to ALCO on a monthly basis.

The following is an analysis of the local group's capital base in accordance with the CRR's requirements. 'Group' figures in the table below represent the consolidated capital position of the local group within the meaning of the CRR, which differs from the scope of consolidation for financial reporting under IFRSs. For regulatory reporting purposes, subsidiaries engaged in insurance activities are excluded from the regulatory consolidation and deducted from regulatory capital subject to thresholds.

	Group		Bank	
	2018	2017	**2018**	2017
	€'000	€'000	**€'000**	€'000
Common Equity Tier 1 (CET) capital				
Called up share capital	**108,092**	108,092	**108,092**	108,092
Retained earnings	**316,421**	334,516	**261,425**	275,625
Revaluation reserve	**34,265**	29,145	**34,265**	29,137
Adjustments				
– depositor compensation scheme	**(23,618)**	(25,188)	**(23,618)**	(25,188)
– intangible assets	**(5,831)**	(4,575)	**(5,831)**	(4,575)
– expected final dividend	**(4,310)**	(29,062)	**(4,310)**	(29,062)
– retained earnings – HSBC Life Assurance (Malta) Limited	**(53,584)**	(57,592)	**—**	—
– prudential valuation adjustment	**(1,025)**	—	**(1,025)**	—
– IFRS 9 transitional adjustments	**7,646**	—	**7,646**	—
– other	**(710)**	(509)	**(710)**	(509)
	377,346	354,827	**375,934**	353,520
Tier 2 capital				
Subordinated debt	**62,000**	4,369	**62,000**	4,369
Revaluation reserve	**—**	36,430	**—**	36,420
Transitional adjustments to Tier 2 capital				
– property revaluation reserve	**—**	(21,567)	**—**	(21,567)
– unrealised gains and losses on financial investments	**—**	(7,578)	**—**	(7,571)
	62,000	11,654	**62,000**	11,651
Total own funds	**439,346**	366,481	**437,934**	365,171

7 Interest and similar income

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
On balances with Central Bank of Malta	**(26)**	—	**(26)**	—
On Treasury Bills	**(515)**	(191)	**(515)**	(191)
On loans and advances to banks	**(578)**	(878)	**(578)**	(878)
On loans and advances to customers	**110,391**	121,378	**110,391**	121,379
	109,272	120,309	**109,272**	120,310
On debt and other fixed income instruments	**17,346**	21,132	**17,334**	20,934
Amortisation of net premiums	**(7,675)**	(8,591)	**(7,675)**	(8,556)
	9,671	12,541	**9,659**	12,378
	118,943	132,850	**118,931**	132,688

Interest income recognised on credit impaired loans and advances, which is entirely included in interest income on loans and advances to customers, amounted to €5,962,000 (2017: €10,830,000).

8 Interest expense

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
On deposits by banks	**562**	813	**562**	813
On customer accounts	**8,353**	9,381	**8,353**	9,381
On subordinated liabilities	**1,406**	1,996	**1,406**	1,996
	10,321	12,190	**10,321**	12,190

9 Net fee income

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Fee income earned on:				
– financial assets or liabilities not at fair value through profit or loss, other than fees included in effective interest rate calculations	**14,871**	15,294	**16,188**	16,981
– trust and other fiduciary activities where the local group holds or invests in assets on behalf of its customers	**6,159**	7,263	**1,142**	1,085
– other	**3,084**	2,504	**2,365**	1,973
	24,114	25,061	**19,695**	20,039
Fee expense	**(1,338)**	(2,326)	**(1,134)**	(1,361)
	22,776	22,735	**18,561**	18,678

Net fee income amounting to €1,122,000 (2017: €1,068,000) is derived from the investment services activities of the local group.

10 Net trading income

	Group/Bank	
	2018	2017
	€000	€000
Net income from foreign exchange activities	**5,061**	4,708
Net income from held for trading financial instruments	**325**	565
	5,386	5,273

11 Dividend income

Dividend income received by the bank in 2018 amounted to €11,425,000, out of which €11,407,000 represents dividend received from a subsidiary company. No dividend income was received by the bank in 2017.

12 Net insurance premium income

	Group		
	Non-linked life insurance	**Linked life insurance**	**Total**
	€000	**€000**	**€000**
Gross insurance premium income	**38,349**	**23,875**	**62,224**
Reinsurers' share of gross premium income	**(3,724)**	**–**	**(3,724)**
Year ended 31 December 2018	**34,625**	**23,875**	**58,500**
Gross insurance premium income	54,467	22,517	76,984
Reinsurers' share of gross premium income	(3,482)	–	(3,482)
Year ended 31 December 2017	50,985	22,517	73,502

13 Other operating income/(expense)

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Operating income				
Rental income from investment property	**867**	856	**867**	856
Gains arising on disposal of re-possessed properties	**1,045**	1,054	**1,045**	1,054
Other income	**996**	242	**1,064**	511
	2,908	2,152	**2,976**	2,421
Loss arising on disposal of properties	**–**	(422)	**–**	(422)
Fair value changes in respect of investment property	**399**	(2,453)	**–**	(2,680)
	3,307	(723)	**2,976**	(681)

14 Net insurance claims, benefits paid and movement in liabilities to policyholders

	Group	
	2018	2017
	€000	€000
Claims, benefits and surrenders paid	**81,701**	64,180
Movement in liabilities	**(38,010)**	13,232
Gross claims, benefits paid and movement in liabilities	**43,691**	77,412
Reinsurers' share of claims, benefits and surrenders paid	**(20,365)**	(2,267)
Reinsurers' share of movement in liabilities	**847**	(782)
Reinsurers' share of claims, benefits paid and movement in liabilities	**(19,518)**	(3,049)
	24,173	74,363

15 Change in expected credit losses and other credit impairment charges

	Group/Bank	
	2018	2017
	€000	€000
Change in expected credit losses:		
– loans and advances to customers including accrued interest	**(1,377)**	N/A
– balances with central banks	**(2)**	N/A
– loans and advances to banks	**2**	N/A
– loan commitments and guarantees	**184**	N/A
– other financial assets	**(63)**	N/A
– debt instruments measured at fair value through other comprehensive income	**(18)**	N/A
Other credit impairment charges:		
– bad debts written off	**5,857**	N/A
– bad debts recovered	**(1,095)**	N/A
	3,488	N/A

16 Net reversal of loan impairment charges

	Group/Bank	
	2018	2017
	€000	€000
Write-downs		
Loans and advances to customers:		
– specific allowances	**N/A**	(20,456)
– collective allowances	**N/A**	(608)
– bad debts written off	**N/A**	(8,938)
	N/A	(30,002)
Reversals of write downs		
Loans and advances to customers:		
– specific allowances	**N/A**	27,731
– collective allowances	**N/A**	1,486
– bad debts recovered	**N/A**	1,918
	N/A	31,135
Other instruments		
– specific allowances	**N/A**	35
	N/A	1,168

17 Movement in provision for brokerage remediation costs

In 2016, the bank recognised a provision amounting to €8,000,000 for a customer remediation programme (refer to Note 43) in respect of a legacy operational and regulatory failure in the bank's brokerage business, which has been wound down during 2014. The failure relates to 'execution only' trades effected by customers purchasing complex instruments through the bank, wherein the bank failed to undertake the appropriateness test in accordance with the requirements stipulated within Markets in Financial Instruments Directive (MiFID). The bank had self-identified and self-reported the issue to the supervisory authorities.

During 2018, the bank effected a partial reversal amounting to €2,028,000 (2017: reversal amounting to €1,800,0000) in respect of this provision. This release was based on both a review of the residual liabilities and confirmation that no further operational costs relating to the programme will be incurred. In 2017, the bank effected a partial reversal in respect of this provision, taking into account the impact on the provision of the revised categorisation of certain instruments as non-complex, on the basis of expert independent advice obtained. These instruments had been re-categorised as non-complex as they were considered to be traded on either regulated or liquid markets. Execution of the remediation programme commenced during 2017 and continued in 2018. During 2018, remediation payments amounting to €346,000 (2017: €2,455,000) were processed. At 31 December 2018, the balance of the provision amounting to €1,371,000 (2017: €3,745,000), has been estimated to be sufficient to cover the residual liabilities emanating from the remediation programme.

In line with HSBC's commitment to the highest standards of conduct and fairness, the provision continues to reflect the estimated cost of ensuring that customers affected by this specific issue are not disadvantaged.

18 Employee compensation and benefits

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Wages, salaries and allowances	**45,804**	45,384	**43,297**	42,935
Defined contribution social security costs	**2,759**	2,634	**2,614**	2,490
Termination benefits and long-term employee benefits	**1,194**	7,987	**1,194**	7,898
Share-based payments	**401**	187	**401**	187
	50,158	56,192	**47,506**	53,510
	Number	Number	**Number**	Number
Average number of employees				
– executive and senior managerial	**324**	308	**316**	289
– other managerial, supervisory and clerical	**1,019**	1,056	**956**	1,001
– others	**9**	14	**9**	13
	1,352	1,378	**1,281**	1,303

Termination benefits and long-term employee benefits

Termination benefits comprise payments and other costs amounting to €428,000 (2017: €387,000) attributable to local group employees that opted for voluntary early retirement during the year.

The local group and the bank have liabilities for long-term employee benefits, treated as defined benefit obligations, arising out of the provisions of the Collective Agreement. The local group has a present obligation towards its employees in respect of long service bonuses, bonuses on retirement due to age and compensation paid upon retirement on medical grounds. The expense recognised in profit or loss during the current year which is attributable to these obligations amounts to €656,000 (2017: €7,600,000).

Share-based payments

In order to align the interests of staff with those of shareholders, share options in ordinary shares of the ultimate parent company are offered to local group employees under all-employee share plans and restricted share awards are awarded to local group senior management under discretionary incentive plans. The local group offered share options to its employees under savings related share option plans and HSBC Holdings Group share option plans. These share option plans are expired and were replaced by Share Match (refer to Note below).

Awards to local group employees also comprise restricted share awards (including Group Performance Share Plans GPSP) referred to above. An assessment of performance over the relevant period is used to determine the amount of the award to be granted. Deferred awards generally require employees to remain in employment over the vesting period and are not subject to performance conditions after the grant date. GPSP awards vest after five years, whereas other deferred awards generally vest over a period of three years. Vested shares may be subject to a retention requirement (restriction) post vesting. GPSP awards are retained until cessation of employment.

In view of the insignificant impact of HSBC restricted share awards on the local group's income statement charge, the other IFRS 2 disclosure requirements attributable to share-based payment arrangements are not being presented in these financial statements.

In 2015, the local group's employees were invited to join Share Match, an HSBC International Employee Share Purchase Plan to acquire shares in HSBC Holdings plc. Under this Plan, HSBC Holdings plc commenced granting matching award shares to the local group's employees subject to a three year service condition. The share-based payment is classified as equity-settled since the share-based payment transactions with the employees are settled by the transfer of shares of HSBC Holdings plc. An employee is required to specify a monthly deduction (subject to a cap) from the salary for buying shares on a quarterly basis at the then current fair value (investment shares). For every three investment shares bought, the employees will receive an additional free share (matching share) on the third anniversary of the scheme (the vesting date) provided the employee remains employed and retains the investment shares until the end of the three-year holding period. The impact of this plan on the local group's financial results and financial position is insignificant, and accordingly the disclosures required by IFRS 2 in relation to share-based payment arrangements have not been deemed necessary.

19 Profit before tax

Profit before tax of the local group is stated after charging auditors' fees (excluding VAT) amounting to €353,000 (2017: €407,500) in relation to the annual statutory audit of the financial statements. Other fees, exclusive of VAT, charged by the appointed independent auditors, comprise other assurance services amounting to €48,000 (2017: €42,000).

General and administration expenses are analysed as follows:

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Premises and equipment costs	**5,410**	5,634	**5,389**	5,613
IT support and telecommunication costs	**9,365**	8,988	**8,701**	8,294
Insurance, security and maintenance costs	**2,645**	2,262	**2,645**	2,262
Investment management and administrator fees	**1,509**	1,329	**—**	—
Actuarial services	**794**	754	**—**	—
Service contracted out costs	**9,916**	9,136	**9,036**	8,199
Regulatory fees	**5,286**	5,365	**5,087**	5,226
Professional fees	**1,912**	4,119	**1,693**	3,868
Other administrative expenses	**16,187**	14,691	**15,620**	13,394
	53,024	52,278	**48,171**	46,856

Other administrative expenses mainly comprise of expense items which are incurred in the course of the operations of the local group and bank.

20 Tax expense

The local group's and the bank's tax expense recognised in profit or loss is analysed below:

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Current Tax	**11,905**	19,033	**11,790**	7,404
– for this year	**14,589**	19,033	**14,474**	7,404
– adjustments in respect of prior year	**(2,684)**	—	**(2,684)**	—
Deferred Tax	**(2,045)**	(65)	**358**	8,490
– origination and reversal of temporary differences	**(1,452)**	(65)	**951**	8,490
– adjustments in respect of prior year	**(593)**	—	**(593)**	—
	9,860	18,968	**12,148**	15,894

The tax recognised in profit or loss on the local group's and the bank's profit before tax differs from the theoretical amount that would arise using the applicable tax rate as follows:

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Profit before tax	**38,556**	49,823	**44,739**	40,879
Tax at the applicable rate of 35%	**13,495**	17,438	**15,659**	14,308
Tax effect of:				
– non-taxable income	**(403)**	(2)	**(182)**	—
– income taxed at different rates	**(345)**	(152)	**(236)**	(94)
– non-deductible expenses	**20**	390	**20**	387
– disallowed expense arising from depreciation of property, plant and equipment	**222**	344	**222**	344
– further allowances on rental income	**(61)**	(60)	**(61)**	(60)
– fair value movement in investment property	**—**	670	**—**	670
– current tax adjustment in respect of prior years	**(2,684)**	—	**(2,684)**	—
– deferred tax not previously recognised	**(593)**	—	**(593)**	—
– others	**209**	340	**3**	339
Tax expense	**9,860**	18,968	**12,148**	15,894

In 2016, the bank recognised a gain on disposal of the bank's membership in Visa Europe amounting to €10,787,000. This had been taxed at the standard corporate tax rate of 35% amounting to €3,775,000. Following the appropriate approval from the Commissioner of Revenue obtained during 2018, the tax charge was revised to €1,048,000 in line with the investment income provisions.

During 2017, the Commissioner of Revenue authorised the insurance subsidiary company not to adjust for any fair value movements through profit or loss in computing taxable income. As from financial year 2017, any such movements are taxable/deductible in the year in which such movements are accounted for. Also, the Commissioner of Revenue authorised that the balance of €7,780,000 representing the deferred tax on fair value movement of investments through the profit or loss as at 31 December 2016, be transferred to current tax. The balance, net of the amounts of tax recoverable, was settled during 2017.

The tax impacts, which are entirely attributable to deferred taxation, relating to components of other comprehensive income and accordingly presented directly in equity are as follows:

	Group					
	2018			2017		
	Before tax	**Tax (charge)/ credit**	**Net of tax**	Before tax	Tax (charge)/ credit	Net of tax
	€000	**€000**	**€000**	€000	€000	€000
Fair valuation of financial investments:						
– net changes in fair value	**(3,919)**	**1,372**	**(2,547)**	(7,290)	2,551	(4,739)
Fair valuation of properties:						
– net changes in fair value	**424**	**(42)**	**382**	–	–	–
Remeasurement of defined benefit obligation:						
– net changes in remeasurement	**(514)**	**180**	**(334)**	–	–	–
	(4,009)	**1,510**	**(2,499)**	(7,290)	2,551	(4,739)

	Bank					
	2018			2017		
	Before tax	**Tax (charge)/ credit**	**Net of tax**	Before tax	Tax (charge)/ credit	Net of tax
	€000	**€000**	**€000**	€000	€000	€000
Fair valuation of financial investments:						
– net changes in fair value	**(3,903)**	**1,366**	**(2,537)**	(7,139)	2,499	(4,640)
Fair valuation of properties:						
– net changes in fair value	**424**	**(42)**	**382**	–	–	–
Remeasurement of defined benefit obligation:						
– net changes in remeasurement	**(514)**	**180**	**(334)**	–	–	–
	(3,993)	**1,504**	**(2,489)**	(7,139)	2,499	(4,640)

21 Earnings per share

Basic earnings per share is calculated by dividing the net profit attributable to equity holders of the local group by the weighted average number of ordinary shares in issue during the year. The profit attributable to equity holders of the local group amounted to €28,696,000 (2017: €30,855,000), while the weighted average number of ordinary shares in issue was 360,306,099 (2017: 360,306,099). The basic earnings per share of the local group amounted to 8.0c (2017: 8.6c). The local group has no instruments or arrangements which give rise to dilutive potential ordinary shares, and accordingly diluted earnings per share is equivalent to basic earnings per share.

22 Balances with Central Bank of Malta, Treasury Bills and cash

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Balances with Central Bank of Malta	**49,252**	48,541	**49,252**	48,541
Malta Government Treasury Bills				
– classified at fair value through other comprehensive income/available-for-sale	**110,347**	80,512	**110,347**	80,512
Cash	**31,169**	35,006	**31,169**	35,006
	190,768	164,059	**190,768**	164,059

The average reserve deposit held for the relevant maintenance period with the Central Bank of Malta in terms of Regulation (EC) No. 1745/2003 of the European Central Bank amounted to €48,497,000 (2017: €48,030,000).

Balances with Central Bank of Malta includes an amount of €710,000 (2017: €509,000) placed in an account held with the Single Resolution Board as an Irrevocable Payment Commitment (IPC) to the latter in terms of the Recovery and Resolution Regulations.

23 Financial investments measured at fair value through profit or loss attributable to insurance operations

	Group	
	2018	2017
	Mandatorily measured at fair value	Designated at fair value
	€000	€000
Debt securities and other fixed income instruments	**260,657**	261,895
Equity and other non-fixed income instruments	**433,424**	465,375
	694,081	727,270

Debt securities and other fixed income instruments

	Group	
	2018	2017
	Mandatorily measured at fair value	Designated at fair value
	€000	€000
Issued by public bodies		
– local government	**96,039**	96,537
– foreign governments	**69,603**	83,162
Issued by other bodies		
– local banks	**2,706**	2,720
– foreign banks	**19,970**	8,287
– other local issuers	**10,093**	8,771
– other foreign issuers	**62,246**	62,418
	260,657	261,895
Listing status		
– listed on the Malta Stock Exchange	**108,838**	108,028
– listed on other recognised exchanges	**151,574**	153,831
– foreign unlisted	**245**	36
	260,657	261,895
At 1 January	**261,895**	638,406
Acquisitions	**36,256**	242,732
Disposals/redemptions	**(30,988)**	(303,598)
Transfers from/(to) Assets attributable to disposal group held for sale (Note 30)	**950**	(323,570)
Changes in fair value	**(7,456)**	7,925
At 31 December	**260,657**	261,895

Equity and other non-fixed income instruments

	Group	
	2018	2017
	Mandatorily measured at fair value	Designated at fair value
	€000	€000
Issued by other bodies		
– local banks	**1,292**	187
– foreign banks	**5,511**	4,445
– other local issuers	**91,776**	90,547
– other foreign issuers	**334,845**	370,196
	433,424	465,375
Listing status		
– listed on the Malta Stock Exchange	**16,175**	14,887
– listed on other recognised exchanges	**50,011**	54,146
– local unlisted	**76,893**	75,847
– foreign unlisted	**290,345**	320,495
	433,424	465,375
At 1 January	**465,375**	765,250
Acquisitions	**299,491**	168,936
Disposals	**(296,671)**	(287,570)
Transfers from/(to) Assets attributable to disposal group held for sale (Note 30)	**6,884**	(220,647)
Changes in fair value	**(41,655)**	39,406
At 31 December	**433,424**	465,375

24 Held for trading derivatives

The local group transacts derivatives primarily to create risk management solutions for clients. This includes the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. As part of this process, the local group considers the customers' suitability in respect of the respective risks involved and the business purpose underlying the transaction. The local group's derivative instruments also comprise contracts managed in conjunction with financial instruments measured at fair value through profit or loss, which are attributable to insurance operations. At 31 December 2017, derivative instruments attributable to insurance operations were presented within 'Assets attributable to disposal group held for sale' (see Note 30). As at 31 December 2018, no derivative instruments attributable to the insurance operations were held.

The local group manages its derivative risk positions principally through offsetting derivative transactions with HSBC Group entities. For accounting purposes, all derivative instruments are classified as held for trading.

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Derivative assets				
Held for trading	**4,956**	5,175	**4,956**	5,175
Derivative liabilities				
Held for trading	**4,991**	5,228	**4,991**	5,228

Derivatives held for trading

	Group			
	2018			
	Notional	**Fair value assets**	**Notional**	**Fair value liabilities**
	€000	**€000**	**€000**	**€000**
Foreign exchange derivatives				
Currency forwards	**62,359**	**1,474**	**63,918**	**1,363**
Interest rate derivatives				
Interest rate swaps	**128,218**	**3,482**	**128,218**	**3,628**
Total derivatives		**4,956**		**4,991**
	2017			
Foreign exchange derivatives				
Currency forwards	46,195	1,228	47,863	1,143
Interest rate derivatives				
Interest rate swaps	144,617	3,947	144,617	4,085
Total derivatives		5,175		5,228

	Bank			
	2018			
Foreign exchange derivatives				
Currency forwards	**62,359**	**1,474**	**63,918**	**1,363**
Interest rate derivatives				
Interest rate swaps	**128,218**	**3,482**	**128,218**	**3,628**
Total derivatives		**4,956**		**4,991**
	2017			
Foreign exchange derivatives				
Currency forwards	46,195	1,228	47,863	1,143
Interest rate derivatives				
Interest rate swaps	144,617	3,947	144,617	4,085
Total derivatives		5,175		5,228

The notional contract amounts of derivatives indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts of risk.

Currency forwards represent commitments to purchase and sell pre-established amounts of currencies, and are gross settled.

Interest rate swaps are commitments to exchange one set of cash flows for another (for example, fixed rate for floating rate). Usually, no exchange of principal takes place.

All of these positions are covered by back-to-back derivative transactions with HSBC Group entities, managing the market risk arising from these positions. Any market risk retained locally is managed within approved local trading mandates.

25 Loans and advances to banks

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Repayable on call and at short notice	**714,676**	771,896	**709,735**	758,287
Term loans and advances	**383,038**	287,412	**383,038**	287,412
	1,097,714	1,059,308	**1,092,773**	1,045,699

26 Loans and advances to customers

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Repayable on call and at short notice	**260,906**	273,550	**260,906**	273,550
Term loans and advances	**2,894,274**	2,895,924	**2,894,274**	2,895,924
Gross loans and advances to customers	**3,155,180**	3,169,474	**3,155,180**	3,169,474
Allowances for uncollectibility	**(44,768)**	(40,641)	**(44,768)**	(40,641)
Net loans and advances to customers	**3,110,412**	3,128,833	**3,110,412**	3,128,833
Credit loss allowances				
- allowances booked under Stage 1	**7,829**	–	**7,829**	–
- allowances booked under Stage 2	**7,060**	–	**7,060**	–
- allowances booked under Stage 3	**29,879**	–	**29,879**	–
- individually assessed allowances	**–**	34,124	**–**	34,124
- collectively assessed allowances	**–**	6,517	**–**	6,517
	44,768	40,641	**44,768**	40,641

27 Financial investments

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Debt securities and other fixed income instruments	**902,215**	924,999	**902,215**	923,786
Equity and other non-fixed income instruments	**2,705**	1,097	**2,703**	1,095
	904,920	926,096	**904,918**	924,881

Debt securities and other fixed income instruments

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Issued by public bodies				
– local government	**489,679**	547,611	**489,679**	547,611
– foreign governments	**225,453**	235,220	**50,206**	234,007
Issued by other bodies				
– other foreign issuers	**187,083**	142,168	**362,330**	142,168
	902,215	924,999	**902,215**	923,786
Listing status				
– listed on the Malta Stock Exchange	**489,679**	547,611	**489,679**	547,611
– listed on other recognised exchanges	**412,536**	377,388	**412,536**	376,175
	902,215	924,999	**902,215**	923,786
At 1 January	**924,999**	1,052,451	**923,786**	1,047,802
Exchange adjustments	**2,867**	(18,502)	**2,851**	(18,502)
Amortisation of premium/discount	**(7,675)**	(8,478)	**(7,675)**	(8,443)
Additions	**242,523**	139,114	**242,523**	139,115
Disposals/redemptions	**(254,972)**	(231,948)	**(253,759)**	(228,699)
Changes in fair value	**(5,527)**	(7,638)	**(5,511)**	(7,487)
At 31 December	**902,215**	924,999	**902,215**	923,786

Debt instruments with a carrying amount of €61,893,000 (2017: €62,880,000) have been pledged against the provision of credit lines by the Central Bank of Malta. At 31 December 2018 and 2017, no balances were outstanding against these credit lines. In addition debt securities with a carrying amount of €24,043,000 (2017: €25,510,000) have been pledged in terms of the Depositor Compensation Scheme (refer to Note 48).

The financial investments which are denominated in currencies other than the reporting currency are economically hedged through balances in corresponding currencies mainly forming part of Customer accounts and Deposits by banks. Thus, the exchange adjustment reflected above does not result in an exchange gain or loss recognised in profit or loss.

Equity and other non-fixed income instruments

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Issued by issuers other than public bodies and banks				
– local issuers	**7**	7	**5**	5
– foreign issuers	**2,698**	1,090	**2,698**	1,090
	2,705	1,097	**2,703**	1,095
Listing status				
– listed on the Malta Stock Exchange	**7**	7	**5**	5
– listed on other recognised exchanges	**2,698**	1,090	**2,698**	1,090
	2,705	1,097	**2,703**	1,095
At 1 January	**1,097**	749	**1,095**	747
Changes in fair value	**1,608**	348	**1,608**	348
At 31 December	**2,705**	1,097	**2,703**	1,095

Equity instruments predominantly comprise preferred stock of Visa Inc., which were received in 2016 by the bank in exchange for its membership interest in Visa Europe Limited, as part of a transaction in which Visa Europe Limited was acquired by Visa Inc.

Each share of the bank's preferred stock will be convertible into ordinary shares of Visa Inc. These have no maturity and represent a residual interest in the issuer's net assets. The holder of the preferred stock is exposed to litigation risk borne by their issuer, and hence the value of these shares depends on the level and success of any future litigation, which is for obvious reasons impossible to accurately forecast.

The purpose of the preferred stock is to provide Visa Inc. with protection against all litigation risk associated with interchange fees linked to the activity of Visa Europe Limited.

The conversion ratio adjustment feature transfers specific litigation risk of Visa Inc. to the holders of the preferred stock, including to the bank. The conversion ratio adjustment is dependent upon the uncertain outcome of litigation, which is still in an embryonic stage.

Due to the lack of recent developments, the estimation arrived at for the purposes of these financial statements remains the best available forecast, in respect of valuation as at date of acquisition and as at reporting date.

As further notifications, claims and settlements evolve, the bank will re-evaluate the likely litigation cost as part of the fair valuation process. The current estimation has been factored into an internal valuation model for the preferred stock, also taking into account the phasing of partial conversions of the preferred stock which was assumed by Visa Europe Limited's legal advisors.

Upon adoption of IFRS 9, these equity investments were designated as measured at fair value through other comprehensive income with an unchanged measurement basis, as these investments are held for reasons other than to generate an investment return.

28 Prepayments and accrued income

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Gross accrued interest	**30,949**	17,901	**27,516**	17,901
Expected credit loss allowances	**(6,239)**	–	**(6,239)**	–
Net accrued interest	**24,710**	17,901	**21,277**	17,901
Other accrued income	**1,473**	5,238	**377**	1,219
Prepayments	**1,129**	1,097	**1,106**	1,079
	27,312	24,236	**22,760**	20,199

29 Reinsurance assets

	Group	
	2018	2017
	€000	€000
Life insurance assets (non-linked)		
Long-term insurance contracts	**84,465**	84,647
Claims outstanding	**1,908**	2,574
Other payables	**(1,168)**	(1,334)
	85,205	85,887

30 Assets attributable to disposal group held for sale

During 2017, HSBC Life Assurance (Malta) Limited entered into a Portfolio transfer agreement with Lombard International Assurance S.A for the sale of the policies of insurance governed by the Wealth Insurance Italy portfolio. This portfolio disposed of for a nominal consideration of €1, forms part of a larger portfolio which was acquired in 2014 and is comprised within Retail Banking and Wealth Management business. The assets and liabilities pertaining to this portfolio were categorised as a disposal group in accordance with IFRS 5 'Non-current Assets Held for sale and Discontinued Operations'. They were consequently considered to be current in nature.

This portfolio was disposed of during 2018 following:

- reclassification of assets with a carrying amount of €9,119,000 to Financial investments measured at fair value through profit or loss attributable to insurance operations (Note 23) and Loans and advances to banks (Note 25);
- net disposals of €7,790,000; and
- changes in unit prices and other movements amounting to €25,095,000.

At 31 December 2017, the disposal group comprised:

	Group
	€000
Assets held to cover linked liabilities - principally at fair value through profit or loss	
Debt securities and other fixed income instruments	
Governments	
– listed	100,846
– unlisted	4,999
Other issuers	
– listed	167,802
– unlisted	7,181
Equity and other non-fixed income instruments	
– listed	54,463
– unlisted	130,557
Policy loans	(37,427)
Derivatives	1,755
Accrued interest	4,436
Cash at bank	39,185
	473,797
Linked liabilities – at fair value through profit or loss	
Liabilities under investment contracts (refer to Note 45)	473,797

The derivatives outstanding at 31 December 2017 comprised of:

	Group		
	Notional	Fair value assets	Fair value liabilities
	€000	€000	€000
Derivatives held to cover linked liabilities			
Currency derivatives			
– foreign exchange contracts	9,872	39	2
– currency options	14,475	1,688	—
Equity derivatives			
– equity options	339	30	—
	24,686	1,757	2

Upon disposal on 7 December 2018, the following assets and liabilities were transferred:

	Group
Assets held to cover linked liabilities - principally at fair value through profit or loss	€000
Debt securities and other fixed income instruments	
Governments	
– listed	114,003
– unlisted	788
Other issuers	
– listed	102,684
– unlisted	9,824
Equity and other non-fixed income instruments	
– listed	56,469
– unlisted	100,570
Derivatives	269
Accrued interest	3,763
Cash at bank	43,423
	431,793
Linked liabilities – at fair value through profit or loss	
Liabilities under investment contracts	431,793

31 Other non-current assets held for sale

As at 31 December 2018, the fair value of assets acquired in satisfaction of debt amounted to €5,908,000 (2017: €7,411,000). Repossessed properties are made available for sale in an orderly fashion, with the proceeds used to reduce or repay the outstanding indebtedness. The local group does not generally occupy repossessed properties for its business use. Repossessed properties consist mainly of immovable property that had been pledged as collateral by customers.

32 Investments in subsidiaries

	Bank			
	Nature of business	Equity interest	**2018**	2017
		%	**€000**	€000
HSBC Life Assurance (Malta) Limited	Life insurance	99.99	**28,578**	28,578
HSBC Global Asset Management (Malta) Limited	Portfolio management services	99.99	**2,281**	2,281
			30,859	30,859

All subsidiaries are incorporated in Malta.

33 Investment property

	Fair value	**Cost**	Fair value	Cost
	2018	**2018**	2017	2017
	€000	**€000**	€000	€000
Group				
Freehold land and buildings				
As at 1 January	**10,600**	**9,216**	13,026	9,189
Additions	**15**	**15**	27	27
Disposals	**(1,300)**	**(768)**	—	—
Fair value adjustments	**399**	**—**	(2,453)	—
At 31 December	**9,714**	**8,463**	10,600	9,216
Bank				
Freehold land and buildings				
As at 1 January	**7,500**	**6,728**	10,180	6,728
Additions	**15**	**15**	—	—
Fair value adjustments	**—**	**—**	(2,680)	—
At 31 December	**7,515**	**6,743**	7,500	6,728

During the year ended 31 December 2018, €867,000 (2017: €856,000) was recognised as rental income in profit or loss relating to investment property for the local group. The bank recognised €867,000 (2017: €834,000) as rental income which was received from a Group company. Related repair and maintenance expenses incurred by the local group and the bank on these properties are reimbursed by the tenant.

Fair values are determined by professional valuers who apply recognised valuation techniques. The local group has in place set benchmarks to ensure that these valuers hold the necessary recognised and relevant professional qualifications as well as the knowledge and experience depending on the location and category of the investment property being valued.

34 Property, plant and equipment

	Group			
	Land and buildings	Computer equipment	Others	Total
	€000	€000	€000	€000
At 1 January 2018				
Cost/revaluation	**44,996**	**18,897**	**47,963**	**111,856**
Additions	**4**	**998**	**1,080**	**2,082**
Revaluation	**153**	**–**	**–**	**153**
Disposals	**–**	**–**	**(1)**	**(1)**
At 31 December 2018	**45,153**	**19,895**	**49,042**	**114,090**
At 1 January 2018				
Accumulated depreciation and impairment losses	**1,420**	**16,402**	**37,726**	**55,548**
Depreciation charge for the year	**426**	**926**	**2,049**	**3,401**
Effects of revaluation	**(271)**	**–**	**–**	**(271)**
Disposals	**–**	**–**	**(1)**	**(1)**
At 31 December 2018	**1,575**	**17,328**	**39,774**	**58,677**
Carrying amount at 1 January 2018	**43,576**	**2,495**	**10,237**	**56,308**
Carrying amount at 31 December 2018	**43,578**	**2,567**	**9,268**	**55,413**
At 1 January 2017				
Cost/revaluation	45,020	19,892	47,641	112,553
Additions	462	420	329	1,211
Disposals	(486)	(1,415)	(7)	(1,908)
At 31 December 2017	44,996	18,897	47,963	111,856
At 1 January 2017				
Accumulated depreciation and impairment losses	1,073	16,736	35,597	53,406
Depreciation charge for the year	430	1,070	2,132	3,632
Disposals	(83)	(1,404)	(3)	(1,490)
At 31 December 2017	1,420	16,402	37,726	55,548
Carrying amount at 1 January 2017	43,947	3,156	12,044	59,147
Carrying amount at 31 December 2017	43,576	2,495	10,237	56,308

	Bank			
	Land and buildings	Computer equipment	Others	Total
	€000	€000	€000	€000
At 1 January 2018				
Cost/revaluation	**45,094**	**18,659**	**47,756**	**111,509**
Additions	**4**	**998**	**1,080**	**2,082**
Revaluation	**153**	**–**	**–**	**153**
Disposals	**–**	**–**	**(1)**	**(1)**
At 31 December 2018	**45,251**	**19,657**	**48,835**	**113,743**
At 1 January 2018				
Accumulated depreciation and impairment losses	**1,420**	**16,155**	**37,519**	**55,094**
Depreciation charge for the year	**426**	**926**	**2,049**	**3,401**
Effects of revaluation	**(271)**	**–**	**–**	**(271)**
Disposals	**–**	**–**	**(1)**	**(1)**
At 31 December 2018	**1,575**	**17,081**	**39,567**	**58,223**
Carrying amount at 1 January 2018	**43,674**	**2,504**	**10,237**	**56,415**
Carrying amount at 31 December 2018	**43,676**	**2,576**	**9,268**	**55,520**
At 1 January 2017				
Cost/revaluation	45,118	19,654	47,434	112,206
Additions	462	420	329	1,211
Disposals	(486)	(1,415)	(7)	(1,908)
At 31 December 2017	45,094	18,659	47,756	111,509
At 1 January 2017				
Accumulated depreciation and impairment losses	1,073	16,490	35,391	52,954
Depreciation charge for the year	430	1,069	2,131	3,630
Disposals	(83)	(1,404)	(3)	(1,490)
At 31 December 2017	1,420	16,155	37,519	55,094
Carrying amount at 1 January 2017	44,045	3,164	12,043	59,252
Carrying amount at 31 December 2017	43,674	2,504	10,237	56,415

Land and buildings reported above are all utilised for own activities.

If the land and buildings were stated on the historical cost basis, the carrying amounts would be:

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
At 31 December				
Cost	**18,239**	18,235	**18,337**	18,333
Accumulated depreciation	**(1,575)**	(1,420)	**(1,575)**	(1,420)
Carrying amount	**16,664**	16,815	**16,762**	16,913

Valuations of land and buildings are carried out on a regular basis such that the carrying amount of property does not differ materially from that which would be determined using fair values at the end of the reporting period.

35 Intangible assets

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Software	**6,128**	4,790	**5,831**	4,575
PVIF	**52,723**	58,497	**—**	—
Deferred acquisition costs	**285**	775	**—**	—
	59,136	64,062	**5,831**	4,575

Software

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Cost				
At 1 January	**30,635**	30,389	**29,126**	28,996
Additions	**3,112**	1,245	**2,937**	1,129
Disposals	**—**	(999)	**—**	(999)
At 31 December	**33,747**	30,635	**32,063**	29,126
Accumulated amortisation				
At 1 January	**25,845**	24,795	**24,551**	23,572
Amortisation charge for the year	**1,774**	1,932	**1,681**	1,861
Disposals	**—**	(882)	**—**	(882)
At 31 December	**27,619**	25,845	**26,232**	24,551
Carrying amount at 1 January	**4,790**	5,594	**4,575**	5,424
Carrying amount at 31 December	**6,128**	4,790	**5,831**	4,575

PVIF

	Group	
	2018	2017
	€000	€000
At 1 January	**58,497**	60,171
Addition from current year new business	**5,668**	4,458
Movement from in-force business	**(11,442)**	(6,132)
At 31 December	**52,723**	58,497

The local group's insurance business is accounted for using the embedded value approach, which, inter alia, provides a comprehensive framework for the evaluation of insurance and related risks.

The following are the key assumptions used in the computation of the local group's PVIF in the current and comparative periods:

	2018	2017
	%	%
Risk free rate	**Euro Swap Curve**	Euro Swap Curve
Risk adjusted discount rate	**Euro Swap Curve + 50 Bps Operational Risk Margin**	Euro Swap Curve + 50 Bps Operational Risk Margin
Expenses inflation	**French Inflation Swap Curve modified for Malta**	French Inflation Swap Curve modified for Malta
Lapse rate	**Different rates for different products**	Different rates for different products

The following table shows the effect on the PVIF of reasonably possible changes in the main economic assumptions across the life insurance business:

		Group	
		PVIF Impact	
		2018	2017
Assumptions	Movement	**€000**	€000
Risk free rate	+100 basis points	**(587)**	(1,440)
Risk free rate	-100 basis points	**4,529**	3,845
Expenses inflation	+10%	**(1,241)**	(1,168)
Expenses inflation	-10%	**1,318**	1,231
Lapse rate	+100 basis points	**2,111**	1,490
Lapse rate	-100 basis points	**(3,043)**	(2,259)

Deferred acquisition costs

	Group	
	2018	2017
	€000	€000
At 1 January	**775**	2,008
Addition from current year new business	**169**	108
Amortisation	**(659)**	(1,341)
At 31 December	**285**	775

36 Deferred tax

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

The following amounts determined after appropriate offsetting are shown in the statement of financial position:

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Deferred tax assets	**21,509**	16,488	**21,509**	16,488
Deferred tax liabilities	**(23,427)**	(26,295)	**(5,119)**	(5,578)
	(1,918)	(9,807)	**16,390**	10,910

Deferred taxes are calculated on all temporary differences under the liability method and are measured 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 (and tax laws) that have been substantively enacted by the end of the reporting period. The principal tax rate used is 35% (2017: 35%), with the exception of deferred taxation on the fair valuation of non-depreciable property, which is computed on the basis applicable to disposals of immovable property principally a tax effect of 8% or 10% (depending on date of acquisition) of the transfer value (2017: 8% or 10%).

The balance at 31 December represents temporary differences attributable to:

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Depreciation of property, plant and equipment	**(913)**	(1,418)	**(913)**	(1,418)
Expected credit losses / loan impairment allowances	**19,444**	15,749	**19,444**	15,749
Fair valuation of property	**(5,295)**	(5,852)	**(5,119)**	(5,578)
Fair value gains on financial investments	**(3,782)**	(5,154)	**(3,782)**	(5,149)
Value of in-force life insurance business	**(18,453)**	(20,425)	**—**	—
Provisions for liabilities and other charges	**6,607**	7,053	**6,279**	6,794
Other	**474**	240	**481**	512
	(1,918)	(9,807)	**16,390**	10,910

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

	Group				
	At 1 January 2018	**Recognised in profit or loss**	**Recognised in OCI**	**Recognised in retained earnings**	**At 31 December 2018**
	€000	**€000**	**€000**	**€000**	**€000**
Depreciation of property, plant and equipment	**(1,418)**	**505**	**–**	**–**	**(913)**
Expected credit loss allowances	**15,749**	**(639)**	**–**	**–**	**15,110**
IFRS 9 transitional adjustment	**–**	**–**	**–**	**4,334**	**4,334**
Fair valuation of property	**(5,852)**	**599**	**(42)**	**–**	**(5,295)**
Fair value movements on financial investments	**(5,154)**	**–**	**1,372**	**–**	**(3,782)**
Value of in-force life insurance business	**(20,425)**	**1,972**	**–**	**–**	**(18,453)**
Provisions for liabilities and other charges	**7,053**	**(626)**		**180**	**6,607**
Other	**240**	**234**	**–**	**–**	**474**
	(9,807)	**2,045**	**1,330**	**4,514**	**(1,918)**

	At 1 January 2017	Recognised in profit or loss	Recognised in OCI	Recognised in retained earnings	At 31 December 2017
	€000	€000	€000	€000	€000
Depreciation of property, plant and equipment	(1,798)	380	–	–	(1,418)
Loan impairment allowances	24,834	(9,085)	–	–	15,749
Fair valuation of property	(5,514)	(338)	–	–	(5,852)
Fair value movements on financial investments	(7,652)	(53)	2,551	–	(5,154)
Value of in-force life insurance business	(21,060)	635	–	–	(20,425)
Fair value movement on policyholders' investments	(8,007)	8,007	–	–	–
Provisions for liabilities and other charges	7,058	(5)	–	–	7,053
Other	(284)	524	–	–	240
	(12,423)	65	2,551	–	(9,807)

	Bank				
	At 1 January 2018	**Recognised in profit or loss**	**Recognised in OCI**	**Recognised in retained earnings**	**At 31 December 2018**
	€000	**€000**	**€000**	**€000**	**€000**
Depreciation of property, plant and equipment	**(1,418)**	**505**	**–**	**–**	**(913)**
Expected credit loss allowances	**15,749**	**(639)**	**–**	**–**	**15,110**
IFRS 9 transitional adjustment	**–**	**–**	**–**	**4,334**	**4,334**
Fair valuation of property	**(5,578)**	**501**	**(42)**	**–**	**(5,119)**
Fair value movements on financial investments	**(5,149)**	**–**	**1,366**	**–**	**(3,783)**
Provisions for liabilities and other charges	**6,794**	**(695)**		**180**	**6,279**
Other	**512**	**(30)**	**–**	**–**	**482**
	10,910	**(358)**	**1,324**	**4,514**	**16,390**

	At 1 January 2017	Recognised in profit or loss	Recognised in OCI	Recognised in retained earnings	At 31 December 2017
	€000	€000	€000	€000	€000
Depreciation of property, plant and equipment	(1,790)	372	–	–	(1,418)
Loan impairment allowances	24,834	(9,085)	–	–	15,749
Fair valuation of property	(5,262)	(316)	–	–	(5,578)
Fair value movements on financial investments	(7,699)	51	2,499	–	(5,149)
Provisions for liabilities and other charges	7,058	(264)	–	–	6,794
Other	(240)	752	–	–	512
	16,901	(8,490)	2,499	–	10,910

The recognised deferred tax assets and liabilities are expected to be recovered or settled principally after more than 12 months from the end of the reporting period.

37 Other assets

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Committed letters of credit	**6,910**	8,951	**6,910**	8,951
Other	**14,904**	7,433	**13,621**	6,735
	21,814	16,384	**20,531**	15,686

38 Deposits by banks

	Group/Bank	
	2018	2017
	€000	€000
Term deposits	–	54,338
Repayable on demand	2,542	365
	2,542	54,703

39 Customer accounts

	Group		Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
Term deposits	1,079,917	1,206,422	1,079,917	1,206,422
Repayable on demand	3,807,556	3,559,573	3,861,063	3,644,509
	4,887,473	4,765,995	4,940,980	4,850,931

40 Accruals and deferred income

	Group		Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
Accrued interest	3,702	4,324	3,478	4,071
Accrued expenses	15,094	13,251	13,369	10,969
Deferred income	355	263	216	263
	19,151	17,838	17,063	15,303

41 Liabilities under investment contracts

	Group	
	2018	2017
	€000	€000
At 1 January	203,136	930,937
Transfers from/(to) Liabilities attributable to disposal group held for sale (Note 45)	9,119	(495,479)
Premiums received	10,130	6,203
Amounts paid on surrender and other terminations during the year	(41,411)	(272,915)
Changes in unit prices and other movements	(14,627)	34,390
At 31 December	166,347	203,136

42 Liabilities under insurance contracts

	Group	
	Gross	Gross
	2018	2017
	€000	€000
Life insurance (non-linked)		
Provisions for policyholders	407,040	432,201
Outstanding claims	2,443	3,334
Total non-linked	409,483	435,535
Life insurance (linked)		
Provisions for policyholders	210,542	222,767
Outstanding claims	756	490
Total linked	211,298	223,257
Total liabilities under insurance contracts	620,781	658,792

	Group			
	Non-linked business	Linked business	All business	
	Provisions for policy-holders	Provisions for policy-holders	Outstanding claims	Total
	€000	€000	€000	€000
At 1 January 2018	**432,201**	**222,767**	**3,824**	**658,792**
Premiums received	**—**	**23,875**	**—**	**23,875**
Other movements for the year	**(25,161)**	**(19,484)**	**(625)**	**(45,270)**
Account balances paid on surrender and other terminations during the year	**—**	**(16,616)**	**—**	**(16,616)**
At 31 December 2018	**407,040**	**210,542**	**3,199**	**620,781**
At 1 January 2017	436,897	205,140	3,524	645,561
Premiums received	—	22,517	—	22,517
Other movements for the year	(4,696)	12,005	300	7,609
Account balances paid on surrender and other terminations during the year	—	(16,895)	—	(16,895)
At 31 December 2017	432,201	222,767	3,824	658,792

43 Provisions for liabilities and other charges

	Group					
	Restructuring costs	Legal proceedings and regulatory matters	Brokerage remediation	Long-term employee benefits	Other provisions	Total
	€000	€000	€000	€000	€000	€000
Provisions (excluding contractual commitments)						
At 31 December 2017	**491**	**641**	**3,745**	**13,712**	**1,473**	**20,062**
Additions	**—**	**240**	**—**	**1,170**	**210**	**1,620**
Amounts utilised	**(364)**	**—**	**(346)**	**—**	**(40)**	**(750)**
Unused amounts reversed	**(28)**	**—**	**(2,028)**	**—**	**—**	**(2,056)**
At 31 December 2018	**99**	**881**	**1,371**	**14,882**	**1,643**	**18,876**
Contractual commitments						
At 31 December 2017						**37**
Impact on transition to IFRS 9 on 1 January 2018						**1,592**
Change in expected credit loss provision						**184**
At 31 December 2018						**1,813**
Total Provisions						
At 31 December 2017						**20,099**
At 31 December 2018						**20,689**

	Bank					
	Restructuring costs	Legal proceedings and regulatory matters	Brokerage remediation	Long-term employee benefits	Other provisions	Total
	€000	€000	€000	€000	€000	€000
Provisions (excluding contractual commitments)						
At 31 December 2017	**491**	**641**	**3,745**	**13,712**	**784**	**19,373**
Additions	**—**	**194**	**—**	**1,170**	**8**	**1,372**
Amounts utilised	**(364)**	**—**	**(346)**	**—**	**(40)**	**(750)**
Unused amounts reversed	**(28)**	**—**	**(2,028)**	**—**	**—**	**(2,056)**
At 31 December 2018	**99**	**835**	**1,371**	**14,882**	**752**	**17,939**
Contractual commitments						
At 31 December 2017						**37**
Impact on transition to IFRS 9 on 1 January 2018						**1,592**
Change in expected credit loss provision						**184**
At 31 December 2018						**1,813**
Total Provisions						
At 31 December 2017						**19,410**
At 31 December 2018						**19,752**

The contractual commitments provision as at 31 December 2017 for both the local group and the bank represented IAS 37 provisions on off balance sheet loan commitments and guarantees, for which expected credit losses are provided following transition to IFRS 9 on 1 January 2018.

(a) Brokerage remediation provision

At 31 December 2016, a provision of €8,000,000 was recognised in respect of the estimated cost of brokerage remediation in relation to the 'execution only' trades effected by customers purchasing complex instruments, through the bank, without the bank undertaking an appropriateness test required by MiFID (refer to Note 17).

During 2016, the bank had engaged a 'Group Business Review Team' that had experience in handling similar remediation projects in the UK to investigate the bank's failure, support the design of a remediation programme, carry out detailed estimates of the remediation costs and to eventually execute the programme.

The estimated liability for brokerage remediation was arrived at after taking into consideration transactions made by customers who dealt in complex bonds, equities and funds over the period of time during which the bank had failed to adhere strictly to the requirements stipulated within MiFID. This included both customers who had purchased and sold such instruments while the bank was still undertaking the brokerage business, as well as customers whose portfolios were transferred to other institutions as a result of the bank's decision to wind down its brokerage business.

Remediation costs for customers that had sold such instruments through the bank's brokerage business were calculated by taking account of the exact amount of units that were purchased and eventually sold by those customers as well as the price at which those units were sold. In respect of instruments that were transferred to other institutions, the estimation for the remediation costs was based on current unit prices, assuming the customer still held those instruments.

The classification of the instruments between those deemed complex and non-complex was carried out by the bank and was subject to an independent review carried out by third party firms specialised in the subject matter.

The remediation costs also included a provision for income/return that such customers would have received on non-complex instruments had they not dealt in such complex instruments, as well as for operational expenditure that was incurred to execute the programme.

During 2018, the bank effected a partial reversal amounting to €2,028,000 (2017: reversal amounting to €1,800,0000) in respect of this provision (refer to Note 17). This release was based on both a review of the residual liabilities and confirmation that no further operational costs relating to the programme will be incurred. In 2017, the bank effected a partial reversal in respect of this provision, taking into account the impact on the provision of the revised categorisation of certain instruments as non-complex, on the basis of expert independent advice obtained. These instruments had been re-categorised as non-complex as they were considered to be traded on either regulated or liquid markets. Execution of the remediation programme commenced during 2017 and continued in 2018. During 2018 remediation payments amounting to €346,000 (2017: €2,455,000) were processed. At 31 December 2018, the balance of the provision amounting to €1,371,000 (2017: €3,745,000), has been estimated to be sufficient to cover the residual liabilities emanating from the remediation programme.

(b) Provisions in respect of long-term employee benefits

The local group has a present obligation towards its employees in respect of long service bonuses, bonuses on retirement due to age and compensation paid upon retirement for medical grounds. This provision is principally non-current in nature, with the maturity profile of the obligation spanning over the estimated remaining working life. These obligations emanate from the provisions of the Collective Agreement. The defined benefit obligation as at 31 December 2018 has been estimated at €14,882,000 by independent actuaries using the projected unit credit method. In this respect, charges of €656,000 and €514,000 were recognised in profit or loss and other comprehensive income respectively, during the current financial year. The charge recognised in profit or loss mainly relates to current services costs; while the charge recognised in other comprehensive income principally comprises actuarial losses attributable to financial assumptions and experience adjustments.

The present value of the defined benefit obligation at 31 December 2018 and 2017 has been estimated after taking into consideration the following assumptions:

i a rate of 1.55% (2017: 1.75%) to discount the future obligations to present value, which is based on the eurozone corporate bond yield curve. The yield curve is derived by considering the market yields on high-quality corporate bonds with currency and term of the corporate bonds (rated AA- or better) consistent with the currency and term of the liabilities;

ii an inflation rate of 1.65% (2017: 2%) in line with the eurozone inflation curve;

iii a salary increase assumption of 2% (2017: 1.75%);

iv withdrawal rates, representing the local group's expectations in respect of retirement of employees, which were based on standard tables used by actuaries after taking into consideration the observed retirement history of the local group;

v retirement age of 61;

vi mortality rates based on generational tables used by actuaries; and

vii ill health rates mainly based on the local group's historical experience.

A sensitivity analysis for significant actuarial assumptions as of the end of the reporting period, showing how the defined benefit obligation would have been affected by changes in the relevant actuarial assumptions that were reasonably possible at that date is not deemed necessary taking into account the materiality and significance of the amount of the provisions in the context of the aggregate level of assets and liabilities of the local group and the level of financial results registered during the current period.

(c) Litigation provision

Litigation provision as at 31 December 2018 amounted to €881,000 (2017: €641,000) for the local group and €835,000 (2017: €641,000) for the bank. This provision is expected to be settled after more than one year from the reporting date. The impact of discounting is not considered to be significant. The movement in these provisions for 2018 comprising mainly an increase in provision of €240,000 (2017: reversal of €261,000) for the local group and €194,000 (2017: reversal of €261,000) for the bank, is recognised in profit or loss under 'General and administrative expenses'.

Based on legal advice, the Board believes that adequate provisions have been recognised, taking into consideration the timing and amount of the probable economic outflows required in respect of the litigation highlighted.

44 Subordinated liabilities

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
5.90% subordinated unsecured loan stock 2018	**—**	29,277	**—**	30,000
Subordinated unsecured loan stock 2028	**62,000**	—	**62,000**	—
	62,000	29,277	**62,000**	30,000

These above liabilities will, in the event of the winding up of the bank, be subordinated to the claims of depositors and other creditors. The bank did not have any defaults of interest or other breaches with respect to its subordinated liabilities during the current and comparative periods.

The 5.9% subordinated unsecured loan stock 2018 matured on 7 October 2018.

The €62,000,000 subordinated unsecured loan stock, with maturity date of 14 December 2028, was issued in December 2018 and has a floating rate linked to a three-month Euribor. As at year end 31 December 2018 the effective interest rate was 1.75%.

45 Liabilities attributable to disposal group held for sale

	Group	
	2018	2017
	€000	€000
At 1 January	**473,797**	—
Transfers (to)/from Liabilities under investment contracts (Note 41)	**(9,119)**	495,479
Premiums received	**33,547**	—
Amounts paid on surrender and other terminations during the year	**(41,337)**	(582)
Changes in unit prices and other movements	**(25,095)**	(21,100)
Transfer to third party	**(431,793)**	—
At 31 December	**—**	473,797

46 Other liabilities

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Bills payable	**15,041**	19,361	**15,041**	19,361
Committed letters of credit	**6,924**	8,951	**6,924**	8,951
Other	**22,312**	35,473	**16,892**	29,776
	44,277	63,785	**38,857**	58,088

47 Called up share capital

	Group/Bank	
	2018	2017
	€000	€000
Authorised		
470,000,000 ordinary shares of 30 cent each	**141,000**	141,000
Issued and fully paid up		
360,306,099 ordinary shares of 30 cent each	**108,092**	108,092

48 Reserves

(a) Revaluation reserve

The revaluation reserve comprises the surplus arising on the revaluation of the local group's freehold and long leasehold properties and the cumulative net change in fair value of financial investments measured at fair value through other comprehensive income held by the local group, net of deferred taxation. The revaluation reserve is not available for distribution.

	Group	Bank
	€000	€000
On land and buildings		
1 January 2017	**26,925**	**26,925**
– transfer to retained earnings upon realisation through disposal	**(252)**	**(252)**
– deferred tax on transfer upon realisation through disposal	**88**	**88**
31 December 2017	**26,761**	**26,761**
– surplus arising on revaluation	**424**	**424**
– deferred tax on revaluation surplus	**(42)**	**(42)**
31 December 2018	**27,143**	**27,143**
On financial investments		
1 January 2017	**14,408**	**14,299**
– fair value adjustments	**(7,290)**	**(7,139)**
– deferred tax on fair value adjustments	**2,551**	**2,499**
31 December 2017	**9,669**	**9,659**
– fair value adjustments	**(3,919)**	**(3,903)**
– deferred tax on fair value adjustments	**1,372**	**1,366**
31 December 2018	**7,122**	**7,122**
Total as at 31 December 2017	**36,430**	**36,420**
Total as at 31 December 2018	**34,265**	**34,265**

(b) Retained earnings

Retained earnings include the Depositor Compensation Scheme reserve which is excluded for the purposes of the Own Funds calculations (refer to Note 6) and the General Banking Risk reserve which is held as a capital buffer for regulatory purposes.

Depositor Compensation Scheme reserve

The Depositor Compensation Scheme reserve amounts to €23,618,000 (2017: €25,188,000). As at 31 December 2018, debt securities with a carrying amount of €24,043,000 (2017: €25,510,000) had been pledged in terms of the Depositor Compensation Scheme (refer to Note 27).

General Banking Risk reserve

Banking Rule BR 09 'Measures addressing credit risks arising from the assessment of the quality of asset portfolios of credit institutions authorised under the Banking Act 1994', issued by the MFSA, requires banks in Malta to hold additional reserves for general banking risks in respect of non-performing loans. This reserve is required to be funded from planned dividends. As at 31 December 2018, the General Banking Risk reserve amounts to €5,135,000 (2017: €6,200,000).

49 Contingent liabilities

	Group Contract amount		Bank Contract amount	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Guarantees	**126,374**	99,274	**126,376**	99,276
Standby letters of credit	**21,203**	21,057	**21,203**	21,057
Other contingent liabilities	**2,206**	2,628	**2,206**	2,628
	149,783	122,959	**149,785**	122,961

The local group provides guarantees and standby letters of credit on behalf of third party customers. These are generally provided in the normal course of the group's banking business. The maximum potential amount of future payments which the local group could be required to make at 31 December is disclosed in the table above. The risks and exposures arising from guarantees and standby letters of credit are captured and managed in accordance with the local group's overall credit risk management policies and procedures.

The above table discloses the nominal principal amounts, which represents the maximum amounts at risk should the contracts be fully drawn upon and clients default. As a significant portion of guarantees and standby letters of credit is expected to expire without being drawn upon, the total of the nominal principal amounts is not indicative of future liquidity requirements.

Guarantees and standby letters of credit have a term of less than one year.

The expected credit loss allowances relating to guarantees and standby letters of credit is disclosed in Note 43.

Other contingent liabilities relate to legal claims against the bank. Based on legal advice, it is not considered probable that settlement will require the outflow of economic benefits in the case of these legal claims, or the amount of the obligation cannot be reliably measured.

50 Commitments

	Group Contract amount		Bank Contract amount	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Documentary credits	**20,235**	19,910	**20,235**	19,910
Undrawn formal standby facilities, credit lines and other commitments to lend	**1,413,538**	1,195,547	**1,414,399**	1,195,591
	1,433,773	1,215,457	**1,434,634**	1,215,501

The expected credit loss allowances on loan commitments are disclosed on Note 43.

The above commitments exclude commitments in relation to capital expenditure and operating leases which are disclosed in Note 51.

51 Capital and lease commitments

(a) Capital commitments

Capital commitments as at 31 December 2018 amounting to €181,000 (2017: €224,000) are mainly related to the acquisition of property, plant and equipment.

(b) Operating leases

At 31 December 2018, the local group and the bank were party to non-cancellable operating lease agreements for properties used by the local group for operational purposes, in respect of which the future minimum lease payments extend over a number of years. The leases run for an initial period of up to one hundred and fifty years. Specific lease arrangements include an option to renew the lease after the original term but the amounts presented in the tables below do not reflect lease charges applicable to the renewal period.

Total future minimum lease net payments under non-cancellable property operating leases

	Group/Bank	
	2018	2017
	€000	€000
Less than one year	**1,163**	1,233
Between one year and five years	**1,065**	1,085
More than five years	**2,359**	2,732
	4,587	5,050

Lease payments recognised in profit or loss under 'General administrative expenses' amounted to €1,111,000 (2017: €1,108,000). This amount includes a payment of €82,000 (2017: €79,000) in respect of rent paid on one property which is subject to a sub-lease agreement for the same amount.

52 Dividends

	Group			
	2018	2017	**2018**	2017
	Cent per 30c share	Cent per 30c share	**€000**	€000
Gross of income tax				
– prior year's final dividend	**12.40**	4.11	**44,677**	14,773
– current year's interim dividend	**4.00**	4.71	**14,412**	16,934
	16.40	8.82	**59,089**	31,707
Net of income tax				
– prior year's final dividend	**8.06**	2.67	**29,041**	9,602
– current year's interim dividend	**2.60**	3.06	**9,368**	11,008
	10.66	5.73	**38,409**	20,610

The Directors have proposed a final gross ordinary dividend of 1.80 cent (2017: 12.40 cent) per share. The final dividend will be payable to shareholders on the bank's register as at 18 March 2019.

	Group	
	2018	2017
	€000	€000
Proposed dividend		
Profit for the year	**28,696**	30,855
Proposed dividend	**13,678**	20,056
Less: interim dividend paid	**(9,368)**	(11,008)
Available for distribution	**4,310**	9,048
Extraordinary dividend	**–**	20,000
Proposed final dividend	**4,310**	29,048
Issued and fully paid up shares (Note 47)	**360,306,099**	360,306,099
	Cent per share	Cent per share
Proposed final dividend		
– gross of income tax per share	**1.8**	12.4
– net of income tax per share	**1.2**	8.1

No allocations were made during the current and previous year to the General Banking Risk Reserve as a result of the drop in the level of non-performing loans (refer to Note 48).

53 Cash and cash equivalents

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Balances of cash and cash equivalents are analysed below:				
Cash	**31,169**	35,006	**31,169**	35,006
Malta Government Treasury Bills of three months or less	**68,318**	53,505	**68,318**	53,505
Balances with Central Bank of Malta (excluding reserve deposit) of three months or less	**45**	511	**45**	511
Loans and advances to banks of three months or less	**712,152**	771,964	**707,211**	758,350
Items in course of collection from other banks	**5,404**	18,158	**5,404**	18,158
Items in course of collection to other banks	**(15,206)**	(30,495)	**(15,206)**	(30,495)
Per Statements of Cash Flows	**801,882**	848,649	**796,941**	835,035
Adjustment to reflect balances with contractual maturity of more than three months	**447,727**	329,091	**453,147**	334,793
Per Statements of Financial Position	**1,249,609**	1,177,740	**1,250,088**	1,169,828
Analysed as follows:				
Cash and balances with Central Bank of Malta	**80,421**	83,547	**80,421**	83,547
Malta Government Treasury Bills	**110,347**	80,512	**110,347**	80,512
Loans and advances to banks	**1,097,714**	1,059,308	**1,092,773**	1,045,699
Items in course of collection from other banks	**5,404**	18,158	**5,404**	18,158
Other liabilities	**(44,277)**	(63,785)	**(38,857)**	(58,088)
	1,249,609	1,177,740	**1,250,088**	1,169,828

54 Segmental information

The local group provides a comprehensive range of banking and related financial services to its customers. The products and services offered to customers are organised by the following global businesses. During 2017, the local group had modified its internal reporting organisation and structure such that the composition of the local group's reportable segments for the purposes of IFRS 8, 'Operating Segments', include the Corporate Centre segment. The Corporate Centre segment had been introduced at Group level.

- Retail Banking and Wealth Management (RBWM) offers a broad range of products and services to meet the personal banking and wealth management needs of individual customers. Typically, customer offerings include personal banking products (current and savings accounts, mortgages and personal loans, credit cards, debit cards and local and international payment services) and wealth management services (insurance and investment products, global asset management services and financial planning services).
- Commercial Banking (CMB) offers a broad range of products and services to serve the needs of our commercial customers, including small and medium sized enterprises, mid-market enterprises and corporates. These include credit and lending and international trade and receivables finance. CMB also offers its customers access to products and services offered by other global businesses, for example Global Markets (GM).
- GM provides tailored financial solutions to corporate and institutional clients. The client-focused business line delivers a full range of banking capabilities including assistance with managing risk via interest rate derivatives, the provision of foreign exchange spot and derivative products, and payment services.
- Corporate Centre comprises mainly of Central Treasury, including Balance Sheet Management.

The local group's internal reporting to the Board of Directors and Senior Management is analysed according to these business lines. For each of the businesses, the Senior Management, in particular the Chief Executive Officer, as chief operating decision-maker, reviews internal management reports in order to make decisions about allocating resources and assessing performance.

The Board considers that global businesses represent the most appropriate information for the users of the financial statements to best evaluate the nature and financial effects of the business activities in which the local group engages, and the economic environments in which it operates. As a result, the local group's operating segments are considered to be the global businesses.

	Group				
	2018				
	Retail Banking and Wealth Management	Commercial Banking	Global Markets	Corporate Centre	Group Total
	€000	€000	€000	€000	€000
Net interest income	**65,832**	**35,294**	**—**	**7,496**	**108,622**
– external	**62,958**	**39,091**	**—**	**6,573**	**108,622**
– internal	**2,874**	**(3,797)**		**923**	**—**
Net non-interest income	**25,669**	**11,523**	**2,478**	**81**	**39,751**
Net operating income before loan impairment charges	**91,501**	**46,817**	**2,478**	**7,577**	**148,373**
Change in expected credit losses and other credit impairment charges	**(1,751)**	**(1,755)**	**—**	**18**	**(3,488)**
Movement in provision for brokerage remediation costs	**2,028**	**—**	**—**	**—**	**2,028**
Net operating income	**91,778**	**45,062**	**2,478**	**7,595**	**146,913**
Employee compensation and benefits	**(36,626)**	**(12,273)**	**(640)**	**(619)**	**(50,158)**
General and administrative expenses	**(37,653)**	**(13,906)**	**(542)**	**(923)**	**(53,024)**
Depreciation of property, plant and equipment	**(2,326)**	**(975)**	**(28)**	**(72)**	**(3,401)**
Amortisation of intangible assets	**(1,235)**	**(489)**	**(14)**	**(36)**	**(1,774)**
Profit before tax	**13,938**	**17,419**	**1,254**	**5,945**	**38,556**
Assets					
Segment total assets	**3,087,012**	**1,046,556**	**6,579**	**2,170,847**	**6,310,994**
Total equity	**223,328**	**158,955**	**8,274**	**68,221**	**458,778**
	2017				
Net interest income	66,142	43,026	(210)	11,702	120,660
– external	63,338	49,039	(22)	8,305	120,660
– internal	2,804	(6,013)	(188)	3,397	—
Net non-interest income	28,573	8,996	2,660	—	40,229
Net operating income before loan impairment charges	94,715	52,022	2,450	11,702	160,889
(Net loan impairment charges)/net reversal of loan impairment charges	2,494	(1,326)	—	—	1,168
Movement in provision for brokerage remediation costs	1,800	—	—	—	1,800
Net operating income	99,009	50,696	2,450	11,702	163,857
Employee compensation and benefits	(40,466)	(14,079)	(898)	(749)	(56,192)
General and administrative expenses	(36,364)	(14,399)	(727)	(788)	(52,278)
Depreciation of property, plant and equipment	(2,476)	(1,036)	(50)	(70)	(3,632)
Amortisation and impairment of intangible assets	(1,336)	(534)	(26)	(36)	(1,932)
Profit before tax	18,367	20,648	749	10,059	49,823
Assets					
Segment total assets	3,576,285	1,116,437	5,312	2,099,949	6,797,983
Total equity	235,185	172,456	7,727	63,670	479,038

55 Related party transactions

The immediate parent company of the local group and the bank is HSBC Europe BV, a company incorporated in the Netherlands, with its registered address at Karspeldreef 6K, Amsterdam, 1101 CJ Netherlands.

The ultimate parent company of the local group and the bank is HSBC Holdings plc, a company incorporated in England, with its registered address at 8, Canada Square, London E14 5HQ, United Kingdom.

Related parties of the local group and the bank include subsidiaries, the ultimate parent, all entities controlled by the ultimate parent, key management personnel, close family members of key management personnel and entities which are controlled or jointly controlled by key management personnel or their close family members.

Key management personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of HSBC Bank Malta p.l.c., being the Directors and the bank's Executive Committee members.

(a) Transactions, arrangements and agreements involving Directors and other key management personnel

Particulars of transactions, arrangements and agreements entered into with Directors and other key management personnel, close family members and companies controlled or jointly controlled by them:

	Group/Bank			
	Highest balance during the year	**Balance at end of year**	Highest balance during the year	Balance at end of year
	2018	**2018**	2017	2017
	€000	**€000**	€000	€000
Credit card balances	**7**	**7**	9	4
Guarantees issued	**—**	**—**	2	—
Commitments to lend	**100**	**100**	124	95

The above banking facilities are part of long-term commercial relationships and were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

(b) Compensation of Directors and other key management personnel

The following represents the compensation of Directors and other key management personnel in exchange for services rendered to the local group and the bank for the period they served during the year.

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Directors' emoluments (including non-executive Directors)				
Salaries and other emoluments	**2,187**	2,102	**934**	847
Benefits	**106**	108	**112**	151
Share-based payments	**33**	39	**23**	30
	2,326	2,249	**1,069**	1,028
Other key management personnel				
Salaries and other emoluments	**1,608**	1,925	**2,380**	2,687
Benefits	**179**	246	**280**	351
Share-based payments	**—**	4	**10**	13
	1,787	2,175	**2,670**	3,051

Directors' emoluments for the local group include the compensation of certain key management personnel of the bank amounting to €884,000 (2017: €875,000) that also serve as Directors of subsidiary companies, as well as the compensation of non-executive Directors of subsidiary companies amounting to €84,000 (2017: €81,000).

(c) Balances and transactions with other related parties

Balance and transactions with HSBC Bank p.l.c.

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Assets				
Derivatives	**927**	202	**927**	202
Loans and advances to banks	**893,650**	983,969	**891,636**	977,403
Other assets	**4,337**	841	**4,337**	841
Prepayments and accrued income	**33**	790	**33**	790
Liabilities				
Derivatives	**4,055**	4,814	**4,055**	4,814
Deposits by banks	**2,252**	—	**2,252**	—
Subordinated liabilities	**62,000**	—	**62,000**	—
Accruals and deferred income	**3,466**	3,752	**2,646**	3,293
Income statement				
Interest income	**(1,632)**	(2,001)	**(1,632)**	(2,001)
Interest expense	**469**	502	**469**	502
Fee income	**604**	1,161	**604**	1,161
Fee expense	**25**	35	**25**	35
Net trading income	**655**	172	**655**	172
Other income	**1,803**	968	**1,803**	968
Employee compensation and benefits	**—**	388	**—**	335
General and administrative expenses	**5,797**	7,818	**4,688**	6,204

Balances and transactions with other subsidiaries of HSBC Holdings plc

	Group		Bank	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Assets				
Loans and advances to banks	**198,605**	66,651	**197,705**	63,316
Prepayments and accrued income	**322**	510	**108**	236
Liabilities				
Deposits by banks	**290**	–	**290**	–
Accruals and deferred income	**2,869**	863	**1,942**	82
Income statement				
Interest income	**1,054**	932	**1,054**	932
Interest expense	**104**	270	**104**	270
Fee income	**1,568**	1,709	**18**	145
Fee expense	**–**	20	**–**	–
Other income	**17**	40	**17**	40
General and administrative expenses	**14,977**	10,436	**13,448**	9,395

Balances and transactions with local group entities

	Bank	
	2018	2017
	€000	€000
Assets		
Prepayments and accrued income	**306**	452
Investment in subsidiaries	**30,859**	30,859
Liabilities		
Customer accounts	**53,507**	83,341
Subordinated liabilities	**–**	723
Income statement		
Interest income	**–**	4
Fee income	**3,024**	3,311
Dividend income	**11,407**	–

The outstanding balances, reflected in tables above, arose from the ordinary course of business and are of substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

56 Effects of adoption of IFRS 9

(a) Classification and measurement of financial instruments

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

	IAS 39			IFRS 9		
		Group	Bank		Group	Bank
	Measurement category	Carrying amount		Measurement category	Carrying amount	
Financial assets		€000	€000		€000	€000
Balances with Central Bank of Malta and cash	**Amortised cost (Loans and receivables)**	**83,547**	**83,547**	**Amortised cost**	**83,544**	**83,544**
Treasury Bills	**FVOCI (Available for sale)**	**80,512**	**80,512**	**FVOCI**	**80,512**	**80,512**
Items in the course of collection from other banks	**Amortised cost (Loans and receivables)**	**18,158**	**18,158**	**Amortised cost**	**18,158**	**18,158**
Financial investments measured at fair value through profit or loss attributable to insurance operations	**FVTPL (Designated)**	**727,270**	**—**	**FVTPL (Mandatory)**	**727,270**	**—**
Held for trading derivatives	**FVTPL (Held for trading)**	**5,175**	**5,175**	**FVTPL (Designated)**	**5,175**	**5,175**
Loans and advances to banks	**Amortised cost (Loans and receivables)**	**1,059,308**	**1,045,699**	**Amortised cost**	**1,059,307**	**1,045,698**
Loans and advances to customers	**Amortised cost (Loans and receivables)**	**3,128,833**	**3,128,833**	**Amortised cost**	**3,123,786**	**3,123,786**
Financial investments	**FVOCI (Available for sale)**	**926,096**	**924,881**	**FVOCI**	**926,096**	**924,881**
Accrued income	**Amortised cost (Loans and receivables)**	**23,139**	**19,120**	**Amortised cost**	**17,515**	**13,496**
Other assets	**Amortised cost (Loans and receivables)**	**8,951**	**8,951**	**Amortised cost**	**8,875**	**8,875**

All financial liabilities except for held for trading derivatives and financial liabilities attributable to investment contracts that continue to be designated at fair value through profit or loss, which are accordingly measured at fair value through profit or loss, remain measured at amortised cost following initial application of IFRS 9. Therefore there is no impact from reclassification/remeasurement upon transition to IFRS 9 on such financial liabilities which principally comprise of customer accounts, deposit by banks and subordinated liabilities.

(b) Reconciliation of statement of financial position balances from IAS 39 to IFRS 9

	Group			
	IAS 39 carrying amount 31 December 2017	Reclassification	Remeasurement	IFRS 9 carrying amount 1 January 2018
	€000	€000	€000	€000
Amortised cost				
Balances with Central Bank of Malta and cash				
Opening balance under IAS 39	83,547			
Remeasurement: ECL allowance			(3)	
Closing balance under IFRS 9				83,544
Items in the course of collection from other banks				
Opening balance under IAS 39 and closing balance under IFRS 9	18,158			18,158
Loans and advances to banks				
Opening balance under IAS 39	1,059,308			
Remeasurement: ECL allowance			(1)	
Closing balance under IFRS 9				1,059,307
Loans and advances to customers				
Opening balance under IAS 39	3,128,833			
Remeasurement: ECL allowance			(5,047)	
Closing balance under IFRS 9				3,123,786
Accrued income				
Opening balance under IAS 39	23,139			
Remeasurement: ECL allowance			(5,624)	
Closing balance under IFRS 9				17,515
Other assets				
Opening balance under IAS 39	8,951			
Remeasurement: ECL allowance			(76)	
Closing balance under IFRS 9				8,875
Total financial assets measured at amortised cost	4,321,936	–	(10,751)	4,311,185
Fair value through profit or loss (FVTPL):				
Financial investments mandatorily measured at fair value through profit or loss attributable to insurance operations				
Opening balance under IAS 39	–			
Addition: From designated at FVTPL (IAS 39)		727,270		
Closing balance under IFRS 9				727,270
Financial investments designated at fair value attributable to insurance operations				
Opening balance under IAS 39	727,270			
Subtraction: To mandatory FVTPL (IFRS 9)		(727,270)		
Closing balance under IFRS 9				–
Held for trading derivatives				
Opening balance under IAS 39 and closing balance under IFRS 9	5,175			5,175
Total financial assets measured at FVTPL	732,445	–	–	732,445
Fair value through other comprehensive income (FVOCI):				
Treasury Bills				
Opening balance under IAS 39 and closing balance under IFRS 9	80,512			80,512
Financial investments - FVOCI (debt instruments)				
Opening balance under IAS 39	–			
Addition: From available for sale (IAS 39)		924,999		
Closing balance under IFRS 9				924,999
Financial investments - FVOCI (equity instruments)				
Opening balance under IAS 39	–			
Addition: From available for sale (IAS 39)		1,097		
Closing balance under IFRS 9				1,097
Financial investments - Available-for-sale				
Opening balance under IAS 39	926,096			
Subtraction: To FVOCI - Equity instruments		(1,097)		
Subtraction: To FVOCI - Debt instruments		(924,999)		
Closing balance under IFRS 9				–
Total financial assets measured at FVOCI	1,006,608	–	–	1,006,608

	At 1 January 2018	
	Fair value	Allowance for ECL
	€000	€000
Financial investments (debt securities) measured at fair value through other comprehensive income	924,999	(37)
Treasury Bills measured at fair value through other comprehensive income	80,512	(2)
Total	1,005,511	(39)

Reconciliation of statement of financial position balances from IAS 39 to IFRS 9

	Bank			
	IAS 39 carrying amount 31 December 2017	Reclassification	Remeasurement	IFRS 9 carrying amount 1 January 2018
	€000	€000	€000	€000
Amortised cost				
Balances with Central Bank of Malta and cash				
Opening balance under IAS 39	83,547			
Remeasurement: ECL allowance			(3)	
Closing balance under IFRS 9				83,544
Items in the course of collection from other banks				
Opening balance under IAS 39 and closing balance under IFRS 9	18,158			18,158
Loans and advances to banks				
Opening balance under IAS 39	1,045,699			
Remeasurement: ECL allowance			(1)	
Closing balance under IFRS 9				1,045,698
Loans and advances to customers				
Opening balance under IAS 39	3,128,833			
Remeasurement: ECL allowance			(5,047)	
Closing balance under IFRS 9				3,123,786
Accrued income				
Opening balance under IAS 39	19,120			
Remeasurement: ECL allowance			(5,624)	
Closing balance under IFRS 9				13,496
Other assets				
Opening balance under IAS 39	8,951			
Remeasurement: ECL allowance			(76)	
Closing balance under IFRS 9				8,875
Total financial assets measured at amortised cost	4,304,308	–	(10,751)	4,293,557
Fair value through profit or loss (FVTPL):				
Held for trading derivatives				
Opening balance under IAS 39 and closing balance under IFRS 9	5,175			5,175
Fair value through other comprehensive income (FVOCI):				
Treasury Bills				
Opening balance under IAS 39 and closing balance under IFRS 9	80,512			80,512
Financial investments - FVOCI (debt instruments)				
Opening balance under IAS 39	–			
Addition: From available for sale (IAS 39)		923,786		
Closing balance under IFRS 9				923,786
Financial investments - FVOCI (equity instruments)				
Opening balance under IAS 39	–			
Addition: From available for sale (IAS 39)		1,095		
Closing balance under IFRS 9				1,095
Financial investments - Available-for-sale				
Opening balance under IAS 39	924,881			
Subtraction: To FVOCI - Equity instruments		(1,095)		
Subtraction: To FVOCI - Debt instruments		(923,786)		
Closing balance under IFRS 9				–
Total financial assets measured at FVOCI	1,005,393	–	–	1,005,393

	At 1 January 2018	
	Fair value	Allowance for ECL
	€000	€000
Financial investments (debt securities) measured at fair value through other comprehensive income	923,786	(37)
Treasury Bills measured at fair value through other comprehensive income	80,512	(2)
Total	1,004,298	(39)

(c) Reconciliation of impairment allowance balance from IAS 39 to IFRS 9 as at 1 January 2018

	Group/Bank		
	Loan loss allowance under IAS 39/Provision under IAS 37	**Remeasurement**	**Expected credit loss allowance under IFRS 9**
Measurement category	**€000**	**€000**	**€000**
Loans and receivable (IAS 39)/Financial assets at amortised cost (IFRS 9)			
Balances with Central Bank of Malta and cash	–	3	3
Loans and advances to banks	–	1	1
Loans and advances to customers	40,641	5,047	45,688
Accrued income	–	5,624	5,624
Other assets	–	76	76
	40,641	10,751	51,392
Available-for-sale financial instruments (IAS 39)/Financial assets at FVOCI (IFRS 9)			
Treasury Bills	–	2	2
Financial investments	–	37	37
	–	39	39
Loans and other credit-related commitments	37	1,270	1,307
Financial guarantees and similar contracts	–	322	322
Total	40,678	12,382	53,060

57 Unconsolidated structured entities

The term 'unconsolidated structured entities' refers to all structured entities that are not controlled by the local group. The local group has established and manages investment funds to provide customers with investment opportunities.

Type of structured entity	Nature and purpose	Interest held by the group
Investment funds	• These vehicles are financed through the issue of units to investors. • To generate fees from managing assets on behalf of third party investors.	• Investments in units issued by the fund • Management fees

As fund manager, the local group may be entitled to receive a management and performance fee based on the assets under management. The total management fees earned during the year were €3,611,000 (2017: €3,879,000).

The table below shows the total assets of unconsolidated structured entities in which the local group has an interest at the reporting date, and the maximum exposure to loss in relation to those interests. The maximum exposure to loss from the local group's interests in unconsolidated structured entities represents the maximum loss that the local group could incur as a result of its involvement with unconsolidated structured entities regardless of the probability of the loss being incurred.

	2018	2017
	€000	€000
Carrying amount of units in HSBC managed investment funds - classified as financial investments measured at fair value through profit or loss	76,893	75,847
Total assets of HSBC managed funds	375,865	412,172

The maximum exposure to loss is equivalent to the carrying amount of the assets held at the reporting date.

58 Trust and custody activities

The local group provides custody services to individuals and retirement benefit plans, whereby it holds and manages assets or invests funds received in various financial instruments at the direction of the customer. In line with Group strategy, during 2018, the bank continued the process of exiting from its trust business.

The local group receives fee income for providing these services. Trust assets and assets held in custody are not assets of the local group and are not recognised in the statements of financial position. The local group is not exposed to any credit risk relating to such placements, as it does not guarantee these investments.

At 31 December 2018, total assets held by the local group on behalf of customers amounted to €571,944,000 (2017: €648,515,000).

59 Registered office and ultimate parent company

The addresses of the registered and principal offices of the bank and its subsidiary companies included in the consolidated financial statements can be found in a separate statement which is filed at the Registrar of Companies in accordance with the provisions of the Third Schedule to the Companies Act, 1995.

The ultimate parent company of HSBC Bank Malta p.l.c. is HSBC Holdings plc, and the immediate parent company is HSBC Europe B.V., which are incorporated and registered in the United Kingdom and the Netherlands respectively. The registered address of HSBC Holdings plc is 8, Canada Square, London E14 5HQ, United Kingdom and the registered address of HSBC Europe B.V. is Karspeldreef 6K, Amsterdam, 1101 CJ, Netherlands. Copies of the HSBC Holdings plc Annual Review 2018, Strategic Report 2018, and Annual Report and Accounts 2018 may be obtained from its registered office or viewed on www.hsbc.com.

60 Investor compensation scheme

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.

61 Critical accounting estimates and judgements

This note contains information about critical judgements, significant assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment and that have the most significant effects on the amounts recognised in the financial statements. Information about assumptions and estimation uncertainties relating to fair valuation of financial instruments is disclosed in Note 5. Estimates and judgements are continually evaluated and are based on historical and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

(a) Expected credit loss allowances on loans and advances

Credit loss allowances represent management's best estimate of expected credit losses in the loan portfolios and other financial assets subject to IFRS 9 impairment requirements at the balance sheet date. In this respect, management is required to exercise judgement in defining what is considered to be a significant increase in credit risk in determining the lifetime and point of initial recognition of revolving facilities, and in making assumptions and estimates to incorporate relevant information about past events, current conditions and forecasts of economic conditions.

In particular, the measurement of the expected credit loss allowance is an area that requires the use of complex models and of statistical analyses of historical information, supplemented with significant management judgement, to assess whether current and future macroeconomic conditions are such that the level of expected credit losses is likely to be greater or less than historical experience. The PD, LGD and EAD models, which support the measurement of ECLs, are reviewed regularly in light of differences between loss estimates and actual loss experience, but given that IFRS 9 requirements have only just been applied, there has been little time available to make these comparisons. Therefore, the underlying models and their calibration, including how they react to forward-looking economic conditions, remain subject to review and refinement.

The exercise of judgement in making estimations requires the use of assumptions that are highly subjective and very sensitive to the risk factors, detailed in note 3(b)(iv), but in particular to changes in economic and credit conditions (to reflect a point in time estimate). Many of the factors have a high degree of interdependency and there is no single factor to which loan impairment allowances as a whole are sensitive. Significant judgement is required in establishing the number and relative weightings of forward looking scenarios.

For individually assessed loans, judgement is required in determining whether these are credit impaired. In this respect, judgement is exercised in evaluating all relevant information on indicators of impairment, including the consideration of whether payments are contractually past-due and the consideration of other factors indicating deterioration in the financial condition and outlook of borrowers affecting their ability to pay. For individually significant credit impaired loans, management determine the size of the allowance required based on a range of factors such as the realisable value of security, the viability of the customer's business model and the capacity to generate cash flow to service debt obligations, under different scenarios. Judgement is applied in estimating the expected future cash flows from each borrower under the different scenarios as well as to attach probabilities to those scenarios.

(b) Policyholder claims and benefits

The estimation of future benefit payments and premiums arising from long-term insurance contracts is one of the local group's most critical accounting estimates. The determination of the liabilities under long-term insurance contracts is dependent on estimates made by the local group. Estimates are made as to the expected number of deaths for each of the years in which the local group is exposed to risk. The local group bases these estimates on industry standard mortality tables that reflect recent historical mortality experience, adjusted where appropriate to reflect the local group's own experience. The estimated number of deaths determines the value of the future benefit payments. The main source of uncertainty is that epidemics such as AIDS, SARS, pandemic flu, swine flu and wide-ranging lifestyle changes, such as in eating, smoking and exercise habits, could result in future mortality being significantly worse than in the past for the age groups in which the local group has significant exposure to mortality risk. New estimates are made each subsequent year to reflect the current long-term outlook.

Estimates are also made as to future investment income arising from the assets backing long-term insurance. These estimates are based on current market returns as well as expectations about future economic and financial developments. Interest rate assumptions for the purposes of valuing liabilities as at reporting date are based on the euro swap rates curve. Appropriate margins were taken for bond portfolio and equities/property portfolio.

If the average future investment returns differ by +/-1% from management's estimates, the insurance liability would decrease by €15,135,000 (2017: €16,670,000) or increase by €21,638,000 (2017: €21,838,000). In this case there is no relief arising from reinsurance contracts held. If the number of deaths in future years differ by +/-10% from management's estimate, the liability would increase by €1,241,000 (2017: €1,153,000) or decrease by €1,360,000 (2017: €1,248,000). These impacts are calculated before considering changes to other assets and liabilities which may offset the gross impact of this change.

(c) Present value of in-force long-term assurance business (PVIF)

The PVIF measures the shareholder's share of the future profits that are expected to be earned in future years attributable to the long-term life insurance business in force at the valuation date. Policies classified as investment contracts are excluded. The approach is to take a present value of the expected future shareholder cash flows discounted using the risk discount rate.

The risk free rate of return used within the valuation is the Euro swap rate curve as at 31 December 2018 (2017: same approach). The risk discount rate is based on the risk free curve with an additional 0.5% margin (2017: 0.5% margin) to allow for operational risk. The PVIF valuation assumes lapse rates varying by product and duration in-force that range from 0% to 18.7% p.a. (2017: from 0% to 18.7% p.a.). Expense inflation is calculated as a blend of wage inflation and price inflation, with the latter based on an adjusted French inflation curve. This results in a term dependent expense inflation assumption increasing from 1.4% p.a. to 2.6% p.a. (2017: 2.0% p.a. to 2.7% p.a.).

As the valuation models are based upon assumptions, changing the assumptions will change the resultant estimate of PVIF. The effect on the PVIF of reasonably possible changes in the main assumptions across the insurance business are included in Note 35.

Additional regulatory disclosures

Introduction

Regulatory framework for disclosures

HSBC Bank Malta p.l.c. falls under the direct supervision of the Joint Supervisory Team (JST) and the Malta Financial Services Authority (MFSA). The JST consists of representatives from the European Central Bank (ECB).

The two regulatory bodies receive information on the capital adequacy requirements for HSBC Bank Malta p.l.c. as an entity. At a consolidated level, we calculate capital for regulatory reporting purposes using the Basel III framework of the Basel Committee on Banking Supervision (the 'Basel Committee') as implemented by the European Union ('EU') in the amended Capital Requirements Directive and Regulation ('CRD IV').

The Basel III framework is structured around three 'pillars': the Pillar 1 minimum capital requirements, Pillar 2 in relation to supervisory review process which is complemented by Pillar 3 that concerns market discipline. The aim of Pillar 3 is to produce disclosures that allow market participants to assess the scope of application by banks of the Basel Committee's framework and the rules in their jurisdiction, their capital condition, risk exposures and risk management processes, hence their capital adequacy.

Pillar 3 requires all material risks to be disclosed to provide a comprehensive view of a bank's risk profile.

These Additional Regulatory Disclosures (ARDs) are aimed at providing the local group's stakeholders further insight to the local group's capital structure, adequacy and risk management practices. The disclosures outlined below have been prepared by the local group in accordance with the Pillar 3 quantitative and qualitative disclosure requirements as governed by Banking Rule BR/07: Publication of Annual Report and Audited Financial Statements of Credit Institutions authorised under the Banking Act, 1994, issued by the MFSA. Banking Rule BR/07 follows the disclosure requirements of Directive 2013/36/EU (Capital Requirements Directive - Pillar 1) and EU Regulation No 575/2013 (Capital Requirements Regulation - Pillar 2) of the European Parliament and of the Council of 26 June 2013.

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

Pillar 3 disclosures

Purpose

HSBC's Pillar 3 disclosures at 31 December 2018 comprise all information required under Pillar 3, both quantitative and qualitative. They are made in accordance with Part 8 of the Capital Requirements Regulation within CRD IV and the European Banking Authority's ('EBA') final standards on revised Pillar 3 disclosures issued in December 2016.

In light of the fact that the local group is considered a significant subsidiary of HSBC Holdings plc within the local market, consolidated supervision at the level of HSBC Holdings plc, the local group is exempt from full disclosure requirements laid down in Part Eight of the CRR.

The Pillar 3 disclosures are governed by the Group's disclosure policy framework. The disclosure policy sets out the governance, control and assurance requirements for publication of the document. While the disclosure statement is not required to be externally audited, the document has been subject to an internal review process in accordance with the banks' financial reporting and governance processes.

Basis of preparation

In our disclosures, to give insight into movements during the year, we provide comparative figures for the previous year or period, analytical review of variances and 'flow' tables for capital requirements.

Where disclosures have been enhanced, or are new, we do not generally restate or provide prior-year comparatives. Wherever specific rows and columns in the tables prescribed by the EBA or Basel are not applicable or immaterial to HSBC's activities, we omit them and follow the same premise for comparative disclosures. The capital resources tables track the position from a CRD IV transitional to an end-point basis.

Pillar 3 requirements may be met by inclusion in other disclosure media. Where we adopt this approach, references are provided to the relevant pages of the *Annual Report and Accounts 2018* or to other locations.

Table 1: Key metrics

Ref*		At 31 December 2018
	Available capital (€000)	
1	Common equity tier 1 ('CET1') capital	**108,092**
2	CET1 capital as if IFRS 9 transitional arrangements had not been applied	**108,092**
3	Tier 1 capital	**377,346**
4	Tier 1 capital as if IFRS 9 transitional arrangements had not been applied	**369,700**
5	Total capital	**439,346**
6	Total capital as if IFRS 9 transitional arrangements had not been applied	**431,700**
	Risk-weighted assets ('RWAs') (€000)	
7	Total RWAs	**2,581,346**
	Capital ratios (%)	
9	CET1	**14.6**
10	CET1 as if IFRS 9 transitional arrangements had not been applied	**14.3**
11	Tier 1	**14.6**
12	Tier 1 as if IFRS 9 transitional arrangements had not been applied	**14.3**
13	Total capital	**17.0**
14	Total capital as if IFRS 9 transitional arrangements had not been applied	**16.7**
	Additional CET1 buffer requirements as a percentage of RWA (%)	
	Capital conservation buffer requirement	**1.9**
	Countercyclical buffer requirement	**—**
	Bank G-SIB and/or D-SIB additional requirements	**1.1**
	Total of bank CET1 specific buffer requirements	**7.5**
	CET1 available after meeting the bank's minimum capital requirements	**6.6**
	Total capital requirement (%)	
	Total capital requirement	**17.0**
	Leverage ratio	
15	Total leverage ratio exposure measure (€000)	**5,789,329**
16	Leverage ratio (%)	**6.5**
	Liquidity Coverage Ratio ('LCR')	
	Total high-quality liquid assets (€000)	**1,043,761**
	Total net cash outflow (€000)	**207,243**
	LCR ratio (%)	**503.6**

**The references in this, and subsequent tables, identify the lines prescribed in the relevant European Banking Authority ('EBA') template where applicable and where there is a value.*

Regulatory Developments

The UK's withdrawal from the EU

The UK is due to formally leave the EU on 29 March 2019. Before 29 March, the UK and the EU are seeking to finalise the Article 50 Withdrawal Agreement, which will need to be approved by their respective parliaments. A comprehensive trade deal will not be concluded within this time frame. A period of transition until 31 December 2020 has been agreed between the UK and the EU. However, there will be no legal certainty until this is enshrined in the Withdrawal Agreement.

The modalities of the UK's exit from the European Union will likely have a significant impact on general economic conditions in the UK and the European Union. The UK's future relationship with the EU and its trading relationships with the rest of the world will likely take a number of years to resolve. This may result in a prolonged period of uncertainty, unstable economic conditions and market volatility, including currency fluctuations. Throughout this period of uncertainty, our priority is to support our clients and continue to service them, independent of the outcome of negotiations.

RWAs and leverage ratio

Basel Committee

In December 2017, the Basel Committee ('Basel') published revisions to the Basel III framework. The final package includes:

- widespread changes to the risk weights under the standardised approach to credit risk;
- a change in the scope of application of the internal ratings based ('IRB') approach to credit risk, together with changes to the IRB methodology;
- the replacement of the operational risk approaches with a single methodology;
- an amended set of rules for the credit valuation adjustment ('CVA') capital framework;
- an aggregate output capital floor that ensures that banks' total risk weighted assets ('RWAs') are no lower than 72.5% of those generated by the standardised approaches; and
- changes to the exposure measure for the leverage ratio.

Further refinements to the leverage ratio exposure measure for centrally cleared derivatives and disclosure of daily-average exposure measures are also under consideration. In January 2019, the final changes to the market risk RWA regime, the Fundamental Review of the Trading book ('FRTB') were published. The new regime has been recalibrated and contains a more clearly defined trading book boundary, the introduction of an internal models approach based upon expected shortfall models, capital requirements for non-modellable risk factors and a more risk-sensitive standardised approach that can serve as a fall-back for the internal models method.

Basel has announced that the package will be implemented on 1 January 2022, with a five-year transitional provision for the output floor, commencing at a rate of 50%. The final standards will need to be transposed into national law before coming into effect.

The final package of Basel III reforms contains a significant number of national discretions which will require transposition into EU law.

European Union

In the EU, the first tranche of the Basel III reforms are being implemented through revisions to the Capital Requirements Regulation ('CRR') and the Capital Requirements Directive ('CRD'), collectively referred to as CRR2. It is understood that this has been agreed in principle but is yet to enter into law and will follow a phased implementation from 2019. It includes a number of provisions such as the changes to market risk under the FRTB, revisions to the counterparty credit risk framework and the new leverage ratio rules.

The European Commission has requested that the European Banking Authority ('EBA') prepare a report on the implementation of the remaining tranche of the Basel III reforms on the EU's banking sector and the wider economy. This will include changes to credit, operational risk and the output floor.

In January 2019, a political agreement was reached between the EU Council and Parliament for a gradual prudential backstop for new non-performing loans, which will result in a deduction from Common Equity Tier 1 (CET1) capital when a minimum impairment coverage requirement is not met. The regime is expected to be implemented in the first half of 2019.

Also in January 2019, a revised securitisation framework came into force in the EU for newly issued securitisations. Existing transactions will be subject to the framework from 1 January 2020. This regime introduces changes to the methodology for determining RWAs for securitisation positions, with beneficial treatments for simple, transparent and standardised securitisation transactions.

Furthermore, the EU continued to work on its 'IRB Repair' programme, issuing near final guidance on the specification of economic downturn for the purposes of the loss given default modelling and final rules on the definition of default.

Capital resources, macro-prudential, recovery & resolution and total loss absorbing capacity

European Union

In addition to the changes to RWAs, alongside the Bank Recovery and Resolution Directive ('BRRD2'), CRR2 will implement changes in the own funds calculation and Minimum Requirements for Own Funds and Eligible Liabilities ('MREL'). In January 2019 the Single Resolution Board ('SRB') published updated policy on MREL for the second wave of resolution plans for the most complex groups, following earlier publication of the SRB policy statement for the first wave of resolution plans on 20 November 2018. The SRB is expected to review its MREL policy for any further updates in 2019, following the publication of CRR2/BRRD2 in the Official Journal of the EU.

Linkage to the Annual Report and Accounts 2018

Basis of preparation

The basis of consolidation for the purpose of financial reporting under International Financial Reporting Standards (IFRSs), described in the Annual Report, differs from that used for regulatory purposes. For regulatory reporting purposes, subsidiaries engaged in insurance activities are excluded from the regulatory consolidation and deducted from regulatory capital subject to thresholds. Therefore for the purposes of ARD, the investment in HSBC Life Assurance (Malta) Limited is excluded for the purpose of regulatory reporting.

The table below provides a full reconciliation of the local group's total own funds to the Statement of Financial Position within the audited financial statements for the year ended 31 December 2018, as required by article 437(1)(a) of the CRR.

Table 2: Reconciliation between accounting and regulatory scope of consolidation

	Group
	31 December 2018
	€000
Common Equity Tier 1	
As per Statement of Financial Position	
- called up share capital	**108,092**
- retained earnings	**316,421**
- revaluation reserve	**34,265**
	458,778
Less: Own Funds adjustments	
– depositor compensation scheme	**(23,618)**
– intangible assets	**(5,831)**
– expected final dividend	**(4,310)**
– retained earnings - HSBC Life Assurance (Malta) Limited	**(53,584)**
– additional valuation adjustment	**(1,025)**
– IFRS 9 transitional adjustments	**7,646**
– other	**(710)**
Sub-total Tier 1	**377,346**
Tier 2 capital	
As per Statement of Financial Position	
Subordinated debt	**62,000**
Sub-total Tier 2	**62,000**
Total own funds	**439,346**

Capital management

Approach and policy

Our approach to capital management is driven by our strategic and organisational requirements, taking into account the regulatory, economic and commercial environment. We aim to maintain a strong capital base to support the risks inherent in our business, invest in accordance with our strategy and meeting both ECB as well as local regulatory capital requirements at all times.

HSBC Bank Malta p.l.c. manages its capital to ensure that it exceeds current and expected future requirements. Throughout 2018, HSBC Bank Malta p.l.c. complied with the European Central Bank ('ECB') regulatory capital adequacy requirements. To achieve this, the bank manages its capital within the context of an annual capital plan which is approved by the Board and which determines the appropriate amount and mix of capital.

The impact of the local group’s capital plan on shareholder returns is therefore recognised by the level of equity capital employed for which the local group seeks to maintain a prudent balance between the advantages and flexibility afforded by a strong capital position and the higher returns on equity from increased leverage.

During 2018, HSBC Bank Malta p.l.c. increased its Tier2 capital consisting of €62m subordinated debt through an intra-group transaction with HSBC Group; this follows the maturity of €30m subordinated debt which occurred in October 2018.

These operations have strengthened HSBC Bank Malta p.l.c.’s total capital base and adjusted its balance sheet structure to its business strategy and applicable requirements.

HSBC Bank Malta p.l.c.’s capital management policy is underpinned by the HSBC Group capital management framework, which enables us to manage our capital in a consistent manner, and by the Bank’s Annual Operation Plan, as validated by the Board of Directors. The Internal Capital Adequacy Assessment Process (‘ICAAP’) which aims at assessing the adequacy of the bank's capital resources in regards of its risk and requirements incorporates different assessment methods of the capital needs within HSBC Bank Malta p.l.c.

Stress testing

Stress testing is incorporated in the capital management framework and is an important component of understanding the sensitivities of the core assumptions included in HSBC Bank Malta p.l.c.’s capital plans to the adverse effect of extreme but plausible events. Stress testing allows senior management to formulate its response, including risk mitigating actions, in advance of conditions starting to reflect the stress scenarios identified.

Overview of regulatory capital framework

Main features of CET1 and T2 instruments issued by the group

For regulatory purposes, HSBC Bank Malta p.l.c.’s capital base is currently divided into two main categories, namely Common Equity Tier 1 and Tier 2, depending on the degree of permanence and loss absorbency exhibited. The main features of capital securities issued by the group are described below.

Common Equity Tier 1 (CET1)

CET 1 capital is the highest quality form of capital, comprising shareholders’ equity, reserve for general banking risk, revaluation reserves made up of the surplus on the revaluation of property net of deferred taxation and gains on the fair valuation of financial investments net of deferred taxation. Under the CRD IV/CRR, various capital deductions and regulatory adjustments are made against these items, including intangible assets, the Depositor Compensation Scheme reserve and other regulatory adjustments.

Tier 2 capital (T2)

The bank’s Tier 2 capital consists of eligible subordinated debt.

The following table illustrates the terms and conditions of called up share capital and subordinated liabilities, which are included in the local group’s total own funds.

Capital instruments main features	HSBC Ordinary shares	Subordinated Tier 2 Regulatory Capital 2028
Unique identifier	MT0000030107	N/A
Governing Law(s) of the instrument	Maltese Law	Maltese Law
Regulatory Treatment		
Transitional CRR rules	Common Equity Tier 1	Tier 2
Post-transitional CRR rules	Common Equity Tier 1	Tier 2
Eligible at solo/(sub)consolidated/solo & (sub)consolidated	Solo and (Sub) consolidated	Solo and (Sub) consolidated
Amount recognised in regulatory capital	108,091,800	62,000,000
Nominal amount of instrument	108,091,800	62,000,000
Issue Price	N/A	At par (€100 per bond)
Redemption Price	N/A	At €100
Accounting classification	Share Equity	Liability - amortised cost
Original date of issuance	January 27, 1993*	December 14, 2018
Perpetual or dated	N/A	Dated
Original maturity date	No	December 14, 2028
Issuer call subject to prior supervisory approval	No	Yes
Coupons/dividends		
Fixed or floating dividend coupon	Floating	Floating
Coupon rate and any related index	N/A	3 month EURIBOR
Existence of dividend stopper	No	No
Fully discretionary, partially discretionary or mandatory (in terms of timing)	Fully discretionary	Mandatory
Fully discretionary, partially discretionary or mandatory (in terms of amount)	Partially discretionary	Mandatory
Existence of step up or other incentive to redeem	N/A	No
Non-cumulative or cumulative	Non-cumulative	Non-cumulative
Convertible or non-convertible	Non-convertible	Non-convertible
Write-down features	No	No
Position in subordination hierarchy in liquidation	Subordinated to HSBC Subordinated Tier 2 Capital	Subordinated to senior creditors and depositors
Non-compliant transitional features	No	No

* *Date when the bank was initially listed on the Malta Stock Exchange*

Further to the above, the local group's total own funds include other items the terms of which are described below.

Retained earnings

The retained earnings represent earnings not paid out as dividends. Interim profits form part of Own funds only if those profits have been verified by the local group's independent external auditor. The local group may only make distributions out of profits available for this purpose.

Retained earnings include an amount of €23,618,000 pledged in favour of the Depositor Compensation Scheme as at 31 December 2018, that are not available to the local group for unrestricted and immediate use to cover risk of losses as soon as they occur. It also includes an amount of €710,000 as an Irrevocable Payment Commitment (IPC) to the Single Resolution Board in terms of the Recovery and Resolution Regulations. These reserves are excluded for the purposes of the Own Funds calculation.

Moreover, an amount of €5,135,000 is also included in retained earnings relating to the reserve for general banking risks, since the local group is required to allocate funds to this reserve in accordance with the revised Banking Rule BR/09: 'Measures Addressing Credit Risks Arising from the Assessment of the Quality of Asset Portfolios of Credit Institutions authorised under the Banking Act, 1994'. This reserve refers to the amount allocated by the bank from its retained earnings, to a non-distributable reserve against potential risks linked to the local group's non-performing loans and advances. No further allocations to the reserve were necessary as a result of a reduction in non-performing exposures.

Revaluation reserves

Property revaluation reserve

This represents the surplus arising on the revaluation of the local group's property net of related deferred tax effects. This reserve is not available for distribution.

Financial investments reserve

This represents the cumulative net change in fair values of financial investments held by the local group, net of related deferred tax effects.

In accordance with article 492 of the CRR, the local group is required to complete a transitional disclosure template during the phasing in of regulatory adjustments from 1 January 2014 to 31 December 2017.

Table 3: Own funds disclosure

Ref			At 31 December 2018
	Common equity tier 1 (CET1) capital: instruments and reserves		**€000**
1	Capital instruments and the related share premium accounts		**108,092**
	– of which: ordinary shares		***108,092***
2	Retained earnings	1	**253,392**
3	Accumulated other comprehensive income (and other reserves)		**34,265**
3a	Funds for general banking risk (related to BR09)		**5,135**
6	**Common equity tier 1 capital before regulatory adjustments**		**400,884**
	Common equity tier 1 capital: regulatory adjustments		
7	Additional Valuation adjustments		**(1,025)**
8	Intangible assets (net of related deferred tax liability)		**(5,831)**
9a	IFRS 9 transitional adjustments		**7,646**
9b	Other		**(710)**
26a	Amount to be deducted from or added to CET1 capital with regard to additional filters and deductions required pre CRR		**(23,618)**
28	**Total regulatory adjustments to Common equity tier 1 (CET1)**		**(23,538)**
29	**Common equity tier 1 (CET1) capital**		**377,346**
51	**Tier 2 (T2) capital before regulatory adjustments**		**62,000**
57	**Total regulatory adjustments to Tier 2 (T2) capital**		**—**
58	**Tier 2 (T2) capital**		**62,000**
59	**Total capital (TC = T1 + T2)**		**439,346**
59a	Risk weighted assets in respect of amounts subject to pre-CRR treatment *– of which:* *Items not deducted from CET1: direct holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities*		***28,578***
	– of which: Items not deducted from CET1: deferred tax assets arising from temporary differences		***21,509***
60	**Total risk-weighted assets**		**2,581,346**
	Capital ratios and buffers		
61	Common equity Tier 1		**14.6%**
62	Tier 1		**14.6%**
63	Total capital		**17.0%**
64	Institution specific buffer requirement		**7.5%**
65	*– of which: capital conservation buffer requirement*		***1.9%***
66	*– of which: counter cyclical buffer requirement*		***0.0%***
67	*– of which: systemic risk buffer requirement*	2	***0.0%***
67a	*– of which: Global Systemically Important Institution (G-SII) or Other Systemically Important Institution (O-SII) buffer*		***1.1%***
68	Common Equity Tier 1 available to meet buffers		**6.6%**
	Amounts below the threshold for deduction (before risk weighting)		
75	Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability)		**21,509**

1 *The retained earnings in the disclosure template above does not agree with the retained earnings in the consolidated results reported by the local group under IFRS due to the exclusion of the subsidiary engaged in insurance activities from the regulatory consolidation.*
2 *The bank does not have any systemic risk buffer as at year end 31 December 2018.*

Leverage ratio

The leverage ratio was introduced into the Basel III framework as a non-risk-based limit, to supplement risk-based capital requirements. It aims at constraining the build-up of excess leverage in the banking sector, introducing additional safeguards against model risk and measurement errors. The Basel III leverage ratio is a volume-based measure calculated as Tier 1 capital divided by total weighted on and off-balance sheet exposures, and further netting possibilities on market instruments. This ratio has been implemented in the EU for reporting and disclosure purposes but, at this stage, has not been set as a binding requirement. Although there is currently no binding leverage ratio requirement on the Bank, the risk of excess leverage is managed as part of HSBC's appetite framework and monitored using a leverage ratio metric within the Risk Appetite Statement ("RAS")

The RAS articulates the aggregate level and types of risk that HSBC Bank Malta p.l.c. is willing to accept in its business activities in order to achieve its strategic business objectives.

The RAS is monitored via the risk appetite profile report, which includes comparisons of actual performance against the risk appetite and tolerance thresholds assigned to each metric, to ensure that any excessive risk is highlighted, assessed and mitigated appropriately. The risk appetite profile report is presented monthly to the Risk Management Meeting ('RMM').

For HSBC Bank Malta p.l.c., the leverage exposure measure is also calculated and presented to the Asset & Liability Management Committee every month.

The following is the local group's leverage ratio, determined in accordance with the requirements stipulated by implementing regulation EU 2016/200.

The following tables show the difference on balance sheet exposures in relation to the calculation of the leverage ratio.

Table 4: Summary reconciliation of accounting assets and leverage ratio exposures

		At	
		31 December 2018	31 December 2017
		€000	€000
1	Total assets as per published financial statements	**6,310,994**	6,797,983
	Adjustments for:		
2	– entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	**(824,662)**	(1,339,692)
4	– derivative financial instruments	**4,275**	4,125
6	– off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	**283,164**	244,354
7	– other	**15,558**	(43,664)
8	**Total leverage ratio exposure**	**5,789,329**	5,663,106

The total exposure measure for the purposes of the leverage ratio has been determined as follows:

Table 5: Leverage ratio common disclosure

		At	
		31 December 2018	31 December 2017
		€000	€000
	On-balance sheet exposures (excluding derivatives)		
1	On-balance sheet items (excluding derivatives)	**5,528,118**	5,414,464
2	(Asset amounts deducted in determining tier 1 capital)	**(31,184)**	(4,574)
3	**Total on-balance sheet exposures (excluding derivatives and SFTs)**	**5,496,934**	5,409,890
	Derivative exposures		
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	**4,956**	4,737
5	Add-on amounts for potential future exposure ('PFE') associated with all derivatives transactions (mark-to-market method)	**4,275**	4,125
11	**Total derivative exposures**	**9,231**	8,862
17	Off-balance sheet exposures at gross notional amount	**1,056,083**	879,715
18	(Adjustments for conversion to credit equivalent amounts)	**(772,919)**	(635,361)
19	**Total Other off-balance sheet exposures**	**283,164**	244,354
	Capital and total exposures		
20	Tier 1 capital	**377,346**	354,827
21	Total leverage ratio exposure	**5,789,329**	5,663,106
	Leverage ratios		
22	**Leverage ratio (%) - transitional**	**6.5**	6.3

Table 6: Leverage ratio – Split of on-balance sheet exposures (excluding derivatives and exempted exposures)

		At	
		31 December 2018	31 December 2017
		€000	€000
EU-5	exposures treated as sovereigns	**874,730**	915,047
EU-7	institutions	**1,090,321**	1,044,754
EU-8	secured by mortgages of immovable properties	**2,506,534**	2,411,842
EU-9	retail exposures	**131,064**	150,680
EU-10	corporate	**200,581**	272,671
EU-11	exposures in default	**156,327**	147,266
EU-12	other exposures (e.g. equity and other non-credit obligation assets)	**568,561**	472,204
	Total	**5,528,118**	5,414,464

Capital buffers

The local group will be fully implementing the CRD IV capital requirements with effect from January 2019. In respect of the local group, Banking Rule BR/15: 'Capital Buffers of Credit Institutions authorised under the Banking Act, 1994', requires additional buffers, namely the 'capital conservation buffer', the 'countercyclical buffer', 'other systemically important institutions (O-SII) buffer' and the 'systemic risk buffer'. Automatic restrictions on capital distributions apply if the local group's CET1 capital falls below the level of its CRD IV combined buffer.

The local group is required to maintain a capital conservation buffer of 2.5%, O-SII buffer of 1.5% and the Institution-specific countercyclical buffer as determined by Article 140 (1) of Directive 2013/36/EU. These capital buffers should be composed of CET 1 capital, as a percentage of the Risk Weighted Assets as from 1 January 2019. These buffers were phased in over the period from 1 January 2016 to 31 December 2018.

CRD IV contemplates a countercyclical buffer in line with Basel III, in the form of an institution-specific countercyclical buffer and the application of increased requirements to address macro-prudential or systemic risk. This is expected to be set in the range of 0 - 2.5% of relevant credit exposure RWAs, whereby the rate shall consist of the weighted average of the 'countercyclical buffer' rates that apply in the jurisdiction where the relevant exposures are located. Given that the local group's exposures are contained within Malta, this buffer results in a marginal percentage.

The tables below provide the geographical distribution of the bank's credit exposure relevant to the calculation of the institution-specific countercyclical buffer rate and the amount of institution-specific countercyclical capital buffer.

Table 7: Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer

	Group				
Breakdown per country	**General credit exposures**	**Own funds requirement**			
	Exposure value for SA	**of which: general credit exposures**	**Total**	**Own funds requirement weights**	**Counter-cyclical capital buffer rate**
	€000	**€000**	**€000**	**%**	**%**
Malta	**4,294,087**	**165,321**	**165,321**	**100.00**	**0.00**
Total as at 31 December 2018	**4,294,087**	**165,321**	**165,321**	**100.00**	**0.00**

Table 8: Amount of institution-specific countercyclical capital buffer

	Group	
	2018	2017
	€000	€000
Total risk amount	**2,581,346**	2,548,420
Institution specific countercyclical buffer rate (%)	**—**	—
Institution specific countercyclical buffer requirement	**—**	—

Given the local group's position and its systematic relevance to the financial system in Malta, the local group is also required to maintain a 1.5% O-SII buffer also made up of CET1 capital. This buffer is also institution specific and may be set at a maximum of 2% of a systemically important institution's total risk exposure amount. In addition to the measures above, CRD IV sets out a 'systemic risk buffer' for the financial sector as a whole, or one or more sub-sectors, to be deployed as necessary by each EU member state with a view to mitigate structural macro-prudential risk. The 'systemic risk buffer' may range between 0% and 5%. In the case of the local group, the higher of the O-SII buffer and the systemic risk buffer applies.

Pillar 1

Pillar 1 covers the capital requirements for credit risk, market risk and operational risk. Credit risk includes counterparty and non-counterparty credit risk requirements. These requirements are expressed in terms of RWAs.

Risk category	Scope of permissible approaches	Approach adopted by HSBC Bank Malta p.l.c.
Credit risk	The Basel Committee's framework applies three approaches of increasing sophistication to the calculation of Pillar 1 credit risk capital requirements. The most basic level, the standardised approach, requires banks to use external credit ratings to determine the risk weightings applied to rated counterparties. Other counterparties are grouped into broad categories and standardised risk weightings are applied to these categories. The next level, the foundation IRB ('FIRB') approach, allows banks to calculate their credit risk capital requirements on the basis of their internal assessment of a counterparty's probability of default ('PD'), but subjects their quantified estimates of EAD and loss given default ('LGD') to standard supervisory parameters. Finally, the advanced IRB ('AIRB') approach allows banks to use their own internal assessment in both determining PD and quantifying EAD and LGD.	For consolidated Group reporting, we have adopted the standardised approach for our business in accordance with Article 317. Under the standardised approach the local group utilises risk weights determined by exposure class, credit risk mitigation and credit ratings as outlined in the CRR.
Counterparty credit risk	Four approaches to calculating CCR and determining exposure values are defined by the Basel Committee: mark-to-market, original exposure, standardised and Internal Model Method ('IMM'). These exposure values are used to determine capital requirements under one of the credit risk approaches: standardised, foundation IRB or advanced IRB.	We use the mark-to-market approach to calculate to CCR exposure value as defined in Article 274 of the Capital Requirements Regulation.
Equity	For the non-trading book, equity exposures can be assessed under standardised or IRB approaches.	For reporting purposes, all non-trading book equity exposures are treated under the standardised approach.
Market risk	Market risk capital requirements can be determined under either the standard rules or the Internal Models Approach ('IMA').	The market risk capital requirement is measured using the standard rules.
Operational risk	The Basel Committee allows firms to calculate their operational risk capital requirement under the basic indicator approach, the standardised approach or the advanced measurement approach.	We currently use the standardised approach in determining our operational risk capital requirement.

Table 9: Net value of exposure at the end of year

	Group		
	2018		
	Net value of exposure at the end of year	Risk-weighted assets	Capital Required[1]
	€000	€000	€000
Central governments or central banks	**874,730**	**–**	**–**
Public sector entities	**196,247**	**1**	**–**
Multilateral development banks	**187,083**	**–**	**–**
Institutions	**1,101,113**	**257,340**	**20,588**
Corporates	**327,713**	**144,553**	**11,564**
Retail exposures	**337,312**	**94,397**	**7,552**
Secured by mortgages on immovable property	**3,206,924**	**1,405,540**	**112,443**
Exposures in default	**119,081**	**137,192**	**10,975**
Items associated with particularly high risk	**40,806**	**47,416**	**3,793**
Equity exposures	**2,752**	**2,752**	**220**
Other items	**208,910**	**234,670**	**18,774**
Credit risk	**6,602,671**	**2,323,861**	**185,909**
Operational risk		**256,893**	**20,551**
Foreign exchange risk		**592**	**48**
Total		**2,581,346**	**206,508**
Own funds			
Common Equity Tier 1			**377,346**
Tier 2			**62,000**
Total own funds			**439,346**
Total capital ratio			**17.0%**

1 *Capital requirements, here and in all tables where the term is used, represents the Pillar I capital charge at 8% of RWAs.*

Table 10: Overview of RWAs (OV1)[1]

		Risk-weighted assets		Minimum capital requirements
		2018	2017	**2018**
		€000	€000	**€000**
1	Credit risk (excluding CCR)	**2,191,894**	2,172,087	**175,352**
2	*– of which: the standardised approach*	***2,191,894***	2,172,087	***175,352***
6	CCR	**6,749**	7,052	**540**
7	*– of which: mark to market*	***6,749***	7,052	***540***
19	Market risk	**592**	975	**48**
20	*– of which: the standardised approach*	***592***	975	***48***
23	Operational risk	**256,893**	262,096	**20,551**
24	*– of which: standardised approach*	***256,893***	262,096	***20,551***
27	Amounts below the thresholds for deduction (subject to 250% risk weight)	**125,218**	106,210	**10,017**
29	**Total**	**2,581,346**	2,548,420	**206,508**

1 *'Capital requirements' here and in all tables where the term is used, represents the minimum total capital charge set at 8% of RWAs by article 92 of the Capital Requirements Regulation.*

Pillar 2 and Internal Capital Adequacy Assessment Process (ICAAP)

Pillar 2

Pillar 2 (Supervisory and own funds management process) consists of the own assessment by banks and of the assessment from supervision authorities, of the need to allocate capital resources to risks that are not covered by the Pillar 1 framework. A major tool of the Pillar 2 is the Internal Capital Adequacy Assessment Process ('ICAAP'), conducted by HSBC Bank Malta p.l.c., to determine a forward-looking assessment of its capital requirements given its business strategy, risk profile, risk appetite and capital plan. This process incorporates HSBC Bank Malta p.l.c.'s risk management processes and governance framework. As part of this ICAAP, a range of stress tests are applied to our base capital plan.

Furthermore, stress testing forms an integral part of the risk and capital management framework and is an important component of ICAAP. Its main purpose is to highlight to senior management potential adverse unexpected outcomes that could arise under hypothetical scenarios, and provides a quantitative indication of how much capital might be required to absorb the losses, should such adverse scenarios occur. Stress testing is used to assess risk concentrations, estimate the impact on revenue, impairments, write-downs and the resultant capital adequacy under a variety of adverse scenarios.

Macroeconomic stress testing considers the impact on both revenue and capital under a range of scenarios. It entails multi-year systemic shocks to assess the local group's ability to meet its capital requirement and liabilities as they fall due under a downturn in the business cycle and/or macroeconomic environment.

The stress testing framework brings multiple benefits to risk management, including: understanding the impact of recessionary scenarios; assessing material risk concentrations; impact of market price movements; and, forecasting of the balance sheet management and liquidity.

This evaluation process is summarised in an annual ICAAP report. The ICAAP is approved by the Board, which has the ultimate responsibility for the effective management of risk and approval of HSBC Bank Malta p.l.c.'s risk appetite. It is then submitted to the supervisory authorities. Pillar 2 is embedded in a broader Supervisory Review and Evaluation Process ('SREP'), which leads to an annual determination of individual capital requirement and guidance under Pillar 2. This process can also include specific demands on all aspects of the bank's management. The SREP process results in a Pillar 2 requirement and a Pillar 2 guidance, which are added to the Pillar 1 requirements.

The Overall Capital Requirement, applicable on total capital is composed of the Pillar 1 requirement, the Pillar 2 requirement add-on, and the cumulated regulatory buffers. This stands as the applicable regulatory minimum on total capital for a bank falling under ECB supervision.

The Total SREP capital requirement, which is composed only of the Pillar 1 requirement and the Pillar 2 requirement add-on, applicable on the total capital ratio as well, is the ratio that banks should respect under stressed scenarios.

The Pillar 2 guidance applies on CET1 ratio, and represents the applicable regulatory minimum on CET1 along with the Pillar 1 requirements, the Pillar 2 requirements and the combined buffer. The Pillar 2 requirement is binding, and breaches can have direct legal consequences for the bank, for example with regards to dividends as well as coupons payments.

Internal capital adequacy assessment process

The Board approves the ICAAP, and together with the Risk Committee, examines the Bank's capital supply, in order to ensure that capital resources:

- remain sufficient to support the bank's risk profile and outstanding commitments;
- exceed current regulatory requirements, and that the bank is well placed to meet those expected in the future;
- allow the bank to remain adequately capitalised in the event of a severe economic downturn stress scenario; and
- remain consistent with the strategic and operational goals, and the shareholders and investors expectations.

The minimum regulatory capital that HSBC Bank Malta p.l.c. is required to hold is determined by the rules and guidance established by the Joint Supervisory Team. These capital requirements are a primary influence shaping the business planning process, in which RWA targets are established for global businesses in accordance with the bank's strategic direction and risk appetite.

As stipulated in Section 1 of Chapter 2 of CRD IV, the local group is required to have in place an internal process to assess the adequacy of capital levels in relation to its overall risk profile. The outcome of this process is enshrined in a document known as the Internal Capital Adequacy Assessment Process (ICAAP).

Credit risk

Overview

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from direct lending, trade finance and leasing business, but also from other products such as guarantees, derivatives and from holding assets in the form of debt securities. Credit risk represents our largest regulatory capital requirement.

There have been no material changes to our policies and practices during 2018.

The tables below set out details of the group's net exposures values by exposure class and approach. The average net exposure value of this financial period is based on the last four end of quarter observations.

Table 11: Total and average net amount of exposures (CRB-B)

		2018	
		Net value of exposure at the end of year	Average net exposure over the year
		€000	€000
15	Total IRB approach	—	—
16	Central government or central banks	**874,730**	**929,881**
18	Public sector entities	**196,247**	**199,583**
19	Multilateral developments banks	**187,083**	**164,270**
21	Institutions	**1,101,113**	**1,027,468**
22	Corporates	**327,713**	**402,526**
23	*– of which: SMEs*	***277,221***	***316,022***
24	Retail	**337,312**	**357,758**
25	*– of which: SMEs*	***24,850***	***42,120***
26	Secured by mortgages on immovable property	**3,206,924**	**3,025,677**
27	*– of which: SMEs*	***620,803***	***542,195***
28	Exposures in default	**119,081**	**128,644**
29	Items associated with particular high risk	**40,806**	**30,632**
33	Equity exposures	**2,752**	**2,743**
34	Other exposures	**208,910**	**215,480**
35	**Total standardised approach**	**6,602,671**	**6,484,662**
36	**Total**	**6,602,671**	**6,484,662**

Credit quality of exposures by exposures class and instruments

A comprehensive picture of the credit quality of an institution's on-balance-sheet and off-balance-sheet exposures at year end.

Table 12: Credit quality of exposures by exposure class and instrument (CR1-A)

		Gross carrying values of					
		Defaulted exposures	Non-defaulted exposures	Specific credit risk adjustments	Write-offs in the year	Credit risk adjustment charges of the period	Net carrying values[1]
		€000	€000	€000	€000	€000	€000
15	**Total IRB approach**	**—**	**—**	**—**	**—**	**—**	**—**
16	Central governments and central banks	**—**	**874,730**	**—**	**—**	**—**	**874,730**
18	Public sector entities	**—**	**196,247**	**—**	**—**	**—**	**196,247**
19	Multilateral development banks	**—**	**187,083**	**—**	**—**	**—**	**187,083**
21	Institutions	**—**	**1,101,115**	**2**	**—**	**—**	**1,101,113**
22	Corporates	**—**	**329,960**	**2,247**	**—**	**(922)**	**327,713**
23	– *of which: SMEs*	**—**	**278,363**	**1,142**	**—**	**(567)**	**277,221**
24	Retail	**—**	**340,589**	**3,277**	**—**	**(840)**	**337,312**
25	– *of which: SMEs*	**—**	**24,850**		**—**	**(494)**	**24,850**
26	Secured by mortgages on immovable property	**—**	**3,214,999**	**8,075**	**—**	**1,449**	**3,206,924**
27	– *of which: SMEs*	**—**	**620,803**		**—**	**592**	**620,803**
28	Exposures in default	**158,318**	**—**	**39,238**	**5,857**	**6,020**	**119,081**
29	Items associated with particularly high risk	**—**	**40,806**	**—**	**—**	**(33)**	**40,806**
33	Equity exposures	**—**	**2,752**	**—**	**—**	**—**	**2,752**
34	Other exposures	**—**	**208,910**	**—**	**—**		**208,910**
35	**Total standardised approach**	**158,318**	**6,497,191**	**52,838**	**5,857**	**5,674**	**6,602,671**
36	**Total as at 31 December 2018**	**158,318**	**6,497,191**	**52,838**	**5,857**	**5,674**	**6,602,671**
37	– *of which: loans*	***156,327***	***4,159,045***	***51,025***	***5,857***	***5,674***	***4,264,347***
38	– *of which: debt securities*	***—***	***1,012,562***	***—***	***—***	***—***	***1,012,562***
39	– *of which: off-balance sheet exposures*	***1,991***	***1,113,922***	***1,813***	***—***	***—***	***1,114,100***

15	Total IRB approach	—	—	—	—	—	—
16	Central governments and central banks	—	915,047	—	—	—	915,047
18	Public sector entities	—	234,274	—	—	—	234,274
19	Multilateral development banks	—	142,168	—	—	—	142,168
21	Institutions	—	1,055,732	—	—	—	1,055,732
22	Corporates	—	379,551	545	—	387	379,006
23	– *of which: SMEs*	—	*288,154*	*95*	—	*294*	*288,059*
24	Retail	—	368,402	1,890	—	491	366,512
25	– *of which: SMEs*	—	*47,760*	—	—	*64*	*47,760*
26	Secured by mortgages on immovable property	—	2,890,918	2,577	—	—	2,888,341
27	– *of which: SMEs*	—	*536,854*	—	—	—	*536,854*
28	Exposures in default	185,306	—	35,629	8,938	7,310	149,677
29	Items associated with particularly high risk	—	33,181	—	—	—	33,181
30	Covered bonds	—	—	—	—	—	—
31	Claims on institutions and corporates with a short-term credit assessment	—	—	—	—	—	—
33	Equity exposures	—	25	—	—	—	25
34	Other exposures	—	196,267	—	—	—	196,267
35	Total standardised approach	185,306	6,215,565	40,641	8,938	8,188	6,360,230
36	Total at 31 December2017	185,306	6,215,565	40,641	8,938	8,188	6,360,230
37	– *of which: loans*	*182,895*	*4,085,914*	*40,548*	*8,938*	*8,188*	*4,228,261*
38	– *of which: debt securities*	—	*1,009,947*	—	—	—	*1,009,947*
39	– *of which: off-balance sheet exposures*	*2,411*	*934,494*	*93*	—	—	*936,812*

1 *Net values is the summation of the defaulted and non-defaulted exposures less any specific credit risk adjustments.*

Credit quality of exposures by industry type

The following table provides a comprehensive picture of the credit quality of an institution's on-balance sheet and off-balance sheet exposures by industry type.

Table 13: Credit quality of exposures by industry or counterparty types (CR1-B)

		Gross carrying values of					
		Defaulted exposures	Non-defaulted exposures	Specific credit risk adjustments	Write-offs in the year	Credit risk adjustment charges of the period	Net carrying values[1]
		€000	€000	€000	€000	€000	€000
1	Agriculture	**528**	**4,792**	**46**	**—**	**30**	**5,274**
2	Mining	**—**	**—**	**—**	**—**	**544**	**—**
3	Manufacturing	**9,841**	**83,755**	**4,016**	**1**	**64**	**89,580**
4	Utilities	**—**	**59,442**	**264**	**—**	**2**	**59,178**
5	Water supply	**—**	**49,478**	**7**	**—**	**(947)**	**49,471**
6	Construction	**34,435**	**73,517**	**4,884**	**575**	**(1,379)**	**103,068**
7	Wholesale & retail trade	**6,419**	**316,491**	**3,957**	**986**	**912**	**318,953**
8	Transportation & storage	**17**	**24,657**	**124**	**5**	**564**	**24,550**
9	Accommodation & food services	**4,896**	**216,856**	**4,166**	**18**	**3**	**217,586**
10	Information & communication	**106**	**39,572**	**888**	**—**	**613**	**38,790**
11	Financial & insurance	**1,512**	**1,337,096**	**1,897**	**—**	**2,044**	**1,336,711**
12	Real estate	**22,377**	**97,471**	**13,883**	**401**	**(260)**	**105,965**
13	Professional activities	**509**	**50,161**	**412**	**2**	**(127)**	**50,258**
14	Administrative service	**769**	**40,140**	**319**	**107**	**105**	**40,590**
15	Public admin & defence	**—**	**123,908**	**6**	**—**	**(17)**	**123,902**
16	Education	**3**	**1,250**	**8**	**—**	**(885)**	**1,245**
17	Human health & social work	**4,960**	**25,722**	**4,082**	**3,014**	**3,007**	**26,600**
18	Arts & entertainment	**157**	**2,359**	**65**	**—**	**44**	**2,451**
19	Other services	**124**	**42,345**	**20**	**43**	**652**	**42,449**
20	Personal	**71,665**	**2,637,456**	**13,794**	**705**	**705**	**2,695,327**
21	Extraterritorial bodies	**—**	**—**	**—**	**—**	**—**	**—**
22	Central government or central banks	**—**	**874,730**	**—**	**—**	**—**	**874,730**
23	Multilateral development banks	**—**	**187,083**	**—**	**—**	**—**	**187,083**
24	Other	**—**	**208,910**	**–**	**—**	**—**	**208,910**
25	**Total at 31 December 2018**	**158,318**	**6,497,191**	**52,838**	**5,857**	**5,674**	**6,602,671**
1	Agriculture	496	1,159	—	—	8	1,655
2	Mining	—	—	—	—	—	—
3	Manufacturing	5,247	120,207	2,506	595	1,143	122,948
4	Utilities	1	86,655	—	—	—	86,656
5	Water supply	—	77,099	—	—	—	77,099
6	Construction	46,909	113,632	9,491	2,916	2,312	151,050
7	Wholesale & retail trade	9,382	358,936	2,807	1,723	672	365,511
8	Transportation & storage	217	40,793	7	—	—	41,003
9	Accommodation & food services	7,677	122,880	1,676	12	3,490	128,881
10	Information & communication	69	48,272	11	—	—	48,330
11	Financial & insurance	2,339	1,136,898	227	358	211	1,139,010
12	Real estate	42,422	123,476	14,279	872	(2,792)	151,619
13	Professional activities	417	53,683	96	139	139	54,004
14	Administrative service	820	23,549	266	148	(52)	24,103
15	Public admin & defence	—	149,520	—	—	—	149,520
16	Education	9	2,119	6	43	43	2,122
17	Human health & social work	8,599	37,215	4,389	—	(1,037)	41,425
18	Arts & entertainment	121	6,706	92	—	—	6,735
19	Other services	36	6,725	15	1,698	(21)	6,746
20	Personal	60,545	2,463,533	4,773	434	4,072	2,519,305
21	Extraterritorial bodies	—	73	—	—	—	73
22	Central government or central banks	—	915,057	—	—	—	915,057
23	Multilateral development banks	—	142,168	—	—	—	142,168
24	Other	—	185,210	—	—	—	185,210
25	Total at 31 December 2017	185,306	6,215,565	40,641	8,938	8,188	6,360,230

1 *Net values is the summation of the defaulted and non-defaulted exposures less any specific credit risk adjustments.*

Credit quality of exposures by geography

The tables provides a comprehensive picture of the credit quality of an institution's on-balance-sheet and off-balance-sheet exposures by geographical concentration.

Table 14: Credit quality of exposures by geography (CR1-C)

		Gross carrying values of					
		Defaulted exposures	Non-defaulted exposures	Specific credit risk adjustments	Write-offs in the year	Credit risk adjustment charges of the period	Net carrying values[1]
		€000	€000	€000	€000	€000	€000
1	**Europe**	**158,318**	**6,424,905**	**52,838**	**5,857**	**5,674**	**6,530,385**
2	Malta	**158,318**	**4,994,579**	**52,838**	**5,857**	**5,674**	**5,100,059**
3	Belgium	**—**	**67,531**	**—**	**—**	**—**	**67,531**
4	Switzerland	**—**	**2,887**	**—**	**—**	**—**	**2,887**
5	Germany	**—**	**174,432**	**—**	**—**	**—**	**174,432**
6	France	**—**	**150,713**	**—**	**—**	**—**	**150,713**
7	United Kingdom	**—**	**899,584**	**—**	**—**	**—**	**899,584**
8	Poland	**—**	**118,525**	**—**	**—**	**—**	**118,525**
9	Netherlands	**—**	**5,002**	**—**	**—**	**—**	**5,002**
10	Other countries	**—**	**11,652**	**—**	**—**	**—**	**11,652**
11	**North America**	**—**	**56,087**	**—**	**—**	**—**	**56,087**
12	Canada	**—**	**14,299**	**—**	**—**	**—**	**14,299**
13	United States	**—**	**41,788**	**—**	**—**	**—**	**41,788**
14	**Asia**	**—**	**15,909**	**—**	**—**	**—**	**15,909**
15	Philippines	**—**	**15,502**	**—**	**—**	**—**	**15,502**
16	Other countries	**—**	**407**	**—**	**—**	**—**	**407**
17	**Other geographical areas**	**—**	**290**	**—**	**—**	**—**	**290**
18	**31 December 2018**	**158,318**	**6,497,191**	**52,838**	**5,857**	**5,674**	**6,602,671**
1	Europe	185,306	6,158,186	40,641	8,938	8,188	6,302,851
2	Malta	185,306	4,794,746	40,641	8,938	8,188	4,939,411
3	Belgium	—	82,459	—	—	—	82,459
4	Switzerland	—	3,765	—	—	—	3,765
5	Germany	—	149,726	—	—	—	149,726
6	France	—	91,026	—	—	—	91,026
7	United Kingdom	—	988,941	—	—	—	988,941
8	Poland	—	42,009	—	—	—	42,009
9	Netherlands	—	5,099	—	—	—	5,099
10	Other countries	—	415	—	—	—	415
11	North America	—	41,165	—	—	—	41,165
12	Canada	—	88	—	—	—	88
13	United States	—	41,077	—	—	—	41,077
14	Asia	—	16,069	—	—	—	16,069
15	Philippines	—	15,869	—	—	—	15,869
16	Other countries	—	200	—	—	—	200
17	Other geographical area	—	145	—	—	—	145
18	31 December 2017	185,306	6,215,565	40,641	8,938	8,188	6,360,230

1 *Net values is the summation of the defaulted and non-defaulted exposures less any specific credit risk adjustments.*
We have restated the comparative period and aggregate geographic exposure with current year reporting

Past due but not impaired exposures, impaired exposures and credit risk adjustments ('CRA')

Past due but not impaired are those loans where although customers have failed to make payments in accordance with the contractual terms of their facilities, they have not met the impaired loan criteria described below.

We analyse past due but not impaired, impaired exposures and impairment allowances, and other credit risk provisions using accounting values on a regulatory consolidation basis. Our approach for determining impairment allowances is explained in HSBC Bank Malta p.l.c. Annual Report and Accounts 2018, and HSBC Bank Malta p.l.c.'s definitions for accounting purposes of 'past due' and 'impaired' are set out in Note 4 of the Annual Report and Accounts. Under the accounting standards currently adopted by HSBC Bank Malta p.l.c., impairment allowances, value adjustments and credit related provisions for off-balance sheet amounts are treated as specific CRAs.

The table below provides an ageing analysis of accounting on-balance sheet past due exposures regardless of their impairment status. The gross carrying values indicated is before impairments and provisions but after the write-offs reported in financial statements.

Table 15: Ageing of past-due unimpaired and impaired exposures (CR1-D)

		Gross carrying values					
		Less than 30 days	Between 30 and 60 days	Between 60 and 90 days	Between 90 and 180 days	Between 180 days and 1 year	Greater than 1 year
		€000	€000	€000	€000	€000	€000
1	Loans	**75,243**	**10,788**	**14,126**	**7,043**	**16,910**	**73,166**
3	**Total exposures at 31 December 2018**	**75,243**	**10,788**	**14,126**	**7,043**	**16,910**	**73,166**
1	Loans	150,252	17,123	6,590	7,865	19,016	53,458
3	Total exposures at 31 December 2017	150,252	17,123	6,590	7,865	19,016	53,458

No debt securities were past due as at 31 December 2018 and 31 December 2017.

The tables below provide an overview of non-performing and forborne exposures as per the Commission Implementing Regulation (EU) No 680/2014

Table 16: Non-performing and forborne exposures

	Gross carrying values of performing and non-performing exposures							Accumulated impairment and provisions and negative fair value adjustments due to credit risk				Collateral and financial guarantees received	
				of which: non-performing				On performing exposures		On non- performing exposures			
		of which: perf-orming but past due between 30 and 90 days	of which: perf-orming forborne		of which: de-faulted	of which: impaired	of which: forborne		of which: forborne		of which: forborne	On non-perf-orming exp-osures	of which: forborne
	€000	€000	€000	€000	€000	€000	€000	€000	€000	€000	€000	€000	€000
At 31 December 2018													
1 Debt securities	**1,012,562**	**—**	**—**	**—**	**—**	**—**	**—**	**(21)**	**—**	**—**	**—**	**—**	**—**
2 Loans	**4,309,478**	**7,944**	**21,761**	**136,261**	**136,261**	**136,261**	**76,335**	**(14,891)**	**—**	**(29,880)**	**(20,124)**	**100,359**	**66,738**
3 Off-balance sheet exposures	**1,582,213**	**—**	**—**	**2,890**	**2,890**	**—**	**—**	**(1,813)**	**—**	**—**	**—**	**—**	**—**
At 31 December 2017													
1 Debt securities	1,009,947	—	—	—	—	—	—	—	—	—	—	—	—
2 Loans	4,304,791	12,675	37,578	167,922	167,922	167,922	106,711	(5,012)	—	(35,630)	(15,690)	127,279	128,658
3 Off-balance sheet exposures	1,321,942	—	—	3,644	3,644	—	—	93	—	—	—	—	—

The table above is presented based on the EBA definitions of 'non-performing' and 'forborne' exposures. Forborne exposures are referred to as renegotiated loans in the *Annual Report and Accounts 2018*. In the *Annual Report and Accounts 2018* we classify and report loans on which concessions have been granted under conditions of credit distress as 'renegotiated loans' when their contractual payment terms have been modified because we have significant concerns about the borrowers' ability to meet contractual payments when due. This is aligned to the EBA definitions of forborne exposures. The EBA and *Annual Report and Accounts 2018* differ in the treatment of cures from the forborne/renegotiated status. Under the EBA definition, exposures are no longer considered forborne once the exposures have complied with the revised contractual obligations for a period of at least three years and the exposures are no longer considered impaired or have any elements that are more than 30 days past due. In the *Annual Report and Accounts 2018*, renegotiated loans retain this classification until maturity or derecognition. The EBA definition of non-performing captures those debtors that have material exposures which are more than 90 days past due or where the debtor is assessed as unlikely to pay its credit obligations in full without the realisation of collateral, regardless of the existence of any past due amounts. Any debtors that are in default for regulatory purposes or impaired under the applicable accounting framework are considered to be unlikely to pay. The *Annual Report and Accounts 2018* does not report non-performing exposure, however the definition of impaired loans is well aligned to the EBA non-performing definitions.

Credit concentration risk analysed by geographical distribution

The geographical concentration of the local group's exposure classes as at the end of the reporting period are analysed in the following table.

Table 17: Geographical breakdown of exposure (CRB-C)

		At 31 December 2018			
		Malta	**Europe**	**Other**	**Total**
		€000	**€000**	**€000**	**€000**
6	Total IRB approach	**—**	**—**	**—**	**—**
7	Central government or central banks	**649,278**	**220,450**	**5,002**	**874,730**
9	Public sector entities	**196,247**	**—**	**—**	**196,247**
10	Multilateral developments banks	**—**	**129,942**	**57,141**	**187,083**
12	Institutions	**11,036**	**1,074,933**	**15,144**	**1,101,113**
13	Corporates	**327,713**	**—**	**—**	**327,713**
14	Retail	**337,312**	**—**	**—**	**337,312**
15	Secured by mortgages on immovable property	**3,206,924**	**—**	**—**	**3,206,924**
16	Exposures in default	**119,081**	**—**	**—**	**119,081**
17	Items associated with particular high risk	**40,806**	**—**	**—**	**40,806**
21	Equity exposures	**2,752**	**—**	**—**	**2,752**
22	Other exposures	**208,910**	**—**	**—**	**208,910**
23	**Total standarised approach**	**5,100,059**	**1,425,325**	**77,287**	**6,602,671**
24	**Total at 31 December 2018**	**5,100,059**	**1,425,325**	**77,287**	**6,602,671**

		At 31 December 2017			
		Malta	Europe	Other	Total
		€000	€000	€000	€000
6	Total IRB approach	—	—	—	—
7	Central government or central banks	681,040	228,908	5,099	915,047
9	Public sector entities	234,274	—	—	234,274
10	Multilateral developments banks	—	85,376	56,792	142,168
12	Institutions	11,088	1,044,057	587	1,055,732
13	Corporates	379,006	—	—	379,006
14	Retail	366,512	—	—	366,512
15	Secured by mortgages on immovable property	2,888,341	—	—	2,888,341
16	Exposures in default	149,677	—	—	149,677
17	Items associated with particular high risk	33,181	—	—	33,181
21	Equity exposures	25	—	—	25
22	Other exposures	196,267	—	—	196,267
23	Total standarised approach	4,939,411	1,358,341	62,478	6,360,230
24	Total at 31 December 2017	4,939,411	1,358,341	62,478	6,360,230

Credit concentration risk

Concentrations of credit risk arise when a number of counterparties or exposures have comparable economic characteristics, or such counterparties are engaged in similar activities, or operate in the same geographical areas or industry sectors, so that their collective ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions. The local group uses a number of controls and measures to minimise undue concentration of exposure in its portfolios across industry, country and customer groups. These include portfolio and counterparty limits, approval and review controls, and stress testing.

Credit concentration risk analysed by counterparty

In terms of Part Four of the CRR 'Large Exposures', the total amount of exposures which exceeded 10% of eligible capital represented 14.7% of the total loan portfolio as at end of 2018. These exposures are strictly monitored by management and every reasonable step is taken to reduce this concentration and spread risk over a wider customer base with further growth in the loan portfolio.

The maximum on-balance sheet credit exposure to any client, group of connected clients or counterparty as at 31 December 2018 amounted to €127,778,000 before taking account of collateral or other credit enhancements.

Within its daily operations, the local group transacts with counterparty banks and other financial institutions. By conducting these transactions, the local group is running the risk of losing funds due to the possible delays in the repayment of existing and future obligations by counterparty banks. To mitigate this risk, the local group places short-term funds solely with pre-approved counterparties subject to pre-established limits determined on the basis of the respective institution's credit rating as well as with its parent. The positions are checked against the limits on a daily basis and in real time.

As prescribed in article 400(2)(c), in light of the fact that the local group is subject to prudential supervision on a consolidated basis, the local group's exposure with its parent is exempt from limits to large exposures outlined in article 395(1) of the CRR. Similarly, the local group invests in debt securities issued by Maltese government, and given that these exposures attract a 0% risk weight, they are also exempt from large exposure limits.

Credit concentration risk analysed by counterparty types

A counterparty sector analysis of the local group's exposure amounts split by exposure class is shown in the following table:

Table 18: Concentration of exposures by counterparty type (CRB-D)

		At 31 December 2018						
		Personal	**Property**	**Manufacturing**	**Government**	**Other commercial**	**Financial**	**Total**
		€000	**€000**	**€000**	**€000**	**€000**	**€000**	**€000**
6	Total IRB approach	**—**	**—**	**—**	**—**	**—**	**—**	**—**
7	Central Government or central banks	**—**	**—**	**—**	**874,730**	**—**	**—**	**874,730**
9	Public sector entities	**—**	**—**	**—**	**123,908**	**72,339**	**—**	**196,247**
10	Multilateral development banks	**—**	**—**	**—**	**—**	**—**	**187,083**	**187,083**
12	Institutions	**—**	**—**	**—**	**—**	**—**	**1,101,113**	**1,101,113**
13	Corporates	**18,612**	**3,022**	**6,081**	**5,027**	**290,875**	**4,096**	**327,713**
14	Retail	**314,818**	**2,760**	**2,558**	**2**	**16,522**	**652**	**337,312**
15	Secured by mortgages on immovable property	**2,371,754**	**83,488**	**74,889**	**—**	**675,962**	**831**	**3,206,924**
16	Exposures in default	**67,882**	**34,837**	**3,175**	**—**	**12,876**	**311**	**119,081**
17	Items associated with particular high risk	**—**	**—**	**—**	**—**	**40,806**	**—**	**40,806**
21	Equity exposures	**—**	**—**	**—**	**—**	**2,752**	**—**	**2,752**
22	Other exposures	**—**	**—**	**—**	**—**	**208,910**	**—**	**208,910**
23	**Total standardised approach**	**2,773,066**	**124,107**	**86,703**	**1,003,667**	**1,321,043**	**1,294,085**	**6,602,671**
	Total at 31 December 2018	**2,773,066**	**124,107**	**86,703**	**1,003,667**	**1,321,043**	**1,294,085**	**6,602,671**

		At 31 December 2017						
		Personal	Property	Manufacturing	Government	Other commercial	Financial	Total
		€000	€000	€000	€000	€000	€000	€000
6	Total IRB approach	—	—	—	—	—	—	—
7	Central Government or central banks	—	—	—	915,047	—	—	915,047
9	Public sector entities	—	—	—	—	234,274	—	234,274
10	Multilateral development banks	—	—	—	—	—	142,168	142,168
12	Institutions	—	—	—	—	—	1,055,732	1,055,732
13	Corporates	1,061	20,776	1,591	—	355,578	—	379,006
14	Retail	317,748	3,574	3,561	—	41,629	—	366,512
15	Secured by mortgages on immovable property	2,140,968	72,306	79,431	—	595,636	—	2,888,341
16	Exposures in default	70,724	44,408	6,966	—	27,579	—	149,677
17	Items associated with particular high risk	—	—	—	—	33,181	—	33,181
21	Equity exposures	—	—	—	—	25	—	25
22	Other exposures	—	—	—	—	196,267	—	196,267
23	Total standardised approach	2,530,501	141,064	91,549	915,047	1,484,169	1,197,900	6,360,230
	Total at 31 December 2017	2,530,501	141,064	91,549	915,047	1,484,169	1,197,900	6,360,230

The residual maturity breakdown by exposure class at year-end was as follows:

Table 19: Maturity of exposures at year-end (CRB-E)

		At 31 December 2018					
		On demand	Less than one year	Over one but less than five years	Over five years	No stated maturity	Total
		€000	€000	€000	€000	€000	€000
6	Total IRB approach	—	—	—	—	—	—
7	Central Government or central banks	—	417,286	391,011	66,433	—	874,730
9	Public sector entities	10,000	1,517	10,002	174,728	—	196,247
10	Multilateral developments banks	—	105,835	81,248	—	—	187,083
12	Institutions	75,575	759,314	265,736	489	—	1,101,113
13	Corporates	133,081	19,371	115,827	59,434	—	327,713
14	Retail	25,677	234,527	43,138	33,970	—	337,312
15	Secured by mortgages on immovable property	394,965	103,267	206,183	2,502,509	—	3,206,924
16	Exposures in default	21,403	21,067	13,770	62,841	—	119,081
17	Items associated with particular high risk	8,787	15,728	16,062	228	—	40,806
21	Equity exposures	—	—	—	—	2,752	2,752
22	Other exposures	—	—	—	—	208,910	208,910
23	**Total standardised approach**	669,488	1,677,912	1,142,978	2,900,631	211,662	6,602,671
24	**Total**	669,488	1,677,912	1,142,978	2,900,631	211,662	6,602,671

		At 31 December 2017					
		On demand	Less than one year	Over one but less than five years	Over five years	No stated maturity	Total
		€000	€000	€000	€000	€000	€000
6	Total IRB approach	—	—	—	—	—	—
7	Central Government or central banks	—	342,806	472,158	100,083	—	915,047
9	Public sector entities	10,010	22,322	—	201,942	—	237,274
10	Multilateral developments banks	—	46,237	95,931	—	—	142,168
12	Institutions	1,423	844,720	159,587	50,002	—	1,055,732
13	Corporates	78,965	19,554	176,526	103,961	—	379,006
14	Retail	31,548	241,550	53,470	39,944	—	366,512
15	Secured by mortgages on immovable property	311,705	55,103	227,356	2,294,177	—	2,888,341
16	Exposures in default	—	149,677	—	—	—	149,677
17	Items associated with particular high risk	5,512	11,071	15,759	839	—	33,181
21	Equity exposures	—	—	—	—	25	25
22	Other exposures	—	—	—	—	196,267	196,267
23	Total standardised approach	439,163	1,733,040	1,200,787	2,790,948	196,292	6,360,230
24	Total	439,163	1,733,040	1,200,787	2,790,948	196,292	6,360,230

Risk mitigation

Mitigation of credit risk is a key aspect of effective risk management. Specific, detailed policies cover the acceptability, structuring and terms of various types of business with regard to the availability of credit risk mitigation, for example in the form of collateral security. These policies together with the setting of suitable valuation parameters, are subject to regular review to ensure that they are supported by empirical evidence and continue to fulfil their intended purpose.

Our approach when granting credit facilities is to do so on the basis of capacity to repay, rather than placing primary reliance on credit risk mitigants. Depending on a customer's standing and the type of product, facilities may be provided unsecured. Mitigation of credit risk is a key aspect of effective risk management and takes many forms. Our general policy is to promote the use of credit risk mitigation, justified by commercial prudence and capital efficiency.

Collateral

The most common method of mitigating credit risk is to take collateral. In our retail residential and commercial real estate ('CRE') businesses, a mortgage over the property is often taken to help secure claims. Loans to private banking and higher wealth clients may be made against a pledge of eligible marketable securities, cash or real estate. Physical collateral is also taken in various forms of specialised lending and leasing transactions where income from the physical assets that are financed is also the principal source of facility repayment. In the commercial and industrial sectors, charges are created over business assets such as premises, stock and debtors.

Other forms of Credit Risk Mitigation

Facilities to SMEs are commonly granted against guarantees given by their owners and/or directors. Guarantees may be taken from third parties where the group extends facilities without the benefit of any alternative form of security, e.g. where it issues a bid or performance bond in favour of a non-customer at the request of another bank. In our corporate lending, we also take guarantees from corporates as part of a parent/subsidiary or common parent relationship and span a number of credit grades.

Valuing collateral

Valuation strategies are established to monitor collateral mitigants to ensure that they continue to provide the anticipated secure secondary repayment source. In the residential mortgage business, collateral values are determined through a combination of professional appraisals and house price indices. Specifically, HSBC Bank Malta p.l.c. utilises the price index to update its mortgage portfolio value on a yearly basis. In addition it obtains professional valuations for high value mortgage loans annually for any loan impaired.

Revaluation is sought where, for example, as part of the regular credit assessment of the obligor, material concerns arise in relation to the performance of the collateral. CRE revaluation also commonly occurs where a decline in the obligor's credit quality gives cause for concern that the principal payment source may not fully meet the obligation.

Recognition of risk mitigation under the standardised approach

Where credit risk mitigation is available in the form of an eligible guarantee, non-financial collateral or credit derivatives, the exposure is divided into covered and uncovered portions. The covered portion, which is determined after applying an appropriate 'haircut' for currency and maturity mismatches (and for omission of restructuring clauses for credit derivatives, where appropriate) to the amount of the protection provided, attracts the risk weight of the protection provider. The uncovered portion attracts the risk weight of the obligor. For exposures fully or partially covered by eligible financial collateral, the value of the exposure is adjusted under the financial collateral comprehensive method using supervisory volatility adjustments, including those arising from currency mismatch, which are determined by the specific type of collateral (and, in the case of eligible debt securities, their credit quality) and its liquidation period. The adjusted exposure value is subject to the risk weight of the obligor.

Table 20: Credit risk mitigation techniques – overview (CR3)

		Exposures unsecured: carrying amount	Exposures secured: carrying amount	Exposures secured by collateral	Exposures secured by financial guarantees
		€000	€000	€000	€000
1	Loans	**1,828,003**	**3,550,444**	**3,321,198**	**229,246**
2	Debt securities	**1,012,562**	**—**	**—**	**—**
3	**Total at 31 December 2018**	**2,840,565**	**3,550,444**	**3,321,198**	**229,246**
4	*– of which: defaulted*	***17,847***	***101,233***	***100,405***	***829***
1	Loans	1,867,063	3,286,928	3,015,414	271,514
2	Debt securities	1,009,947	—	—	—
3	Total at 31 December 2017	2,877,010	3,286,928	3,015,414	271,514
4	*– of which: defaulted*	*36,209*	*113,468*	*112,104*	*1,364*

Credit risk exposures and credit risk mitigant techniques

The table below illustrates the effect of all CRM techniques applied in accordance with Part Three, Title II, Chapter 4 of the CRR, including the financial collateral simple method and the financial collateral comprehensive method in the application of Article 222 and Article 223 of the same regulation on standardised approach capital requirements' calculations. RWA density provides a synthetic metric on the riskiness of each portfolio.

Table 21: Standardised approach – credit conversion factor ('CCF') and credit risk mitigation ('CRM') effects (CR4)

		Exposures before CCF and CRM		Exposures post-CCF and CRM		RWAs and RWA density	
		On-balance sheet amount	Off-balance sheet amount	On-balance sheet amount	Off-balance sheet amount	RWAs	RWA density
		€000	€000	€000	€000	€000	%
	Asset classes[1]						
1	Central governments or central banks	**874,730**	**—**	**874,730**	**—**	**—**	**—**
3	Public sector entities	**146,978**	**49,269**	**2**	**—**	**1**	**50**
4	Multilateral development banks	**187,083**	**—**	**187,083**	**—**	**—**	**—**
6	Institutions	**1,090,321**	**10,794**	**1,090,319**	**2,953**	**257,341**	**24**
7	Corporates	**201,686**	**119,043**	**95,213**	**43,900**	**137,804**	**99**
8	Retail	**131,064**	**208,383**	**124,710**	**4,138**	**94,397**	**73**
9	Secured by mortgages on immovable property	**2,506,534**	**708,465**	**2,485,586**	**186,686**	**1,405,540**	**53**
10	Exposures in default	**156,327**	**1,991**	**116,390**	**163**	**137,192**	**118**
11	Higher-risk categories	**25,044**	**15,761**	**24,498**	**7,113**	**47,416**	**150**
15	Equity	**2,752**	**—**	**2,752**	**—**	**2,752**	**100**
16	Other items	**206,704**	**2,206**	**206,704**	**2,206**	**234,670**	**112**
17	**Total at 31 December 2018**	**5,529,223**	**1,115,913**	**5,207,986**	**247,158**	**2,317,111**	**42**
1	Central governments or central banks	915,047	—	915,047	—	—	—
3	Public sector entities	123,285	110,989	—	29,785	29,785	100
4	Multilateral development banks	142,168	—	142,168	—	—	—
6	Institutions	1,044,754	10,978	1,044,754	2,652	225,428	22
7	Corporates	272,671	97,473	181,460	34,805	211,964	98
8	Retail	150,680	215,832	143,403	5,295	106,107	71
9	Secured by mortgages on immovable property	2,411,841	476,498	2,397,717	117,659	1,289,830	51
10	Exposures in default	147,266	2,411	146,457	931	180,550	122
11	Higher-risk categories	21,542	11,639	21,285	5,230	39,773	150
15	Equity	25	—	25	—	25	100
16	Other items	185,184	11,085	185,184	11,085	194,835	99
17	Total at 31 December 2017	5,414,463	936,905	5,177,500	207,442	2,278,297	42

1 *Derivative instruments exposures are not included in the above table, on which RWA's amounted to € 6,749,000 (2018) and €7,052,000 in (2017).*

Counterparty credit risk

Overview

Counterparty credit risk is the risk that the counterparty to a transaction may default before completing the satisfactory settlement of the transaction. It arises on derivatives, securities financing transactions and exposures to counterparties in both the trading and non-trading books. The table below sets out details of the local Group's counterparty credit risk exposures through its over the counter (OTC) derivative exposures.

Four approaches may be used under CRD IV to calculate exposure values for CCR: mark-to-market, original exposure, standardised and IMM. Exposure values calculated under these approaches are used to determine RWAs; we use the mark-to-market approach. Under the mark-to-market approach, the EAD is calculated as current exposure plus regulatory add-ons.

Table 22: Analysis of counterparty credit risk ('CCR') exposure by approach

		Replacement cost	Potential future exposure	EAD post-CRM	RWAs
		€000	€000	€000	€000
1	Mark to market	**4,956**	**4,275**	**9,231**	**6,749**
11	**Total at 31 December 2018**	**4,956**	**4,275**	**9,231**	**6,749**
1	Mark to Market	4,737	4,125	8,862	7,052
11	Total at 31 December 2017	4,737	4,125	8,862	7,052

Credit quality of financial assets

As outlined previously, the local group's credit risk rating processes are designed to highlight exposures which require closer management attention because of their greater probability of default and potential loss. The credit quality of unimpaired loans is assessed by reference to the local group's standard credit rating system.

The five credit quality classifications below describe the credit quality of the local group's lending, debt securities and derivatives.

Quality classification definitions

'Strong' exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss. Personal accounts operate within product parameters and only exceptionally show any period of delinquency.

'Good' exposures require closer monitoring and demonstrate good capacity to meet financial commitments, with low to moderate default risk. Personal accounts typically show only short periods of delinquency, with any losses expected to be minimal following the adoption of recovery processes.

'Satisfactory' exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk. Personal accounts typically show only short periods of delinquency, with any losses expected to be minor following the adoption of recovery processes.

'Sub-standard' exposures require varying degrees of special attention and default risk is of greater concern. Personal portfolio segments show longer delinquency periods of generally up to 90 days past due and/or expected losses are higher due to a reduced ability to mitigate these through security realisation or other recovery processes.

'Impaired' exposures have been assessed, individually or collectively, as impaired.

As illustrated in the table below, these classifications each encompass a range of more granular, internal credit rating grades assigned to corporate and personal lending business as well as external rating grades, attributed by external agencies to debt securities. There is no direct correlation between the internal and external ratings at granular level, except to the extent each falls within a single quality classification.

	Debt securities and other bills – External credit rating	Wholesale and retail lending – Internal credit rating
Quality classification		
Strong	**A- and above**	**CRR1 to CRR2**
Good	**BBB+ to BBB-**	**CRR3**
Satisfactory	**BB+ to B and unrated**	**CRR4 to CRR5**
Sub-standard	**B- and below**	**CRR6 to CRR8**
Impaired	**Impaired**	**CRR9 to CRR10**

The Customer Risk Rating (CRR) 10-grade scale assigned to corporate and personal lending business summarises a more granular underlying CRR scale for these customer segments; this combines obligor and facility/product risk factors in a composite measure.

For debt securities and certain other financial instruments, external ratings have been aligned to the five quality classifications.

Impaired loans and advances

Impaired loans and advances are those that are classified as Customer Risk Rating (CRR) 9 or CRR 10. These grades are assigned when the local group considers that either the customer is unlikely to pay its credit obligations in full, without recourse to security, or when the customer is more than 90 days on any material credit obligation to the local group.

Impaired loans and advances also include renegotiated loans and advances that have been subject to a change in contractual cash flows as a result of a concession which the local group would not otherwise consider, and where it is probable that without the concession the borrower would be unable to meet the contractual payment obligations in full, unless the concession is insignificant and there are no other indicators of impairment.

The table below analyses the change in stock of specific credit risk adjustment for the financial year ended 31 December 2018.

Table 23: Changes in the stock of general and specific credit risk adjustments

		Accumulated specific credit risk adjustment
		€000
1	Opening balance at 01 January 2018 [1]	**53,021**
2	Increases due to amounts set aside for estimated loan losses during the period [2]	**5,674**
4	Decreases due to amounts taken against accumulated credit risk adjustments	**(5,857)**
	Recoveries on credit risk adjustments written off in previous years	**—**
6	Impact of exchange rate differences	**—**
8	Other adjustments	**—**
9	Closing balance at 31 December 2018	**52,838**
10	Recoveries on credit risk adjustments recorded directly to the statement of profit or loss	**1,095**

		Accumulated specific credit risk adjustment
		€000
1	Opening balance at 01 January 2017	51,361
2	Increases due to amounts set aside for estimated loan losses during the period	29,357
3	Decreases due to amounts reversed for estimated loan losses during the period	(29,217)
4	Decreases due to amounts taken against accumulated credit risk adjustments	(8,081)
6	Impact of exchange rate differences	(324)
8	Other adjustments	(2,455)
9	Closing balance at 31 December 2017	40,641
10	Recoveries on credit risk adjustments recorded directly to the statement of profit or loss	—

1 *Includes a day one increase of €12.4mn arising from the adoption of IFRS 9 'Financial Instruments'*
2 *Following adoption of IFRS 9 'Financial instruments', the movement due to amounts set aside for estimated loan losses during the period has been reported net.*

The local group does not account for any general credit risk adjustments.

Defaulted exposures

The accounting definition of impaired and the regulatory definition of default are generally aligned. For particular retail exposures regulatory default is identified at 180 days past due, while the exposures are identified as impaired at 90 days past due.

Changes in stock of defaulted loans and debt securities

Table 24: Changes in stock of defaulted loans and debt securities

		Gross carrying value defaulted exposures
		31 December 2018
		€000
1	**Opening balance at 31 December 2017**	**185,306**
2	Loans and debt securities that have defaulted or impaired since the last reporting period	**14,220**
3	Returned to non-defaulted status	**(20,413)**
4	Amounts written off	**(5,857)**
5	Other changes	**(14,938)**
6	**Closing balance at 31 December 2018**	**158,318**

		Gross carrying value defaulted exposures
		31 December 2017
		€000
1	Opening balance at 31 December 2016	249,148
2	Loans and debt securities that have defaulted or impaired since the last reporting period	18,979
3	Returned to non-defaulted status	(28,938)
4	Amounts written off	(8,394)
5	Other changes	(45,489)
6	Closing balance at 31 December 2017	185,306

In 2018, interest income amounting to €5,962,000 was recognised in profit or loss on loans for which individually assessed impairment provisions existed.

The local group's impaired and past due but not impaired loans and advances to customers are all concentrated in Malta.

Expected Loss ('EL') and credit risk adjustments

With effect from 01 January 2019 we analyse credit loss experience in order to assess the performance of our risk measurement and control processes, and to inform our understanding of the implications for risk and capital management of dynamic changes occurring in the risk profile of our exposures.

When comparing EL with measures of expected credit losses ('ECL') under IFRS 9, differences in the definition and scope should be considered. These differences can give rise to material differences in the way economic, business and methodological drivers are reflected quantitatively in the accounting and regulatory measures of loss. In general HSBC calculates ECL using three main components, a probability of default, a loss given default, and the exposure at default.

Expected credit losses include impairment allowances (or provision in the case of commitments and guarantees) for the 12-month ECL ('12-month ECL') and lifetime ECL, and on financial assets that are considered to be in default or otherwise credit impaired.

ECL resulting from default events that are possible within the next 12 months are recognised for financial instruments in stage 1. An assessment of whether credit risk has increased significantly since initial recognition is performed at each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument.

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

ECL resulting from default events that are possible beyond 12 months ('Life time ECL') are recognised for financial instruments in stages 2 and 3.

Change in expected credit losses and other credit impairment charges represent the movement in the ECL during the year including write-offs, recoveries and foreign exchange. EL represents the one-year regulatory expected loss accumulated in the book at the balance sheet date.

Credit risk adjustments ('CRAs') encompass the impairment allowances or provisions balances, changes in expected credit losses and other credit impairment charges.

Further information on the measurement of loans and advances is disclosed in the Note 3 of the Significant accounting policies within the *Annual Report and Accounts*

Collateral and other credit enhancements

It is the local group's practice to lend on the basis of the customer's ability to meet their obligations out of their cash flow resources rather than rely on the value of security offered. Depending on the customer's standing and the type of product, facilities may be provided unsecured. For other lending a charge over collateral is obtained and considered in determining the credit decision and pricing. In the event of a default, the group may utilise the collateral as a source of repayment. Depending on its form, collateral can have a significant financial effect in mitigating exposure to credit risk.

The principal collateral types are as follows:

– In the personal sector, mortgages over residential properties, cash and securities; and

– In the commercial real estate sector, charges over the properties being financed;

The table below represents for each exposure class, the total exposure value that is covered by eligible collateral, analysed into residential immovable property, commercial immovable property and other eligible collateral. In the case of exposures secured by mortgage on immovable property, the value is limited to 70% of the market value of the property or the mortgage lending value of the property in the case of residential property, and 50% of the market value of the property or 60% of the mortgage lending value of the property in the case of commercial property. The local group also holds other eligible collateral classified as funded credit protection, such as cash and life insurance policies, as well as liquid sovereign debt securities. The local group does not use any guarantees or credit derivatives as referred to in Article 453(g) of the CRR as a credit risk mitigant to cover credit exposures.

Table 25: Exposure cover by class

	At 31 December 2018				
	Exposure value covered by				
	Residential immovable property	Commercial immovable property	Other eligible collateral	Exposure value not covered by eligible collateral	Total
	€000	€000	€000	€000	€000
Central government or central banks	—	—	—	874,730	874,730
Public sector entities	—	—	196,245	2	196,247
Multilateral development banks	—	—	—	187,083	187,083
Institutions	—	—	—	1,101,113	1,101,113
Corporates	—	—	6,411	321,302	327,713
Retail Exposures	—	—	6,187	331,125	337,312
Secured by mortgages on immovable property	2,392,010	795,901	19,012	—	3,206,924
Exposures in default	50,700	49,705	829	17,847	119,081
Items associated with particular high risk equity	6,938	25,944	562	7,362	40,806
Equity exposures	—	—	—	2,752	2,752
Other items	—	—	—	208,910	208,910
Total at 31 December 2018	**2,449,648**	**871,550**	**229,246**	**3,052,227**	**6,602,671**

	At 31 December 2017				
	Exposure value covered by				
	Residential immovable property	Commercial immovable property	Other eligible collateral	Exposure value not covered by eligible collateral	Total
	€000	€000	€000	€000	€000
Central government or central banks	—	—	—	915,047	915,047
Public sector entities	—	—	234,274	—	234,274
Multilateral development banks	—	—	—	142,168	142,168
Institutions	—	—	—	1,055,732	1,055,732
Corporates	—	—	8,523	370,483	379,006
Retail Exposures	—	—	9,141	357,371	366,512
Secured by mortgages on immovable property	2,218,441	651,987	17,913	—	2,888,341
Exposures in default	60,617	51,487	1,364	36,209	149,677
Items associated with particular high risk equity	6,938	25,944	299	—	33,181
Equity exposures	—	—	—	25	25
Other items	—	—	—	196,267	196,267
Total at 31 December 2017	2,285,996	729,418	271,514	3,073,302	6,360,230

Market risk

Market risk is the risk that movements in market risk factors, including foreign exchange rates, interest rates, credit spreads, equity prices and commodity prices, will reduce the group's income or the value of our portfolios.

There were no material changes to the policies and practices for the management of market risk during 2018. A summary of our current policies and practices for the management of market risk is set out in Note 4 'Financial Risk Management' section 2.4.2.6.

Table 26: Market risk under standardised approach

		At		
		31 December 2018	31 December 2017	**31 December 2018**
		RWAs	RWAs	**Capital requirements**
		€000	€000	**€000**
	Outright products			
3	Foreign exchange risk	**592**	975	**48**

Other Risks

Risk management of insurance operations

We operate an integrated bancassurance model that provides insurance products principally for customers with whom we have a banking relationship.

The insurance contracts we sell relate to the underlying needs of our banking customers, which we can identify from our point-of-sale contacts and customer knowledge. The majority of sales are of savings and investment products and term life contracts.

By focusing largely on the personal lines of business, we are able to optimise volumes and diversify individual insurance risks.

We choose to manufacture these insurance products in our subsidiary HSBC Life Assurance Malta Ltd. based on an assessment of operational scale and risk appetite. Manufacturing insurance allows us to retain the risks and rewards associated with writing insurance contracts by keeping part of the underwriting profit and investment income within the group. We also engage with external third party insurance providers to provide general insurance as part of specific propositions or in relation to home loans.

The risk profile of our insurance manufacturing business is measured using an economic capital approach. Assets and liabilities are measured on a market value basis, and a capital requirement is defined to ensure that there is a less than one-in-200 chance of insolvency over a one year time horizon, given the risks to which the business is exposed. The methodology for the economic capital calculation is aligned to the Solvency II insurance capital regulations.

HSBC Life Assurance (Malta) Ltd is excluded from the regulatory consolidation by excluding assets, liabilities and post-acquisition reserves, leaving the investment of the insurance subsidiary to be recorded at cost and deducted from CET1 subject to thresholds (amounts below the thresholds are risk-weighted).

Reputational Risk

Reputational risk is the risk of failing to meet stakeholder expectations as a result of any event, behaviour, action or inaction, either by HSBC, our employees or those with whom we are associated. This might cause stakeholders to form a negative view of the local Group and result in financial or non-financial effects or loss of confidence in the HSBC Bank Malta p.l.c. Reputational risk relates to stakeholders' perceptions, whether fact-based or otherwise. Stakeholders' expectations change constantly and so reputational risk is dynamic and varies between geographical regions, groups and individuals. We have an unwavering commitment to operating at the high standards we set for ourselves in every jurisdiction. Any material lapse in standards of integrity, compliance, customer service or operating efficiency may represent a potential reputational risk. We have taken, and are taking, measures to enhance our AML, sanctions and other regulatory compliance frameworks. These measures should also enhance our reputational risk management in the future.

Sustainability Risk

Sustainability risk arises from the provision of financial services to companies or projects which indirectly result in unacceptable impacts on people or on the environment.

Sustainability risk is:

- measured by assessing the potential sustainability effect of a customer's activities and assigning a Sustainability Risk Rating to all high-risk transactions;
- monitored quarterly by the RMM on a monthly basis and by the Chief Risk Officer ; and
- managed using sustainability risk policies covering project finance lending and sector-based sustainability policies for sectors and themes with potentially large environmental or social impacts.

Business Risk

Business risk is the potential negative effect on profits and capital from the local Group not meeting our strategic objectives, as a result of unforeseen changes in the business and regulatory environment, exposure to economic cycles and technological changes.

We manage and mitigate business risk through our risk appetite, business planning and stress testing processes, so that our business model and planned activities are monitored, resourced and capitalised consistent with the commercial, economic and risk environment in which the local Group operates, and that any potential vulnerabilities of our business plans are identified at an early stage so that mitigating actions can be taken.

Dilution Risk

Dilution risk is the risk that an amount receivable is reduced through cash or non-cash credit to the obligor, and arises mainly from factoring and invoice discounting transactions.

Where there is recourse to the seller, we treat these transactions as loans secured by the collateral of the debts purchased and do not report dilution risk for them. For our non-recourse portfolio, we do not report any dilution risk, as we obtain an indemnity from the seller that indemnifies us against this risk. Moreover, factoring transactions involve lending at a discount to the face-value of the receivables which provides protection against dilution risk.

Interest Rate Risk

The Interest Rate Risk in the Banking Book ('IRRBB') arises from timing mismatches in the repricing of non-traded assets and liabilities and is the potential adverse impact of changes in interest rates on earnings and capital. The component of IRRBB that can be economically neutralised in the market is transferred to the BSM to manage, in accordance with internal transfer pricing rules. In its management of IRRBB, the local group aims to balance mitigating the effect of future interest rate movements which could reduce net interest income against the cost of hedging. The monitoring of the projected net interest income and economic value of equity ('EVE') sensitivity under varying interest rate scenarios is a key part of this. EVE represents the present value of the future banking book cash flows that could be distributed to equity providers under a managed run-off scenario, i.e. the current book value of equity plus the present value of future net interest income in this scenario. An EVE sensitivity is the extent to which the EVE value will change due to a pre-specified movements in interest rates, where all other economic variables are held constant.

Liquidity and funding risk

Strategies and processes in the management of liquidity risk

HSBC Bank Malta p.l.c. has an internal liquidity and funding risk management framework ('LFRF') which aims to allow it to withstand very severe liquidity stresses. It is designed to be adaptable to changing business models, markets and regulations. The management of liquidity and funding is primarily undertaken locally in compliance with the Group's LFRF, and with practices and limits set by the GMB through the RMM and approved by the Board. The local group's policy is that it should be self-sufficient in funding its own activities.

Structure and organisation of the liquidity risk management function

Asset, Liability and Capital Management ('ALCM') team are responsible for the application of the LFRF with HSBC Bank Malta p.l.c. The elements of the LFRF are underpinned by a robust governance framework, the two major elements of which are:

- Asset and liability management committees ('ALCOs'); and
- Annual individual liquidity adequacy assessment process ('ILAAP') used to validate risk tolerance and set risk appetite.

Asset, Liability & Capital Management ('ALCM')

HSBC Bank Malta p.l.c. ALCM team is responsible for the implementation of local regulatory policy at a legal entity level.

Balance Sheet Management ('BSM')

Along with the Group's Global Business Lines, the Balance Sheet Management ('BSM') team forms the first line of defence in the management of liquidity risk, ensuring continuous compliance with the local group risk appetite operating within their risk mandates.

Hedging and mitigating liquidity risk at HSBC Group

Management of liquidity and funding risk

Liquidity coverage ratio

The Liquidity Coverage Ratio ('LCR') aims to ensure that a bank has sufficient unencumbered high-quality liquid assets ('HQLA') to meet its liquidity needs in a 30 calendar day liquidity stress scenario. For the calculation of the LCR, HSBC Bank Malta p.l.c. follows the guidelines set by the European Commission.

Net stable funding ratio ('NSFR')

HSBC Bank Malta p.l.c. uses the NSFR as a basis for establishing stable funding within the group. The NSFR requires institutions to maintain sufficient stable funding and reflects a bank's long-term funding profile (funding with a term of more than one year).

Liquid assets

Liquid assets are held and managed on a stand-alone operating entity basis. Most are held directly by each operating entity's BSM department, primarily for the purpose of managing liquidity risk in line with the LFRF.

Liquid assets also include any unencumbered liquid assets held outside the BSM department for any other purpose. The LFRF gives ultimate control of all unencumbered assets and sources of liquidity to BSM.

Overall adequacy of liquidity risk management

All operating entities are required to manage liquidity risk and funding risks on a stand-alone basis in accordance with the LFRF, which includes the preparation of an Individual Liquidity Adequacy Assessment Process ('ILAAP') document, to ensure that:

- liquidity resources are adequate, both as to the amount and quality;
- there is no significant risk that liabilities cannot be met as they fall due;
- a prudent structural funding profile is maintained;
- adequate liquidity resources continue to be maintained; and
- that the operating entity's liquidity risk framework is adequate and robust.

The two key objectives of the ILAAP process are to:

- demonstrate that all material liquidity and funding risks are captured within the internal framework; and
- validate the operating entity's risk tolerance/appetite by demonstrating that reverse stress testing scenarios are acceptably remote; and vulnerabilities have been assessed through the use of severe stress scenarios.

The final conclusion of the ILAAP, approved by the Board of Directors, is that each operating entity:

- maintains liquidity resources which are adequate in both amount and quality at all times, and ensures that
- there is no significant risk that its liabilities cannot be met as they fall due; and
- ensures its liquidity resources contain an adequate amount of high quality liquid assets ('HQLA') and maintains a prudent funding profile.

Liquidity stress testing

The local group undertakes liquidity stress testing to test that its risk appetite is correct, to validate that it can continue to operate under various stress scenarios and to test whether the stress assumptions within the LCR scenario are appropriate and conservative enough for the local group's business. The local group also conducts reverse stress testing with the specific aim of reviewing the remoteness of the scenarios that would lead the local group to exhaust its liquidity resources. If the scenarios are not deemed remote enough, then corrective action is taken. Several different stress testing scenarios are run that test the quality of liquidity resources under stresses of varying durations and nature. As part of this exercise, various assumptions are used which are approved by the relevant ALCO and Board and the results of the stress testing are presented through the ILAAP to the Board and on a quarterly basis to the relevant ALCO.

Liquidity management across the group

The structure of the local group means that liquidity and funding risk cannot practically be managed on a consolidated local group basis and can only be managed by entity on a stand-alone basis. HSBC Bank Malta p.l.c.'s liquidity and funding risk framework requires all operating entities to manage liquidity and funding risk on a stand-alone basis in accordance with the local Group's liquidity and funding risk management framework and the liquidity and funding risk tolerances set out in the Risk Appetite Statement.

The local group's internal liquidity and funding risk management framework does not therefore seek to manage liquidity and funding risk on a consolidated basis, other than to ensure that the position of the consolidated group meets the minimum regulatory requirements.

Asset encumbrance

The disclosure on asset encumbrance is a new requirement introduced in Banking Rule 07 transposing the provisions of the EBA Guidelines on Disclosure of Encumbered and Unencumbered Assets (EBA/ GL/2014/03).

The following is the disclosure of on-balance sheet encumbered and unencumbered assets, and off-balance sheet collateral (represented by median values of monthly data points in 2018) based on the requirement in Part Eight of CRD IV.

The objective of this disclosure is to facilitate an understanding of available and unrestricted assets that could be used to support potential future funding and collateral needs. An asset is defined as encumbered if it has been pledged as collateral against an existing liability, and as a result is no longer available to the group to secure funding, satisfy collateral needs or be sold to reduce the funding requirement.

The disclosure is not designed to identify assets which would be available to meet the claims of creditors or to predict assets that would be available to creditors in the event of a resolution or bankruptcy.

In accordance with the EBA 'Guidelines on disclosure of encumbered and unencumbered assets', the amounts disclosed in the table below represent median values, being the rolling quarterly amounts over the previous 12 months.

Table 27: Encumbered and unencumbered assets

		Group			
		At 31 December 2018			
		Carrying amount of encumbered gross assets	Fair value of encumbered gross assets	Carrying amount of unencumbered gross assets	Fair value of unencumbered gross assets
		€000	€000	€000	€000
010	Assets of the reporting institution	**87,375**	**–**	**5,389,405**	**–**
020	Loans on demand	**–**	**–**	**656**	**–**
030	Equity instruments	**–**	**–**	**2,842**	**2,842**
040	Debt Securities	**87,375**	**87,385**	**953,198**	**953,198**
100	Loans and advances	**–**	**–**	**4,223,197**	**–**
120	Other Assets	**–**	**–**	**205,990**	**–**

		Group			
		At 31 December 2017			
		Carrying amount of encumbered gross assets	Fair value of encumbered gross assets	Carrying amount of unencumbered gross assets	Fair value of unencumbered gross assets
		€000	€000	€000	€000
010	Assets of the reporting institution	90,306	—	5,409,020	—
020	Loans on demand	—	—	468	—
030	Equity instruments	—	—	957	957
040	Debt Securities	90,306	90,306	1,024,581	1,024,580
100	Loans and advances	—	—	4,226,661	—
120	Other Assets	—	—	186,252	—

The local group does not encumber any of the collateral received or any of its own debt securities issued.

As at 31 December 2018, the local group did not have any outstanding liabilities associated with encumbered assets and collateral received.

The bank undertakes the following types of encumbrance:

i. Pledging of loans and advances to customer and debt securities against the provision of credit lines by the Central Bank of Malta.

ii. Pledging of balances held with the Central Bank of Malta and debt securities in favour of the Depositor Compensation Scheme.

Remuneration policy

Information on the local group's remuneration policy and practices is disclosed in the Remuneration Report section within the *Annual Report and Accounts*

Income statements and statements of comprehensive income: Five-year comparison

Group income statements

	2018	2017	2016	2015	2014
	€000	€000	€000	€000	€000
Interest receivable and similar income	118,943	132,850	142,062	150,567	155,789
Interest expense	(10,321)	(12,190)	(15,635)	(23,531)	(33,227)
Net interest income	108,622	120,660	126,427	127,036	122,562
Net non-interest income	41,779	42,029	47,115	49,319	50,698
Change in expected credit losses and other credit impairment charges	(3,488)	—	—	—	—
Loan impairment charges	N/A	1,168	(9,030)	(10,826)	(22,545)
Operating expenses	(108,357)	(114,034)	(102,291)	(118,757)	(98,594)
Profit before tax	38,556	49,823	62,221	46,772	52,121
Tax expense	(9,860)	(18,968)	(22,008)	(17,292)	(18,504)
Profit for the year	28,696	30,855	40,213	29,480	33,617
Earnings per share	8.0c	8.6c	11.2c	8.5c	9.7c

Group Statements of Comprehensive Income

	2018	2017	2016	2015	2014
	€000	€000	€000	€000	€000
Profit for the year	28,696	30,855	40,213	29,480	33,617
Other comprehensive income					
Items that will be reclassified subsequently to profit or loss when specific conditions are met:					
Debt instruments at fair value through other comprehensive income/available-for-sale investments:	(3,592)	(4,739)	(7,392)	2,767	7,759
– fair value (losses)/gains	(5,527)	(7,290)	(585)	4,938	13,656
– fair value losses reclassified to profit or loss on disposal	—	—	(10,787)	(682)	(1,719)
– income taxes	1,935	2,551	3,980	(1,489)	(4,178)
Items that will not be reclassified subsequently to profit or loss:					
Properties:	382	—	2,299	1,199	(25)
– surplus arising on revaluation	424	—	2,299	—	(28)
– income taxes	(42)	—	—	1,199	3
Defined benefit obligation:	(334)	—	—	—	—
– remeasurement of defined benefit obligation	(514)	—	—	—	—
– income taxes	180	—	—	—	—
Equity instruments designated at fair value through other comprehensive income:	1,045	N/A	N/A	N/A	N/A
– fair value gains	1,608	N/A	N/A	N/A	N/A
– income taxes	(563)	N/A	N/A	N/A	N/A
Other comprehensive income, net of tax	(2,499)	(4,739)	(5,093)	3,966	7,734
Total comprehensive income	26,197	26,116	35,120	33,446	41,351

Statements of financial position: Five-year comparison

	2018	2017	2016	2015	2014
	€000	€000	€000	€000	€000
Assets					
Balances with Central Bank of Malta, Treasury Bills and cash	**190,768**	164,059	122,418	187,563	118,033
Items in course of collection from other banks	**5,404**	18,158	16,796	12,559	10,990
Financial investments designated at fair value attributable to insurance operations	**N/A**	727,270	1,383,606	1,372,484	1,421,580
Financial investments mandatorily measured at fair value through profit or loss attributable to insurance operations	**694,081**	N/A	N/A	N/A	N/A
Held for trading derivatives	**4,956**	5,175	11,440	11,492	13,170
Loans and advances to banks	**1,097,714**	1,059,308	1,077,859	841,411	875,095
Loans and advances to customers	**3,110,412**	3,128,833	3,320,332	3,284,615	3,273,381
Financial investments	**904,920**	926,096	1,053,200	1,203,638	1,153,884
Prepayments and accrued income	**27,312**	24,236	31,178	40,863	44,730
Current tax assets	**16,728**	13,911	12,963	11,792	8,833
Reinsurance assets	**85,205**	85,887	85,228	83,088	85,337
Assets attributable to disposal group held for sale	**—**	473,797	—	—	—
Other non-current assets held for sale	**5,908**	7,411	9,750	11,347	9,297
Investment property	**9,714**	10,600	13,026	15,458	16,326
Property, plant and equipment	**55,413**	56,308	59,147	58,559	59,481
Intangible assets	**59,136**	64,062	67,773	69,653	73,971
Deferred tax assets	**21,509**	16,488	22,163	22,642	13,612
Other assets	**21,814**	16,384	19,085	13,959	21,267
Total assets	**6,310,994**	6,797,983	7,305,964	7,241,123	7,198,987
Liabilities					
Deposits by banks	**2,542**	54,703	10,770	14,286	59,848
Customer accounts	**4,887,473**	4,765,995	5,000,836	4,950,257	4,867,124
Held for trading derivatives	**4,991**	5,228	12,600	11,732	13,870
Accruals and deferred income	**19,151**	17,838	17,171	30,073	27,514
Current tax liabilities	**538**	—	177	3,508	172
Liabilities under investment contracts	**166,347**	203,136	930,937	987,008	1,030,928
Liabilities under insurance contracts	**620,781**	658,792	645,561	616,657	592,378
Provisions for liabilities and other charges	**20,689**	20,099	17,631	17,133	2,417
Deferred tax liabilities	**23,427**	26,295	34,586	32,249	28,244
Subordinated liabilities	**62,000**	29,277	87,418	87,363	87,284
Liabilities attributable to disposal group held for sale	**—**	473,797	—	—	—
Other liabilities	**44,277**	63,785	74,753	29,741	44,103
Total liabilities	**5,852,216**	6,318,945	6,832,440	6,780,007	6,753,882
Total equity	**458,778**	479,038	473,524	461,116	445,105
Total liabilities and equity	**6,310,994**	6,797,983	7,305,964	7,241,123	7,198,987
Memorandum items					
Contingent liabilities	**149,783**	122,959	118,469	133,771	133,448
Commitments	**1,433,773**	1,215,457	1,225,232	1,292,605	1,291,225

Statements of cash flows: Five-year comparison

	2018	2017	2016	2015	2014
	€000	€000	€000	€000	€000
Net cash (used in)/from operating activities	**(71,376)**	(156,694)	16,105	(54,019)	448,298
Cash flows from investing activities					
Dividends received	**18**	—	—	—	—
Interest received from financial investments	**20,091**	32,305	33,435	54,037	39,435
Purchase of other financial investments	**(242,523)**	(139,115)	(100,609)	(312,346)	(413,566)
Proceeds from sale and maturity of financial investments	**254,972**	231,950	227,414	323,562	217,133
Purchase of property, plant and equipment, investment property and intangible assets	**(5,194)**	(2,999)	(990)	(4,640)	(5,264)
Proceeds on sale of property, plant and equipment, intangible assets and liquidation of subsidiary company	**—**	—	2,639	3	81
Proceeds on disposal of card acquiring business	**1,300**	—	—	—	—
Net cash flows from/(used in) investing activities	**28,664**	122,141	177,994	60,616	(162,181)
Cash flows from financing activities					
Dividends paid	**(38,409)**	(20,610)	(22,717)	(17,455)	(19,349)
Issue of subordinated liabilities	**62,000**	—	—	—	—
Repayment of subordinated liabilities	**(29,277)**	(58,158)	—	—	—
Net cash used in financing activities	**(5,686)**	(78,768)	(22,717)	(17,455)	(19,349)
(Decrease)/increase in cash and cash equivalents	**(48,398)**	(113,321)	155,277	(10,858)	266,768

Accounting ratios: Five-year comparison

	2018	2017	2016	2015	2014
	%	%	%	%	%
Net operating income before loan impairment charges to total assets	**2.4**	2.4	2.5	2.4	2.4
Operating expenses to total assets	**1.7**	1.7	1.4	1.6	1.4
Cost efficiency ratio	**73.0**	70.9	60.0	59.0	56.8
Profit before tax to total assets	**0.6**	0.7	0.9	0.6	0.7
Profit before tax to equity	**8.4**	10.4	13.1	10.1	11.7
Profit after tax to equity	**6.1**	6.5	8.5	6.4	7.6

	2018	2017	2016	2015	2014
Shares in issue (millions)	**360.3**	360.3	360.3	360.3	324.3
Net assets per 30 cent share (cent)	**127.3**	133.0	131.4	128.0	137.3
Earnings per 30 cent share (cent)	**8.0**	8.6	11.2	8.5	9.7
Dividend per 30 cent share (cent)					
– gross	**5.8**	17.1	11.2	7.7	9.7
– net	**3.8**	11.1	7.3	5.0	6.3
Dividend cover	**2.1**	0.8	1.5	1.5	1.5

Branches and offices

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Registered Office/Head Office
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Valletta VLT 1444
Tel: 2380 2380

Retail Banking and Wealth Management
Business Banking Centre
80 Mill Street, Qormi QRM 3101
Tel: 2380 2380

Premier Centre

Wealth Management Office
Business Banking Centre
80 Mill Street, Qormi QRM 3101
Tel: 2148 9100

Commercial Banking
Business Banking Centre
80 Mill Street, Qormi QRM 3101
Tel: 2380 8000

International Banking Centre
High Street, Sliema SLM 1549
Tel: 2380 2600

Trade Services
Business Banking Centre
80 Mill Street, Qormi QRM 3101
Tel: 2380 1828

Operations Centre
80 Mill Street, Qormi QRM 3101
Tel: 2380 2380

Card Operations
Operations Centre
80 Mill Street, Qormi QRM 3101
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Contact Centre
Operations Centre
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Tel: 2380 2380

Inheritance Unit
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Legal Office
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Branches

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HSBC Life Assurance (Malta) Limited
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