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Annual Report 2018

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SCHARTS

Chairman's Review

Michael Bussey

In my first very enjoyable full year as Chairman of MDB Group, I have recognised significant development in the strengths and capabilities of the organisation as it continues to develop its medium term commercial strategies whilst investing in its governance and operating infrastructure which is critical to the ongoing success of the Group. Our staff numbers have expanded in all our locations as we continue to attract talented and ambitious individuals to help drive our growth and the quality of our customer offering.

Full year profits after tax are reported at €23.4 million, an improvement of 35% on the previous year, but more importantly the Group had a highly successful and significant capital raise, which became effective in September and November 2017, the benefits of which will be reflected in the coming financial year and beyond.

The Board continues to invest its efforts in two strategic priorities: 1) The continued focus on meeting all of the Group's regulatory requirements on an ongoing basis, recognising the very high standards to which we are held as one of only 118 credit institutions in Europe that is directly supervised by the ECB due to the systemic nature of the Group in its home jurisdiction. 2) The further development of the commercial proposition of the Group, building around its core competencies in the Belgian market and its highly competitive operating capabilities that it has developed in Malta in support of its pan European activities. The Board is of the opinion that the Group is exceptionally well positioned for the next stage of its development.

Commercially, the Group's statement of financial position has expanded as it has deployed capital into its international lending activities in an appropriate and prudent manner whilst benefitting from a growing and loyal depositor base which ensures the Group is extremely well funded. Many of our individual depositors continue to develop their relationship with the Group through increasing participation in our innovative wealth management offering where we are pleased to report strong momentum in both assets under management and under custody.

Bolstered by our capital raise, our year end Tier 1 Capital Ratio stood at 14.2% with our overall prudential ratio at 16.6%, significantly in excess of our regulatory requirements and underpinning our growth objectives for the future.

2018/19 will be a significant year for the Group as we look to diversify our activities and evolve our core commercial strengths .The Board is confident that that the Group is well positioned to compete strongly in our chosen markets, it is robustly capitalised and it is fully capable of delivering on its obligations to all its stakeholders.

Finally, we have an exceptional group of staff in all our locations - they have again earned the very sincere thanks of myself and the Board for their hard work during the year.

MICHAEL BUSSEY
CHAIRMAN

30 July 2018

Chief Executive Officer's Review

Mark A. Watson

The 2017/18 financial year represented another year of progress underpinned by a significant equity capital injection from a variety of third party investors which will support our growth going forward and enable us to enhance our product capabilities underpinning our future diversification strategies.

After a series of successful meetings with investors through the late summer of 2017, the Group managed to raise €77.6 million of equity capital that supported the growth of our international corporate lending, which at year end stood at €1.6 billion, a growth of 16% over the financial year. Continued deployment of capital into this core strategy will underpin the growth of the Group in this coming financial year, whilst we look to develop supplementary activities as we continue to invest in the infrastructure that supports our business lines.

Own funds now stand at €357 million, a significant increase on the prior period, with the Tier 1 ratio standing at 14.2% and the overall prudential ratio at 16.6%. Thus through the course of the last financial year we have increased the after tax profitability of the Group, increased the capital base of the Group and strengthened the capital ratios that support our overall activity.

Our wealth management business continues to gain momentum in both Malta and Belgium, with overall assets growing from €625.4 million to €838.12 million. An interesting observation in both countries has been the broadening and deepening of the relationship we have with our existing customer base which has enabled us to drive the value of wealth management assets higher whilst continuing to reduce the cost of our deposit base which now stands at 104bp, a reduction of 38bp through the year. This demonstrable longevity of relationships ensures a very stable funding base for the Group on an ongoing basis.

Full year profit after tax came in at €23.4 million, which together with the ongoing deployment of the increased capital base will put us on to a trajectory to realise the scalability of the platform and significantly enhance our returns over the coming years.

Our situation as an Other Systematically Important Institution ("OSII") continues to be challenging in terms of the resources required from a small institution such as ourselves, however we remain very proud of our track record in meeting all our regulatory requirements in a timely and appropriate manner and indeed are of the opinion that this framework is leading to significant opportunities to further develop the strategy of the Group.

I would like once again to thank all our employees for their continued efforts in supporting and implementing the strategy and growth of the MDB Group.

MARK A. WATSON
DIRECTOR AND CHIEF EXECUTIVE OFFICER

30 July 2018

Directors' report

The directors present their annual report of MDB Group Limited (the "Company" or "MDB Holding"), formerly MeDirect Group Limited, and of the Company and its subsidiaries ("the Group" or "MDB Group") for the year ended 31 March 2018. This report is prepared in terms of the Maltese Companies Act (Cap. 386) and complies with the disclosure requirements of the Sixth Schedule to the same Act.

The Group's results reflect the consolidated position of MDB Holding and its principal subsidiaries, namely MeDirect Bank (Malta) plc ("MeDirect Malta") formerly Mediterranean Bank plc, MeDirect Malta's wholly owned subsidiary being MeDirect Bank SA ("MeDirect Belgium") and in 2017 also Mediterranean Corporate Bank Limited ("MedCorp"), and Charts Investment Management Service Limited ("Charts") (together the "Subsidiaries"). The Group also includes Grand Harbour I B.V., a controlled special purpose entity, established in the Netherlands and Medifin Estates, a property leasing partnership.

CHANGE IN NAME

By virtue of a shareholders' resolution dated 30 November 2017, the shareholders of the Company resolved to change the name of the Company from MeDirect Group Limited to MDB Group Limited.

PRINCIPAL ACTIVITIES

The Company is mainly involved in the holding of shares in subsidiaries which are mainly credit institutions.

The principal activities of the Group comprise lending to international and local corporates and the provision of banking services primarily to the mass affluent sector in Malta and Belgium, focusing primarily on term deposit savings and wealth management, as well as local corporate banking in Malta.

MeDirect Malta is licensed by the Malta Financial Services Authority ("MFSA") in terms of the Maltese Banking Act (Cap. 371) amongst other things, to carry out the business of banking, to undertake money transmission services, to issue and administer means of payment, to issue guarantees and commitments, to trade on own account and/or for the account of customers in a number of instruments, to provide portfolio management and advice and to provide safe keeping services. MeDirect Malta also holds a Category 2 licence and a Category 4 licence issued by the MFSA which authorise MeDirect Malta to provide investment services, to hold or control customers' money and to act as trustee or custodian of collective investment schemes.

The principal customer-related activities of MeDirect Malta include the following:

- The provision of senior secured loans and revolving credit facilities to foreign companies;
- The provision of loans and overdraft facilities to local companies;

- The receipt and acceptance of customers' monies for deposit in savings and fixed term deposit accounts denominated in euro and other major currencies;

- The provision of wealth management products;

- Trading for the account of customers in foreign exchange;

- The provision of money transmission services; and

- The provision of safe custody services with a wide range of custom-tailored solutions as well as administration and safekeeping of securities.

MeDirect Malta's previous subsidiary, MedCorp, was focused on providing a full range of banking services to corporate clients in Malta, including corporate lending, deposit taking, foreign exchange services and payment services. For accounting purposes, with effect from 1 April 2017, MedCorp was merged with MeDirect Malta.

MeDirect Malta's wholly owned subsidiary MeDirect Belgium established a highly competitive online offering for the Belgian market. MeDirect Belgium's operations are based on:

- Online client delivery;

- Competitive and cost effective savings and wealth management products;

- Transparent and customer friendly products and delivery; and

- The provision of senior secured loans to foreign companies.

Charts is a licensed member of the Malta Stock Exchange and regulated by the MFSA. Charts is principally engaged in providing stock-broking and corporate finance services and other authorised investment services under a Category 3 licence, including the underwriting of the public issue of bonds. For accounting purposes, with effect from 1 April 2018, Charts was merged with MeDirect Malta.

BUSINESS REVIEW

During the financial year ended 31 March 2018, the Group continued to implement its business plan with the aim of sustaining the Group's long-term profitability by building its international corporate lending portfolio and its deposit and wealth management customer base in the mass affluent market both in Malta and Belgium and also with select corporates in Malta.

The Group recorded a profit after tax for the financial year ended 31 March 2018 of €23.4 million (2017: €17.3 million). The tax credit in this financial year is mainly due to the new notional interest deduction rules that were introduced by the Maltese Government in October 2017. This resulted in the recognition of deferred tax assets on any unutilised notional interest deduction allowances.

Total operating income for the year ended 31 March 2018 was €71.4 million (2017: €68.1 million).

The Group's profitability has been mainly driven through the increase in capital together with a healthy level of savings and term deposit customers, primarily in the Maltese and Belgian markets, deploying liquidity in the Group's international corporate lending activities and efforts to achieve efficient cost management.

The Group continues to fund its portfolios through deposits and through the international wholesale financial markets. The growth of the Group's deposit base in Belgium has strengthened and made more robust the Group's funding platform. Access to the Eurex repo platform has also provided efficient funding for the Group. The Group's core deposit offering is a range of fixed-term and other savings products. As of 31 March 2018, the Group's deposit base reached €2 billion (2017: €1.9 billion). Growth of the Group's deposit base has also provided cross selling opportunities for investment and wealth management products.

The Group's loans and advances to customers ("Lending Portfolio") largely consist of senior secured loans and revolving credit facilities to corporate borrowers domiciled in Western Europe. Substantially, all loans and revolving credit facilities in the portfolio are denominated in euro or pound sterling and substantially all of the loans are floating rate instruments (some have interest rate floors embedded within the contracts) and would not be adversely affected by material decreases in interest rates.

In this respect, the Group's Lending Portfolio (international and domestic) stood at €1.7 billion (2017: €1.4 billion) as of 31 March 2018, net of collective impairment loss allowances of €5.6 million (2017: €5.1 million) and specific impairment loss allowances of €17.0 million (2017: €16.9 million). In addition the Group had commitments of €361.8 million under revolving credit facilities as at 31 March 2018 (2017: €288.3 million) and other undrawn credit facilities of €74.7 million (2017: €49.5 million).

The MeDirect Malta Group, which comprises MeDirect Malta and MeDirect Belgium (together "MeDirect banking entities"), also holds a portfolio of liquid assets. As of 31 March 2018, MeDirect Malta Group's Treasury portfolio stood at €560.2 million (2017: €698.5 million) consisting of available-for-sale ("AFS") securities. The fair value of the AFS book is risk managed through interest rate derivatives such as interest rate swaps where the hedge accounting methodology under IAS 39 was adopted.

The Group also continues to make significant investments in technology that have allowed it to enhance its online banking and investment services for its customers, together with systems to support such services. Investment services include online execution of brokerage transactions in equities, bonds and funds as well as foreign exchange execution capabilities. The Group also offers online retirement and investment planning capabilities, model portfolios analytical tools to enable customers to analyse portfolio and investment alternatives and a broad range of research and market data resources.

Capital, specifically instruments that qualify as Common Equity Tier 1 capital ("CET1") in terms of the Capital Requirements Regulation ("CRR") is key to the Group's growth. By virtue of board resolutions dated 20 September 2017, 27 September 2017, 1 November 2017 and 7 November 2017 the Group accepted capital contributions from its immediate parent company, Medifin Finance Limited, amounting to €6.0 million, €5.0 million, €12.0 million and €54.6 million respectively.

The Group remains committed to operating with strong regulatory ratios and a robust liquidity position. At 31 March 2018 the Group's Capital Adequacy Ratio stood at 16.6% (2017: 13.7%), whilst the Group's Liquidity Coverage Ratio stood at 636.0% (2017: 576.7%).

Under the Single Supervisory Mechanism ("SSM"), as from January 2016, the Group came under the direct supervision of the European Central Bank ("ECB"). The Group continues to ensure that appropriate capital levels are maintained reflecting the economic environment and the challenges that the Group is faced with. The SSM has led to further strengthening of the controls and corporate governance of the Group. It is also a good opportunity to continue strengthening the reputation of the Group both in Malta and internationally. The Group is confident that it will continue meeting the high expectations of the ECB.

KEY PERFORMANCE INDICATORS

The evaluation of management's implementation of corporate and financial strategy is based on the use of key performance indicators ("KPIs") enabling the Group to adopt corrective measures. The KPIs (and associated risk appetite and risk tolerance metrics) ensure that key risks are constantly monitored. KPIs play an essential role within the Group's performance management process.

The Board primarily focuses on quantitative KPIs and does not actively monitor on a regular basis any specific non-financial KPIs. However, the Board engages in regular substantive discussions in which it evaluates non-financial metrics such as customer satisfaction, employee involvement and engagement and sustainability. The Board is developing a regular framework for the regular evaluation and monitoring of such non-financial metrics and the establishment of non-financial KPIs.

The principal financial KPIs of the Group tracked by the Board of directors are presented in the following table:

Key performance indicators	**2018**	2017
Business performance management		
Annualised return on equity	**8.6%**	8.0%
Overall net interest margin	**2.7%**	2.5%
Capital management		
CET 1 ratio	**14.2%**	11.7%
Leverage ratio	**10.29**	7.29
Liquidity management		
Liquidity coverage ratio ("LCR")	**636.0%**	576.7%
Net stable funding ratio ("NSFR")	**140.0%**	128.9%
Credit management		
Non-performing loans ratio	**4.4%**	4.4%
Loan loss provisioning ratio	**1.4%**	1.5%

OUTLOOK AND FUTURE BUSINESS DEVELOPMENTS

The ongoing robustness of capital and liquidity ratios provides a stable foundation from which to produce attractive and sustainable returns. The strategy that has been defined by the Board of Directors over the last few years has resulted in significant growth whilst producing attractive returns and an ability to invest in the capabilities of the Group.

The relative overall stability of the European markets had an overall positive effect on the Group's funding cost and securities portfolios. Stability in the international capital markets results in a positive effect on the Group's wealth management and investment services businesses since greater investor confidence leads to increased customer interest in the investment products offered by the Group.

The eurozone macroeconomic environment remains challenging, especially with the uncertainty surrounding the UK Brexit, and that any reversal of positive trends described above would have a negative effect on the Group's asset portfolios and business. Despite these ongoing challenges, the Group remains confident that its underlying strategy will continue to result in profitable growth. Furthermore, the Group is currently exploring new opportunities in order to diversify the Group's asset classes and the relative revenue streams.

MeDirect Malta will consolidate and expedite its Maltese growth strategy through its portfolio of Maltese clients which is complementary to the Group's existing customer base and is aligned with the Group's future growth strategies.

The Group has recently been operating at a relatively stable leverage ratio of 10.29% (2017: 7.29%) and intends to continue to operate with a capital adequacy ratio in excess of the minimum capital requirements provided by the Capital Requirements Directive ("CRD") IV and also in conformity with any other guidance issued by the Group's regulator, the ECB's Joint Supervisory Team (the "JST").

The developments mentioned above enable the Board of Directors to look forward to the future with cautious optimism.

RISK MANAGEMENT

A comprehensive risk management framework is applied throughout the Group, with effective governance and corresponding risk management tools. This framework is underpinned by the Group's risk culture. The 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 Group.

An established risk governance framework and ownership structure ensures oversight of accountability for the effective management of risk. The Group's risk management framework fosters the continuous monitoring of the risk environment and an integrated evaluation of risks and their interaction. The Group's risk management framework is designed to provide appropriate risk monitoring and assessment.

The Board is responsible for the overall approval of the Group's Risk Appetite Statement ("RAS"). The principal objective of the Group's RAS is to outline the level and types of risk that the Group is willing to assume, within its risk capacity, to achieve its strategic objectives and business plan. The RAS is a material part of the decision-making processes of the Group.

The Group's RAS articulates the type and quantum of risk that the Group is able and willing to accept in pursuit of delivering its strategy. The Group's RAS is mostly based on qualitative statements which express the risk taking intent of the Group, and is supported by quantitative limits and controls. Internal quantitative measures enable measurement of the Group's risk profile against risk appetite and risk capacity.

The risk areas covered by the Group's RAS reflect the material risks contemplated by the Group, relative to the business model, size and complexity of the Group. The Group has identified a number of risk themes which in turn are classified under two categories, namely Financial and Non-Financial Risks.

Whilst it may be argued that all risks that a banking group may encounter can ultimately have some form of financial impact, for the sake of providing alignment to industry standard approaches to categorising risk themes, the Group adopts a simplistic definition that a financial risk is a risk that directly impacts the financial performance of the Group. Taking into consideration the business model of the Group as well as its strategic objectives, financial risks were categorised under five main themes as follows: capital adequacy, liquidity and funding risk, earnings volatility, credit risk and market risk.

Non-financial risks have risen in prominence over the past few years, with many banking groups experiencing increasing impacts as a result of operational risk and associated risk types such as conduct, compliance, reputation and business model risk. The Group has identified the following risk themes under this category: reputational risk, operational risk, compliance and regulatory risk and business and strategy risk.

A detailed review of the Group's use of financial instruments, the Group's exposure to liquidity risk, credit risk and market risk, and the respective financial risk management objectives and policies are included in Note 2 to the financial statements.

ENVIRONMENTAL AND EMPLOYEE MATTERS

Sustainability

November 2017 marked a new chapter in the Group's story. As part of our strategy to strengthen brand recognition and having outgrown the Valletta headquarters, the support and administrative functions were consolidated within new offices located at The Centre, Tigné Point, Sliema. The new premises also house the Sliema Branch, Charts and the Corporate Banking Team.

As part of this relocation exercise, we also took the opportunity to overhaul and upgrade our entire network and security infrastructure so that we now have the very latest technology in place and make use of different service providers with multiple fibre optic cables connecting us to our customers in Malta and across Europe.

Managing our own environmental footprint supports business efficiency and is part of our long-term contribution to society. During this financial year, the Group continued to invest in energy efficient technology through the use of more efficient LED technology. Furthermore, the Group has introduced various initiatives in order to reduce paper printing by its staff.

Employees

We believe that if someone is worth talking to, they are worth listening to. Exchange meetings are our way of doing that: meetings with no agendas and where human resources representatives are participants rather than leaders. These meetings allow people to express themselves without interruption or rebuttal.

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

Grievances

The Group's grievance procedures are made available to all employees of the Group and a copy is provided to all new employees. The purpose of the Group's grievance procedures is to enable employees to raise any complaints concerning work-related matters so that any issues may be addressed promptly, within as short a time as possible and to the most appropriate level, yet as close as possible to the point of origin. It establishes a process for employees to express and resolve concerns or grievances in relation to their employment in a fair and equitable manner, maintaining a healthy environment of dialogue and respect.

Financial crime and human rights

Financial crime such as bribery, corruption and money laundering hinders economic progress and harms communities. We ensure that we have strong financial crime compliance standards by making enhancements to our financial crime controls, training our staff and sharing best practice with clients.

As an employer, a provider of financial services and a procurer of goods and services, we have a responsibility to respect human rights across our business. We address human rights through the Group's policies.

BOARD OF DIRECTORS

In accordance with the Company's Articles of Association, during the Annual General Meeting, all the directors serving at that time will retire and may offer themselves for reappointment.

The directors of the Company who held office during the year were:

Michael Bussey (Chairman)
Mark A. Watson (Chief Executive Officer)
Benjamin Hollowood
Dominic Wallace
Frederick Mifsud Bonnici – resigned on 17 July 2017
Joaquin Vicent
Michael Walker
John Zarb – appointed on 17 July 2017

DIVIDENDS AND RESERVES

Retained earnings of the Company amounting to €80.0 million (2017: €67.3 million) and of the Group amounting to €124.6 million (2017: €101.2 million) were carried forward to the next financial year. The directors of the Company do not propose the payment of a final dividend.

STATEMENT OF DIRECTORS' RESPONSIBILITIES FOR THE FINANCIAL STATEMENTS

The directors are required by the Maltese Companies Act (Cap. 386) to prepare financial statements that give a true and fair view of the state of affairs of the Company and the Group as at the end of each reporting year and of the profit or loss for that year.

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

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

The directors are also responsible for designing, implementing and maintaining internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and that comply with the Maltese Companies Act (Cap. 386). They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The financial statements of MDB Group Limited for the year ended 31 March 2018 are included in the Annual Report 2018, which is published in hard-copy printed form and will be made available on the Group'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 Group'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.

RELATED PARTIES

During the year ended 31 March 2018, other than the transactions described under Note 33 to the financial statements, there were no material changes in related party transactions as compared with those detailed within the financial statements for the year ended 31 March 2017. During the financial years ended 31 March 2018 and 2017, no related party transactions materially affected the financial position or liquidity of the Group, with the exception of dividend payment, movements in shareholders' contributions and loan agreements with Group companies as described in Notes 15, 16, 21 and 33.

Furthermore, there were no material contracts to which the Company, or anyone of its subsidiary undertakings, was party to and in which anyone of the directors was directly or indirectly interested.

EVENTS AFTER THE REPORTING DATE

Transfer of shareholding in Charts to MeDirect Malta and subsequent merger of Charts into MeDirect Malta

On 1 February 2018, MeDirect Malta announced that the boards of directors of MeDirect Malta and Charts have each voted to merge Charts into MeDirect Malta, subject to receipt of all applicable regulatory approvals and completion of all legal requirements. On 1 April 2018 the shares held by MDB Group Limited in Charts were transferred to MeDirect Malta. With effect from 1 April 2018, the merger between MeDirect Malta and Charts became effective for accounting purposes. Thus all the transactions of Charts have been treated as being those of MeDirect Malta with effect from 1 April 2018.

Dividends paid

By virtue of a shareholders' resolution dated 30 May 2018, MDB Group Limited approved and paid an interim dividend of €7.23 million.

Shareholder contributions effected

By virtue of board resolutions dated 30 May 2018 the Company provided capital contributions to its direct subsidiary company, MeDirect Bank (Malta) plc amounting to €3.1 million.

There were no other events after the reporting date that would have a material effect on the financial statements.

GOING CONCERN

After due consideration of the Group's profitability, financial position, capital adequacy and solvency, the directors declare that the Group is in a position to continue operating as a going concern for the foreseeable future.

ADDITIONAL REGULATORY DISCLOSURES

The Group is required to publish 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 Maltese Banking Act (Cap. 371), issued by the MFSA, which follows the disclosure requirements of Directive 2013/36/EU (CRD) and EU Regulation No 575/2013 (CRR) of the European Parliament and of the Council of 26 June 2013.

These disclosures are prepared on an annual basis and are appended in a separate section as part of the Annual Report.

AUDITORS

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

STATEMENT BY THE DIRECTORS

We, the undersigned, declare that to the best of our knowledge, the financial statements were prepared in accordance with the applicable accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group and the Company, and that this report includes a fair review of the performance of the business and the position of the Group and the Company, together with a description of the principal risks and uncertainties that it faces.

On behalf of the board

Michael Bussey
Chairman

Mark A. Watson
Director and Chief Executive Officer

Registered Office
The Centre, Tigné Point,
Sliema, TPO 0001
Malta

30 July 2018

medirect GROUP

Statement of Compliance with the Principles of good corporate governance

Introduction

The Group hereby reports on the extent to which the Code of Principles of Good Corporate Governance (the "Code") has been adopted by its subsidiary MeDirect Bank (Malta) plc ("MeDirect Malta") as required by the Listing Rules of the Malta Listing Authority as amended on 11 August 2016. The Group acknowledges that the Code does not dictate or prescribe mandatory rules, but recommends principles of good practice. However, the directors strongly believe that such practices are in the best interests of the Group, its shareholders and other stakeholders, primarily because compliance with principles of good corporate governance is expected by investors on the Malta Stock Exchange and evidences the MeDirect Malta directors' and the Group's commitment to a high standard of corporate governance.

The MeDirect Malta directors report that since MeDirect Malta is a company that only issues debt securities and has not issued equity securities which are traded in a multilateral trading facility, it is exempt from disclosing the information prescribed in Listing Rules 5.97.1, 5.97.2, 5.97.3, 5.97.6 and 5.97.7 in this corporate governance statement. It is in the light of these factors that the directors are herein reporting on the corporate governance of MeDirect Malta.

The directors are aware that the Code highlights principles which although of general application to listed companies are adaptable by each company depending on its particular circumstances. Those circumstances are more often than not determined by two factors, namely: (i) the specific nature of the business of the company itself; and (ii) the fact that whilst certain principles in the Code are applicable to companies the equity securities of which are listed on the Stock Exchange, they are not altogether applicable, or not applicable in the same manner, to companies that fall within the definition of a listed company by virtue of having issued debt instruments which are listed on the Malta Stock Exchange. In this context, the directors believe that MeDirect Malta's current organisational set up guarantees the proper and efficient functioning of MeDirect Malta and provides adequate corporate governance safeguards.

Compliance with the Code

Principles 1 and 3: Board of Directors and composition of the Board

MeDirect Malta's Board of Directors (the "Board") is composed of persons with a diverse range of skills and experience acquired in senior roles with international banks and financial organisations, professional firms and governmental entities. At 31 March 2018, the MeDirect Malta Board consisted of five non-executive members and two executive members. Taking into account certain factors such as the size of MeDirect Malta, the size of its Board and the balance of skills and experience represented by its members, the MeDirect Malta directors are considered to be appropriate for the requirements of MeDirect Malta's business.

In line with MeDirect Malta's Articles of Association, the Chairman of the Board and Board directors resign and seek re-election at each Annual General Meeting of MeDirect Malta. All directors are required to be fit and proper to direct the business of MeDirect Malta.

Statement of compliance with the Principles of good corporate governance - continued

Principle 2: Chairman and Chief Executive

The positions of MeDirect Malta's Chairman and Chief Executive are held by different individuals, avoiding concentration of authority and power in one individual and differentiating the leadership of the Board from that of the running of MeDirect Malta's business.

MeDirect Malta's Chairman is responsible to lead MeDirect Malta's Board and he ensures that MeDirect Malta's Board discussions on any issue put before it go into adequate depth, that the opinions of all the directors are taken into account, and that all MeDirect Malta Board decisions are supported by adequate and timely information. On the other hand, MeDirect Malta's Chief Executive Officer leads the MeDirect Malta Management Executive Committee that is responsible to execute the agreed strategy and manage the business.

Principles 4, 5 and 8: Responsibilities of the Board and Board Meetings and Committees

MeDirect Malta's Board has the first level responsibility for executing the four basic roles of corporate governance namely: accountability, monitoring, strategy formulation and policy development.

Functioning of the Board

MeDirect Malta's Board of Directors reviews and evaluates corporate strategy, major operational and financial plans, risk policy and performance objectives. The MeDirect Malta Board monitors implementation of its decisions and corporate performance, taking into account the requirements of all relevant laws, regulations and codes of best business practice. In particular, the MeDirect Malta Board:

- defines MeDirect Malta's strategy, policies, management performance criteria and business policies;
- ensures the proper functioning of MeDirect Malta's Audit Committee;
- establishes a clear internal and external reporting system so that the MeDirect Malta Board has continuous access to accurate, relevant and timely information;
- assesses and monitors MeDirect Malta's present and future operations, opportunities, threats and risks in the external environment and current and future strengths and weaknesses;
- evaluates management's implementation of MeDirect Malta's corporate strategy and financial objectives using key performance indicators;
- ensures that MeDirect Malta has appropriate policies and procedures in place to enable MeDirect Malta and its staff to comply with the highest standards of corporate conduct, including compliance with applicable laws, regulations and business and ethical standards; and
- ensures that MeDirect Malta's financial statements and the annual audit of such statements are completed within the stipulated time periods.

Notices of the dates of scheduled meetings of MeDirect Malta's Board together with supporting materials are circulated to the directors well in advance of such meetings. Advance notice is also given of ad hoc meetings of MeDirect Malta's Board to allow directors sufficient time to re-arrange their commitments in order to be able to participate. After each MeDirect Malta's Board meeting and before the next meeting, minutes that faithfully record attendance, deliberations and decisions of MeDirect Malta's Board are prepared and circulated to all directors.

Statement of Compliance with the Principles of good corporate governance - continued

This section provides details of the members of MeDirect Malta's Board of Directors and the members of each of the committees of MeDirect Malta's Board.

Board of Directors

Since the date of the previous annual general meeting of MeDirect Malta, fourteen Board meetings were held, including eight regularly scheduled meetings and six ad hoc meetings.

		Meetings attended %
Michael Adrian Bussey	Independent Chairman and Non-Executive Director	100
John Zarb	Independent Non-Executive Director (appointed on 17 July 2017)	89
Michael Walker	Independent Non-Executive Director	86
Frederick Mifsud Bonnici	Independent Non-Executive Director (resigned on 17 July 2017)	100
Dominic Wallace	Non-Executive Director	100
Benjamin Hollowood	Non-Executive Director	86
Mark A. Watson	Executive Director – Chief Executive Officer	100
Joaquin Vicent	Executive Director – Director of Treasury and Investments	100

Committees of the Board

Certain responsibilities of MeDirect Malta's Board of Directors are delegated to MeDirect Malta's Board committees. The Board committees play an essential role in supporting MeDirect Malta's Board in fulfilling its responsibilities and ensuring that the highest standards of corporate governance are maintained. When deemed necessary, each MeDirect Malta's Board committee reports to MeDirect Malta's Board following each of its meetings and the minutes of meetings of each MeDirect Malta's Board committee meeting are available to MeDirect Malta's full Board.

Statement of compliance with the Principles of good corporate governance - continued

Board Committees

A. Audit Committee

MeDirect Malta's Audit Committee is primarily responsible for reviewing and approving specific matters relating to MeDirect Malta's audit, internal control and risk management systems. In particular, MeDirect Malta's Audit Committee:

- reviews and approves the annual internal audit plan and subsequent revisions and monitors progress against the annual audit plan;
- ensures that the scope of work performed in accordance with the audit plan was adequate and appropriate;
- vets and approves related party transactions in accordance with Listing Rule 5.138;
- reviews work performed on all internal audit engagements; and
- reviews and interacts with external auditors on the annual statutory audit to obtain feedback on the internal control framework and financial reporting of MeDirect Malta.

The members of MeDirect Malta's Audit Committee are:

John Zarb	Committee Chairman and Independent Non-Executive Director
Michael Bussey	Member and Independent Non-Executive Chairman
Michael Walker	Member and Independent Non-Executive Director

In terms of Listing Rules 5.117 and 5.118, John Zarb is the director whom MeDirect Malta's Board considers as competent in accounting and/or auditing.

John Zarb retired from his role as partner at PwC at the end of 2014 after a career spanning over 40 years spent within the audit and advisory practices of the firm. He is a past president of the Malta Institute of Accountants, and served for a number of years on the Accountancy Board and as Malta's representative on the EU Accounting Regulatory Committee. John is currently the chairman of PG plc, a board member and chairman of the audit committee of Tumas Investments plc and a director of Foster Clark Products Limited.

During the year ended 31 March 2018, eight meetings of MeDirect Malta's Audit Committee were held. The Chief Financial Officer, the Chief Internal Audit Officer, the Group Head of Compliance, the Head of Commercial Strategy and Legal and a representative of the external auditors attend MeDirect Malta's Audit Committee meetings by invitation.

B. Nomination and Remuneration Committee

MeDirect Malta's Nomination and Remuneration Committee is considered under the Remuneration Report. The disclosures in the Remuneration Report reflect the requirements of the EU Capital Requirements Regulation (575/2013) to the extent applicable to the financial year under review.

MeDirect Malta's Nomination and Remuneration Committee is composed of non-executive directors with no personal financial interest, being Michael Bussey (Chairman), Michael Walker and Benjamin Hollowood.

Statement of compliance with the Principles of good corporate governance - continued

Board Committees - continued

C. Board Risk Committee

The Risk Committee is responsible for reviewing the Group's risks in sufficient detail that it can assess whether they are consistent with the Group's risk appetite, and for reviewing management's proposed courses of action if not. It may then approve these plans or require them to be altered, as appropriate. It is also responsible for assessing the Group's high-level controls, limits, and risk aggregation and reporting framework to ensure that these are sufficient to maintain its level of risk (including, but of course not limited to, operational risk) within its appetite.

The current members of MeDirect Malta's Risk Committee are:

Michael Walker	Committee Chairman and Independent Non-Executive Director
Dominic Wallace	Member and Non-Executive Director
Benjamin Hollowood	Member and Non-Executive Director

The Chief Executive Officer and the Chief Risk Officer attend MeDirect Malta's Risk Committee meetings by invitation. MeDirect Malta's Chairman of the Board and Chairman of the Audit Committee attend MeDirect Malta's Risk Committee meetings as an observer.

The main objective of MeDirect Malta's Risk Committee is to ensure that MeDirect Malta adheres to the approved risk policy and procedures, and operates within the approved risk appetite of MeDirect Malta's Board. The key Committee functions are to:

- review and approve changes to MeDirect Malta's risk policy and procedures;
- ensure that the risk functions are appropriately resourced and structured to meet their obligations and are working effectively to maintain an effective control environment;
- review any violations to the lending limits;
- review the product distribution strategy, including product structure, pricing and targeting; and
- monitor:
    - the effectiveness of risk management processes implemented in support of risk policies;
    - portfolio risk and sector concentration risk, including evolution of the risk profile against plan;
    - credit quality trends;
    - provision levels;
    - regulatory ratios;
    - interest rate, currency and other market risk;
    - liquidity risk;
    - operational risk; and
    - contingent exposures.

The Chairman of the Committee reports on all matters to MeDirect Malta's Board after each meeting and notifies MeDirect Malta's Board of any decisions made. The Committee makes whatever recommendations to the main Board that it deems necessary.

The Committee is convened at least on a bi-monthly basis, and more frequently if the need arises. All attendees and invitees receive copies of the minutes.

Statement of compliance with the Principles of good corporate governance - continued

Principal Management Committees

A. Executive Management Committees (“EXCO”)

MeDirect Malta’s ExCo management structure is split into two different management forums in order to enhance the execution of MeDirect Malta’s business priorities and reinforce the governance of MeDirect Malta’s activities.

- MeDirect Malta’s Strategy ExCo is made up of a small group of senior management, meeting fortnightly, that focuses on MeDirect Malta’s broader growth strategies and new initiatives and monitors MeDirect Malta’s ability to respond to new regulatory developments. It is thus responsible for the formulation and implementation of Board-approved strategies and plans and for ensuring that the Group’s business is operated in accordance with such strategies and plans. MeDirect Malta’s Strategy ExCo is chaired by the Chief Executive Officer and includes the Executive Director of Treasury and Investments, the Chief Risk Officer, the Chief Investment Officer, the Chief Technology Officer, the Group Chief Financial Officer, the Chief Strategy Officer and the MeDirect Bank SA Chief Executive Officer.
- MeDirect Malta’s Management ExCo meets weekly and is responsible for the ongoing priorities that underpin MeDirect Malta’s business model and the regulatory environment in which MeDirect Malta operates. The Management ExCo is chaired by the Chief Executive Officer and includes the Executive Director of Treasury and Investments, the Chief Risk Officer, the Chief Investment Officer, the Chief Technology Officer, the Chief Financial Officer, the Chief Strategy Officer, the Group Head of Treasury, the Group Head of Human Resources and Administration, the Head of Commercial Strategy and Legal, the Group Head of Operations, the Head of Business Development, the Group Head of Wealth Products and the MeDirect Bank SA Chief Executive Officer. The Chief Internal Audit Officer is a standing invitee to MeDirect Malta’s Management ExCo.

B. Management Credit Committee

MeDirect Malta’s Management Credit Committee is responsible for approving credit and investment recommendations and making other credit and investment decisions within its authority as delegated by the Board through its approval of the Group’s applicable policies, including approving or rejecting investment and credit recommendations presented by the Treasury and Investments team; taking decisions on individual credits; reviewing and recommending credit and large exposures to the Board; considering credit hedging strategies, and recommending concentration limits for Board approval. The MCC is composed of three sub-committees:

- International Corporate Lending Management Credit Committee whose purpose is to approve credit and investment recommendations within its authority delegated by the Board and to oversee the credit and investment strategies and objectives of the Group’s International Corporate Lending portfolio;
- Local Lending Management Credit Committee whose purpose is to approve credit and investment recommendations within its authority delegated by the Board and to oversee the credit and investment strategies and objectives of the Group’s local corporate lending portfolio; and
- Treasury Management Credit Committee whose purpose is to approve credit and investment recommendations within its authority delegated by the Board and to oversee the credit and investment strategies and objectives of the Group’s Treasury portfolio.

The Committee is chaired by the Chief Risk Officer who carries the casting vote and a right of veto in all Credit Committees. Members of the Credit Committee in attendance would also include two of the following: the Chief Investment Officer, an assistant portfolio manager from the corporate credit team, a member of the corporate credit risk team and a member of the corporate credit team.

Statement of compliance with the Principles of good corporate governance - continued

Principal Management Committees - continued

The Committee will meet from time to time as required for the proper fulfilment of its duties. It will meet at least quarterly to review the Group's Lending portfolio and to make decisions on internal credit ratings and recommendations on any impairments to be taken.

C. Asset and Liability Committee ("ALCO")

MeDirect Malta's ALCO sets and reviews overall policies and objectives for asset and liability management, capital management and allocation, capital usage and efficiency, transfer pricing, risk management, and underwriting, dealing and trading activities according to the risk appetite set by the Board.

The members of MeDirect Malta's ALCO include the Executive Director of Treasury and Investments (Committee Chairman), Chief Executive Officer, Group Head of Treasury, Chief Risk Officer, Group Chief Financial Officer, the MeDirect Bank SA – Chief Financial Officer and the Group Head of Operations. MeDirect Malta's ALCO schedules meetings monthly but also holds additional ad hoc meetings.

D. New Products and Services Committee

MeDirect Malta's New Products and Services Committee exists to analyse potential new products and services that the Group proposes to offer to its customers or to undertake on its own account. Its primary mandate is to ensure that these products and services are not implemented or offered to customers unless the Group is adequately prepared, both legally and operationally. While EXCO acts as the main commercial decision-making body and hence decides on whether the Group intends, subject to this preparedness, to offer a new product or service, NPSC has the mandate to assess whether EXCO was fully informed of all material facts and risks when it made its decision.

The Chief Risk Officer is the Chairman of MeDirect Malta's New Products and Services Committee. No meeting of this Committee will be deemed quorate unless members from the Operations, Finance, Technology and Legal and Compliance teams are in attendance, or have nominated delegates who are in attendance.

Code Provision 4.2.7 - Succession planning

MeDirect Malta has established a list of Key Personnel Substitutes to cover instances in which executive directors or other key personnel are temporarily incapacitated or otherwise unable to complete their duties for a significant period of time.

If such directors or key personnel are permanently unable to re-assume their duties, MeDirect Malta's management, in consultation with the Board, will designate permanent successors, either from MeDirect Malta's existing management team or, if appropriate, by selecting an outside candidate.

As part of succession planning and talent management, MeDirect Malta's Board and the Chief Executive Officer ensure that MeDirect Malta implements appropriate schemes to recruit, retain and motivate high quality executive officers. They also encourage members of management to move to higher ranks, seek to maintain high morale amongst MeDirect Malta's personnel and identify high performing employees with the potential to take on more responsibilities.

The succession plan ensures that MeDirect Malta is constantly empowering and developing existing employees, guaranteeing that there is a pool of talent ready and waiting for advancement and promotion into ever more challenging roles when they arise. This requires developing employees at every level of MeDirect Malta and not just at the top.

Statement of compliance with the Principles of good corporate governance - continued

Principle 6: Information and professional development

In addition to the responsibilities of MeDirect Malta's Board previously listed, MeDirect Malta's Board actively participates in the appointment of senior management. Board members receive regular updates on MeDirect Malta's strategic, operational, corporate governance, compliance, risk management and financial plans and objectives.

MeDirect Malta's Board appoints the Chief Executive Officer of MeDirect Malta upon guidance and recommendation by the ultimate controlling party. The Board has engaged third party consultants to work with it to update and enhance its Board evaluation and training programmes. The training programmes have the aim of improving the Board's awareness of risk, regulation, and compliance developments in the financial services sector, with topics to be covered ranging from the new regulatory environment to managing risk.

MeDirect Malta 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 MeDirect Malta's expense.

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

Principle 7: Evaluation of the Board's performance

On an annual basis, MeDirect Malta's Board carries out an evaluation procedure whereby Board members are requested to complete a questionnaire on the Board's performance and that of its committees. The evaluation is co-ordinated by the Board's Chairman, an independent non-executive director, and all directors participate in the process. Feedback from the evaluation is presented to the Board for analysis.

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

MeDirect Malta maintains on-going communication with its shareholders and the market on its strategy and performance in order to enhance trust and confidence in MeDirect Malta. During the period under review MeDirect Malta 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 its financial position. Through public announcements, MeDirect Malta's website, financial reports and interaction with the general media in Malta, MeDirect Malta provides the market with regular, timely, accurate, comprehensive and comparable information in sufficient detail to enable investors to make informed investment decisions in respect of MeDirect Malta's listed securities.

MeDirect Malta's ultimate controlling party is represented on its Board of Directors and actively monitors its investment in MeDirect Malta.

The Chairmen of MeDirect Malta's Audit, Nomination and Remuneration and the Risk Committees are available to answer questions at the Annual General Meeting. The conduct of the meeting is conducive to valid discussion and appropriate decision making. In terms of MeDirect Malta'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 MeDirect Malta.

Statement of compliance with the Principles of good corporate governance - continued

Principle 11: Conflicts of interest

MeDirect Malta's Articles of Association provide that any director who is in any way, whether directly or indirectly, interested in a transaction or proposed transaction with MeDirect Malta must (i) declare to the other directors the nature of such interest, (ii) not participate in or be present for any discussion relative to any such transaction or proposed transaction, and (iii) not vote in respect of any such transaction or proposed transaction.

On joining the MeDirect Malta Board and regularly thereafter, directors are informed and reminded of their obligations in respect of dealing in MeDirect Malta's securities within the parameters of law and the Listing Rules.

Principle 12: Corporate social responsibility

During the financial year ended 31 March 2018, MeDirect Malta proudly continued to support and promote Maltese sportive, cultural, and charitable causes and events. MeDirect Malta's commitment to these initiatives was once again established through the various sponsorships and donation agreements that support a wide variety of community organisations.

Sports

MeDirect Malta's patronage of the sporting community was further strengthened with a number of donations to sporting associations and events. MeDirect Malta's significant support of the Malta Rugby Football Union ("MRFU"), including the women national rugby team, has assisted the MRFU to further its ambitions at both an international level as well as at a local level, where the game's popularity continues to rapidly grow. The MRFU Cup (the local senior division league), is known as the 'MeDirect Bank Cup'. MRFU started promoting the 7's tournament internationally last year and has actively started promoting Rugby in schools as an inclusion and educational program as from last year.

MeDirect Malta is also present in Gozo where MeDirect Malta sponsors the Otters Water Polo Club/Aquatic club. Another presence in Gozo is the collaboration with Oasi, a rehabilitation and inclusion centre for kids and adults alike, where MeDirect Malta has funded the trophies for their annual marathon and fund raising event and also donated funds for some essential goods needed by the centre.

Maltese Heritage

The preservation of Malta's national heritage is also important to MeDirect Malta and to this end it has supported a number of organisations and initiatives.

Music and Performing Arts

As part of MeDirect Malta's on-going corporate social responsibility programme and commitment, it also continues to support and promote the music and performing arts scene. In line with this commitment, MeDirect Malta is once again the main benefactor of the Manoel Theatre for the coming season.

Also as a continuous support to the Malta Philharmonic Orchestra ("MPO"), MeDirect Malta donated funds to support the production of certain events and sponsors one of its musicians.

Statement of compliance with the Principles of good corporate governance - continued

Principle 12: Corporate Social Responsibility - continued

Youth and charity

The Salesians Brigade summer school benefitted from a donation for one of their events organised to raise funds. The National Blood Transfusion Centre was donated merchandise to be given to blood donors and the Sliema Scout Group was also supported during one of their events.

MeDirect Malta is proud of its continued support to the Lady Bird Foundation and in fact once again chose this foundation to be the beneficiary of its 2017 annual Christmas charity campaign reflecting business generated during the month of December. MeDirect Malta also maintained its yearly appointment and presented a donation to the President's Community Chest Fund Campaign L-Istrina, on behalf of MeDirect Malta.

Last but not least, upon staff initiative and supported by MeDirect Malta, proceeds derived from the Christmas raffle at the Group's Christmas Staff Party, that were doubled by the Bank, were donated to the Malta Hospice for their remarkable work carried out with cancer patients and their families.

Education

As part of MeDirect Malta's collaboration towards the promotion of educational programmes nationwide, MeDirect Malta part sponsored a project, in collaboration with another local company, the local Government and the local Councils, called EM Citizen. This initiative comprised tutorial and informative meetings held around Malta and Gozo to teach senior citizens how to get familiar with a smartphone, tablet and the internet in general and various apps that can make their life comfortable without them having to leave their home, such as internet banking and a supermarket app.

Other Disclosures

There were no material contracts to which MeDirect Malta, or its subsidiary were a party, and in which any one of MeDirect Malta's Directors was directly or indirectly interested.

Statement of compliance with the Principles of good corporate governance - continued

Management's internal controls over financial reporting

MeDirect Malta's Board is responsible for ensuring that MeDirect Malta's senior management develops and implements a sound system of internal controls and for reviewing its effectiveness. Such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss. MeDirect Malta operates a system of internal control that provides reasonable assurance of effective and efficient operations covering all controls, including financial and operational controls and compliance with laws and regulations. Processes are in place for identifying, evaluating and managing the significant risks facing MeDirect Malta.

The management of MeDirect Malta is responsible for instituting and preserving sufficient internal control over financial reporting. Internal control over financial reporting is a process designed under the supervision of the Group Chief Financial Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union.

Internal control over financial reporting includes policies and procedures that pertain:

- to maintaining records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets;
- to providing reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with IFRS as adopted by the EU;
- to ensuring that receipts and expenditures are made only in accordance with authorisations of management and the respective directors; and
- to providing reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use or disposition of assets that could have a material effect on the financial statements.

Michael Bussey
Chairman

Mark A. Watson
Director and Chief Executive Officer

30 July 2018

Remuneration report

Remuneration governance

The primary purpose of the Nomination and Remuneration Committee ("NRC") is to review remuneration levels in the Group and to consider whether to approve performance-related bonus awards and long-term incentive plan awards.

The NRC receives recommendations from the management of the Group regarding remuneration levels and the awarding of bonuses. It may request market-related information from time to time to verify the recommendations made by management.

One of the NRC's primary functions is to ensure that the Group is able to attract and retain suitable employees at all levels at an acceptable cost.

Membership and meetings

The members of the NRC are:

Michael Bussey	Committee Chairman/Independent Non-Executive Board Chairman
Michael Walker	Independent Non-Executive Director
Benjamin Hollowood	Non-Executive Director

During the year ended 31 March 2018, the NRC met on two occasions and these meetings were attended by all members of the NRC.

Remuneration policy statement

The Board is responsible for ensuring that this statement and its contents adhere to all laws, rules and regulations issued by the Malta Financial Services Authority, particularly BR 12, and international regulations incorporated in the Capital Requirement Directive. The Board, directly and through the NRC, carries out effective monitoring and evaluation of the Group's remuneration system on an on-going basis. The NRC and the Board monitor the on-going performance by executive directors and senior management and determine the design and implementation of an effective remuneration system.

The NRC is charged with aligning the Group's remuneration policy and in particular performance-related elements of remuneration, with the best interests of the stakeholders and with the Group's business strategy and risk tolerance, objectives, values and long-term interests.

Remuneration consists of base salary and, where applicable, performance based bonus awards. Performance-related compensation is determined both on (i) a Group wide basis, and (ii) an individual employee basis.

Compliance with the Group's rules and requirements and involvement on a continuing basis in risk management are taken into account when determining performance-based remuneration for all employees. Other non-financial factors are considered such as skills acquired, personal development, commitment to the Group's business strategies and policies and contribution to the performance of the team. Performance is measured in relation to non-financial and financial goals and, where appropriate, failure to perform in non-financial areas of responsibility outweighs success in profit generation in determining compensation. Control functions are adequately rewarded in order to ensure that the Group is able to attract skilled individuals for such roles.

The Group's remuneration policy includes "clawback" provisions applicable to all identified and key staff where, even though variable compensation is remunerated in cash, it is possible for the Group to clawback variable performance related pay if respective employees were responsible for circumstances that resulted in significant losses to the Group or in situations where the most appropriate standards of fitness and propriety were not met during the period for which the performance bonus was awarded.

Remuneration report - continued

Remuneration policy statement - continued

The Group does not intend to effect any changes to its remuneration policy for the following financial year.

(a) Measures of performance as basis for awarding of pay

Base pay is expected to comprise the majority of the Group's overall compensation cost.

i. All staff

The NRC considers a variety of factors in determining compensation tailored to the role of the individual concerned and takes into account factors such as risk management, development of systems, monitoring of risk and creation of long-term value for the Group.

In accordance with Article 450 of the CRR we confirm that there is only one employee that receives total remuneration equal to or greater than €1 million. The salary of such employee is in the range €1 million - €1.5 million.

ii. Members of management and control functions

Recommendations by management as to the remuneration of members of control functions are made by the Chief Executive Officer. Such recommendations are reviewed and approved or rejected by the NRC.

Variable remuneration is not contractual and depends on both individual and collective performance. It takes into account quantitative and qualitative criteria and is not directly or solely linked to the amount of profits or revenues generated. Assessment of performance is made in the context of a multi-year analysis, taking into account the business cycle and the Group's business risks. The criteria used to set variable remuneration pools, as well as their allocation, takes into account all risks, both qualitative and quantitative.

The methods used for determining the variable remuneration of control functions are designed to encourage staff not to compromise their objectivity and independence. Where control function staff receive variable remuneration, it is appraised and the variable part of remuneration determined separately from the business units they control, including the performance which results from business decisions where the control function is involved. The criteria used for assessing performance and risk is based exclusively on internal control objectives.

Senior members of management have historically participated in a Long-term Incentive Plan ("LTIP"), through the purchase of shares in the ultimate parent company, enabling such managers to participate in the long-term profitability of the Group. This plan was originally designed to incentivise senior management to maximise the long-term value of the Group.

In view of regulatory considerations, the Group amended the LTIP to provide that participants would receive no more than the original purchase price of such shares upon exit by the ultimate controlling party from its investment in the Group.

iii. Non-executive directors

The remuneration of non-executive directors is not performance based and is not linked to the Group's short term results. It is determined based on remuneration levels for directors of similar financial companies and takes into account factors such as time invested and responsibilities.

Remuneration report - continued

Remuneration policy statement - continued

(b) Measures of performance as basis for awarding of bonuses

A bonus pool is established for the Group as a whole and is calculated at Group level based on the success of the Group in meeting its business objectives. The variable remuneration pool shall be set and shall be calculated on the basis of the qualitative and quantitative factors.

These objectives relate, amongst other things, to profitability, sustainability of performance, risk management, building of business lines and creation of long-term shareholder value.

Quantitative factors shall include:
- economic capital, economic profit, return on risk weighted assets and return on allocated equity;
- the cost and quality of the capital required for the risks of its activities;
- the cost and quantity of liquidity risk assumed in the course of business; and
- indirect liquidity costs.

Qualitative factors include:
- market practices in terms of remuneration;
- general conditions in the markets in which the results were generated;
- the stage of maturity of the activity; and
- an independent assessment carried out by the Risk Management function regarding risk management and compliance.

Individuals, including executive directors, are compensated out of that bonus pool based on their contribution to the achievement of the Group’s business objectives. Such individual criteria depend on the role of the individual in the Group.

The allocations of individual variable remuneration awards shall be correlated to the staff member’s formalised annual individual appraisal that takes into consideration quantitative and qualitative objectives known to the employees, as well as risk management considerations. Individuals will be compensated out of that bonus pool based on their contribution to the achievement of the Group’s and/or the subsidiary’s business objectives. Such individual criteria will depend on the role of the individual in the Group. For example, portfolio managers will be judged on factors such as risk management, overall continuing performance of the portfolio, contribution to development of the Group’s or a subsidiary’s systems, while members of the treasury team will be assessed on effectiveness in managing liquidity. The amount of variable remuneration will vary depending on the performance of the staff member, as well as of the staff member’s business unit and the institution as a whole. Depending on performance, variable remuneration can be reduced to zero. Variable remuneration will be significantly reduced or nullified in the case of any kind of unethical or non-compliant behaviour.

The ratio between the variable components of remuneration and the fixed components shall be limited to 100% (200% with shareholders’ approval, subject to certain conditions being met).There were no instances throughout the current financial year and the preceding financial year when such ratio was exceeded.

Variable remuneration that as mentioned above may never exceed 100% of the fixed remuneration component, is delivered in the form of cash and such variable pay is never larger than €100,000. Such variable remuneration is normally paid out in the first quarter of the subsequent financial year as determined by the Nomination and Remuneration Committee. Variable remuneration paid to identified staff and other key personnel is subject to clawback provisions. The clawback provisions state that the bonus may have to be repaid to the Group in certain circumstances that would have led to significant losses to the Group or in case of failure to meet appropriate standards of fitness and propriety, including cases of fraud, dishonesty or gross negligence.

Remuneration report - continued

Remuneration policy statement - continued

(b) Measures of performance as basis for awarding of bonuses - continued

As per Article 450 of the CRR we confirm that there is no remuneration that is subject to deferral.

Control functions are judged on success in developing appropriate policies, developing effective risk management controls and procedures, monitoring risk and building control systems. Whilst the general bonus pool of the Group will be based on the Group's financial results, compensation of control functions is not directly tied to the results of any business unit.

Staff savings account

All of the Group's Malta-based employees are entitled to make equal monthly deposits of a specified amount direct from after tax payroll into an employee savings account. At the end of each calendar year, MeDirect Malta will pay 5% interest on the accumulated savings remaining in the account in December. On such date, amounts remaining in such savings accounts may be withdrawn and the terms of such accounts may be reset.

Home loan subsidy

As from 2018 the Bank is granting its Malta employees an annual subsidy equivalent to a 2% interest rate in respect of the home loans that such employees have acquired from third party banks.

Identified staff

The target population defined as Identified Staff for the purposes of this report (excluding those allocated to the supervisory function) represents 7.77% of the total number of employees in the MeDirect Malta Group. Identified staff were determined in line with the Regulatory Technical Standard EU 604/2014 that came into force in June 2014 and includes:

- Non-executive directors that are responsible for providing a monitoring role;
- Executive directors that are also responsible for certain business units; and
- Senior management responsible for business units/business lines or Finance, Administration and Human Resources, as well as those responsible for internal audit and risk management functions of the Group.

Identified staff consist of members of staff whose actions have a material impact on the risk profile of the Group.

For the purposes of remuneration, Identified staff have been aggregated and split into business areas according to the European Banking Authority ("EBA") guidelines on the remuneration benchmarking exercise EBA/GL/2014/08 dated 16 July 2014. The following tables therefore include total fixed and variable remuneration and number of beneficiaries per and within each business area.

Remuneration report - continued

Identified staff - continued

For the purposes of information provided hereunder 'Senior Management' shall mean Directors and Management Executive Committee members and other management as determined by the NRC. Material Risk Takers consist of the remaining identified staff.

	Supervisory function	Management function	Investment banking and wealth management	Retail banking	Corporate functions	Independent control functions
Senior Management						
Number of identified staff	6	2	3	3	7	1
Total fixed remuneration (€)[1]	502,913	1,769,404	886,931	731,381	1,659,211	155,031
Total variable remuneration (€) (delivered in cash)	-	200,000	121,298	21,000	362,903	50,000
Material Risk Takers (non-senior management)						
Number of identified staff	-	-	-	-	3	4
Total fixed remuneration (€)[1]	-	-	-	-	411,906	490,275
Total variable remuneration (€) (delivered in cash)	-	-	-	-	90,000	31,000
Total						
Number of identified staff	6	2	3	3	10	5
Total fixed remuneration (€)[1]	502,913	1,769,404	886,931	731,381	2,071,117	645,306
Total variable remuneration (€) (delivered in cash)	-	200,000	121,298	21,000	452,903	81,000

[1]Total fixed remuneration comprises non-cash benefits such as accommodation and life and health insurance.

Remuneration - directors

Non-executive Directors are non-employees and receive a fee for their services as Directors. 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 Europe. Based on the recommendations of the NRC, the directors' fees earned by the MeDirect Malta's non-executive directors, including the Chairman, for the year ended 31 March 2018 amounted to €0.4 million.

Total emoluments earned by the executive directors of MeDirect Malta during the year ended 31 March 2018, are reported below:

	€	%
Fixed remuneration	**1,704,194**	87
Variable remuneration	**200,000**	10
Non-cash benefits	**65,210**	3
	1,969,404	100

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Remuneration report - continued

Remuneration - directors - continued

Non-cash benefits relate to the gross rent payable on accommodation based in Malta and health and life insurance premiums paid by MeDirect Malta on behalf of the directors.

All the executive directors as of 31 March 2017 were engaged under indefinite employment contracts.

Remuneration - senior management

Total emoluments received by 14 senior management (excluding directors), during the year ended 31 March 2018, are reported below:

	€	%
Fixed remuneration	**3,363,713**	84
Variable remuneration	**555,201**	14
Non-cash benefits	**68,842**	2
	3,987,756	100

Non-cash benefits relate to health and life insurance premiums paid by the Group on behalf of its senior management since the Group provides a health and life insurance policy to all its employees. The provision of such insurance policies form part of the contract of employment of each staff member.

Sign-on and severance payments

During the year ended 31 March 2018, there were no new sign-on and severance payments made either to directors or members of senior management of the Group.

Michael Bussey
Chairman

Mark A. Watson
Director and Chief Executive Officer

30 July 2018

Independent auditor's report

To the Shareholders of MDB Group Limited

Report on the audit of the financial statements

Our opinion

In our opinion:

- MDB Group Limited's consolidated and parent company financial statements (the "financial statements") give a true and fair view of the Group and the Company's financial position as at 31 March 2018, and of the Group's and the Company's financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU; and
- The financial statements have been prepared in accordance with the requirements of the Maltese Companies Act (Cap. 386).

What we have audited

MDB Group Limited's financial statements, set out on pages 39 to 162, comprise:

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

Basis for opinion

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

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

Independence

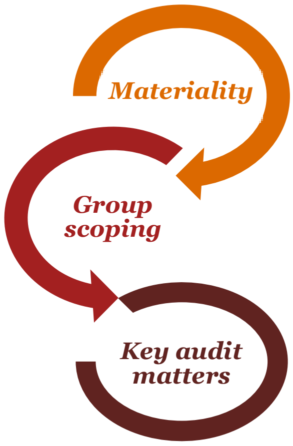
We are independent of the Group and the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements of the Accountancy Profession (Code of Ethics for Warrant Holders) Directive issued 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 the IESBA Code.

Independent auditor's report

To the Shareholders of MDB Group Limited

Our audit approach

Overview



- Overall group materiality: €0.7 million, which represents 5% of profit before tax.

- The audit carried out by the group engagement team covered all the local components as at and for the year ended 31 March 2018 comprising MeDirect Bank (Malta) plc and Charts Investment Management Service Limited.

- Impairment of loans and advances to customers of the Group
- Recognition of interest income on loans and advances utilising the effective interest rate method

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	€731,000 (2017: €956,000)
How we determined it	5% of profit before tax
Rationale for the materiality benchmark applied	We chose profit before tax as the benchmark because, in our view, it is the benchmark against which the performance of the Group is most commonly measured by users, and is a generally accepted benchmark. We chose 5% which is within the range of acceptable quantitative materiality thresholds in auditing standards.

Independent auditor's report

To the Shareholders of MDB Group Limited

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above €73,000 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Key audit matters

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

Key audit matter	How our audit addressed the key audit matter
Impairment of loans and advances to customers of the Group Impairment allowances in respect of loans and advances to customers represent management's best estimate of the losses incurred within the loan portfolios at the balance sheet date. The Group have two principal lending portfolios: the international lending portfolio, comprising syndicated senior secured loans to international large corporates, with a carrying amount of €1,620.2 million at 31 March 2018, and a significantly smaller local lending portfolio, predominantly consisting of loans to the real estate activities sector in Malta, with a carrying amount of €81.5 million at 31 March 2018. Impairment of loans and advances to customers is considered a key area of focus in respect of the international lending portfolio. All loans within the Group's international portfolio are considered individually significant. As a result, impairment losses are calculated on an individual basis. A collective impairment assessment is also performed in respect of the international lending portfolio to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment.	The policies and methodologies used by MeDirect Malta Group in respect of impairment of loans and advances within the international lending portfolio as well as changes to inputs within the collective allowance models and significant inputs in respect of individually significant loan impairments were discussed with the Audit Committee. For collective allowances in respect of the international lending portfolio the appropriateness of the modelling policy and methodology used was independently assessed by reference to the requirements of accounting standards and market practices. We understood and critically assessed the models used for collective allowances. Since, modelling assumptions and parameters are based on historic data, we assessed whether historic experience was representative of current circumstances and of the recent losses incurred within the portfolio. The appropriateness of management's judgements was also independently considered in respect of calculation methodologies and judgemental overlays. We tested the completeness and accuracy of data extracted from underlying systems that is utilised in the models. Based on the evidence obtained, we found that the model assumptions, data used within the models and overlays to be reasonable.

Independent auditor's report

To the Shareholders of MDB Group Limited

Key audit matter	How our audit addressed the key audit matter
The calculation of both collective and individual impairment allowances is inherently judgemental; judgement is applied to determine appropriate parameters and assumptions used to calculate impairment. Collective impairment allowances are calculated using statistical models, which approximate the impact of current economic and credit conditions on the portfolio of loans. For incurred but not yet identified impairments, this model is based on the probabilities of default and loss given default parameters taking into account the Group's historical experience as well as the estimated emergence period between impairment occurring and loss recognition. The inputs to these models are subject to management judgement and model overlays are often required. Key assumptions and judgements include the probabilities of default based on the transition from one credit grade to another and the loss given default based on the Group's historical experience, measured by reference to impairment charges and write offs in respect of impaired loans. The methodologies used by the Group to calculate collective impairment allowances are relatively standard, which means that modelling risk is low but that changes in individual inputs can have a significant bearing on the impairment charge recognised in profit or loss. Due to the nature of the Group's international lending, management validates its collective impairment allowance through the utilisation of a separate model that uses market implied probabilities of default and recovery rates for loans of a similar nature.	For specific allowances in respect of the international lending portfolio, the appropriateness of provisioning methodologies and policies was independently assessed. We understood and evaluated the processes for identifying impairment events within the loan portfolio, as well as the impairment assessment processes. The controls management has established to identify which loans and advances are impaired were tested. For individual loans, this includes a review and approval process that management have in place for the identification of impairment events, in the form of a thorough quarterly portfolio review process through which each individual loan is scrutinised for impairment indicators both by the front-line business as well as by the Group's independent risk management function. We determined that we could rely on these controls for the purposes of our audit, particularly in respect of fully performing loans. For underperforming loans, we assessed critically the criteria used for determining whether an impairment event had occurred and therefore whether there was a requirement to compute a specific impairment allowance. We performed tests of detail on a sample of underperforming loans (for instance customers experiencing financial difficulty) to challenge whether impairment events had actually occurred by forming our own judgement as to whether the classification of the loans as unimpaired was appropriate and to challenge whether all relevant events had been identified by management. For all individually impaired loans within the international lending portfolio we performed tests of detail to review the latest developments at the level of the borrower and the basis of measuring the impairment provisions. We considered whether key judgments were appropriate given the borrowers' circumstances.

Independent auditor's report

To the Shareholders of MDB Group Limited

Key audit matter	How our audit addressed the key audit matter
For specific impairments in respect of the international lending portfolio, judgement is required to determine when an impairment event has occurred and then to estimate the expected future cash flows related to that loan. In the case of the Group, estimated future cash flows are generally dependent on parameters or assumptions such as market multiples in relation to borrowers' enterprise values, the estimation of borrowers' operating cash flows, and the use of multiple scenarios to estimate impairments where uncertainty surrounding the borrower's circumstances exists. We focused on impairment 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. Relevant references in the Annual Report and Financial Statements: • Accounting policy: Note 1.6; • Credit risk management: Note 2.2; • Critical accounting judgements and estimates: Note 3.3; • Note on Loans and advances to customers: Note 7; and • Note on Net impairment charges: Note 27.	An independent view was formed on the level of provisions recorded based on the detailed loan and customer information available. In particular, we formed our view on key inputs to the impairment calculation including market multiples used to determine borrowers' enterprise values, the estimation of borrowers' operating cash flows as well as the plausibility of the scenarios used and the probabilities associated with such scenarios. We also engaged our valuation specialist to review and critique the market multiples applied by management. Based on the evidence obtained, we found management's judgements to be reasonable.
Recognition of interest income on loans and advances utilising the effective interest rate method Interest income on loans and advances to customers is recognised using the effective interest rate method. Measuring interest income on loans and advances to customers under the effective interest rate method requires management to apply judgement, particularly in the case	Our audit procedures in respect of the application of the effective interest rate method to loans and advances within the international lending portfolio, in particular relating to the assumptions on loan expected lives and to the determination of which fees are considered to form an integral part of the effective interest rate, included the following: • We challenged the appropriateness of assumed expected lives on a loan by loan basis, by comparing these to available historical borrowing customer data and trends;

Independent auditor's report

To the Shareholders of MDB Group Limited

Key audit matter	How our audit addressed the key audit matter
of the Group's senior secured loans to international borrowers, constituting the international lending portfolio. A model is utilised by the Group to compute the impact of application of the effective interest rate method on an individual loan basis, by discounting estimated future cash flows through the expected life of the instrument to the net carrying amount, including all fees and ponts paid or received that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts. A key judgement in respect of the application of the effective interest rate method to the international lending portfolio is the assumed expected life for the loans, effectively determining the period over which interest income is recognised utilising the effective interest rate method, and accordingly determining the pattern of recognition of income throughout different accounting periods. The determination as to which fees are considered an integral part of the effective interest rate and hence included within the effective interest rate calculations is also judgemental for the international lending portfolio. Management determines an assumed expected life for each individual loan within its international lending portfolio. The sensitivity to a change in assumed expected life can vary significantly between different loans, depending on the characteristics, terms and conditions of the underlying lending transaction and parameters included within the respective effective interest rate calculation such as fee income and discounts or premiums identified at inception.	• We challenged the appropriateness of changes to assumed expected lives in relation to specific loans by reference to our own expectations, based on our knowledge of the Group, our experience of the industry and of the specialised lending sector, taking into consideration the available emerging information in relation to such borrowers in respect of which assumptions have been modified; • We assessed the accuracy of the model used for the recognition of interest income and for the measurement of loans and receivables at amortised cost using the effective interest rate method by re-performing a sample of effective interest rate calculations at individual loan level. Our audit procedures comprised performing tests of detail on the selected sample of lending arrangements by agreeing transaction details within the respective model to loan agreements and other supporting documentation. For the selected sample, we also assessed whether all the appropriate fees had been reflected within the effective interest rate calculations based on the requirements within the relevant accounting pronouncements. Based on the results of our audit procedures we concluded that the assumptions used by management were reasonable.

Key audit matter	How our audit addressed the key audit matter
MeDirect Malta Group has historical experience in respect of the international lending portfolio, which is limited to six years, for the purposes of supporting the expected life assumption applied to each loan. Consequently, MeDirect Malta Group determines loan expected life assumptions on the basis of its forecasting process, which takes into account historical data but also the Group's expertise and experience in this specialised lending sector. Any changes in the expected loan life assumptions are based on management's assessment of emerging market trends (for instance changes in market interest rates and the ability of the borrower to re-finance in the circumstances) and borrower specific information that indicates changes to repayment profiles and the extent of such changes. Relevant references in the Annual Report and Financial Statements: • Accounting policy: Note 1.5.2.2; and • Critical accounting judgements and estimates: Note 3.2.	

How we tailored our group audit scope

The Group is composed of three components: MDB Group Limited (the parent company), and its subsidiaries MeDirect Bank (Malta) plc and Charts Investment Management Service Limited, with the former determined to be a financially significant entity.

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

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

Other information

The directors are responsible for the other information. The other information comprises the:

- Chairman's review;
- Chief Executive Officer's review
- Directors' report;
- Statement of compliance with the Principles of good corporate governance
- Remuneration report; and
- Additional regulatory disclosures

but does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information, including the directors' report.

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

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

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

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

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

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

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

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

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

Independent auditor’s report

To the Shareholders of MDB Group Limited

Auditor’s responsibilities for the audit of the financial statements

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

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

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

We communicate with 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.

Independent auditor's report

To the Shareholders of MDB Group Limited

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

Other matters on which we are required to report by exception

We also have responsibilities under the Maltese Companies Act (Cap. 386) to report to you if, in our opinion:

- returns adequate for our audit have not been received from branches not visited by us; and
- certain disclosures of directors' remuneration specified by law are not made in the financial statements, giving the required particulars in our report.

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

PricewaterhouseCoopers
78, Mill Street
Qormi
Malta

FAxisa

Fabio Axisa
Partner

30 July 2018

Statements of financial position

		Group		Company	
		2018	2017	**2018**	2017
	Notes	**€000**	€000	**€000**	€000
ASSETS					
Balances with Central Banks and cash	4	**103,739**	245,195	**-**	-
Derivative financial instruments	5	**470**	1,627	**-**	-
Loans and advances to financial institutions	6	**113,654**	106,945	**31**	50
Loans and advances to customers	7	**1,701,716**	1,449,970	**-**	-
Investments					
- Corporate	8	**-**	228	**-**	-
- Treasury	8	**560,245**	698,474	**-**	-
- Subsidiaries	9	**-**	-	**279,011**	194,911
Property and equipment	10	**1,223**	410	**-**	-
Intangible assets	11	**3,051**	607	**-**	-
Non-current assets classified as held for sale	12	**1,785**	1,785	**-**	-
Current tax assets		**9,641**	8,403	**-**	-
Deferred tax assets	13	**18,970**	8,398	**2,867**	-
Prepayments and accrued income	14	**18,278**	19,149	**-**	-
Other assets	15	**19,412**	31,682	**4,554**	9,252
Total assets		**2,552,184**	2,572,873	**286,463**	204,213

The notes on pages 48 to 162 are an integral part of these financial statements.

Statements of financial position - continued

		Group		Company	
		2018	2017	**2018**	2017
	Notes	**€000**	€000	**€000**	€000
EQUITY					
Called up issued share capital	16	**55,738**	55,738	**55,738**	55,738
Share premium	16	**13,756**	13,756	**13,756**	13,756
Shareholders' contribution	16	**136,300**	58,700	**136,300**	58,700
Reserve for general banking risks	16	**1,694**	1,694	**-**	-
Other reserves	16	**(3,056)**	(4,808)	**-**	-
Retained earnings	16	**124,552**	101,174	**80,024**	67,277
Total equity		**328,984**	226,254	**285,818**	195,471
LIABILITIES					
Derivative financial instruments	5	**3,581**	2,323	**-**	-
Amounts owed to financial institutions	17	**126,428**	359,183	**-**	-
Amounts owed to customers	18	**1,979,159**	1,901,512	**-**	-
Subordinated liabilities	19	**66,949**	46,993	**-**	-
Current tax liabilities		**156**	71	**18**	19
Accruals and deferred income	20	**34,413**	30,499	**10**	15
Other liabilities	21	**12,514**	6,038	**617**	8,708
Total liabilities		**2,223,200**	2,346,619	**645**	8,742
Total equity and liabilities		**2,552,184**	2,572,873	**286,463**	204,213
Memorandum items					
Commitments to purchase financial assets	7 - 8	**118,250**	108,865		
Commitments to extend credit, guarantees and other similar commitments	30 - 32	**449,130**	352,256		

The notes on pages 48 to 162 are an integral part of these financial statements.

The financial statements on pages 39 to 162 were approved and authorised for issue by the Board on 30 July 2018 and were signed by:

Michael Bussey
Chairman

Mark A. Watson
Director and Chief Executive Officer

Income statements

	Notes	Group 2018 €000	Group 2017 €000	Company 2018 €000	Company 2017 €000
Interest income		**90,894**	89,922	**55**	55
Interest expense		**(27,902)**	(32,299)	**-**	-
Net interest income	22	**62,992**	57,623	**55**	55
Fee and commission income					
– Corporate lending fees		**141**	711	**-**	-
– Other		**6,536**	4,807	**-**	-
Fee and commission expense					
– Corporate lending fees		**(244)**	(282)	**-**	-
– Other		**(1,321)**	(1,382)	**(1)**	-
Net fee and commission income	23	**5,112**	3,854	**(1)**	-
Net trading income	24.1	**3,928**	2,178	**-**	-
Net income from other financial instruments at fair value through profit or loss		**128**	-	**-**	-
Other operating income					
– Realised gains on disposal of other investments	24.2	**43**	800	**-**	-
– Realised (losses)/gains on disposal of loans and advances		**(1,028)**	3,594	**-**	-
– Other income	24.3	**197**	17	**14,344**	-
Total operating income		**71,372**	68,066	**14,398**	55
Personnel expenses	25	**(18,036)**	(17,426)	**-**	-
Depreciation and amortisation	10-11	**(315)**	(619)	**-**	-
Other administrative expenses	26	**(30,106)**	(25,301)	**(17)**	(10)
Total operating expenses		**(48,457)**	(43,346)	**(17)**	(10)
Net operating income before impairment charges		**22,915**	24,720	**14,381**	45
Net impairment charges	27	**(8,302)**	(5,607)	**(2,649)**	-
Profit before tax		**14,613**	19,113	**11,732**	45
Taxation	28	**8,765**	(1,846)	**1,015**	(22)
Profit for the year		**23,378**	17,267	**12,747**	23

The notes on pages 48 to 162 are an integral part of these financial statements.

Statements of other comprehensive income

	Group		Company	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Profit for the year	**23,378**	17,267	**12,747**	23
Other comprehensive income				
Items that may be reclassified subsequently to profit or loss				
Fair valuation of available-for-sale financial assets:				
- Net change in fair value, before tax	**1,219**	8,500	**-**	-
- Net amount reclassified to profit or loss, before tax	**(114)**	(794)	**-**	-
Income tax relating to other comprehensive income	**(408)**	(453)	**-**	-
Contingent delayed payment in relation to full acquisition of subsidiary	**(200)**	-	**-**	-
Adjustment to deferred taxation as a result of new taxation legislation in Malta	**1,255**	-	**-**	-
Other comprehensive income, net of tax	**1,752**	7,253	**-**	-
Total comprehensive income, net of tax	**25,130**	24,520	**12,747**	23

The notes on pages 48 to 162 are an integral part of these financial statements.

Statements of changes in equity

Group	Share capital €000	Share premium €000	Shareholders' contribution €000	Reserve for general banking risks €000	Other reserves €000	Retained earnings €000	Total €000
Balance at 1 April 2016	55,738	13,756	58,700	1,194	(12,137)	86,983	204,234
Total comprehensive income							
Profit for the year	-	-	-	-	-	17,267	17,267
Other comprehensive income, net of tax:							
Fair valuation of available-for-sale financial assets:							
- Net change in fair value arising during the period, net of tax	-	-	-	-	8,005	-	8,005
- Reclassification adjustments – net amounts reclassified to profit or loss, net of tax	-	-	-	-	(752)	-	(752)
Total other comprehensive income, net of tax	-	-	-	-	7,253	-	7,253
Total comprehensive income, net of tax	-	-	-	-	7,253	17,267	24,520
Transactions with owners							
Dividends paid	-	-	-	-	-	(2,500)	(2,500)
Total transactions with owners	-	-	-	-	-	(2,500)	(2,500)
Transfer to Reserve for general banking risks	-	-	-	500	-	(500)	-
Transfer to Statutory legal reserve	-	-	-	-	76	(76)	-
Balance at 31 March 2017	**55,738**	**13,756**	**58,700**	**1,694**	**(4,808)**	**101,174**	**226,254**

The notes on pages 48 to 162 are an integral part of these financial statements.

Statements of changes in equity - continued

Group	Share capital €000	Share premium €000	Shareholders' contribution €000	Reserve for general banking risks €000	Other reserves €000	Retained earnings €000	Total €000
Balance at 1 April 2017	55,738	13,756	58,700	1,694	(4,808)	101,174	226,254
Total comprehensive income							
Profit for the year	-	-	-	-	-	23,378	23,378
Other comprehensive income, net of tax:							
Fair valuation of available-for-sale financial assets:							
- Net change in fair value arising during the period, net of tax	-	-	-	-	798	-	798
- Reclassification adjustments – net amounts reclassified to profit or loss, net of tax	-	-	-	-	(101)	-	(101)
Contingent delayed payment in relation to full acquisition of subsidiary	-	-	-	-	(200)	-	(200)
Adjustment to deferred taxation as a result of new taxation legislation in Malta	-	-	-	-	1,255	-	1,255
Total other comprehensive income, net of tax	-	-	-	-	1,752	-	1,752
Total comprehensive income, net of tax	-	-	-	-	1,752	23,378	25,130
Transactions with owners							
Shareholders' contribution	-	-	77,600	-	-	-	77,600
Total transactions with owners	-	-	77,600	-	-	-	77,600
Balance at 31 March 2018	**55,738**	**13,756**	**136,300**	**1,694**	**(3,056)**	**124,552**	**328,984**

The notes on pages 48 to 162 are an integral part of these financial statements.

Statements of changes in equity - continued

Company

	Share capital €000	Share premium €000	Shareholders' contribution €000	Retained earnings €000	Total €000
Balance at 1 April 2016	55,738	13,756	58,700	69,754	197,948
Total comprehensive income					
Profit for the year	-	-	-	23	23
Transactions with owners					
Dividends paid	-	-	-	(2,500)	(2,500)
Balance at 31 March 2017	**55,738**	**13,756**	**58,700**	**67,277**	**195,471**
Balance at 1 April 2017	55,738	13,756	58,700	67,277	195,471
Total comprehensive income					
Profit for the year	-	-	-	12,747	12,747
Transactions with owners					
Shareholders' contribution	-	-	77,600	-	77,600
Total transactions with owners	-	-	77,600	-	77,600
Balance at 31 March 2018	**55,738**	**13,756**	**136,300**	**80,024**	**285,818**

The notes on pages 48 to 162 are an integral part of these financial statements.

Statements of cash flows

	Group		Company	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Cash flows from operating activities				
Interest and commission receipts	**109,358**	112,103	**-**	-
Interest and commission payments	**(29,537)**	(35,772)	**-**	-
Payments to employees and suppliers	**(47,518)**	(43,972)	**-**	-
Operating profit before changes in operating assets/liabilities	**32,303**	32,359	**-**	-
Decrease/(increase) in operating assets:				
- Reserve deposit with Central Banks	**178,075**	(184,630)	**-**	-
- Loans and advances to financial institutions and customers	**(276,168)**	(225,770)	**-**	-
(Decrease)/increase in operating liabilities:				
- Amounts owed to financial institutions and customers	**(126,021)**	357,360	**-**	-
- Other payables	**5,842**	1,774	**-**	-
- Derivative financial instruments	**(848)**	(7,494)	**-**	-
Tax refunded/(paid)	**9,219**	(5,248)	**7,441**	3,150
Net cash (used in)/from operating activities	**(177,598)**	(31,649)	**7,441**	3,150

The notes on pages 48 to 162 are an integral part of these financial statements.

Statements of cash flows - continued

	Note	Group 2018 €000	Group 2017 €000	Company 2018 €000	Company 2017 €000
Net cash (used in)/from operating activities		**(177,598)**	(31,649)	**7,441**	3,150
Cash flows from investing activities					
Acquisition of property and equipment		**(1,045)**	(7)	**-**	-
Acquisition/development of intangible assets		**(2,559)**	-	**-**	-
Acquisition of available-for-sale assets		**(25,718)**	(26,939)	**-**	-
Disposal/redemption of available-for-sale assets		**154,698**	196,078	**-**	-
Disposal of equity investments		**-**	81	**-**	-
Repayment of advances to subsidiary		**-**	-	**(7,460)**	(820)
Net cash from/(used in) investing activities		**125,376**	169,213	**(7,460)**	(820)
Cash flows from financing activities					
Shareholders' contribution		**77,600**	-	**-**	-
Issue of debt securities		**19,963**	-	**-**	-
Dividends paid		**-**	(2,500)	**-**	(2,500)
Net advances from immediate parent company		**653**	1,624	**-**	-
Net advances from group companies		**1,258**	1,442	**-**	-
Net cash from/(used in) financing activities		**99,474**	566	**-**	(2,500)
Net increase/(decrease) in cash and cash equivalents		**47,252**	138,130	**(19)**	(170)
Cash and cash equivalents at beginning of year		**102,193**	(35,937)	**50**	220
Cash and cash equivalents at end of year	29	**149,445**	102,193	**31**	50

The notes on pages 48 to 162 are an integral part of these financial statements.

Notes to the financial statements

1. Summary of significant accounting policies

1.1 Reporting entity

MDB Group Limited (the "Regulatory Parent" or the "Company") is a limited liability company domiciled and incorporated in Malta.

The consolidated financial statements as at and for the financial year ended 31 March 2018 comprise the financial statements of the Company and its subsidiaries, together referred to as "the Group". Therefore, these financial statements report the consolidated financial results of MDB Group Limited for the financial year ended 31 March 2018, including the financial results of MeDirect Bank (Malta) plc ("MeDirect Malta") and its subsidiary namely MeDirect Bank SA ("MeDirect Belgium"), Charts Investment Management Service Limited ("Charts") and Grand Harbour I B.V. ("GH I"), a controlled special purpose entity established to obtain funding for identified assets. The Group has retained substantially all risks and rewards pertaining to the activities of GH I and hence to assets, liabilities and related income and expenditure attributable to GH I, and as such, all assets, liabilities and related income and expenditure have been reflected within the Group's consolidated financial statements.

The comparative financial information of the Group also include the results of Mediterranean Corporate Bank Limited ("MedCorp"). MedCorp became a principal subsidiary of MeDirect Malta on 25 September 2014, the date of acquisition. On 21 November 2016, MeDirect Malta announced that the Boards of Directors of MeDirect Malta and MedCorp have each voted to merge MedCorp into MeDirect Malta, subject to receipt of all applicable regulatory approvals and completion of all legal requirements. With effect from 1 April 2017, the merger between MeDirect Malta and MedCorp became effective for accounting purposes. Thus all the transactions of MedCorp have been treated as being those of MeDirect Malta with effect from 1 April 2017 (see Note 36).

MeDirect Bank SA is a credit institution licensed in Belgium. As from May 2015 it took over the operations from the branch that MeDirect Malta had established in Belgium in prior years. On 1 June 2015, MeDirect Bank SA was authorised as a Belgian credit institution, which is now carrying out all of the Group's activities in Belgium.

During the financial year ended 31 March 2017, MeDirect Malta and MeDirect Belgium transferred a portfolio of syndicated senior secured loans to GH I. GH I was funded through two intragroup loan facilities subscribed to by MeDirect Malta and MeDirect Belgium. The transaction lead to a transfer of risk from MeDirect Belgium to MeDirect Malta, without changing the Group's overall risk profile on a consolidated basis. MeDirect Belgium and MeDirect Malta invested in GH I on a 78% - 22% basis (2017: 69% - 31% basis) respectively, with the tranche bought by MeDirect Belgium (the "Senior Loan") amounting to €893 million (2017: €474 million) having a senior ranking vis-à-vis the tranche acquired by MeDirect Malta (the "Junior Loan") amounting to €252 million (2017: €214 million).

Medifin Estates, a property leasing partnership, was set up to lease property which is then leased back to the Group.

1. Summary of significant accounting policies - continued

1.2 Basis of preparation

The Company's consolidated financial statements have been prepared in accordance with the requirements of International Financial Reporting Standards as adopted by the European Union.

These financial statements have also been drawn up in accordance with the provisions of the Maltese Companies Act (Cap. 386).

These financial statements have been prepared on the basis of the historical cost convention, except for:
- available-for-sale financial assets which are measured at fair value;
- derivative financial instruments which are measured at fair value;
- recognised financial assets designated as hedged items in qualifying fair value hedge relationships which are measured at amortised cost adjusted for changes in fair value attributable to the risk being hedged; and
- equity investments which are measured at fair value.

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

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

Standards, interpretations and amendments to published standards effective in 2018

During the financial year ended 31 March 2018, the Group adopted new standards, amendments and interpretations to existing standards that are mandatory for the Group's accounting period beginning on 1 April 2017. The adoption of these revisions to the requirements of IFRSs as adopted by the EU did not result in significant changes to the Group's accounting policies impacting the Group's financial performance and position.

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

Certain new accounting standards and interpretations have been published, which are not mandatory for 31 March 2018 reporting periods and which have not been early adopted by the Group, in particular IFRS 9 'Financial Instruments'.

There are no standards, other than IFRS 9, that are not yet effective and that would be expected to have a material impact on the Group in the current or future reporting periods and on foreseeable future transactions.

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

1.2 Basis of preparation - continued

Future accounting developments

IFRS 9 "Financial Instruments"

The IASB issued the final version of IFRS 9 'Financial Instruments' in July 2014 to replace IAS 39 'Financial Instruments: Recognition and Measurement'. This comprehensive standard is effective for financial periods beginning on or after 1 January 2018, with the possibility of early adoption. In this regard, the Group has not early adopted the provisions of IFRS 9 and, as a result, the date of initial application of IFRS 9 for the Group is set at 1 April 2018. The adoption and implementation of IFRS 9 requires the Group to revise its accounting processes and internal controls relating to the reporting of financial instruments so as to ensure that the requirements emanating from IFRS 9 relating to the classification of financial assets and liabilities, the impairment of financial assets and hedge accounting are met.

Classification and measurement

The classification and measurement criteria under IFRS 9 is driven by the entity's business model for managing the financial instruments and the contractual cash flow characteristics of the financial instruments.

In line with the provisions of IFRS 9, the Group classifies and measures all financial assets under any one of the following three categories:
- Amortised cost;
- Fair value through other comprehensive income (FVOCI); or
- Fair value through profit or loss (FVTPL).

The Group determines the classification and measurement basis for financial assets based on an assessment of both the business model within which the financial assets are held and a review of the contractual terms of each financial asset to determine if cash flows are solely principal and payments of interest (SPPI).

In this regard, subsequent to initial recognition, financial instruments are measured at:
(i) amortised cost if the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows ('Hold to Collect') and the contractual terms of the financial asset give rise to cash flows that are SPPI;
(ii) FVOCI if the financial asset is held within a business model whose objective is achieved by both holding financial assets in order to collect contractual cash flows and selling financial assets ('Hold to Collect and Sell') and the contractual terms of the financial asset give rise to cash flows that are SPPI; or
(iii) FVTPL if the financial asset does not pass the business model assessment and SPPI criteria.

Once the contractual cash flows of a financial instrument fail the SPPI criterion, the instrument is automatically classified and measured at FVTPL, irrespective of the result of the business model assessment.

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

1.2 Basis of preparation - continued

Classification and measurement - continued

A business model refers to the manner in which financial assets are managed in order to achieve a particular business objective, whether by collecting contractual cash flows only, selling financial instruments, or both. The Group's business model is determined by 'key management personnel' (as defined in Note 33 of this set of financial statements) and the assessment is based on matters of fact, reflecting the strategic purpose and intention for the portfolio.

The business model is determined at a level that reflects how groups of financial assets are managed together to achieve a particular business objective. Therefore, if the business model is set at a portfolio level, the classification assessment for this criterion is assessed at that level. Accordingly, it is not an instrument-by-instrument analysis but is determined at a higher level of aggregation.

The Group's business model for managing financial assets is observable through the activities that are undertaken by management to achieve the objective of the business model. The following aspects are considered in determining the IFRS 9 accounting classification:

(i) how the performance of the business model and the financial assets held within it are evaluated and reported to key management personnel;
(ii) how managers are compensated for business performance (e.g., whether the compensation is based on the fair value of the assets managed or the contractual cash flows collected); and
(iii) consideration of risks affecting performance and how they are managed.

The Group has identified three separate portfolios which require separate business model assessments due to the fact that these are managed separately and by different business units / management teams, namely (i) the Treasury portfolio; (ii) the International Corporate Lending portfolio; and (iii) the Local Lending portfolio.

A key distinction between business models relates to whether the 'sale' of financial instruments is integral to the achievement of the desired business objectives. In order for a sale of financial instruments to steer the classification of the entire portfolio away from a 'Hold to Collect' and towards a 'Hold to Collect and Sell' business model, sales need to be integral to the objective of the business model, rather than incidental to it.

This means that the Group is not required to hold all financial instruments in a 'Hold to Collect' portfolio until maturity. On the contrary, the business model can be to hold financial assets to collect contractual cash flows even where sales of financial assets occur or are expected to occur in the future.

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

1.2 Basis of preparation - continued

Classification and measurement - continued

In this regard, the Group performs an assessment to determine whether the sale of financial instruments from a portfolio implies that the classification of the exposures to the 'Hold to Collect' business model is inappropriate. This assessment is based on information about past sales and expectations about future sales, and in the determination of the business model, the Group takes into consideration the following:

(i) The historical frequency, timing and value of sales;
(ii) The reason for the sales (such as credit deterioration); and
(iii) Expectations about future sales activity.

For financial assets where the intention of the business model is to hold the financial assets to collect the contractual cash flows or to hold to collect and to sell, the Group assesses whether the contractual cash flow characteristics of these assets meet the SPPI requirements of IFRS 9. In this respect, the contractual cash flow characteristics are deemed to be SPPI if the terms are consistent with a basic lending arrangement.

The contractual cash flows are assessed based on conditions at the date of initial recognition of the instrument. However, if a loan modification occurs resulting in the existing loan being derecognised and a new loan recognised, the modified asset is considered as a new loan under IFRS 9 and as such is considered for the SPPI assessment. In such a case, the date of the modification is treated as the date of initial recognition of the new financial asset. If, however, the

existing loan was renegotiated or modified but was not derecognised, then the contractual cash flows of the modified loan are not considered for the SPPI assessment.

The 'principal' of a financial asset refers to the fair value of the financial instrument at initial recognition rather than the amount that is due under the contractual terms of the instrument. On the other hand, 'interest' is the compensation for time value of money and credit risk, may include consideration for other basic lending risks (e.g. liquidity risk), costs associated with holding the financial assets for a particular period of time (e.g. administrative costs) and/or a profit margin.

In performing the SPPI assessment, the Group considers the following contractual terms to determine whether these introduce variability in contractual cash flows that is inconsistent with a basic lending arrangement, amongst others:

(i) Variable interest rates, which typically consider the time value of money, credit risk and other basic lending risks and costs;
(ii) Leverage, which is a contractual cash flow characteristic that results in increased variability in contractual cash flows;
(iii) Modifications of the time value of money; and
(iv) Contractual features that could alter the timing or amount of contractual cash flows of a financial asset, such as contingent events, prepayment and extension options.

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

1.2 Basis of preparation - continued

Classification and measurement - continued

More specifically, from the assessment that the Group conducted the following classification and measurement matters have been determined:

(i) loans and advances to banks and to customers that are classified as loans and receivables under IAS 39 will continue to be measured at amortised cost under IFRS 9; and
(ii) a portfolio of debt securities classified as available-for-sale under IAS 39 will be 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, while a portfolio of debt securities classified as available-for-sale under IAS 39 will be measured at amortised cost under IFRS 9.

The Group has estimated that, on the adoption of IFRS 9 at 1 April 2018, the impact of these changes (before tax), attributable mainly to the measurement of certain debt securities at amortised cost under IFRS 9, is an increase in the Group's equity of €2.2 million.

Impairment

IFRS 9 requires the measurement of impairment allowances on financial instruments using the 'expected loss model', in accordance to which the Group estimates expected credit losses (ECLs) using a forward-looking approach that emphasises shifts in the credit risk attached to a financial instrument, and consequently the probability of future credit losses, even if no loss events have yet occurred.

Since movements in the fair value of financial instruments measured at FVTPL are recognised directly in profit or loss, no impairment allowances are deemed necessary for these financial instruments.

In contrast, financial assets measured at amortised cost or FVOCI are subject to impairment requirements using the general impairment model stipulated by IFRS 9. This is due to the fact that, since an integral aspect of both business models is to collect contractual cash flows, the effect of changes in credit risk are more relevant to a user's understanding than the effects of other changes, such as changes in market interest rates.

IFRS 9 impairment requirements are also applicable to loan commitments that are not measured at FVTPL (if the terms and conditions of the arrangement give rise to an enforceable contract to extend credit), financial guarantee contracts and recognised lease receivables to which IAS 17 Leases applies. None of these are within the scope of IFRS 9 but are still subject to impairment requirements in accordance with IFRS 9.

1. Summary of significant accounting policies - continued

1.2 Basis of preparation - continued

Impairment - continued

IFRS 9 outlines a ‘three-stage’ model for impairment based on changes in credit quality since initial recognition. The key driver of the measurement of ECLs therefore relates to the level of credit risk for each exposure and, as a result, an assessment of the change in credit risk over the expected life of an asset is a core element in determining the staging criteria under IFRS 9.

In this regard, financial instruments that:

- Have not had a significant increase in credit risk (SICR) since initial recognition or that have low credit risk at the reporting date are classified in Stage 1 and 12-month ECLs are recorded to measure the expected losses that result from default events that are possible within 12 months after the reporting date;
- Have experienced a SICR since initial recognition are classified in Stage 2 and lifetime ECLs are recorded to measure the expected losses that result from all possible default events over the expected life of the financial instrument; and
- Demonstrate objective evidence of impairment, and which are considered to be in default or credit-impaired, are classified in Stage 3, also requiring the measurement of lifetime ECLs.

Financial instruments are all classified within Stage 1 upon initial recognition, unless a financial instrument is purchased or originated credit-impaired (POCI). Therefore, the Group calculates an impairment allowance based on 12-month ECL. Subsequent changes in credit risk will be reflected in the staging of the exposure, with a transfer of the exposure to Stage 2 or 3 conditional upon the identification of a SICR or impairment respectively.

Significant increase in credit risk

The concept of default risk is central to IFRS 9 – therefore, a key risk parameter used by the Group in its credit risk management activities is the probability that the obligor defaults either within the next 12-month period (in case of Stage 1 exposures) or over the lifetime of the exposure (in case of Stage 2 / 3 exposures).

In order to identify indicators of SICR since initial recognition, the Group compares the credit risk level on each financial instrument at each IFRS 9 reporting date with the credit risk level as at the date of initial recognition. The assessment requires the consideration of all reasonable and supportable information that is available without undue cost. If a SICR is identified, the financial instruments are transferred into Stage 2 and lifetime ECLs are recognised.

It is possible for multiple instruments to the same borrower to be classified under different stages. This may occur when the Group holds exposures originated at differing time intervals whereby the relative increase in credit risk since origination between two instruments may be significant for one instrument, but less significant for an instrument originated at a later time interval.

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

1.2 Basis of preparation - continued

Impairment - continued

To assess a SICR event, the Group considers both actual and forward-looking information relating to external market indicators, internal factors and borrower-specific information.

The Group's credit risk management framework comprises the use of both quantitative and qualitative SICR triggers. However, the assessment performed by the Group to identify a SICR varies across each of the Group's portfolios of financial instruments.

- *International Corporate Lending portfolio:*

Financial instruments within the Group's International Corporate Lending portfolio are managed on an individual basis for credit purposes, whereby the Group's credit analysts have access to the obligors and their financial information, the latter comprising both historical and forecasted financial information.

The 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 four credit quality classifications below describe the credit quality of the Group's key financial assets. An internal risk grade is assigned to each obligor. Throughout the Group's Credit Committee meetings, the members of the Credit Committee review the grading proposed by the Corporate Credit team and reviewed by the Risk Management team. The following are the internal risk grades:

(i) Regular - no material credit concerns.
(ii) Focus - no immediate prospect that a loss will ultimately be suffered, but worthy of close attention.
(iii) Under Surveillance - significant credit concerns and some prospect that a loss may ultimately be suffered.
(iv) Impaired - exposures have been assessed individually as impaired.

In order to identify SICR, the Group has adopted a holistic approach covering both qualitative and quantitative indicators of risk. Accordingly, the Group has defined a number of qualitative triggers for the identification of SICR through its Credit policy. These triggers are designed to capture the level of credit risk linked to each financial instrument and are reflected through the internal risk grade proposed by the Group's credit analysts and reviewed / approved by the Credit Committee.
Meanwhile, the Group's quantitative assessment to determine whether a SICR has occurred since initial recognition is based on a ratings-based approach that uses 'Point in Time' (PiT) PDs (i.e. PD in current economic conditions) for the identification of SICR.

1. Summary of significant accounting policies - continued

1.2 Basis of preparation - continued

Impairment - continued

In this regard, due to the lack of internal history of defaults, the Group uses a credit risk modelling solution developed by an external vendor to estimate unconditional PiT PDs by:

(i) Benchmarking the obligor's financial statements with those of the underlying model dataset; and
(ii) Applying a qualitative scorecard to adjust the quantitative unconditional PiT PDs to better reflect obligor-specific peculiarities.

Lifetime PDs are determined by estimating the marginal 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, whereas 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 for the remaining years. The summation of marginal PDs results in the derivation of the cumulative lifetime PD term structure. Cumulative lifetime PDs increase at a diminishing rate as the residual life of the loan shortens.

Unconditional PDs refer to the PD term structure based on historical information and prior to the application of the forward-looking scenarios. The Group then applies multiple forward-looking macroeconomic scenarios to the unconditional PiT PD term structure in order to estimate the forward-looking probability weighted conditional PiT PD at an obligor level.

PDs are determined at an obligor-level rather than at a facility-level. Therefore, different facilities with the same obligor originated at the same time are expected to have an identical PD, whereas facilities with the same obligor originated at different time intervals will probably have different PDs, since the credit risk related to an obligor is likely to have changed in the meantime.

For the purposes of the identification of SICR, the forward-looking probability weighted conditional PiT PD estimated by the model is mapped to an implied default rating, which adopts Moody's public ratings agency scale terminology from Caa–C up to AAA.

When performing the SICR assessment, the Group compares the implied rating at origination to the implied rating at the reporting date and determines the difference in notches between them. The Group's staging criteria is therefore deemed to be based on a ratings/notch deterioration approach.

Although the Group has adopted a ratings-based approach (i.e. based on notch deterioration) for its SICR assessment, each implied rating is represented by an underlying PD.

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

1.2 Basis of preparation - continued

Impairment - continued

In this regard, a simple or absolute comparison of PDs at initial recognition and at the reporting date is not appropriate to determine the stage of an exposure. All other things kept constant, the PD of a financial instrument is expected to reduce with the passage of time. Thus, in order to take this into consideration, the Group estimates the annualised PD over the remaining life of the financial asset as at the origination date and the annualised PD over the remaining life of the financial asset as at the reporting date. These are then mapped to implied ratings which are used to determine potential SICR events and consequently the credit stage of a financial instrument through a combination of relative and absolute thresholds using the implied credit ratings.

The relative threshold approach involves calculating the magnitude of the difference between the reporting date rating and the origination date rating based on the deterioration in the number of notches between the two ratings. The appropriate stage is determined based on the magnitude of this difference. On the other hand, the stage allocation decision using an absolute threshold is based on the reporting date rating of the instrument.

The quantitative assessment through the Group's implied credit rating staging criteria is considered alongside qualitative SICR triggers and form part of the overall SICR trigger assessment. In this regard, where qualitative SICR triggers are observed by credit analysts, the Group applies a management override to the model, thereby overriding the SICR quantitative assessment made by the model.

- *Treasury portfolio:*

The provisions of IFRS 9 include a practical expedient to measure impairment allowances using 12-month ECL for financial instruments having low credit risk as at the reporting date. In practical terms, this means that, in those cases where a financial instrument is deemed to have low credit risk, management is not required to perform an assessment to determine whether a SICR has occurred.

Given that credit ratings are a reflection of possible significant increases in credit risk, the Group simply refers to external credit ratings in order to monitor SICR in relation to its Treasury portfolio, which comprises exposures to which a credit rating has been assigned by Moody's, Fitch and Standard & Poor's. In this regard, an exposure is deemed to have low credit risk if it is assigned an investment grade status by one of these three external credit rating agencies.

Should the credit rating of a financial instrument fall below the investment grade threshold, i.e. BBB (or equivalent) the financial instrument is deemed to have suffered a SICR. As a result, the financial instrument will be re-classified as a Stage 2 exposure, which will impact the measurement of the loss allowance, moving from a 12-month ECL assumption to a lifetime ECL assumption.

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

1.2 Basis of preparation - continued

Impairment - continued

- *Local Lending portfolio:*

Similarly to the approach taken for the International Corporate Lending portfolio, the Group categorises exposures within the Local Lending portfolio to one of the four internal risk grades. This determination is based on a review by respective relationship managers which takes into consideration evidence of past-due information as well as additional qualitative SICR triggers.

Exposures within the Local Lending portfolio are therefore managed at an individual exposure level for credit purposes, through relationship managers who have access to the customers and their financial information. An internal risk grade is assigned to each borrower and reviewed on an annual basis.

Although assigned at an obligor level rather than at facility level, internal risk grades can still be used to assess and identify SICR since initial recognition. In this regard, the Group's internal risk grades are aligned to the three stages contemplated by IFRS 9.

Financial instruments that:

(i) Have not deteriorated significantly in credit quality since initial recognition must be recognised as either "1-Regular" or "2-Focus" within the Group's internal risk grading system;
(ii) Have incurred a SICR is classified as "3-Under Surveillance", in which case the Group recognises lifetime ECLs; and
(iii) Demonstrate objective evidence of default are classified as "4-Doubtful" and assessed individually for provisioning purposes.

Definition of default

In order to assess whether there has been an increase in credit risk of a financial instrument since initial recognition, changes in default risk are considered over the remaining life of the financial instrument. The definition of default is therefore critical to the application of IFRS 9 requirements. However, IFRS 9 does not specifically define default, but requires the Group to apply a definition that is consistent with the definition used for internal credit risk management purposes, requiring consideration of qualitative indicators, where appropriate.

IFRS 9 introduces a rebuttable presumption that default does not occur later than when a contractual repayment relating to a financial asset is 90 days past due, unless reasonable and supportable information is available to demonstrate that a more lagging criterion is more appropriate.

This presumption has not been rebutted by the Group, meaning that default is deemed not to have occurred later than when a financial asset is 90 days past due. Although this presumption is applicable to all three portfolios managed by the Group, it is much more relevant for identifying defaulted exposures within the Local Lending portfolio.

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

1.2 Basis of preparation - continued

Impairment - continued

The definition of default is addressed in more detail by guidelines issued by the European Banking Authority (EBA) and the Basel Committee on Banking Supervision (BCBS). These guidelines provide detailed definitions of what should be considered in the determination of defaulted exposures for regulatory purposes.

As a result, the Group has decided to align the IFRS 9 definition of default to the definitions provided in the EBA and BCBS guidelines with the definition used for accounting purposes, thereby ensuring that a single consistent view of credit risk is applied for internal risk management, regulatory capital and the measurement of ECLs.

In this regard, defaulted exposures are those that satisfy either or both of the following criteria:

(i) material exposures which are past due by more than 90 days;

(ii) the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of days past due.

The Group defines a financial asset as credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred. Therefore, since the criteria for credit-impaired under IFRS 9 can be interpreted consistently with the definition of default for regulatory purposes, all defaults in terms of regulation are deemed to be credit-impaired, and vice versa. Defaulted exposures are therefore classified under Stage 3 for IFRS 9 purposes.

Modified financial assets

In accordance with IFRS 9, the modification of contractual cash flows of a financial instrument could result in one of two possible outcomes:

(i) If the modification is not considered to be significant, the modified cash flows are considered to pertain to the original financial asset; or

(ii) If the modification is considered to be significant, the original asset is considered to be extinguished and accordingly the original asset is derecognised and replaced by a new financial asset.

The assessment of whether a modification is considered to be significant is therefore critical in determining the accounting implications of modifications to an asset’s contractual cash flows. The Group therefore applies judgement in assessing whether a change in contractual terms (such as a change in interest rates, currency or the remaining term of the loan) is substantial enough to represent an expiry of the original instrument.

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

1.2 Basis of preparation - continued

Impairment - continued

In this regard, when considering a change in the contractual terms, the Group evaluates how the cash flows under the revised terms compare with the cash flows under the original terms of the loan and also takes into consideration qualitative factors. Qualitative considerations include extension of terms, insertion of credit enhancements, changes in interest rates, etc. If the modification is deemed substantial derecognition of the financial instrument is warranted.

When the modification is not substantial enough to result in the derecognition of that financial asset, the Group recalculates the gross carrying amount of the financial asset as the present value of the modified contractual cash flows discounted at the original effective interest rate (or credit-adjusted effective interest rate for POCI financial assets). The difference is recognised as a modification gain or loss in profit or loss.

When there is a substantial modification to the terms of a financial asset resulting in the derecognition of the existing financial asset and the subsequent recognition of the modified financial asset, the modified asset is considered a 'new' financial asset. A loss is booked in profit or loss (normally as a write-off) since the carrying amount of the new instrument is calculated as the present value of future cash flows discounted at the original effective interest rate.

Forbearance measures

A financial asset is also derecognised if, as a result of the deterioration in the borrower's credit position, the exposure is restructured in such a manner that would result in a write-off of a portion of the debt and the inclusion of equity warrants instead.

Forbearance measures consist of concessions extended to any exposure towards a debtor facing or about to face difficulties in meeting its financial commitments with a view to recover expected principal and interest payments when a borrower is in financial difficulties. Concessions may consist of:

(i) a modification of the previous terms and conditions of a contract which the debtor was considered unable to comply with due to its financial difficulties ("troubled debt") to allow for sufficient debt service ability, that would not have been granted had the debtor not been in financial difficulties, or

(ii) a total or partial refinancing of a troubled debt contract, that would not have been granted had the debtor not been in financial difficulties.

Forbearance measures typically result in terms and conditions that are more favourable than those provided initially. The key objective of granting forbearance measures is to pave the way for non-performing borrowers to exit their non-performing status, or to help prevent performing borrowers from reaching a non-performing status.

1. Summary of significant accounting policies - continued

1.2 Basis of preparation - continued

Impairment - continued

Through the extension of forbearance measures, the Group aims to return the exposure to a situation of sustainable repayment and is only considered viable where it can demonstrate that the obligor can realistically afford the forbearance solution. Therefore, the extension of forbearance measures is always backed up by a complete assessment of the borrower's financial situation.

The modification of a financial instrument only leads to derecognition if it is significant. In this regard, when the modification of a financial instrument is deemed significant, the new instrument is typically deemed to be credit-impaired as at the modification date and therefore classified as POCI. In this case, the instrument is classified as POCI until derecognition, meaning that lifetime ECLs are required to be measured in relation to that asset until maturity (i.e. no cure is permitted).

However, in those cases where a modification is not significant enough to warrant derecognition the Group performs an assessment of whether the instrument can be classified as performing forborne (i.e. not credit impaired). This can only be the case if the exposure was not deemed to be credit-impaired at the date when the forbearance measures were extended, and the extension of the forbearance measures do not lead the exposure to be classified as credit-impaired. If the Group deems that the obligor will be able to comply with the modified terms, the exposure is deemed performing forborne and generally classified as Stage 2.

Expected credit losses

ECLs are defined as the probability-weighted estimate of credit losses over the expected life of a financial instrument. Credit losses are in turn defined as the present value of all expected cash shortfalls between contractual and expected cash flows, discounted using the original effective interest rate (EIR).

Lifetime ECLs refer to the ECLs that result from all possible default events over the expected life of a financial instrument, whilst 12-month ECLs are a portion of lifetime ECLs and represent the lifetime cash shortfalls that result if a default occurs in the 12 months after the reporting date, weighted by the probability of the default occurring.

For each portfolio, the Group calculates ECLs on its financial instruments based on three key inputs, namely: probability of default ("PD"), loss given default ("LGD") and exposure at default ("EAD"). 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 entire residual life of the exposure.

1. Summary of significant accounting policies - continued

1.2 Basis of preparation - continued

Impairment - continued

Probability of Default

The concept of default risk is central to IFRS 9 – therefore, one of the key risk parameters used by the Group in its ECL calculation is the probability that the obligor defaults either within the next 12-month period (in case of Stage 1 exposures) or over the lifetime of the exposure (in case of Stage 2 / 3 exposures).

The 12-month and lifetime PDs therefore represent the probability of default occurring over the next 12 months and the residual life of the instrument, respectively. Since the PD is a probability measure used to capture the likelihood that a borrower will default over a defined period of time, this is estimated at a borrower level.

The PDs for the Group's Treasury and International Corporate Lending portfolios are estimated based on statistical models developed by external vendors. On the other hand, due to the lack of internally available history of defaults within the local lending portfolio, the PDs for the Group's Local Lending portfolio are estimated based on observations of other portfolios within the market.

Loss Given Default

The second key risk parameter used by the Group relates to the estimation of the recovery rate expected to be observed in the event that a 'default' occurs. In this regard, the Group uses the LGD to capture this element within the ECL calculation.

The LGD of an exposure measures the size of the estimated loss (as a proportion of the total EAD) that is expected to materialise in the event that a borrower defaults. It is based on the difference between the contractual cash flows due and the cash flows that the Group expects to receive from the borrower, whether from the borrower's cash flows or from any collateral.

In contrast with PDs, LGDs are estimated at a facility level. Whilst linked to the general credit risk of the obligor, recovery rates are also impacted by the relative ranking of a particular facility within the obligor's debt structure.

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

1.2 Basis of preparation - continued

Impairment - continued

The Group's Treasury portfolio consists of covered bonds, bonds issued by supranational organisations and sovereign bonds. For its supranational exposures and sovereign exposures, the Group uses the LGD value obtained from the statistical model developed by an external vendor while for covered bonds the LGD is aligned with regulatory standards.

For all of its assets within its International Corporate Lending portfolio, the Group also uses the external vendor model to estimate recovery by benchmarking exposure-specific characteristics with the underlying dataset.

Finally, the LGD used for the Local Lending portfolio is driven by the loan-to-value ratio of the individual facilities, whilst also taking into consideration other factors such as costs to sell, valuation haircuts and the time value of money.

Exposure at Default

The EAD is used to estimate the Group's expected exposure at the time of default of an obligor, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, and any expected drawdowns on committed facilities.

The maximum period over which ECLs are measured is the maximum contractual period over which the Group is exposed to credit risk. For exposures within the Treasury and Local Lending portfolios, the maturity date is deemed to be equal to the contractual maturity of the exposure. However, for its International Corporate Lending portfolio, the Group makes use of behavioural rather than contractual maturity, thereby reflecting expectations on the exercise of prepayment or extension options.

To measure the EAD of off-balance sheet exposures, including loan commitments, the Group estimates the amount that a borrower will have drawn down by the time of default. Therefore, the Group estimates the part of the undrawn facility that the borrower is expected to convert into a funded amount typically referred to as a credit conversion factor (CCF).

Forward looking information

The recognition and measurement of ECL requires the incorporation of multiple forward-looking economic conditions into the ECL estimates to meet the measurement objective of IFRS 9.

As a result, in estimating ECLs, the Group considers both its own expectations of credit losses based on obligor-specific information (such as historical or projected financial performance), thereby capturing idiosyncratic credit risk, and observable market information deemed to influence the obligor's credit risk (such as the correlation between credit risk and GDP movements), thereby capturing systemic risk.

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

1.2 Basis of preparation - continued

Impairment - continued

The Group takes into consideration reasonable and supportable information relating to forecasts of future macroeconomic conditions in order to determine the expected level of and movement in credit risk for specific obligors.

Through statistical selection methods to determine the macroeconomic variables that have the highest correlation to systemic credit risk factors, the Group selects the macroeconomic variables deemed relevant for the estimation of ECLs for each exposure within the portfolios of financial instruments in question in order to capture systemic risk in the ECL calculation.

IFRS 9 does not require every possible scenario to be identified. However, it requires the Group to estimate ECLs by taking into consideration multiple forward-looking macroeconomic scenarios, since the use of a single 'most likely' scenario is not deemed sufficient. As a result, the measurement of ECLs in line with IFRS 9 involves the use of significant judgement.

The development of multiple macroeconomic scenarios is necessary to capture the non-linear relationship between different forward-looking scenarios and corresponding ECL outcomes.

In this regard, the Group uses the external vendor model solution for all of its portfolios in order to capture the level of systemic risk linked to an obligor, and to estimate forward-looking probability weighted conditional PiT PDs using multiple forecasts of macroeconomic conditions.

IFRS 9 does not require forecasts of future conditions to extend over the entire expected life of the financial instrument in question. The Group uses macroeconomic forecasts for up to 20 quarters to estimate a probability-weighted ECL. For maturities that go beyond this 5-year period, the Group extrapolates projections from available data.

- *International Corporate Lending and Treasury portfolios*

The Group applies five macroeconomic scenarios, to the unconditional PD and LGD term structures for the estimation of ECLs for its Stage 1 and Stage 2 exposures within its International Corporate Lending and Treasury portfolios. These macroeconomic scenarios are linked to a set of macroeconomic variables, including country-level variables such as country-specific GDP, that are deemed to have the highest correlation to the Group's portfolio.

The Group uses five macroeconomic scenarios to capture non-linearity across credit portfolios. The scenarios include a base case scenario as predicted by market forecasts and two additional scenarios on each side of the base case scenario to reflect severe and less severe upside and downside scenarios.

These macroeconomic forecasts are sourced from an external vendor and are supported by a scenario narrative that reflects the current principal and emergent risks.

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

1.2 Basis of preparation - continued

Impairment - continued

The relative severity of each scenario, together with the relative probability weights, disclosed in the table below, are determined by the Group based on expert judgement. In doing so, the Group determines the relative portion of the probability distribution which is representative of each of the five scenarios selected.

Scenarios	Severe Upside	Upside	Base case	Downside	Severe Downside
Severity	96%	90%	50%	10%	4%
Probability Weight	7%	23%	40%	23%	7%

The appropriateness of the relative severity and probability weights of the scenarios will be re-assessed on a periodic basis in order to ensure that the model is accurately estimating unbiased and probability-weighted ECLs.

With regards to Stage 3 exposures within the Group's International Corporate Lending portfolio, ECLs are based on a fundamental analysis aimed at assessing the level of credit risk in detail and estimating the recoverable amount for the instrument. In line with IFRS 9 requirements, such exposures still require a consideration of multiple forward-looking scenarios. The scenarios are designed specifically for each obligor in question by considering:

(i) The different work-out options available to the Group in respect of each impaired exposure, such as the initiation of court proceedings to enforce foreclosure of collateral or reaching an amicable out-of-court agreement with the obligor to sell the collateral in the market and repay the exposure from the sales proceeds, also assigning probability weightings;

(ii) The different cash flows that may accrue to the Group under different macro-economic scenarios; and

(iii) The different cash flows that may accrue to the Group under the contractual agreement resulting from restructuring, which may include derivative features including pay-outs if certain targets or objectives are met at a future date.

In line with the requirements of IFRS 9, the Group assigns a probability weight, based on management judgement, to each of the scenarios considered in the estimation of ECLs. Due to the high level of subjectivity involved, decisions relating to the selection of scenarios, probabilities and multiples are subject to scrutiny through the Group's governance structure around credit risk.

- *Local Lending portfolio*

The Group uses the same conceptual framework as that used for the International Corporate Lending and Treasury portfolios to estimate unbiased and probability-weighted ECLs based on forward-looking macroeconomic scenarios for exposures classified in Stage 1 and 2.

1. Summary of significant accounting policies - continued

1.2 Basis of preparation - continued

Impairment - continued

In this regard, the Group also determines the key macroeconomic variables driving the systemic credit risk of exposures within the Local Lending portfolio, establishes the relative severity of the multiple macroeconomic scenarios and assigns probability weights to each scenario.

The key difference lies within the number of scenarios used for Local Lending exposures, since the Group estimates unbiased and probability-weighted ECLs using three (rather than five) macroeconomic scenarios, due to the lack availability of a full set of five scenarios for the local market.

The three scenarios include a base case scenario and two additional outer scenarios, representing an upside and a downside scenario, supported by a scenario narrative that reflects less likely but emergent risks.

The severity of the upside scenario is established to reflect more favourable conditions than 90% of the possible scenarios, whereas only 10% of possible scenarios are more severe than downside scenario. The probability weights assigned to each of these scenarios (as per the below table) are determined based on expert judgement and are deemed appropriate for the computation of unbiased ECLs.

Scenarios	Upside	Base case	Downside
Severity	90%	50%	10%
Probability Weight	30%	40%	30%

Presentation of ECL in the Statement of Financial Position

The loss allowance for financial assets that are measured at amortised cost is presented as a deduction from the gross carrying amount of the assets. On the other hand, for financial assets measured at FVOCI, the loss allowance is presented within other comprehensive income rather than against the carrying amount of the assets. Therefore, no deduction is made from the carrying amount of financial assets measured at FVOCI, which is always shown at fair value.

Transition

The classification and measurement and impairment requirements of IFRS 9 are applied retrospectively by adjusting the statement of financial position at the date of initial application, which is 1 April 2018 for the Group. Since it is impracticable to restate comparatives without undue cost and effort, the Group has not restated comparative periods in the financial statements for the year ending 31 March 2018.

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

1.2 Basis of preparation - continued

Transition - continued

In this regard, the Group applies the provisions of IFRS 9 retrospectively by adjusting the opening balance of its retained earnings to take account of the effect of applying the new standard in the year of initial application. Any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application is recognised in the opening retained earnings.

Based on the data and current implementation status of IFRS 9 as at 31 March 2018, the Group estimates the adoption of IFRS 9 to lead to an overall reduction in the Group's total shareholders' equity of approximately €8 million before tax. This reduction results from increased IFRS 9 impairment requirements of approximately €10 million, compensated for by an increase in equity of €2.2 million, which as described earlier, result from changes to the classification and measurement of certain debt securities.

The MDB Group has adopted the regulatory transitional arrangements adopted by the EU on 27 December 2017. These permit banks to add back to their capital base a proportion of the impact that IFRS 9 has upon their impairment allowances during the first five years of use. The proportion that banks may add back starts at 95% in the financial year ending 31 March 2019, and reduces to 25% in the financial year ending 31 March 2023. As a result, MDB Group's CET 1 ratio after the regulatory transitional period of five years is expected to reduce by 22 basis points.

The Group is in the final stages of determining the amount of the impact referred to above. This assessment is subject to further transition work including refinement of the Group's models for ECL calculations. The new accounting policies, assumptions, judgements and estimation techniques employed are subject to refinement until the Group finalises its first financial statements that include the date of initial application.

IFRS 9 disclosures

IFRS 9 requires extensive new disclosures, particularly relating to classification and measurement, the criteria used to identify significant increases in credit risk, impairment methodology, ECLs, the use of forward looking information and hedge accounting.

The objective of the transition disclosures is to help market participants understand how ECL works, its implications and the choices made by the Group in implementing IFRS 9. Transition disclosures also play an important role in helping market participants understand the implications of differences between the IAS 39 and IFRS 9 provisioning models, together with explaining how IAS 39 incurred loss concepts map onto new ECL-related concepts.

Such disclosures will be required in the year of initial application of IFRS 9, which will be the financial year ending 31 March 2019.

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

1.2 Basis of preparation - continued

Hedge Accounting

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link with risk management strategy and permitting hedge accounting to be applied to a greater variety of hedging instruments and risks, but do not explicitly address macro hedge accounting strategies.

In this regard, IFRS 9 allows entities to continue applying IAS 39 hedge accounting requirements of IAS 39. In this regard, the Group has opted to maintain the accounting policy on hedge accounting in line with the provisions of IAS 39 on all of its hedging relationships.

1.3 Consolidation

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

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

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

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. The accounting policies of the subsidiaries are consistent with the policies adopted by the Group.

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

1.3 Consolidation - continued

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

1.4 Foreign currency transactions and balances

a) Functional and presentation currency

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

b) Transactions and balances

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

1.5 Financial assets

1.5.1 Initial recognition and derecognition

The Group recognises a financial asset in its statement of financial position when it becomes a party to the contractual provisions of the instrument.

The Group initially recognises loans and advances to customers at the date of transfer of beneficial ownership or when cash is advanced to borrowers. Investments and transactions in all other financial instruments consisting of regular way purchases and sales are recognised on settlement date.

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

When assets are sold to a third party with a concurrent total return swap on the transferred assets, the transaction is accounted for as a secured financing transaction, retaining the asset on the statement of financial position because the Group retains all or substantially all the risks and rewards of ownership of such assets.

Similarly, when assets are sold to a structure through which the Group is deemed to have retained all, or substantially all, risks and rewards, the transferred assets are not derecognised.

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

1.5 Financial assets - continued

1.5.1 Initial recognition and derecognition - continued

In transactions in which the Group neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset and it retains control over the asset, the Group continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

In certain transactions the Group retains the obligation to service the transferred financial asset for a fee. The transferred asset is derecognised if it meets the derecognition criteria. An asset or liability is recognised for the servicing contract, if the servicing fee is more than adequate (asset) or is less than adequate (liability) for performance of the servicing.

1.5.2 Classification

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

1.5.2.1 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 Group as at fair value through profit or loss upon initial recognition.

Financial instruments classified within this category are recognised initially at fair value and transaction costs are taken directly to profit or loss. These instruments are subsequently measured at fair value. Gains and losses arising from changes in fair value are included directly in profit or loss.

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 as hedging instruments and the related hedging relationships are effective.

The Group’s held for trading financial instruments comprise derivative contracts.

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

1.5 Financial assets - continued

1.5.2 Classification - continued

1.5.2.1 Financial assets at fair value through profit or loss - continued

Designated as at fair value through profit or loss upon initial recognition

The Group may designate certain financial assets upon initial recognition as at fair value through profit or loss (fair value option). This designation cannot be subsequently changed. According to IAS 39, the fair value option is only applied when the following conditions are met:
- the application of the fair value option reduces or eliminates an accounting mismatch that would otherwise arise; or
- the financial assets are part of a portfolio of financial instruments which is risk managed and reported to senior management on a fair value basis; or
- the financial assets consist of debt hosts and embedded derivatives that must be separated.

The Group has designated certain equity investments as financial assets as at fair value through profit or loss upon initial recognition.

1.5.2.2 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 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 Group upon initial recognition designates as available-for-sale; or
- those for which the holder may not recover substantially all of their initial investment, other than because of credit deterioration.

Loans and receivables are initially recognised at fair value – which is the cash consideration to originate or purchase the loan including any transaction costs – and measured subsequently at amortised cost using the effective interest rate method. 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. Interest on loans and receivables is included in profit or loss and is reported as 'interest income'. In the case of an impairment, the impairment loss is reported as a deduction from the carrying value of the loan and receivable and recognised in profit or loss as 'net impairment charges'.

Loans and receivables mainly consist of balances with Central Banks, loans and advances to banks and customers, other receivables together with accrued income and other assets.

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

1.5 Financial assets - continued

1.5.2 Classification - continued

1.5.2.3 Held-to-maturity financial assets

Held-to-maturity financial assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity, other than:

- those that the Group upon initial recognition designates as at fair value through profit or loss;
- those that the Group designates as available-for-sale; and
- those that meet the definition of loans and receivables.

These are initially recognised at fair value, including direct and incremental transaction costs, and measured subsequently at amortised cost using the effective interest rate method.

Interest on held-to-maturity financial assets is included in profit or loss and reported as "interest income". In the case of an impairment, the impairment loss is being reported as a deduction from the carrying value of the investment and recognised in profit or loss.

The Group did not hold any held-to-maturity financial assets as at the end of the current and preceding reporting periods.

1.5.2.4 Available-for-sale financial assets

Available-for-sale financial assets 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, held-to-maturity financial assets or financial assets at fair value through profit or loss.

Available-for-sale financial assets are initially recognised at fair value, which is the cash consideration including any transaction costs, and measured subsequently at fair value with gains and losses being recognised in other comprehensive income, except for impairment losses and foreign exchange gains and losses (in case of monetary assets), until the financial asset is derecognised. If an available-for-sale financial asset is determined to be impaired, the cumulative gain or loss previously recognised in other comprehensive income is reclassified to profit or loss.

Interest income is calculated using the effective interest method and is recognised in profit or loss as are foreign currency gains and losses on monetary assets classified as available-for-sale. Changes in the fair value of monetary securities denominated in foreign currency classified as available-for-sale are analysed between translation differences resulting from changes in the amortised cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in amortised cost are recognised in profit or loss, and other changes in carrying amount are recognised in other comprehensive income. Dividends on available-for-sale equity instruments are recognised in profit or loss when the Group's right to receive payment is established.

1. Summary of significant accounting policies - continued

1.5 Financial assets - continued

1.5.2 Classification - continued

1.5.2.4 Available-for-sale financial assets - continued

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analyses, and option pricing models making maximum use of market inputs and relying as little as possible on entity-specific inputs.

The Group's principal investments, consisting mainly of debt securities and Malta Government treasury bills, are classified as available-for-sale as at the end of the reporting period.

1.6 Impairment of financial assets

1.6.1 Assets carried at amortised cost

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

The criteria that the Group uses to determine that there is objective evidence of an impairment loss include:

- significant financial difficulty of the issuer or obligor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- it becomes probable that the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of active market for financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
  - adverse changes in the payment status of borrowers in the portfolio; and
  - national or local economic conditions that correlate with defaults on the assets in the portfolio.

The estimated period between a loss occurring and its identification is determined by management for each identified portfolio. In general, the periods used throughout the financial year under review and the comparative financial year vary between three months and twelve months.

1. Summary of significant accounting policies - continued

1.6 Impairment of financial assets - continued

1.6.1 Assets carried at amortised cost - continued

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss. If a loan or held-to-maturity financial asset has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Group may measure impairment on the basis of an instrument's fair value using an observable market price.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Group's grading process that considers asset type, collateral type, past due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist.

Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period (for example, changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in profit or loss.

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

1.6 Impairment of financial assets - continued

1.6.1 Assets carried at amortised cost - continued

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 classified as held for sale’.

1.6.1.1 Forborne loans

Forbearance describes concessions made on the contractual terms of a loan in response to an obligor’s financial difficulties.

Forbearance activity is undertaken selectively where it has been identified that repayment difficulties against the original terms already have, or are very likely to materialise, i.e. where the customer is experiencing, or is very likely to experience, difficulty in meeting a payment obligation to the Group due to current credit distress.

Loans that have been identified as forborne retain this designation until payment performance has been observed for an extended period of time.

Forborne loans are typically assessed for impairment individually. The individual impairment assessment takes into account the higher risk of the non-payment of future cash flows inherent in forborne loans. Loans subject to individual impairment assessment, which have been subject to a forbearance measure, are subject to ongoing review to determine whether they remain impaired.

A forborne loan is classified as impaired when:

- there has been a change in contractual terms as a result of a concession which the Group would otherwise not consider by offering terms it would not normally be prepared to offer as not based on current market rates; and
- it is probable that without the concession, the borrower would be unable to meet contractual payment obligations in full .

A forborne 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. The minimum period of payment performance required depends on the nature of the loan in the portfolio, but is not less than twelve months. The period of performance will vary depending on the frequency of payments to be made by the customer under the amended agreement and the extent to which the customer’s financial position is considered to have improved. Forborne loans cannot be returned to a non-impaired grade when a specific impairment allowance remains against any of the customer’s credit facilities.

Forborne loans are not classified as impaired where the forbearance has resulted from significant concern about a borrower’s ability to meet their contractual payment terms but the modified terms are based on current market rates and contractual cash flows are expected to be collected in full following the renegotiation. Non-impaired forborne loans also include previously impaired forborne 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.

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

1.6 Impairment of financial assets - continued

1.6.1 Assets carried at amortised cost - continued

1.6.1.1 Forborne loans - continued

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

The impairment loss before an expected restructuring is measured as follows:

- If the expected restructuring will not result in derecognition of the existing asset, then the estimated cash flows arising from the modified financial asset are included in the measurement of the existing asset based on their expected timing and amounts discounted at the original effective interest rate of the existing financial asset.

- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

When a loan is restructured as part of forbearance strategy and the restructuring results in derecognition of the existing loan, the new loan is disclosed as forborne.

1.6.2 Assets classified as available-for-sale

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 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 (adjusted for 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 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 any 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.

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

1.6 Impairment of financial assets - continued

1.6.2 Assets classified as available-for-sale - continued

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.

In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is objective evidence of impairment resulting in the recognition of an impairment loss.

Once an impairment loss has been recognised on 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 in profit or loss on equity instruments 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.

1.7 Offsetting financial instruments

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

1.8 Intangible assets

1.8.1 Goodwill

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

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

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

1.8 Intangible assets - continued

1.8.1 Goodwill - continued

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

1.8.2 Computer software

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

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

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

Directly attributable costs that are capitalised as part of the software product include the software development employee costs and an appropriate portion of relevant overheads.

Capitalised development costs are amortised from the point at which the asset is ready for use.

Other development expenditure that does not meet these criteria is recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

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

1.9 Property, plant and equipment

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

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

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

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of 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.

Depreciation on 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:

- improvement to premises	4 – 10 years
- computer equipment	3 – 5 years
- other equipment	4 years
- fixtures and fittings	10 years
- motor vehicles	5 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.

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

1. Summary of significant accounting policies - continued

1.10 Impairment of non-financial assets

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

1.11 Non-current assets classified as held for sale

Non-current assets are classified as held for sale when their carrying amounts will be recovered principally through a sale transaction 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 is measured in accordance with the Group's accounting policies. Non-current assets classified as held for sale are generally measured at the lower of their carrying amount and fair value less costs to sell. Impairment losses for any initial or subsequent write-down of an asset to fair value less costs to sell are recognised in profit or loss. Gains for any subsequent increase in fair value less costs to sell of an asset are recognised only up to the extent of the cumulative impairment loss recognised, and are reflected within profit or loss.

1.12 Current and deferred income tax

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

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

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

1.12 Current and deferred income tax - continued

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

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

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

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

1.13 Investment in subsidiaries

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

The Company'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.

1.14 Share capital

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

1.15 Financial liabilities

The Group recognises a financial liability on its statement of financial position when it becomes a party to the contractual provisions of the instrument. The Group's financial liabilities, other than derivative financial liabilities (refer to Note 1.16), are classified as financial liabilities which are not at fair value through profit or loss under IAS 39.

Financial liabilities not at fair value through profit or loss are recognised initially at fair value, being the fair value of consideration received, net of transaction costs that are directly attributable to the acquisition or the issue of the financial liability. These liabilities are subsequently measured at amortised cost using the effective interest method.

1. Summary of significant accounting policies - continued

1.15 Financial liabilities - continued

The 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 amounts owed to financial institutions, amounts owed to customers, other payables and other liabilities.

1.16 Derivative financial instruments

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

Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in profit or loss. If a derivative is not designated in a qualifying hedge relationship, then all changes in its fair value are recognised immediately in profit or loss as a component of net trading income.

The Group designates certain derivatives as hedging instruments in qualifying hedging relationships. On initial designation of the hedge, the Group formally documents the relationship between the hedging instrument/s and hedged item/s, including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationship. The Group makes an assessment, both at the inception of the hedge relationship as well as on an ongoing basis, as to whether the hedging instrument/s is/are expected to be ‘highly effective’ in offsetting the changes in the fair value of the respective hedged item/s during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80-125 percent.

1.16.1 Fair value hedges

When a derivative is designated as a hedging instrument in a hedge of the change in fair value of a recognised asset or liability or a firm commitment that could affect profit or loss, changes in the fair value of the derivative are recognised immediately in profit or loss together with changes in the fair value of the hedged item that are attributable to the hedged risk.

If the hedging derivative expires or is sold, terminated, or exercised, or the hedge no longer meets the criteria for fair value hedge accounting, or the hedge designation is revoked, then hedge accounting is discontinued prospectively.

Any adjustment up to that point of discontinuation to a hedged item for which the effective interest method is used, is amortised to profit or loss as part of the recalculated effective interest rate of the item over its remaining life.

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

1.17 Embedded derivatives

Derivatives may be embedded in another contractual arrangement (a host contract). The Group accounts for an embedded derivative separately from the host contract when:

- the host contract is not itself carried at fair value through profit or loss;
- the terms of the embedded derivative would meet the definition of a derivative if they were contained in a separate contract; and
- the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract.

Separated embedded derivatives are measured at fair value, with all changes in fair value recognised in profit or loss.

1.18 Provisions

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

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

1.19 Interest income and expense

Interest income and expense for all interest-bearing financial instruments are recognised within ‘interest income’ and ‘interest expense’ in profit or loss using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

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

1.19 Interest income and expense - continued

Interest income and expense presented in the income statement include:

- interest on financial assets and financial liabilities measured at amortised cost calculated using the effective interest method;
- interest on available-for-sale investments calculated using the effective interest method; and
- the effective portion of fair value changes attributable to qualifying hedging derivatives designated in fair value hedges of interest rate risk, together with changes in fair value of the hedged items attributable to interest rate risk.

Fair value changes attributable to other derivatives in hedging relationships which are discontinued are presented in 'net trading income' with effect from the last date on which the hedge was demonstrated to be effective.

Interest on 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.

1.20 Fees and commissions

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

Other fee and commission income, comprising account servicing fees, underwriting fees, investment management fees, foreign exchange execution fees, guarantee fees, placement fees and syndication fees, are recognised in profit or loss as the related services are performed.

Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan.

When a loan commitment is not expected to result in the drawdown of a loan, the related loan commitment fees are recognised in profit or loss on a straight-line basis over the commitment period.

Fee and commission expense, relating mainly to transaction and service fees, is expensed as the services are received.

Consideration payable to customers, comprising incremental costs in the form of cash amounts that the Group pays to wealth management customers, are incurred in acquiring new customer contracts. These costs are deferred within "Other assets" and subsequently amortised over the life of the contract as follows:

- For customer contracts with a contractual fixed period, these costs are amortised over the contractual life.
- For customer contracts with no contractual fixed period, these costs are amortised over the estimated life of the contract, which is reviewed periodically with reference to the Group's experience with surrenders by wealth management customers.

1. Summary of significant accounting policies - continued

1.21 Net trading income

Net trading income comprises all realised and unrealised foreign exchange differences and all fair value changes arising on derivatives held for trading, including derivatives that are not designated as hedging instruments and derivatives that no longer meet the criteria for hedge accounting.

1.22 Net income from other financial instruments carried at fair value through profit or loss

Net income from other financial instruments carried at fair value through profit or loss comprises all realised and unrealised fair value changes, interest income, dividends, and foreign exchange differences attributable to financial assets designated upon initial recognition as at fair value through profit or loss.

1.23 Leases - Group is the lessee

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

1.24 Financial guarantee contracts

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

Financial guarantees are initially recognised in the financial statements at fair value on the date the guarantee was given. The fair value of a financial guarantee at the time of signature is zero because all guarantees are agreed on arm's length terms and the value of the premium agreed corresponds to the value of the guarantee obligation. No receivable for the future premiums is recognised. Subsequent to initial recognition, the Group's liabilities under such guarantees are measured at the higher of the initial amount, less amortisation of fees recognised in accordance with IAS 18, and the best estimate of the amount required to settle the guarantee. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgement of management. The fee income earned is recognised in profit or loss over the life of the guarantee. Any increase in the liability relating to guarantees is recognised in profit or loss.

1.25 Cash and cash equivalents

Cash and cash equivalents are carried in the statement of financial position at face value. Cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash in hand, unrestricted balances held with Central Banks, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less. 'Amounts owed to financial institutions' that are repayable on demand or have a contractual maturity of three months or less and which form an integral part of the group's cash management are included as a component of cash and cash equivalents for the purpose of the Statements of Cash Flows.

1. Summary of significant accounting policies - continued

1.26 Customer assets

Customer assets, including client monies, are held with the Group in a fiduciary capacity and are segregated from the assets of the Group in accordance with the applicable rules and regulations on protection of customer assets, except when such customer assets are held by the Group to cover a required margin or when they are used to secure an obligation towards the Group.

Client monies are held in client accounts with reputable credit institutions, the details of which are provided to the Group's clients and also provided on the Group's website. Clients' rights may be affected, or even prejudiced, depending on the jurisdiction in which client assets are held. The Group is not liable for any act, omission of and/or other circumstance affecting the credit institutions entrusted by the Group to hold client assets.

Accordingly, client assets and client monies are not presented within the Group's statement of financial position.

1.27 Dividend distribution

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

2. Financial risk management

2.1 Introduction and overview

The Group's core business activities include:
- deposit taking;
- the provision of wealth management and investment services; and
- the granting of loans to international and local corporates.

The Group also provides basic retail services such as money transfer, spot currency exchange and currency forward contracts. Currency swaps, foreign exchange forwards and interest rate swaps are also entered into for risk management purposes.

In respect of funding, the Group continues to access the international wholesale funding markets through bilateral repo lines and the Eurex repo platform.

The major components within the Group's asset base are a portfolio of loans to international corporates, a treasury debt securities portfolio and another portfolio of loans to local customers, mainly corporates.

Therefore the main risks assumed by the Group are: (a) counterparty credit risk arising primarily from loans and advances to customers, but also from other financial instruments; (b) liquidity risk arising from maturity mismatches; (c) market risk; and (d) operational risk.

This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing these risks and the Group's management of capital.

2. Financial risk management - continued

2.1 Introduction and overview

These risks principally relate to MeDirect Malta Group's banking activities and are managed by MeDirect Malta's Board of Directors. As a result, this note presents information about the financial risk management of the MeDirect Malta Group, which comprises MeDirect Malta and MeDirect Belgium.

2.1.1 Risk management framework

The Group recognises the need to have an effective and efficient risk management function and therefore it has adopted a comprehensive risk management process that provides an appropriate balance between the growth of the Group, maximising its profitability and managing the associated risks.

The Group's objective is to deploy an integrated risk management approach that ensures an awareness of, and accountability for, the risks taken throughout the Group and also to develop the tools needed to address those risks. This integrated approach is implemented through the governance structure of the Group and relies on three lines of defence – business units' management, an independent risk management function, and independent on-going reviews by internal audit.

2.2 Credit risk

Credit risk is the risk of loss to the Group's business or of adverse change in the financial position, resulting from fluctuations in the credit standing of issuers of securities, customers, counterparties and any debtors in the form of default or other significant credit loss event (e.g. downgrade or spread widening).

2.2.1 Management of credit risk

The Group has in place standards, policies and procedures for the control and monitoring of credit risk. The Group's objective is to maximise its returns while maintaining a sound and prudent credit risk profile. To facilitate achieving this target, the Group invests in a diversified portfolio of financial assets, including both high-quality securities with strong ratings stability and a diversified portfolio of loans to/securities issued by corporates, whose higher returns are viewed as justifying a greater level of risk.

With respect to its debt securities portfolio, the Group focuses on acquiring securities, mainly covered bonds, issued by financial institutions (some of which may carry a government guarantee), supranational agencies and governments. Lending to corporate borrowers, by subscribing to debt securities or by providing loans and revolving credit facilities, is typically on a senior secured basis. MeDirect Malta's Credit and Investment Policy permits it to manage its credit risk through credit derivatives, subject to Board approval, although to date it has not done so.

The purpose of MeDirect Malta's Credit and Investment Policy is to establish the credit standards, internal controls, reporting requirements and approval processes that govern the selection and on-going management of the investment assets of the Group.

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.1 Management of credit risk - continued

The MeDirect Malta Board of Directors has established limits for exposures to individual credits based on the Capital Requirements Regulation ("CRR") regulatory requirements governing large exposures of credit institutions, as well as prudential requirements. Exposure limits are monitored on an on-going basis by the Risk, Corporate Credit and Treasury teams. The Credit and Investment Policy among others outlines the following specific exposures and trading limits:

- Concentration limits;
- Country limits; and
- Minimum credit quality within each asset class.

Limits on counterparty exposure are established by ALCO. Such limits relate to net exposure, after application of cash (and cash equivalent) collateral, as provided in industry-standard documentation such as the ISDA and GMRA agreements, and the Treasury Management Policy.

The Group's financial assets are managed on a portfolio basis, taking into account correlations between asset classes. The Group diversifies its exposures to avoid excessive concentration in particular countries or types of financial institutions. The Group also considers the impacts of lending to corporate borrowers within the Group's portfolio on its risk assessment.

The Group's credit risk taking activities comprise principally investments in debt securities within its treasury portfolio and loans to international corporate clients, which activities are described below.

All securities in the portfolio as well as international corporate loans undergo a thorough analytical credit research process. The research process reviews all securities and international corporate loans not only from a credit perspective but also from a legal, financial and ratings perspective. The Credit team, which manages the credit analysis and research process, is composed of highly-trained individuals with specialised skill sets and years of experience in the Fixed Income and Corporate Syndicated Loans markets. The credit analysis and research process subjects potential investments to scenario analysis to determine whether they can withstand significant adverse credit and market events. Additionally, the portfolio is subject to a continual, thorough monitoring and oversight process in order to identify any securities and loans which require increased monitoring of performance. Further details on the credit approval and monitoring processes are provided within the Additional Regulatory Disclosures.

2. **Financial risk management** - continued

2.2 Credit risk - continued

2.2.2 Maximum exposure to credit risk

The following table presents the maximum exposure to credit risk from on balance sheet and off-balance sheet financial instruments, before taking account of any collateral held or other credit enhancements. For financial assets recognised on balance sheet, the maximum exposure to credit risk equals their carrying amount. For financial guarantees granted, it is the maximum amount that the Group 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.

MeDirect Malta Group	**2018**	2017
	€000	€000
Net exposure:		
Loans and receivables		
Balances with Central Banks and cash	**103,739**	245,194
Loans and advances to financial institutions	**113,623**	106,895
Loans and advances to customers	**1,701,716**	1,449,970
Accrued income	**15,878**	16,830
Loans to related parties (included in other assets)	**14,965**	24,040
	1,949,921	1,842,929
Available-for-sale debt investments	**560,245**	698,474
Held for trading derivative financial instruments	**470**	861
Derivative financial instruments designated as hedging instruments	**-**	766
	2,510,636	2,543,030
Commitments to purchase financial assets	**118,250**	108,865
Commitments to extend credit, guarantees and other commitments (excluding operating leases and capital commitments)	**441,677**	345,649

2.2.3 Credit quality of financial assets

The 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.

As disclosed in the Additional Regulatory Disclosures (ARDs) presented in line with CRR requirements, the Group adopts a five-scale internal credit classification rating scale This aligns to the Group's Standardised Approach to credit risk and takes cognisance of the IFRS 9 principles that will be applicable with effect from 1 April 2018.

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.3 Credit quality of financial assets - continued

Throughout the Group's Credit Committee meetings, the members of the Credit Committee review the grading proposed by the Corporate Credit team and reviewed by the Risk Management team.

Performing
1. Regular - no material credit concerns.
2. Focus - no immediate prospect that a loss will ultimately be suffered, but worthy of close attention.

Underperforming
3. Under Surveillance - significant credit concerns and some prospect that a loss may ultimately be suffered.

Non-Performing
4. Doubtful - it is likely that the contractual terms of the debt will not be met and that a credit loss will be suffered.
5. Write-off - full or partial credit impairment suffered, with little prospect of recovery.

Deteriorating Credits

The Group is required to identify non-performing exposures (NPEs) and to assess the recoverability of the recognised exposures.

The principal guidance on the definition of NPEs, as referred to in Commission Implementing Regulation (EU) No 680/2014 (referred to as the "EBA International Technical Standards on supervisory reporting"), seeks to ensure the consistent implementation of the key drivers of the NPE definition, namely the "past-due" criterion and the "unlikely-to-pay" criterion.

According to the EBA International Technical Standards on supervisory reporting, "non-performing exposures" are those that satisfy either or both of the following criteria:

a) material exposures which are more than 90 days past-due;

b) the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of days past due.

Assessment is made at an obligor (rather than facility) level. This implies that in those cases where a particular debtor has multiple facilities with the Group, the Group considers whether there are indications of unlikeliness to pay at the level of the debtor, irrespective of the different levels of losses that can be incurred in respect of the different facilities resulting from different levels of seniority.

For further clarity, exposures in respect of which a "default" is considered to have occurred, and exposures that have been found "impaired" in accordance with IFRSs as adopted by the EU, shall always be considered as "non-performing exposures".

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.3 Credit quality of financial assets - continued

The following table sets out information about the credit quality of financial assets held by the MeDirect Malta Group and the related impairment allowances:

	Performing		Under performing	Non-performing		
	Regular	Focus	Under surveillance	Impaired	Impairment allowances	Total
MeDirect Malta Group	**€000**	**€000**	**€000**	**€000**	**€000**	**€000**
As at 31 March 2018						
Balances with Central Banks	103,543	-	-	-	-	**103,543**
Derivative financial instruments	470	-	-	-	-	**470**
Loans and advances to financial institutions	113,623	-	-	-	-	**113,623**
Loans and advances to customers	1,364,412	170,681	112,926	76,335	(22,638)	**1,701,716**
Investments	560,245	-	-	-	-	**560,245**
Accrued income	13,515	859	1,048	456	-	**15,878**
Loans to related parties (included in other assets)	14,965	-	-	-	-	**14,965**
	2,170,773	171,540	113,974	76,791	(22,638)	**2,510,440**

	Performing		Under performing	Non-performing		
	Regular	Focus	Under surveillance	Impaired	Impairment allowances	Total
MeDirect Malta Group	**€000**	**€000**	**€000**	**€000**	**€000**	**€000**
As at 31 March 2017						
Balances with Central Banks	244,895	-	-	-	-	244,895
Derivative financial instruments	1,627	-	-	-	-	1,627
Loans and advances to financial institutions	106,895	-	-	-	-	106,895
Loans and advances to customers	1,090,059	181,355	136,271	64,347	(22,062)	1,449,970
Investments	698,474	-	-	-	-	698,474
Accrued income	13,330	899	1,888	713	-	16,830
Loans to related parties (included in other assets)	24,040	-	-	-	-	24,040
	2,179,320	182,254	138,159	65,060	(22,062)	2,542,731

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.3 Credit quality of financial assets - continued

For investment securities, the Group's credit quality classifications encompass a range of more granular external rating grades attributed by external agencies to debt securities. The following table illustrates this information:

MeDirect Malta Group	**2018** **€000**	2017 €000
National Government securities		
A+ to A	**7,022**	7,097
Regional Government securities		
AAA	**52,755**	42,063
AA+ to AA-	**14,502**	-
Other securities		
AAA	**338,272**	389,042
AA+ to AA-	**147,694**	196,913
A+ to A	**-**	63,359
Total	**560,245**	698,474

The portfolio of available-for-sale securities is also categorised under the credit quality classifications used by the Group (i.e. regular, focus, under surveillance and impaired) and these ratings would be determined by MeDirect Malta's Credit Committee.

2.2.4 Past due but not impaired financial assets

An exposure is "past due" when any amount of principal, interest or fee has not been paid on the date it was due. Past due but not impaired loans are those loans and advances for which contractual interest or principal payments are past due but the Group believes that impairment is not appropriate on the basis of the stage of collection of amounts owed to the Group. The Group's past due exposures consist solely of loans and advances to customers.

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.4 Past due but not impaired financial assets - continued

The past due but not impaired ageing analysis of the MeDirect Malta Group's loans and advances to customers is reflected in the following table:

MeDirect Malta Group	**2018**	2017
	€000	€000
Up to 30 days		
Principal	**317**	15,788
Interest	**-**	95
31 to 60 days		
Principal	**92**	3,995
Interest	**-**	35
Total	**409**	19,913

MeDirect Malta and MeDirect Belgium do not have any exposures forming part of the international corporate loan portfolio which are past due but not impaired. All past due but not impaired facilities form part of the local lending portfolio to counterparties domiciled in Malta and are concentrated within the real estate and construction sector.

2.2.5 Impaired financial assets and impairment allowances

The Group's impaired financial assets comprise solely loans and advances to customers. All credit exposures have been reviewed on a case by case basis (see Accounting Policy Note 1.6). Impaired loans are those where there is objective evidence that a loss event has occurred since initial recognition and the Group establishes that the loss event has an impact on future estimated cash flows as it is unlikely that it will collect the full principal and/or interest due according to the contractual terms of the loan without reverting to the respective collateral.

The Group establishes an allowance for impairment losses that represents its estimate of incurred losses in its Lending Portfolio. The main component of this allowance is a specific loss component that relates to individual exposures. The Group also establishes an allowance for impairment at collective level on its loans and advances to customers.

The following table analyses the specific impairment allowances recognised for impaired loans and advances that are individually assessed, and collective impairment allowances on loans and advances not classified as individually impaired.

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.5 Impaired financial assets and impairment allowances - continued

MeDirect Malta Group	**Specific impairment allowances €000**	**Collective impairment allowances €000**
Year ended 31 March 2018		
At beginning of year	16,928	5,134
Exchange differences	(899)	-
Loan impairment charge	968	507
At end of year	**16,997**	**5,641**
- of which relating to local lending portfolio	3,995	537
New allowances	7,160	5,641
Release of allowances no longer required	(6,192)	(5,134)
Total loan impairment charge	968	507
- **of which relating to local lending portfolio**	(1,408)	(154)
Year ended 31 March 2017		
At beginning of year	12,369	4,439
Exchange differences	318	-
Loan impairment charge	4,241	695
At end of year	16,928	5,134
- of which relating to local lending portfolio	5,403	691
New allowances	6,489	5,134
Release of allowances no longer required	(2,248)	(4,439)
Total loan impairment charge	4,241	695
- **of which relating to local lending portfolio**	(2,243)	(4)

The impaired local loans and advances are mainly attributable to the real estate and construction sector. Sectorial information in respect of impairment charges relating to international loans and advances is not deemed meaningful.

During the current financial year, the Group's interest income amounting to €2.9 million (2017: €2.6 million) was recognised in profit or loss on loans for which individually assessed impairment allowances existed.

2. **Financial risk management** - continued

2.2 Credit risk - continued

2.2.6 Loans and advances to customers with renegotiated terms and the Group's forbearance policy

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer. An existing loan whose terms have been modified would be derecognised in certain circumstances and the renegotiated loan recognised as a new loan at fair value.

Forbearance measures always aim to return the exposure to a situation of sustainable repayment. Forbearance measures consist of concessions towards a debtor facing or about to face difficulties in meeting its financial commitments ("financial difficulties").

The Group renegotiates loans to customers in financial difficulties (referred to as 'forbearance activities') to maximise collection opportunities and minimise the risk of default. Under the Group's forbearance policy, loan forbearance is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

A concession is defined in the EBA final draft Implementing Technical Standards (2014) and refers to either of the following actions:

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

The revised terms usually applied by the Group include extending the maturity, amending the terms of loan covenants and partial write-offs where there is reasonable financial evidence to demonstrate the borrower's inability to repay the loan in full. The Group's Credit Committees regularly review reports on forbearance activities.

For the purposes of these financial statements, 'loans with renegotiated terms' are defined as loans that have been restructured due to a deterioration in the borrower's financial position, for which the Group has made concessions by agreeing to terms and conditions that are more favourable for the borrower than the Group had provided initially and that it would not otherwise consider. A loan continues to be presented as part of loans with renegotiated terms until maturity, early repayment or write-off, unless certain prescriptive conditions are met.

Typically, the Group initially categorises a forborne exposure as performing and classifies the exposure as forborne non-performing at a later date once unlikely-to-pay indicators are evidenced, as outlined in the Non-Performing and Default Exposure section of the Group's Credit Policy.

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.6 Loans and advances to customers with renegotiated terms and the Group's forbearance policy - continued

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.

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 a new loan is recognised, for accounting purposes. However, newly recognised loans retain the 'renegotiated loans' classification.

When determining whether a loan that is restructured should be derecognised and a new loan recognised, the Group 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.

Irrespective of whether loans with renegotiated terms have been derecognised, as outlined previously, they remain 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.

2. **Financial risk management** - continued

2.2 Credit risk - continued

2.2.6 Loans and advances to customers with renegotiated terms and the Group's forbearance policy - continued

The following table shows the carrying amount of the Group's loans and advances to customers by forbearance and past due status:

MeDirect Malta Group	**International Lending Portfolio**		**Local Lending Portfolio**		
	Non forborne exposures €000	**Forborne exposures €000**	**Non forborne exposures €000**	**Forborne exposures €000**	**Total €000**
As at 31 March 2018					
Performing					
Neither past due nor impaired	1,465,415	2,902	66,202	250	**1,534,769**
Past due but not impaired:					
- by up to 30 days	-	-	298	-	**298**
- between 31 to 60 days	-	-	26	-	**26**
Under performing					
Neither past due nor impaired	45,711	64,419	447	2,264	**112,841**
Past due but not impaired:					
- by up to 30 days	-	-	19	-	**19**
- between 31 to 60 days	-	-	66	-	**66**
Non-performing					
Impaired, net of specific impairment allowances	9,090	37,769	704	11,775	**59,338**
Loans and advances, net of specific impairment allowances	**1,520,216**	**105,090**	**67,762**	**14,289**	**1,707,357**
Specific impairment allowances	7,482	5,520	647	3,348	**16,997**
Collective impairment allowances	4,865	239	532	5	**5,641**

2. **Financial risk management** - continued

2.2 Credit risk - continued

2.2.6 Loans and advances to customers with renegotiated terms and the Group's forbearance policy - continued

MeDirect Malta Group	**International Lending Portfolio**		**Local Lending Portfolio**		
	Non forborne exposures €000	**Forborne exposures €000**	**Non forborne exposures €000**	**Forborne exposures €000**	**Total €000**
As at 31 March 2017					
Performing					
Neither past due nor impaired	1,209,936	21,053	24,255	1,201	1,256,445
Past due but not impaired:					
- by up to 30 days	-	-	10,974	-	10,974
- between 31 to 60 days	-	-	3,504	491	3,995
Under performing					
Neither past due nor impaired	59,583	71,590	190	94	131,457
Past due but not impaired:					
- by up to 30 days	-	-	12	4,802	4,814
Non-performing					
Impaired, net of specific impairment allowances	4,494	31,038	788	11,099	47,419
Loans and advances, net of specific impairment allowances	1,274,013	123,681	39,723	17,687	1,455,104
Specific impairment allowances	6,741	4,784	644	4,759	16,928
Collective impairment allowances	4,091	352	597	94	5,134

2. **Financial risk management** - continued

2.2 Credit risk - continued

2.2.6 Loans and advances to customers with renegotiated terms and the Group's forbearance policy - continued

MeDirect Malta Group

	2018	2017
	€000	€000
Total forborne loans and advances to customers as a percentage of total gross loans and advances to customers	**7%**	10%

Interest income recognised by MeDirect Malta Group during the financial year ended 31 March 2018 in respect of forborne exposures amounted to €10.5 million (2017: €9.2 million).

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

MeDirect Malta Group	**2018**	2017
	€000	€000
Year ended 31 March		
At beginning of year	**150,911**	101,626
Loans to which forbearance measures have been extended during the year without derecognition	**54,107**	72,231
Capitalised interest	**2,551**	1,419
Capitalised fees	**(102)**	(97)
Repayments or disposals	**(72,985)**	(24,169)
Exchange differences	**(673)**	(206)
Write-offs	**(6,218)**	-
Issue of warrants	**(240)**	-
Amortisation of premium or discount	**896**	107
At end of year	**128,247**	150,911

As at 31 March 2018, specific impairment allowances on forborne loans was equivalent to €8.9 million (2017: €9.5 million). Reversals of specific impairment allowances on forborne loans reflected in profit or loss during the current year amounted to €7.3 million (2017: charge of €1.8 million).

2. **Financial risk management** - continued

2.2 Credit risk - continued

2.2.6 Loans and advances to customers with renegotiated terms and the Group's forbearance policy - continued

The following tables show the gross carrying amounts of the MeDirect Malta Group's holdings of renegotiated loans and advances to customers analysed by industry sector and credit quality classification:

MeDirect Malta Group	**Neither past due nor impaired €000**	**Past due but not impaired €000**	**Impaired €000**	**Total €000**
As at 31 March 2018				
Real estate and construction	**2,264**	**-**	**11,198**	**13,462**
Manufacturing	**37,433**	**-**	**-**	**37,433**
Other	**30,138**	**-**	**47,214**	**77,352**
	69,835	**-**	**58,412**	**128,247**
As at 31 March 2017				
Financial services	-	-	40	40
Real estate and construction	827	4,086	10,983	15,896
Manufacturing	14,615	1,207	-	15,822
Other	78,496	-	40,657	119,153
	93,938	5,293	51,680	150,911

The MeDirect Malta Group's forborne loans consist of corporate exposures based in the European Union. The forborne local loans are mainly categorised as exposures to corporate customers within the real estate and construction sector.

2.2.7 Write-off policy

The Group writes off financial assets when the relevant Credit Committee of the Banks determine that the balance is uncollectible. This determination is made after considering information such as the occurrence of significant changes in the borrower's/issuer's financial position such that the borrower/issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. Financial assets written off by the Group during the year amounted to €6.8 million (2017: €0.7 million).

2.2.8 Collateral

The Group holds collateral against loans and advances to local customers in the form of hypothecary rights over immovable assets, registered rights over movable assets and guarantees. The asset held as collateral is assigned a fair value at the time of credit approval. The value assigned is regularly monitored to identify assets that need revaluation.

2. **Financial risk management** - continued

2.2 Credit risk - continued

2.2.8 Collateral - continued

Depending on the customer's standing and the type of product, facilities may be provided on an unsecured basis. 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.

Collateral received by the Group includes residential and commercial property, as well financial collateral such as debt securities and cash on deposit. The immovable property collateral received is mainly located in Malta. The Group follows Articles 124 to 126 of the CRR in order to determine whether exposures are fully and completely secured by immovable property, and which risk weight to apply in order to calculate the own funds requirement.

In order to make use of the financial collateral for credit risk mitigation purposes, the Group follows the conditions set out in Chapter 4, Title I, Part Three of CRR, in particular applying Article 222 of the regulation. Collateral that is not eligible in terms of CRR is not taken into consideration for credit risk mitigation.

The financial collateral is mostly made up of high quality debt securities, comprising bonds issued by a Central Government. This collateral is valued daily against statements received from the Central Bank showing bond values after haircuts, in order to determine whether additional collateral is required in respect of the relative exposure.

The following tables show the gross amount (before impairment allowances) of the local loans and advances to customers by level of collateral expressed through the loan-to-value ratio ("LTV"). The collateral measured for the purposes of the tables below consists of fixed first charges on real estate and charges over cash and marketable financial instruments. The collateral amounts 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.

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.8 Collateral - continued

MeDirect Malta Group	Forborne		Non-forborne		Total	
	2018	2017	**2018**	2017	**2018**	2017
	€000	€000	**€000**	€000	**€000**	€000
Non-impaired						
a) Not collateralised	**-**	-	**967**	67	**967**	67
b) Fully collateralised						
- Up to 50% LTV	**1,694**	4,777	**41,744**	24,522	**43,438**	29,298
- 51% to 75% LTV	**820**	1,811	**19,087**	11,960	**19,907**	13,771
- 76% to 90% LTV	**-**	-	**2,350**	480	**2,350**	480
- 91% to 100% LTV	**-**	-	**1,300**	1,906	**1,300**	1,906
c) Partially collateralised						
- greater than 100% LTV	**-**	-	**1,610**	-	**1,610**	-
- of which collateral value	**-**	-	***822***	-	***822***	-
	2,514	6,588	**67,058**	38,935	**69,572**	45,522
Impaired						
a) Not collateralised	**-**	243	**60**	237	**60**	480
b) Fully collateralised						
- Up to 50% LTV	**5,345**	4,126	**328**	231	**5,673**	4,357
- 51% to 75% LTV	**-**	10,426	**963**	-	**963**	10,426
- 76% to 90% LTV	**-**	1,063	**-**	-	**-**	1,063
- 91% to 100% LTV	**9,778**	-	**-**	-	**9,778**	-
c) Partially collateralised						
- greater than 100% LTV	**-**	-	**-**	964	**-**	964
- of which collateral value	**-**	-	**-**	*880*	**-**	*880*
	15,123	15,858	**1,351**	1,432	**16,474**	17,290

As at 31 March 2018 the Group held senior secured loans to international borrowers which amounted to €1.6 billion (2017: €1.4 billion). In respect of such financial assets, the Group normally has a right over the borrower's unencumbered assets.

With respect to the Group's debt securities portfolio, as at 31 March 2018, the Group held covered bonds amounting to €237.7 million (2017: €303.3 million) which are backed by a separate group of assets in the form of loans.

2. **Financial risk management** - continued

2.2 Credit risk - continued

2.2.9 Concentration of credit risk exposures

2.2.9.1 Concentration of investment securities

The Group's exposure to sovereign Eurozone government bonds as at 31 March 2018 represented 13% (2017: 7%) of the Group's total investment securities. As at 31 March 2018 and 2017, the Group's exposure to sovereign Eurozone governments related to Maltese and German Government securities.

No impairment provisions in respect of these exposures were required during the years ended 31 March 2018 and 2017.

The Group monitors concentrations of investment securities for credit risk by type of exposure. An analysis of concentrations of credit risk at the reporting date is shown below.

	Investments	
	2018	2017
MeDirect Malta Group	**€000**	€000
Concentration by type		
Carrying amount:		
Covered bonds	**237,747**	303,280
Government and regional government securities	**74,278**	49,160
Supranationals and agencies	**248,220**	265,475
Unsecured corporate and treasury lending	**-**	80,559
	560,245	698,474

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.9 Concentration of credit risk exposures - continued

2.2.9.2 Concentration of loans and advances to customers

An analysis of concentration of loans and advances to customers by industry sector and geography, before impairment allowances, is shown in the following tables. The local Lending Portfolio, categorised within EU in the tables above, is mainly attributable to the real estate activities sector.

MeDirect Malta Group	**EU**	**Other European countries**	**North America**	**Asia**	**Total**
	€000	**€000**	**€000**	**€000**	**€000**
As at 31 March 2018					
Accommodation and food service activities	**171,318**	**-**	**-**	**-**	**171,318**
Administrative and support service activities	**218,932**	**14,750**	**24,510**	**10,279**	**268,471**
Arts, entertainment and recreation activities	**84,063**	**-**	**8,750**	**-**	**92,813**
Construction	**31,428**	**-**	**-**	**-**	**31,428**
Financial and insurance activities	**34,082**	**-**	**7,002**	**-**	**41,084**
Households and individuals	**8,846**	**-**	**-**	**-**	**8,846**
Human health and social work activities	**58**	**-**	**-**	**-**	**58**
Information and communication	**214,073**	**-**	**55,359**	**-**	**269,432**
Manufacturing	**475,582**	**6,500**	**74,856**	**-**	**556,938**
Professional, scientific and technical activities	**4,305**	**-**	**-**	**-**	**4,305**
Real estate activities	**45,260**	**-**	**-**	**-**	**45,260**
Wholesale and retail trade, repairs of motor vehicles and motor cycles	**68,157**	**4,000**	**-**	**-**	**72,157**
Other service activities	**115,581**	**16,542**	**-**	**-**	**132,123**
Other	**30,121**	**-**	**-**	**-**	**30,121**
	1,501,806	**41,792**	**170,477**	**10,279**	**1,724,354**

2. **Financial risk management** - continued

2.2 Credit risk - continued

2.2.9 Concentration of credit risk exposures - continued

2.2.9.2 Concentration of loans and advances to customers - continued

MeDirect Malta Group	**EU €000**	**Other European countries €000**	**North America €000**	**Asia €000**	**Total €000**
As at 31 March 2017					
Accommodation and food service activities	78,429	-	-	-	**78,429**
Administrative and support service activities	110,234	-	-	-	**110,234**
Arts, entertainment and recreation activities	91,553	-	-	-	**91,553**
Construction	28,956	-	-	-	**28,956**
Financial and insurance activities	35,738	9,830	-	-	**45,568**
Households and individuals	7,066	-	-	-	**7,066**
Human health and social work activities	51,767	-	-	-	**51,767**
Information and communication	240,615	10,957	59,811	-	**311,383**
Manufacturing	360,938	-	49,022	-	**409,960**
Professional, scientific and technical activities	37,460	-	-	10,270	**47,730**
Real estate activities	25,850	148	-	-	**25,998**
Transport and storage	38,930	-	-	-	**38,930**
Wholesale and retail trade, repairs of motor vehicles and motor cycles	76,445	-	-	-	**76,445**
Other service activities	57,072	11,461	21,670	-	**90,203**
Other	57,810	-	-	-	**57,810**
	1,298,863	**32,396**	**130,503**	**10,270**	**1,472,032**

Exposures to United Kingdom counterparties which are included within the EU categorisation in the preceding table as at 31 March 2018 of the Group amounted to €523.6 million (2017: €423.3 million).

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.10 Offsetting financial assets and financial liabilities

The Group is eligible to present certain financial assets and financial liabilities on a net basis in the statement of financial position in accordance with the Group's policy described in Note 1.7 'Offsetting Financial Instruments'.

The following tables set out:
- the impact of offsetting financial assets and financial liabilities on the consolidated statement of financial position;
- the financial impact of netting for instruments subject to an enforceable master netting arrangement or similar agreement; and
- the available financial collateral received or pledged in relation to the total amounts of assets and liabilities that were not offset.

The Group enters into derivative transactions under International Swap and Derivatives Association (ISDA) master netting agreements. In general, under such agreements the amounts owed by each counter-party on a single day in respect of all transactions outstanding in the same currency are aggregated into a single net amount that is payable by one party to the other. In certain circumstances such as when an event of default occurs, all outstanding transactions under the agreement are terminated and settled in a single net amount per currency.

The ISDA agreements do not meet the criteria for offsetting the positive and negative values in the statement of financial position. This is attributable to the fact that the Group and its counterparties do not have any currently legally enforceable right to settle on a net basis or to realise the assets and settle the liability simultaneously because the right to offset is enforceable only on the occurrence of future credit events.

The Group also enters in certain transactions which are settled through clearing houses. The gross settlement mechanisms used by clearing houses, with features that eliminate credit and liquidity risk in a single settlement process, are effectively equivalent to net settlement. As a result such financial assets and liabilities are offset and the net amount is reported in the consolidated statement of financial position.

The Group also pledges and receives collateral in the form of cash and marketable securities primarily for sale and repurchase agreements and for margining purposes on OTC derivative transactions. Pledges are generally conducted under terms that are usual and customary for standard contracts and transactions of this nature. The rights of set off relating to such collateral are conditional upon the default of the counterparty.

The net amount of financial instruments that do not meet the on-balance sheet offsetting criteria, including collateral pledged and received, presented within the following tables is equal to the amount presented in the statement of financial position for that instrument.

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.10 Offsetting financial assets and financial liabilities - continued

Below is a table showing financial instruments subject to offsetting, enforceable master netting arrangements and similar agreements.

	Gross amounts of recognised financial instruments	Gross amounts of recognised financial instruments offset in the statement of financial position	Net amounts of financial instruments presented in the statement of financial position	Related amounts not offset in the statement of financial position		
				Financial instruments that do not meet off-setting criteria	Financial collateral pledged /(received) (incl. cash)	Net amount
	€000	€000	€000	€000	€000	€000
MeDirect Malta Group						
As at 31 March 2018						
Financial assets						
Derivative financial instruments	**470**	**-**	**470**	**-**	**(2)**	**468**
Financial liabilities						
Derivative financial instruments	**(3,581)**	**-**	**(3,581)**	**-**	**3,581**	**-**
Amounts owed to financial institutions	**(126,428)**	**-**	**(126,428)**	**118,428**	**8,000**	**-**
	(130,009)	**-**	**(130,009)**	**118,428**	**11,581**	**-**
As at 31 March 2017						
Financial assets						
Derivative financial instruments	1,627	-	1,627	-	(633)	994
Financial liabilities						
Derivative financial instruments	(2,323)	-	(2,323)	-	2,200	(123)
Amounts owed to financial institutions	(359,183)	-	(359,183)	348,265	10,918	-
	(361,506)	-	(361,506)	348,265	13,118	(123)

2. Financial risk management - continued

2.3 Liquidity risk

2.3.1 Management of liquidity risk

The Group's management of liquidity risk is the responsibility of MeDirect Malta's Treasury team and is monitored by MeDirect Malta's Risk Office, under the oversight of the Management Asset-Liability Committee and the Board Risk Committee of the MeDirect banking entities, taking into account the approach set out in MeDirect Malta's Treasury Management Policy.

Treasury Management Policy ("TMP")

MeDirect Malta's TMP establishes the principles, standards, internal controls, high-level reporting requirements together with escalation and approval processes that govern the ongoing management of the:

- liquidity and asset-liability mix;
- market, interest rate and currency risks; and
- credit risk taken on in connection with the activities above.

It is also designed to ensure compliance with all laws and regulations that are applicable to these activities.

Management Asset and Liability Committee

MeDirect Malta and MeDirect Belgium established a Management Asset and Liability Committee ("ALCO") which is responsible for the management of funding, liquidity, interest rate and currency risks. ALCO sets and reviews overall policies and objectives for asset and liability management, capital management and allocation. The Committee is responsible for approving the asset-classes in which the Treasury team invests taking into account the risk appetite set by the respective Board; reviewing the liquidity position of the Group, and for approving the pricing of the Group's deposits. ALCO also monitors the Group's interest rate risk exposures by reference to the limits established within the TMP, and also approves the permitted hedging instruments for managing interest rate risk.

Board Risk Committee

The Risk Committees of MeDirect Malta and MeDirect Belgium are responsible for setting policies in respect of liquidity and funding, interest rate and currency risks and for reviewing and approving any changes to the overall asset-liability management strategy, taking into account the strategy set by the Board.

Roles and responsibilities

Management of the Group's liquidity position and of its market risk is the responsibility of MeDirect Malta's Treasury function and is monitored by MeDirect Malta's Risk function (under the oversight of ALCO and of the Board Risk Committee of the respective group entities), as is management of the credit risk that arises from these activities. In broad terms:

- Treasury has primary responsibility for managing and reporting the Group's projected liquidity position (the "base case"), and for managing its market risk position on a day-to-day basis; and
- Risk has primary responsibility for defining potential adverse liquidity scenarios that should be considered and for reporting exposure to these scenarios (the "downside case"), as well as for regular formal reporting of the Group's market risk position.

2. **Financial risk management** - continued

2.3 Liquidity risk - continued

2.3.1 Management of liquidity risk - continued

Funding strategy

Banks traditionally perform a role of liquidity transformation, whereby they fund through liabilities that are liquid in the short to medium-term, in order to invest in longer term and less liquid assets. This mismatch of liquid liabilities and less liquid assets is a near-universal feature of bank balance sheets and clearly leads to a risk if liabilities cannot be rolled over when they mature (which may be every day in the case of money held in current or savings accounts).

The Group's strategy to mitigate this risk has three main components:
- Limiting its exposure to customer deposit withdrawal by use of term rather than overnight deposits as its primary instrument of customer funding;
- Limiting its exposure to wholesale funding withdrawal by locking in term funding against less liquid assets and by diversifying its sources of funding; and
- Maintaining a contingency source of funding by ensuring that the bulk of its Treasury portfolio is eligible for funding as part of the ECB programmes if alternative sources are unavailable.

The Group's objective is to maintain a prudent funding structure drawn from diverse funding sources while recognising its position as a regulated credit institution.

Alternative funding sources may include, but are not limited to:
- Deposits from retail and corporate customers;
- Bond issuance, either secured, senior unsecured or subordinated;
- Issuance of capital instruments;
- Interbank funding (either secured, for example through repurchase agreements or Total Return Swaps or unsecured); and
- Central Bank funding.

In order to ensure that the Group has adequate liquidity to meet its near-term obligations, Treasury projects the Group's expected liquidity position for each day over the subsequent week, as well as the "residual" cash balance that takes into account known inflows and outflows (for example settlements of asset purchases or sales) beyond this period.

The Group monitors liquidity risk by referencing to the following key metric:

- The ratio of liquid assets to wholesale (margin-sensitive) funding was 491.7% as at 31 March 2018 (2017: 147.3%). This cash buffer is designed to ensure that the Group can meet any additional margin requirement that might be imposed by the ECB or by repo counterparties, resulting either from changes in market values of assets or from increases in applicable haircuts.

2. **Financial risk management** - continued

2.3 Liquidity risk - continued

2.3.1 Management of liquidity risk - continued

MDB Group also complies with the Liquidity Coverage Ratio ("LCR") in relation to short term liquidity and monitors the Net Stable Funding Ratio ("NSFR") in order to assess long term liquidity:

- The Liquidity Coverage Ratio ("LCR"): The ratio aims to ensure that institutions are able to withstand a 30-day period of stress by virtue of having sufficient unencumbered High Quality Liquidity Assets ("HQLA"). HQLA consist of cash or assets that can be converted into cash at little or no loss of value in the markets. The LCR metric is designed to promote the short-term resilience of the Group's liquidity profile, and became a minimum regulatory standard from 1 October 2015, under European Commission ("EC") Delegated Regulation 2015/61.

  The table below displays the LCR year-end levels for the Group:

	2018	2017
	%	%
At 31 March		
Actual LCR Ratio	**636.0**	576.7
Regulatory Minimum – Transitional provisions	**100**	80
Regulatory Minimum – Fully phased in	**100**	100

  During the year ended 31 March 2018 and 2017 the LCR ratio was within both the regulatory minimum and the risk appetite set by the Group.

- The Net Stable Funding Ratio ("NSFR"): This ratio looks at the relationship between long term assets and long term funding. 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 European calibration of NSFR is pending following the European Commission's proposal in November 2016. As a result, the Group calculates NSFR in line with Basel Committee on Banking Supervision Publication 295, pending its implementation in Europe. This calculation requires various interpretations of the text, and therefore the Group's NSFR may not be directly comparable with the ratios of other institutions.

	2018	2017
	%	%
At 31 March		
Actual NSFR Ratio	**140.0**	128.9

2. **Financial risk management** - continued

2.3 Liquidity risk - continued

2.3.2 Liquidity risk reporting

MeDirect Malta's Risk Office is responsible for producing three key reports that describe the key risks to the Group's liquidity position and quantify its ability to withstand the associated shocks:

- Scenario analysis report, quantifying the potential liquidity impact of adverse market movements or rating agency actions on the Group's asset base and any associated wholesale funding eligibility, considering a number of scenarios of varying severity;

- Deposit concentration report, highlighting borrower-level and sector-level concentrations that can be used to assess the Group's vulnerability to deposit flight; and

- Maximum cumulative outflow report, projecting the Group's cash position in both idiosyncratic and market wide adverse (stress) scenarios through time, modelling the effectiveness of contingency funding actions that can be taken. The liquidity stress scenarios are modelled monthly and take into account a wide range of potential funding outflows including:

    i. Deposit flight (retail and corporate, specific and general);
    ii. Undrawn commitments;
    iii. Margin postings due to market movements and haircut changes; and
    iv. Failure of bilateral repo counterparties to roll financing.

2. **Financial risk management** - continued

2.3 Liquidity risk - continued

2.3.3 Contractual maturity ladder

The following is an analysis of financial assets and liabilities by remaining contractual maturities as at the reporting date with the exception of the analysis of loans and advances to customers that is based on the expected maturities since this is how the liquidity of the Group is monitored on a regular basis. Refer also to Note 2.3.5 that provides an analysis of the encumbered investments.

MeDirect Malta Group	Not more than 1 month	Between 1 and 3 months	Between 3 months and 1 year	Between 1 and 5 years	More than 5 years	No maturity date	Total
	€000	€000	€000	€000	€000	€000	€000
As at 31 March 2018							
Assets							
Balances with central banks	88,242	-	-	-	-	15,301	103,543
Derivative financial instruments	32	69	1	-	-	368	470
Loans and advances to financial institutions	113,623	-	-	-	-	-	113,623
Loans and advances to customers	17,509	15,095	238,893	1,403,369	26,850	-	1,701,716
Investments	-	10,015	49,362	459,154	41,714	-	560,245
Accrued income	6,002	6,454	3,422	-	-	-	15,878
Loans to related parties (included in other assets)	-	-	-	-	-	14,965	14,965
Total financial assets	225,408	31,633	291,678	1,862,523	68,564	30,634	2,510,440
Liabilities							
Derivative financial instruments	1,094	2,039	-	300	148	-	3,581
Amounts owed to financial institutions	21,428	40,000	65,000	-	-	-	126,428
Amounts owed to customers	563,289	86,587	858,256	470,720	307	-	1,979,159
Subordinated liabilities	-	-	-	22,276	44,673	-	66,949
Accrued interest expense	1,125	886	3,749	10	-	-	5,770
Amounts due to related parties (included in other liabilities)	-	-	-	-	-	4,815	4,815
Total financial liabilities	586,936	129,512	927,005	493,306	45,128	4,815	2,186,702
Liquidity gap	(361,528)	(97,879)	(635,327)	1,369,217	23,436		
Cumulative liquidity gap	(361,528)	(459,407)	(1,094,734)	274,483	297,919		

2. Financial risk management - continued

2.3 Liquidity risk - continued

2.3.3 Contractual maturity ladder - continued

MeDirect Malta Group	Not more than 1 month	Between 1 and 3 months	Between 3 months and 1 year	Between 1 and 5 years	More than 5 years	No maturity date	Total
	€000	€000	€000	€000	€000	€000	€000
As at 31 March 2017							
Assets							
Balances with central banks	231,770	-	-	-	-	13,125	244,895
Derivative financial instruments	763	94	4	650	116	-	1,627
Loans and advances to financial institutions	106,895	-	-	-	-	-	106,895
Loans and advances to customers	12,224	40,668	92,729	1,289,983	14,366	-	1,449,970
Investments	17,999	-	56,598	570,507	53,370	-	698,474
Accrued income	6,130	5,207	5,493	-	-	-	16,830
Loans to related parties (included in other assets)	-	-	-	-	-	24,040	24,040
Total financial assets	375,781	45,969	154,824	1,861,140	67,852	37,165	2,542,731
Liabilities							
Derivative financial instruments	855	1,344	1	123	-	-	2,323
Amounts owed to financial institutions	69,183	130,000	160,000	-	-	-	359,183
Amounts owed to customers	516,866	65,182	977,418	341,221	825	-	1,901,512
Subordinated liabilities	-	-	-	22,341	24,702	-	47,043
Accrued interest expense	1,255	1,221	3,708	18	-	-	6,202
Amounts due to related parties (included in other liabilities)	-	-	-	-	-	3,184	3,184
Total financial liabilities	588,159	197,747	1,141,127	363,703	25,527	3,184	2,319,447
Liquidity gap	(212,378)	(151,778)	(986,303)	1,497,437	42,325		
Cumulative liquidity gap	(212,378)	(364,156)	(1,350,459)	146,978	189,303		

Current accounts and savings deposits payable on demand or at short notice amounted to €478 million as at 31 March 2018 (2017: €483 million). This amount is disclosed within the 'Not more than 1 month' maturity grouping. In addition, as at 31 March 2018, savings deposits with a withdrawal notice period of three months amounting to €765 million (2017:€883 million) are disclosed within the 'Between 3 months and 1 year' maturity grouping. Furthermore, as at 31 March 2018, savings deposits with a withdrawal notice period of one year amounting to €181 million are disclosed within the 'Between 1 year and 5 years' maturity grouping. However, in practice these deposits are maintained with the MeDirect Malta Group for longer periods; hence the effective date of repayment is later than the contractual date.

2. **Financial risk management** - continued

2.3 Liquidity risk - continued

2.3.3 Contractual maturity ladder - continued

As at 31 March 2018 unencumbered financial assets classified as available-for-sale amounting to €453 million as at 31 March 2018 (2017: €334 million), form part of the Group's high quality liquid asset portfolio for LCR purposes. Accordingly, they may be liquidated within one month.

2.3.4 Residual contractual maturities of financial liabilities

The following is an analysis of undiscounted cash flows payable under the principal non-derivative financial liabilities by remaining contractual maturities as at the reporting date.

MeDirect Malta Group	**Carrying amount €000**	**Total outflows €000**	**Less than 1 month €000**	**Between 1 and 3 months €000**	**Between 3 months and 1 year €000**	**Between 1 and 5 years €000**	**More than 5 years €000**
31 March 2018							
Non-derivative liabilities							
Amounts owed to financial institutions							
- Due to clearing houses	**105,000**	104,707	-	39,893	64,814	-	-
- Due to other banks	**21,428**	21,428	21,428	-	-	-	-
Amounts owed to customers	**1,979,159**	2,150,108	560,888	90,451	900,450	597,974	345
Subordinated liabilities	**66,949**	91,295	-	-	4,227	34,108	52,960
	2,172,536	**2,367,538**	**582,316**	**130,344**	**969,491**	**632,082**	**53,305**
31 March 2017							
Non-derivative liabilities							
Amounts owed to financial institutions							
- Due to clearing houses	**340,000**	339,390	49,934	129,822	159,634	-	-
- Due to other banks	**19,183**	19,183	19,183	-	-	-	-
Amounts owed to customers	**1,901,512**	1,982,275	517,170	65,793	1,014,055	384,254	1,003
Subordinated liabilities	**47,043**	65,065	-	-	3,259	32,215	29,591
	2,307,738	2,405,913	586,287	195,615	1,176,948	416,469	30,594

2. **Financial risk management** - continued

2.3 Liquidity risk - continued

2.3.4 Residual contractual maturities of financial liabilities - continued

The following is an analysis of undiscounted cash flows relating to the MeDirect Malta Group's principal derivative financial instruments by remaining contractual maturities at the reporting date.

Group	**Carrying amount €000**	**Inflows/ (Outflows) €000**	**Less than 1 month €000**	**Between 1 and 3 months €000**	**Between 3 months and 1 year €000**	**Between 1 and 5 years €000**	**More than 5 years €000**
31 March 2018							
Derivative assets							
Derivative financial instruments							
- Foreign exchange swaps	**102**	**15**	**1**	**13**	**1**	**-**	**-**
Inflows		*62,570*	*35,710*	*26,818*	*42*	*-*	*-*
Outflows		*(62,555)*	*(35,709)*	*(26,805)*	*(41)*	*-*	*-*
- Others (no maturity)	**368**	**-**	**-**	**-**	**-**	**-**	**-**
	470	**15**	**1**	**13**	**1**	**-**	**-**
Derivative liabilities							
Derivative financial instruments							
- Interest rate swaps	**448**	**(1,000)**	**-**	**-**	**(106)**	**(724)**	**(170)**
- Foreign exchange swaps	**3,133**	**(3,510)**	**(1,102)**	**(2,408)**	**-**	**-**	**-**
Inflows		*316,598*	*119,923*	*196,634*	*41*	*-*	*-*
Outflows		*(320,108)*	*(121,025)*	*(199,042)*	*(41)*	*-*	*-*
	3,581	**(4,510)**	**(1,102)**	**(2,408)**	**(106)**	**(724)**	**(170)**
31 March 2017							
Derivative assets							
Derivative financial instruments							
- Interest rate swaps	766	1,442	-	-	90	1,202	150
- Foreign exchange swaps	861	837	747	86	4	-	-
Inflows		*125,016*	*93,880*	*30,996*	*140*	*-*	*-*
Outflows		*(124,179)*	*(93,133)*	*(30,910)*	*(136)*	*-*	*-*
	1,627	2,279	747	86	94	1,202	150
Derivative liabilities							
Derivative financial instruments							
- Interest rate swaps	123	(245)	-	-	(26)	(219)	-
- Foreign exchange swaps	2,200	(2,333)	(862)	(1,468)	(3)	-	-
Inflows		*191,332*	*80,127*	*111,068*	*137*	*-*	*-*
Outflows		*(193,665)*	*(80,989)*	*(112,536)*	*(140)*	*-*	*-*
	2,323	(2,578)	(862)	(1,468)	(29)	(219)	-

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2. Financial risk management - continued

2.3 Liquidity risk - continued

2.3.5 Encumbered assets

The following tables set out the availability of the financial assets of the MeDirect Malta Group to support future funding.

MeDirect Malta Group	Encumbered		Unencumbered		
	Pledged as collateral €000	Other* €000	Available as collateral €000	Other** €000	Total €000
31 March 2018					
Balances with Central Banks and cash	52	-	103,491	196	**103,739**
Derivative financial instruments	-	-	-	470	**470**
Loans and advances to financial institutions	42,082	19,233	-	52,308	**113,623**
Loans and advances to customers – corporate	-	-	-	1,694,141	**1,694,141**
Loans and advances to customers – retail	-	-	-	7,575	**7,575**
Investments	107,181	5,479	447,585	-	**560,245**
Accrued income	-	-	-	15,878	**15,878**
Loans and advances to related parties (included in other assets)	-	-	-	14,965	**14,965**
	149,315	**24,712**	**551,076**	**1,785,533**	**2,510,636**
31 March 2017					
Balances with Central Banks and cash	52	-	241,782	3,360	245,194
Derivative financial instruments	-	-	-	1,627	1,627
Loans and advances to financial institutions	-	21,139	-	85,756	106,895
Loans and advances to customers – corporate	-	-	-	1,438,586	1,438,586
Loans and advances to customers – retail	-	-	-	11,384	11,384
Investments	350,089	5,880	324,506	17,999	698,474
Accrued income	-	-	-	16,830	16,830
Loans and advances to related parties (included in other assets)	-	-	-	24,040	24,040
	350,141	**27,019**	**566,288**	**1,599,582**	**2,543,030**

Represents assets that are not pledged for funding purposes but that the Group believes it is restricted from using to secure funding, for legal or other reasons.

***Represents assets that are not restricted for use as collateral, but that the Group would not consider as readily available to secure funding in the normal course of business.*

2. Financial risk management - continued

2.4 Market risk

Market risk is the risk that changes in market prices, such as interest rates, foreign exchange rates and credit spreads (not relating to changes in the obligor's/issuer's credit standing) will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

2.4.1 Management of market risks

Similar to liquidity risk, management of market risk is the responsibility of MeDirect Malta's Treasury team and is monitored by MeDirect Malta's Risk Office, under the oversight of the ALCO and the Board Risk Committee of the MeDirect banking entities taking into account the approach set out in MeDirect Malta's Treasury Management Policy.

2.4.2 Foreign exchange risk

Foreign exchange risk is the risk that the value of the Group's positions may fluctuate due to movements in underlying foreign currency exchange rates. Although a large majority of the Group's assets and liabilities denominated in euro, the Group does offer deposits in other major currencies and its Lending Portfolio includes a number of exposures denominated in pound sterling. The Group seeks to minimise foreign exchange risk and thus hedges all material net exposures in the different currencies in this area through the use of currency swaps and forward foreign exchange contracts.

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

MeDirect Malta Group

	Euro currency €000	GBP currency €000	USD currency €000	Other €000	Total €000
As at 31 March 2018					
Financial assets					
Balances with Central Banks and cash	103,702	5	21	11	**103,739**
Derivative financial instruments	470	-	-	-	**470**
Loans and advances to financial institutions	59,633	9,092	34,600	10,298	**113,623**
Loans and advances to customers	1,219,885	469,470	11,892	469	**1,701,716**
Investments	554,512	5,733	-	-	**560,245**
Accrued income	12,970	2,633	269	6	**15,878**
Loans to related parties (included in other assets)	14,912	53	-	-	**14,965**
	1,966,084	**486,986**	**46,782**	**10,784**	**2,510,636**
Financial liabilities					
Derivative financial instruments	3,581	-	-	-	**3,581**
Amounts owed to financial institutions	118,195	8,233	-	-	**126,428**
Amounts owed to customers	1,790,236	135,885	29,991	23,047	**1,979,159**
Subordinated liabilities	60,556	6,393	-	-	**66,949**
Accrued interest expense	4,718	980	25	47	**5,770**
Amounts owed to related parties (included in other liabilities)	4,762	53	-	-	**4,815**
	1,982,048	**151,544**	**30,016**	**23,094**	**2,186,702**
Net on-balance sheet financial position		**335,442**	**16,766**	**(12,310)**	
Notional of derivative financial instruments		**(336,771)**	**(18,015)**	**12,133**	
Residual exposure		**(1,329)**	**(1,249)**	**(177)**	

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2. Financial risk management - continued

2.4 Market risk - continued

2.4.2 Foreign exchange risk - continued

MeDirect Malta Group

	Euro currency €000	GBP currency €000	USD currency €000	Other €000	Total €000
As at 31 March 2017					
Financial assets					
Balances with Central Banks and cash	245,158	20	13	3	245,194
Derivative financial instruments	1,627	-	-	-	1,627
Loans and advances to financial institutions	69,093	23,253	8,170	6,379	106,895
Loans and advances to customers	1,031,008	409,154	9,808	-	1,449,970
Investments	692,611	5,863	-	-	698,474
Accrued income	14,923	1,782	125	-	16,830
Loans to related parties (included in other assets)	24,040	-	-	-	24,040
	2,078,460	**440,072**	**18,116**	**6,382**	**2,543,030**
Financial liabilities					
Derivative financial instruments	2,323	-	-	-	2,323
Amounts owed to financial institutions	359,180	3	-	-	359,183
Amounts owed to customers	1,709,427	125,284	40,150	26,651	1,901,512
Subordinated liabilities	41,892	5,151	-	-	47,043
Accrued interest expense	5,178	956	22	46	6,202
Amounts owed to related parties (included in other liabilities)	3,184	-	-	-	3,184
Others	-	-	4,105	-	4,105
	2,121,184	**131,394**	**44,277**	**26,697**	**2,323,552**
Net on-balance sheet financial position		**308,678**	**(26,161)**	**(20,315)**	
Notional of derivative financial instruments		**(308,332)**	**26,247**	**20,149**	
Residual exposure		**346**	**86**	**(166)**	

The net currency exposure in GBP and USD as at 31 March 2018 reflected in the previous tables, is mainly attributable to net of impairment charges.

The Group uses derivative financial instruments to hedge movements in foreign exchange rates by entering into derivative contracts with notional amounts which substantially reflect the net exposure in each currency. As a result the Group is not materially exposed to fluctuations in foreign exchange rates as evidenced in the tables above, reflecting the policy to eliminate foreign exchange risk as much as is practicable.

In view of the Group's policy for managing currency risk, the Board does not deem necessary the presentation of a sensitivity analysis disclosing how profit or loss and equity would have been affected by changes in foreign exchange rates that were reasonably possible at the end of the reporting period.

2. **Financial risk management** - continued

2.4 Market risk - continued

2.4.3 Interest rate risk

The principal risk to which the Group is exposed in this respect is the risk of loss from fluctuations in the future cash flows or fair values of financial instruments because of a change in market interest rates.

The Group's interest rate risk is managed by MeDirect Malta's Treasury team within the prevailing interest rate risk limits approved by ALCO. Adherence to these limits is monitored by MeDirect Malta's Risk Office.

In fact, ALCO of the respective group entities are the oversight body for compliance with the established limit framework and MeDirect Malta's Risk Office is actively involved in day-to-day monitoring activities.

Interest rate risk is managed principally by matching the interest rate risk profile of assets carried at amortised cost with the fixed term profile of its retail deposits, and by hedging the fair value interest rate risk arising on longer-term fixed rate available-for-sale ("AFS") securities by purchasing interest rate derivatives, primarily interest rate swaps. MeDirect Malta's Treasury team also make use of placements with other institutions and wholesale funding to manage certain residual interest rate risk exposures that arise during given periods.

Interest rate risk reporting and analysis

As part of its monitoring duties, MeDirect Malta's Risk Office prepares and reports on the Group's interest rate risk position on a monthly basis. The report outputs show the effects of 200 basis points shift in yield curves on the:

- Projected net interest margin;
- Group's capital position;
- Economic value of the Group's financial assets and liabilities, assuming that no fixed-rate deposits are rolled over; and
- Economic value of the Group's financial assets and liabilities, incorporating assumptions around fixed-rate deposit rolls.

2. Financial risk management - continued

2.4 Market risk - continued

2.4.3 Interest rate risk - continued

The table below discloses the mismatch of the dates on which interest on financial assets and financial liabilities are next reset to market rates on a contractual basis or the dates on which the instruments mature. 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 in respect of financial assets and liabilities.

MeDirect Malta Group

		Repricing in:				
	Carrying amount €000	Not more than 3 months €000	Between 3 months to 1 year €000	Between 1 and 3 years €000	Between 3 and 5 years €000	More than 5 years €000
As at 31 March 2018						
Balances with Central Banks	**103,543**	103,543	-	-	-	-
Loans and advances to financial institutions	**113,623**	113,623	-	-	-	-
Loans and advances to customers	**1,701,716**	1,464,646	237,056	14	-	-
Investments	**560,245**	92,715	18,361	338,117	69,338	41,714
	2,479,127	1,774,527	255,417	338,131	69,338	41,714
Amounts owed to financial institutions:						
- Due to clearing houses	**105,000**	40,000	65,000	-	-	-
- Due to other banks	**21,428**	21,428	-	-	-	-
Amounts owed to customers	**1,979,159**	634,114	866,058	372,439	106,241	307
Subordinated liabilities	**66,949**	-	-	47,021	19,928	-
	2,172,536	695,542	931,058	419,460	126,169	307
Interest rate repricing gap		1,078,985	(675,641)	(81,329)	(56,831)	41,407
Impact of hedging interest rate derivatives – notional Amounts – net liabilities	**448**	396,000	-	(273,000)	(78,000)	(45,000)
Net interest repricing gap		1,474,985	(675,641)	(354,329)	(134,831)	(3,593)

2. **Financial risk management** - continued

2.4 Market risk - continued

2.4.3 Interest rate risk - continued

MeDirect Malta Group

		Repricing in:				
	Carrying amount €000	**Not more than 3 months €000**	**Between 3 months to 1 year €000**	**Between 1 and 3 years €000**	**Between 3 and 5 years €000**	**More than 5 years €000**
As at 31 March 2017						
Balances with Central Banks	**244,895**	244,895	-	-	-	-
Loans and advances to financial institutions	**106,895**	106,895	-	-	-	-
Loans and advances to customers	**1,449,970**	1,221,774	228,104	89	3	-
Investments	**698,474**	75,332	63,694	126,593	379,485	53,370
	2,500,234	1,648,896	291,798	126,682	379,488	53,370
Amounts owed to financial institutions:						
- Due to clearing houses	**340,000**	180,000	160,000	-	-	-
- Due to other banks	**19,183**	19,183	-	-	-	-
Amounts owed to customers	**1,901,512**	582,048	977,418	168,931	172,290	825
Subordinated liabilities	**47,043**	-	-	22,341	-	24,702
	2,307,738	781,231	1,137,418	191,272	172,290	25,527
Interest rate repricing gap		867,665	(845,620)	(64,590)	207,198	27,843
Impact of hedging interest rate derivatives – notional Amounts – net assets	**643**	571,000	-	(111,000)	(415,000)	(45,000)
Net interest repricing gap		1,438,665	(845,620)	(175,590)	(207,802)	(17,157)

The Group's exposure to interest rate risk arises predominantly from repricing risk emanating from its asset/liability structure, specifically the lag which exists between the Group's loans which reprice periodically (generally every three months) and the term structure of customer deposits, as well as from possible impacts on the Mark-to-Market ("MtM") value of its fixed rate instruments if market interest rates increase. The presence of interest rate floors embedded in the majority of the loans enable the Group to mitigate its repricing risk from the Group's asset/liability structure, whilst the Bank generally hedges the repricing risk from its financial assets, namely the treasury securities, and wholesale repo funding.

A positive interest rate sensitivity gap exists where more assets than liabilities reprice 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 repricing periods and among currencies.

2. Financial risk management - continued

2.4 Market risk - continued

2.4.3 Interest rate risk - continued

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.

The management of interest rate risk attributable to interest rate repricing gap limits is supplemented by monitoring the sensitivity of the Group's financial assets and liabilities to various interest rate scenarios.

The estimated impact on the Group's Net Interest Margin ("NIM") as a result of a 100 basis points ("bps") movement and on Economic Value as a result of a 100 basis points ("bps") parallel fall / rise in the yield curves would be as follows:

31 March 2018

- NIM would increase by €1.9 million / increase by €8.9 million.
- Economic Value would increase by €26.4 million / increase by €7.1 million.

31 March 2017

- NIM would increase by €7.5 million / increase by €9.7 million.
- Economic Value would increase by €28.7 million / increase by €10.8 million.

These values are determined taking into account the impact of hedge accounting.

The main assumptions used in the model utilised to measure the benchmarks referred to above are:

- Interest bearing assets are assumed to mature on their contractual maturity and are not replaced (static balance sheet);
- Certain senior secured loans have floors and thus are not fully affected by a decrease in interest rate;
- The Group will not change deposit rates in the next 24 months even if there is an increase or decrease in ECB base rate;
- The liability maturity profile is extended to match the assets' maturity profile;
- There is an implicit zero floor option on customer deposits as the Group will not charge negative rates to customers;
- The Δ NIM and Δ EV metrics includes the effect of changes in value of the contractual automatic options embedded in the banking book assets; and
- Customer deposits follow their contractual repricing schedule and are not behavioralised.

Interest rate movements affect reported equity in the following ways:

- retained earnings arising from increases or decreases in net interest income after taking into consideration the net impact of interest rate hedging instruments; and
- fair value reserves arising from increases or decreases in fair values of available-for-sale financial instruments reported directly in equity.

2. Financial risk management - continued

2.5 Operational risk

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

The Group's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Group's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity while maintaining risk taking within a tolerable limit.

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

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

Compliance with the Group's standards is supported by a programme of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of the business unit to which they relate, with summaries submitted to the Audit Committees and senior management of the MeDirect banking entities.

A financial measurement of this risk is calculated by the Group for the purpose of allocating risk capital using the Basic Indicator Approach under Regulation (EU) No.575/2013 of the European Parliament and of the Council of 26 June 2013, also known as CRR. The risk weighted assets for operational risk under this method as at 31 March 2018 were calculated at €110.8 million (2017: €85.0 million).

2. **Financial risk management** - continued

2.6 Capital management - regulatory capital

The Group's regulator, the ECB's Joint Supervisory Team (the "JST"), sets and monitors capital requirements for the Group.

The CRR and Capital Requirements Directive ("CRD IV") implemented the Basel III into Europe with the sole objective of improving the banking sector's ability to absorb shocks arising from financial and/or economic stress, which in turn mitigate spill-over damage to the real economy. The CRD IV legislation has been implemented with an effective date of 1 January 2014.

In implementing current capital requirements, the regulation requires the Group to maintain a prescribed ratio of total capital to total risk-weighted assets.

The Group does not engage in trading and is exempt from having a trading book. Risk-weighted assets on the banking book are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets including balances with counterparties and other illiquid assets.

The Group complies with the provisions of CRR in respect of regulatory capital and it applies the standardised approach for credit risk. For regulatory purposes, the Group's capital base is divided in two main categories, namely Common Equity Tier 1 Capital and Tier 2 Capital.

- Common Equity Tier 1 Capital which includes ordinary share capital, share premium, shareholders' contributions, retained earnings, fair value reserve and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes including deductions relating to Reserve for Depositor Compensation Scheme ('Other reserves') and certain other regulatory items; and

- Tier 2 Capital consists of unrealised gains included within the fair value reserve and subordinated liabilities in issue, which rank after the claims of all depositors (including financial institutions) and all other creditors.

The Group's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Group recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Group has complied with all externally imposed capital requirements throughout the year.

MDB Group Limited publishes full Pillar 3 disclosures as a separate document which is appended to these financial statements.

2. Financial risk management - continued

2.7 Fair value measurement

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

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if the transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. 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.

If there is no quoted price in an active market, then the Group uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price - i.e. the fair value of the consideration given or received. If the Group determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by the quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss only to the extent that it arises from a change in a factor (including time) that market participants would consider in setting a price.

If an asset or a liability measured at fair value has a bid price and an ask price, then the Group measures assets and long positions at a bid price and liabilities and short positions at an ask price.

2. **Financial risk management** - continued

2.7 Fair value measurement - continued

2.7.1 Fair value hierarchy

The Group measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: inputs that are quoted market prices (unadjusted) in active markets for identical instruments.

- Level 2: inputs other than quoted market prices included within Level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data. Financial instruments which are generally included in this category include over-the-counter derivatives where the fair value is based on observable inputs.

- Level 3: inputs that are unobservable. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

2.7.2 Use of valuation techniques

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;
- selecting an appropriate discount rate for the instrument; and
- judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective.

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.

Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premiums used in estimating discount rates, bond and foreign currency exchange rates and expected price volatilities and correlations.

The objective of valuation techniques is to arrive at a fair value measurement that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date.

2. Financial risk management - continued

2.7 Fair value measurement - continued

2.7.2 Use of valuation techniques - continued

The Group uses widely recognised valuation models for determining the fair value of common and simple financial instruments, such as interest rate and currency swaps that use only observable market data and require minimal management judgement and estimation.

Fair value of investment securities in inactive markets are based on:

- quoted prices of similar instruments, performing numerical procedures such as interpolation when input values do not directly correspond to the most active market trade parameters; or
- price quotations in respect of orderly transactions between market participants provided by reputable dealers.

Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over the counter derivatives such as interest rate swaps. Availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determining fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

2.7.3 Financial instruments measured at fair value

The following table analyses financial instruments measured at fair value at the end of the reporting period, by the respective levels within the fair value hierarchy into which the respective fair value measurement is categorised. The fair value amounts are based on the carrying amounts reflected in the statement of financial position.

MeDirect Malta Group	**Level 1**	**Level 2**	**Level 3**	**Total**
	€000	**€000**	**€000**	**€000**
As at 31 March 2018				
Assets				
Investments				
- Available-for-sale	**560,245**	**-**	**-**	**560,245**
Derivative financial instruments	**-**	**470**	**-**	**470**
Total financial assets	**560,245**	**470**	**-**	**560,715**
Liabilities				
Derivative financial instruments	**-**	**3,581**	**-**	**3,581**
Total financial liabilities	-	**3,581**	-	**3,581**

2. **Financial risk management** - continued

2.7 Fair value measurement - continued

2.7.3 Financial instruments measured at fair value - continued

MeDirect Malta Group	Level 1 €000	Level 2 €000	Level 3 €000	Total €000
As at 31 March 2017				
Assets				
Investments				
- Available-for-sale	698,474	-	-	**698,474**
Derivative financial instruments	-	1,627	-	**1,627**
Total financial assets	**698,474**	**1,627**	**-**	**700,101**
Liabilities				
Derivative financial instruments	-	2,323	-	**2,323**
Total financial liabilities	-	**2,323**	-	**2,323**

As at 31 March 2018 and at 31 March 2017, the fair value of the AFS investment securities represents the closing bid price quoted in an active market.

Level 2 assets principally comprise:

- Derivatives held for risk management that are fair valued based on valuation models with the key methodology utilised comprising the calculation of the net present value of a series of expected cash flows, taking into account the different terms of each specific contract/instrument (discounted cash flow approach). These models use as their basis independently sourced market parameters including, for example, interest rate yield curves. Market parameters are either directly observable or are implied from observable instrument prices. The model may perform numerical procedures in respect of pricing such as interpolation when input values do not directly correspond to the most active market trade parameters.

2.7.3.1 Transfers between levels

The Group recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the transfer has occurred.

There were no transfers between Level 1 and Level 2 of the fair value hierarchy during the financial years ended 31 March 2018 and 2017.

2. **Financial risk management** - continued

2.7 Fair value measurement - continued

2.7.4 Financial instruments not measured at fair value

The following table sets out the fair values of financial instruments not measured at fair value and analyses them by the respective level within the fair value hierarchy into which the respective fair value measurement is categorised. This table includes only financial instruments in respect of which fair value is estimated to be materially different than the carrying amounts.

MeDirect Malta Group

	Level 1 €000	Level 2 €000	Level 3 €000	Total fair values €000	Total carrying amount €000
As at 31 March 2018					
Assets					
Loans and advances to customers	**-**	**1,149,073**	**-**	**1,149,073**	**1,151,819**
Total financial assets	**-**	**1,149,073**	**-**	**1,149,073**	**1,151,819**
Liabilities					
Subordinated liabilities	**70,309**	**-**	**-**	**70,309**	**66,949**
Total financial liabilities	**70,309**	**-**	**-**	**70,309**	**66,949**
As at 31 March 2017					
Assets					
Loans and advances to customers	-	1,109,807	-	1,109,807	1,124,707
Total financial assets	**-**	**1,109,807**	**-**	**1,109,807**	**1,124,707**
Liabilities					
Subordinated liabilities	49,287	-	-	49,287	47,043
Total financial liabilities	**49,287**	**-**	**-**	**49,287**	**47,043**

2. **Financial risk management** - continued

2.7 Fair value measurement - continued

2.7.4 Financial instruments not measured at fair value - continued

The Level 1 fair values reflected in the tables above consist of quoted market prices of debt securities issued which are traded in active markets.

The Level 2 fair value disclosures mainly comprise price quotations in respect of internationally traded loans and advances, consisting of the Group's international loan book with foreign corporates.

The Group's financial instruments not measured at fair value comprise balances with Central Banks, loans and advances to financial institutions and customers, and amounts owed to financial institutions and customers. The fair values of these financial assets and liabilities 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.

Loans and advances to financial institutions of the MeDirect Malta Group amounting to €113.6 million (2017: €106.9 million), which represent 100% of all loans and advances to financial institutions (2017: 100%), re-price or mature in less than one year; hence their fair value is not deemed to differ materially from their carrying amount at the reporting date.

Loans and advances to customers forming part of the international lending book of the MeDirect Malta Group amounting to €468 million (2017: €269 million), net of specific impairment allowances, have not been reflected in the preceding tables. These mainly re-price within three months; hence their fair value is not deemed to differ materially from their carrying amount at the reporting date.

The carrying amount for local loans and advances to customers amounting to €81.5 million (2017: €56.7 million) approximates their fair value because these loans are repriceable at the Group's discretion.

All trade receivables amounting to €2.7 million (2017: €4.5 million) are stated net of specific impairment allowances, within loans and advances to customers. Their fair value is not deemed to differ materially from their carrying amount at the reporting date.

Fair values referred to above are estimated using discounted cash flows, applying market rates. These estimates are considered Level 2 fair value estimates.

The majority of the 'Amounts owed to financial institutions' of the Group amounting to €126.4 million (2017: €359.2 million) and 'Amounts owed to customers' of the Group amounting to €1.5 billion (2017: €1.6 billion) sourced from the Maltese and Belgian markets, re-price or mature in less than one year; hence their fair value is not deemed to differ materially from their carrying amount at the reporting date. Fair values of these liabilities are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. These are considered Level 2 fair value estimates. The fair value of a demand deposit is not less than the amount payable on demand, discounted from the first date on which the amount payable is required to be paid.

3. Accounting estimates and judgements

3.1 Critical accounting estimates and judgements in applying the Group's accounting policies

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

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

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognised prospectively.

Information about assumptions, estimations and uncertainties that have a significant risk of resulting in a material adjustment in the year ending 31 March 2018 is set out below in relation to estimated cash flows for the purposes of applying the effective interest method and the impairment of financial instruments.

3.2 Estimated cash flows upon application of the effective interest method

As part of the calculation of the effective interest rate for financial assets and liabilities measured at amortised cost utilising the effective interest method, the Group takes into account the estimated cash flows attributable to the respective financial instrument considering all contractual terms of the instrument (e.g. prepayment, call and similar options), but excluding the impact of future credit losses.

In the case where an instrument gives the issuer the option to require the instrument to be early redeemed or cancelled, and the terms of the instrument are such that it is not certain whether the option will be exercised, the probability of the option being exercised will be assessed in determining the estimated cash flows.

3.3 Impairment losses on loans and advances

Financial assets measured at amortised cost are evaluated for impairment on the basis described in Accounting Policy Note 1.6. Loan impairment allowances represent management's best estimate of losses incurred in the loan portfolios at the balance sheet date. Management is required to exercise judgement in making assumptions and estimates when calculating loan impairment allowances on both individually and collectively assessed loans and advances.

The individual component of the total allowances for impairment applies to financial assets evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a debtor's financial situation and the net realisable value of any underlying collateral. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently approved by the respective subsidiary's Credit Risk Management function.

3. Accounting estimates and judgements - continued

3.3 Impairment losses on loans and advances - continued

For individually assessed loans, judgement is required in determining whether there is objective evidence that a loss event has occurred. In determining whether there is objective evidence that a loss event has occurred, 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. A higher level of judgement is required for loans to borrowers showing signs of financial difficulty in market sectors experiencing economic stress.

The Group might provide loan forbearance to borrowers experiencing financial difficulties by agreeing to modify the contractual payment terms of loans in order to improve the management of customer relationships, maximise collection opportunities or avoid default or repossession. Where forbearance activities are present, higher levels of judgment and estimation uncertainty are involved in determining their effects on loan impairment allowances.

The collective component of the total allowances is established for portfolios of loans and advances with similar credit risk characteristics when there is objective evidence to suggest that they contain impaired items but the individual impaired items cannot yet be identified.

In assessing the need for collective loss allowances, management considers factors such as credit quality, portfolio size, concentrations, and economic factors. To estimate the required allowance, assumptions are made to define the way inherent losses are modelled and to determine the required input parameters, based on historical experience and current economic conditions. The accuracy of the allowances depends on the model assumptions and parameters used in determining the collective allowance.

The estimation methods include the use of statistical analyses of historical information, supplemented with significant management judgement, to assess whether current economic and credit conditions are such that the actual level of incurred losses is likely to be greater or less than historical experience.

The methodology and the assumptions used in calculating impairment losses are reviewed regularly in the light of differences between loss estimates and actual loss experience. Loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

4. Balances with Central Banks and cash

	Group	
	2018	2017
	€000	€000
At amortised cost:		
Balances with Central Banks	**103,543**	244,895
Cash	**196**	299
	103,739	245,194

Balances held with Central Banks include reserve deposits relating to the Minimum Reserve Requirement in terms of Regulation (EC) No 1745/2003 of the ECB amounting to €15.3 million (2017: €13.1 million) bearing interest at 0% (2017: 0%) per annum and overnight deposits with Central Banks amounting to €87.6 million (2017: €227.5 million) subject to a negative interest rate of 0.4% (2017: negative interest rate of 0.4%) per annum.

The balances with Central Banks also include a balance of €52 thousand (2017: €52 thousand) that is pledged in favour of the Depositor Compensation Scheme (“DCS”) in terms of the Depositor Compensation Scheme Regulations (Subsidiary Legislation, 371.09) of the Laws of Malta.

5. Derivative financial instruments

The Group, through MeDirect Malta, established derivative lines with counterparties to purchase interest rate caps, swaps and swaptions, foreign exchange forwards and other appropriate instruments approved for hedging risks.

The Group uses over-the-counter foreign exchange swaps to hedge its exposure to changes in foreign exchange rates. The Group also transacts derivatives to create risk management solutions for clients. This includes the structuring of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. As part of this process, the Group considers the customers’ suitability in respect of the respective risks involved and the business purpose underlying the transaction. The Group manages these derivative risk positions principally through offsetting derivative transactions with its counterparties.

All foreign exchange swaps mature within 4 months (2017: 12 months) from the reporting date.

The Group uses over-the-counter interest rate swaps to hedge its exposure to changes in the fair values of its fixed rate AFS securities attributable to changes in market interest rates. Interest rate swaps are matched to fixed rate AFS securities in designated fair value hedging transactions. The net loss on the hedging instruments during the year was €2.3 million (2017: €0.9 million). The net gain on the hedged items arising during the year attributable to the hedged risk was €1.9 million (2017: €0.4 million).

5. Derivative financial instruments - continued

Foreign exchange and interest rate swaps are commitments to exchange one set of cash flows for another, resulting in an economic exchange of currencies or interest rates (for example, fixed rate for floating rate). Usually, no exchange of principal takes place. Interest rate swaptions are options granting the right but not the obligation to enter into an underlying swap.

Analysed as follows:

	Group	
	2018	2017
	€000	€000
Derivative financial assets	**470**	1,627
Derivative financial liabilities	**(3,581)**	(2,323)

The fair values of the held for trading derivatives and derivatives designated as hedging instruments in fair value hedges together with the related notional amounts are as follows:

	Notional	**Fair value**	Notional	Fair value
	2018	**2018**	2017	2017
	€000	**€000**	€000	€000
Derivatives held for trading – Assets				
Instrument type:				
- Foreign exchange swaps	**62,556**	**102**	124,379	861
- Other derivative financial instruments		**368**		-
		470		861
Derivatives held for trading – Liabilities				
Instrument type:				
- Foreign exchange swaps	**320,100**	**(3,133)**	193,325	(2,200)
Net derivatives held for trading		**(2,663)**		(1,339)

5. Derivative financial instruments - continued

Group	Notional 2018 €000	Fair value 2018 €000	Notional 2017 €000	Fair value 2017 €000
Derivatives designated as hedging instruments in fair value hedges – Assets				
Instrument type:				
- Interest rate swaps maturing in				
More than one year and less than five years	-	-	447,000	650
More than five years	-	-	45,000	116
		-		766
Derivatives designated as hedging instruments in fair value hedges – Liabilities				
Instrument type:				
- Interest rate swaps maturing in				
More than one year and less than five years	**351,000**	**(300)**	79,000	(123)
More than five years	**45,000**	**(148)**	-	-
		(448)		(123)
Net derivatives designated as hedging instruments in fair value hedges		**(448)**		643

6. Loans and advances to financial institutions

	Group		Company	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
At amortised cost:				
Repayable on call and at short notice	**90,833**	89,488	**31**	50
Term loans and advances	**22,821**	17,457	**-**	-
	113,654	106,945	**31**	50

Loans and advances to financial institutions up to €61 thousand (2017: €68 thousand) are pledged in favour of other banks providing credit card facilities to MeDirect Malta's customers.

As at 31 March 2018, an amount of €5.0 million (2017: €5.0 million) has been contributed to a clearing fund held by Eurex Clearing AG, of which MeDirect Malta is a member. The clearing fund protects members against losses until they leave the clearing fund.

Loans and advances to financial institutions as at 31 March 2018 and 31 March 2017 were neither past due nor impaired and no forbearance measures were applied by the Group in this respect.

7. Loans and advances to customers

	Group	
	2018	2017
	€000	€000
At amortised cost:		
Repayable on call and short notice: retail	**4,242**	5,143
Repayable on call and short notice: corporate	**6,783**	3,446
Term loans and advances: retail	**4,604**	7,537
Term loans and advances: corporate	**1,708,725**	1,455,906
Gross loans and advances to customers	**1,724,354**	1,472,032
Less allowances for impairment		
- Individually assessed allowances	**(16,997)**	(16,928)
- Collectively assessed allowances	**(5,641)**	(5,134)
	1,701,716	1,449,970

As at 31 March 2018, the acquisition of €118.3 million (2017: €108.9 million) of the Group's "Term loans and advances to customers: corporate" was contracted but beneficial ownership was not yet transferred.

There were no disposals of loans and advances as at 31 March 2018 and 2017 which were contracted but in respect of which instruments' beneficial ownership was not yet transferred.

Gross loans and advances to customers of the Group amounting to €76.3 million (2017: €64.3 million) were deemed to be impaired. Specific impairment allowances recorded on the Group's loans and advances to customers amounted to €17.0 million (2017: €16.9 million).

The aggregate amount of impaired loans and advances of the Group and on which interest is reserved is €15.6 million (2017: €16.3 million) gross of impairment allowances, against which €4.0 million (2017: €5.4 million) is being provided for after taking into account the extendible value of security backing such loans and advances. Interest in suspense as at the end of the reporting period amounted to €4.0 million (2017: €3.5 million).

7. Loans and advances to customers - continued

	Group	
	2018	2017
	€000	€000
Specific allowances for impairment		
At beginning of year	**16,928**	12,369
Exchange differences	**(899)**	318
Impairment allowances (Note 27)	**968**	4,241
At end of year	**16,997**	16,928
Collective allowances for impairment		
At beginning of year	**5,134**	4,439
Impairment allowances (Note 27)	**507**	695
At end of year	**5,641**	5,134
Total allowances for impairment	**22,638**	22,062

Loans and advances amounting to €6.8 million have been written off during the current financial year in view of a debt restructuring. Specific impairment allowances amounting to €5.8 million had been recognised in respect of these loans and advances.

8. Investments

	Group	
	2018	2017
	€000	€000
Available-for-sale investments	**560,245**	698,702

8. Investments - continued

Available-for-sale investments

	Group 2018 €000	Group 2017 €000
Debt securities and other fixed income securities		
Issued by public bodies		
- local government	**7,022**	7,097
- foreign national and regional governments	**67,256**	42,063
- supranationals	**248,220**	156,985
Issued by other bodies		
- foreign banks	**237,747**	446,088
- other foreign issuers	**-**	46,241
Equity		
Issued by other bodies		
- local issuers	**-**	228
	560,245	698,702
Listing status		
- listed on the Malta Stock Exchange	**7,022**	7,325
- listed on other recognised exchanges	**553,223**	691,377
	560,245	698,702

	Group 2018 €000	Group 2017 €000
Year ended 31 March		
At beginning of year	**698,702**	872,667
Additions	**25,729**	26,889
Disposals/Redemptions	**(154,698)**	(193,076)
Gains on hedged items attributable to the hedged risk	**1,917**	444
Amortisation of premium/discount	**(12,496)**	(15,566)
Exchange differences	**(128)**	(1,156)
Changes in fair value	**1,219**	8,500
At end of year	**560,245**	698,702

No objective evidence of specific impairment was identified on investments during the financial years ended 31 March 2018 and 31 March 2017.

The majority of the investment securities are pledged as collateral with Eurex against the provision of borrowing facilities (Note 17), except for investments amounting to €324 million (2017: €343 million) which are free and unencumbered securities as at 31 March 2018.

As at 31 March 2018, investment securities held by the Group with a nominal value of €5.3 million (2017: €5.8 million) and a fair value of €5.5 million (2017: €5.9 million) are pledged in favour of the DCS.

8. **Investments** - continued

The cash value of unutilised borrowing facilities (headroom), which are secured by investment securities, amounted to €448.4 million as at 31 March 2018 (2017: €312.5 million).

As at 31 March 2018 and 31 March 2017, the Group had no commitment to purchase further investment securities.

9. **Investment in subsidiaries**

Name of subsidiary	Country of incorporation	Nature of business	Equity interest 2018 %	Equity interest 2017 %	Carrying amount 2018 €000	Carrying amount 2017 €000
MeDirect Bank (Malta) plc	Malta	Banking	**100**	100	**130,914**	130,914
Charts Investment Management Service Limited	Malta	Investment services	**100**	100	**745**	3,194
					131,659	134,108
Shareholders' contribution advanced to MeDirect Bank (Malta) plc					**147,352**	60,803
					279,011	194,911

	2018 €000	2017 €000
Year ended 31 March		
At beginning of year	**194,911**	194,911
Additional shareholders' contribution	**86,549**	-
Additions (refer to note below)	**200**	-
Impairment (Note 27)	**(2,649)**	-
At end of year	**279,011**	194,911

MeDirect Malta owns the following subsidiaries:

Name of subsidiary	Country of incorporation /formation	Nature of business	Equity interest 2018 %	Equity interest 2017 %
Mediterranean Corporate Bank Limited	Malta	Banking	**-**	100
MeDirect Bank SA	Belgium	Banking	**100**	100
Medifin Estates (partnership)	Malta	Operating lease of branches	**97**	97

9. Investment in subsidiaries - continued

On 11 April 2014, MeDirect Malta entered into an agreement to acquire 100% of the share capital of Volksbank Malta Limited ("Volksbank"). Following regulatory approval by the MFSA, on 25 September 2014, MeDirect Malta acquired 100% of the share capital of Volksbank for a cash consideration of €35.3 million. Volksbank was subsequently re-named Mediterranean Corporate Bank Limited ("MedCorp").

On 21 November 2016, MeDirect Malta announced that the board of directors of MeDirect Malta and MedCorp have each voted to merge MedCorp into MeDirect Malta, subject to receipt of all applicable regulatory approvals and to completion of all legal requirements. With effect from 1 April 2017, the merger between MeDirect Malta and MedCorp became effective for accounting purposes. Thus all the transactions of MedCorp have been treated as being those of MeDirect Malta with effect from 1 April 2017 (refer to Note 36).

MeDirect Belgium was incorporated on 16 June 2014 and was authorised as a Belgian credit institution on 1 June 2015. As part of that process, the assets and liabilities of MeDirect Malta's Belgian branch were contributed to MeDirect Belgium which is carrying out all of the Group's activities in Belgium.

Medifin Estates is a partnership set up on 5 June 2012. This partnership enters into operating leases for property to be used as offices and branches which are then leased to the Group.

By virtue of board resolutions dated 29 September 2017, 1 November 2017, 7 November 2017 and 29 March 2018, the MeDirect Malta Group accepted capital contributions from the Company amounting to €8.2 million, €12.0 million, €55.4 million and €10.95 million respectively.

The Group had a call option arrangement whereby the Group had the option to purchase the remaining shareholding of Charts subject to the terms and conditions specified in the agreement. On 6 May 2015, the Company entered into an agreement to acquire the remaining 35% shareholding for a cash consideration of €1.7 million, of which €0.2 million were contingent upon the achievement of certain predefined targets. The contingent consideration has been deemed to have materialised in 2018, thus increasing the carrying amount of this investment. This consideration was paid subsequent to the year end.

Charts distributed €0.95 million to the Company as a final dividend which was executed on 29 March 2018.

The investment in Charts was impaired by €2.6 million to reflect the consideration of the sale of the shares in Charts to MeDirect Malta subsequent to the end of the reporting period on 1 April 2018 (Notes 27 and 37).

On 1 February 2018, MeDirect Malta announced that the boards of directors of MeDirect Malta and Charts have each voted to merge Charts into MeDirect Malta, subject to receipt of all applicable regulatory approvals and completion of all legal requirements. On 1 April 2018 the shares held by MDB Group Limited in Charts were transferred to MeDirect Malta. With effect from 1 April 2018, the merger between MeDirect Malta and Charts became effective for accounting purposes. Thus all the transactions of Charts have been treated as being those of MeDirect Malta with effect from 1 April 2018.

10. Property and equipment

Group	Improvements to premises €000	Computer equipment €000	Other equipment €000	Fixtures and fittings €000	Motor vehicles €000	Total €000
As at 1 April 2016						
Cost	1,133	2,973	331	1,559	279	6,275
Accumulated depreciation	(1,018)	(2,575)	(325)	(1,141)	(264)	(5,323)
Net book amount	115	398	6	418	15	952
Year ended 31 March 2017						
At beginning of year	115	398	6	418	15	952
Additions	-	7	-	-	-	7
Depreciation for the year	(35)	(361)	(3)	(140)	(10)	(549)
At end of year	80	44	3	278	5	410
As at 31 March 2017						
Cost	1,133	2,980	331	1,559	279	6,282
Accumulated depreciation	(1,053)	(2,936)	(328)	(1,281)	(274)	(5,872)
Net book amount	80	44	3	278	5	410
Year ended 31 March 2018						
At beginning of year	80	44	3	278	5	410
Additions	398	111	142	394	-	1,045
Disposals	(1,006)	(2,833)	(317)	(796)	(137)	(5,089)
Depreciation for the year	(35)	(35)	(6)	(105)	(5)	(186)
Depreciation released on disposals	989	2,819	314	784	137	5,043
At end of year	**426**	**106**	**136**	**555**	**-**	**1,223**
As at 31 March 2018						
Cost	525	258	156	1,157	142	2,238
Accumulated depreciation	(99)	(152)	(20)	(602)	(142)	(1,015)
Net book amount	**426**	**106**	**136**	**555**	**-**	**1,223**

The Group operates from seven immovable properties which are held under operating lease agreements (see Note 30) as at 31 March 2018 (2017: nine).

There were no capitalised borrowing costs related to the acquisition of property and equipment during the period (2017: nil).

There was no property and equipment not put in use as at the reporting date.

11. Intangible assets

Group	Goodwill €000	Computer software €000	Customer list €000	Total €000
As at 1 April 2016				
Cost	461	6,194	474	7,129
Accumulated amortisation	-	(6,167)	(285)	(6,452)
Net book amount	461	27	189	677
Year ended 31 March 2017				
At beginning of year	461	27	189	677
Amortisation for the year	-	(23)	(47)	(70)
At end of year	461	4	142	607
As at 31 March 2017				
Cost	461	6,194	474	7,129
Accumulated amortisation	-	(6,190)	(332)	(6,522)
Net book amount	461	4	142	607
Year ended 31 March 2018				
At beginning of year	461	4	142	607
Additions	-	2,559	-	2,559
Disposals	-	(301)	-	(301)
Amortisation for the year	-	(82)	(47)	(129)
Amortisation released on disposals	-	315	-	315
At end of year	**461**	**2,495**	**95**	**3,051**
As at 31 March 2018				
Cost	461	8,452	474	9,387
Accumulated amortisation	-	(5,957)	(379)	(6,336)
Net book amount	**461**	**2,495**	**95**	**3,051**

Capitalised staff costs included with “Additions” in the table above amount to €1.7 million (2017: nil). Amortisation of amounts capitalised of €1.5 million had not yet commenced by the end of the reporting period.

There were no capitalised borrowing costs related to the acquisition of software during the year (2017: nil).

Impairment assessment on goodwill arising on the acquisition of Charts

The recoverable amount of the investment in Charts was based on its value in use and was determined by discounting the future cash flows to be generated from its continuing operations taking into account synergies as well as the improved client platform being developed. The recoverable amount of the investment was determined to be higher than the carrying amount (consisting of the net assets and goodwill). As a result, no impairment was deemed necessary.

11. **Intangible assets** - continued

Key assumptions used in discounted cash flow projection calculations

Disclosure of the key assumptions used in the calculation of recoverable amounts was not deemed necessary taking cognisance of the carrying amount of goodwill in this respect. There were no changes in the underlying assumptions during the year.

12. **Non-current assets classified as held for sale**

As at 31 March 2018, the fair value of assets acquired in satisfaction of debt amounted to €1.8 million (2017: €1.8 million).

Repossessed properties are made available for sale in an orderly fashion, with the proceeds used to reduce or repay the outstanding indebtedness. The 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.

13. **Deferred tax assets and liabilities**

Deferred tax assets and liabilities are attributable to the following:

	Group		**Company**	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Assets				
Property and equipment	**15**	7	**-**	-
Available-for-sale securities and derivative financial instruments	**944**	141	**-**	-
Unutilised tax losses	**3,076**	4,141	**-**	-
Unutilised notional interest deduction	**5,712**	-	**2,867**	-
Impairment allowances	**9,223**	4,109	**-**	-
Net deferred tax assets	**18,970**	8,398	**2,867**	-

The Group's deferred tax asset presented within the statement of financial position on a gross basis amounted to €19 million (2017: €8.4 million) whereas that of the Company amounted to €2.9 million (2017: nil).

Notional interest deduction rules have recently been introduced for Maltese corporate income tax purposes and apply to the Group with effect from the financial year ended 31 March 2017. Under these amended tax rules Maltese entities may claim a deduction of notional interest computed by reference to risk capital and a benchmark interest rate.

Excess notional interest deduction which cannot be utilised against chargeable income for the respective financial year can be carried forward and added to the notional interest deduction for the following financial year. Unutilised notional interest deduction does not have an expiry date. A deferred tax asset is recognised in respect of unutilised notional interest deduction only to the extent that it is probable that sufficient future taxable profits will be available against which the unutilised deduction can be used.

13. **Deferred tax assets and liabilities** - continued

The recognised deferred tax assets are expected to be recovered or settled principally after more than 12 months from the end of the reporting period, with the exception of the deferred tax asset attributable to unutilised notional interest deduction which is expected to be recovered within 12 months from the reporting date. Unutilised tax losses have no expiry date and can be carried forward indefinitely.

Movements in deferred tax during the year:

		Recognised in profit or loss		Recognised in other comprehensive income		
Group	**Balance at beginning of year €000**	**Impact of change in effective tax rate €000**	**Current year credit/ (charge) €000**	**Impact of change in effective tax rate €000**	**Current year charge/ (credit) €000**	**Balance at end of year €000**
Year ended 31 March 2018						
Property and equipment	7	25	(17)	-	-	15
Available-for-sale securities and derivative financial instruments	141	-	(44)	1,255	(408)	944
Unutilised tax losses	4,141	-	(1,065)	-	-	3,076
Unutilised notional interest deduction	-	-	5,712	-	-	5,712
Impairment allowances	4,109	4,508	606	-	-	9,223
	8,398	**4,533**	**5,192**	**1,255**	**(408)**	**18,970**

Group	**Balance at beginning of year €000**	**Recognised in profit or loss €000**	**Recognised in other comprehensive Income €000**	**Balance at end of year €000**
Year ended 31 March 2017				
Property and equipment	(6)	13	-	7
Available-for-sale securities and derivative financial instruments	594	-	(453)	141
Unutilised tax losses	4,163	(22)	-	4,141
Impairment allowances	4,847	(738)	-	4,109
	9,598	(747)	(453)	8,398

Company	**Balance at beginning of year €000**	**Recognised in profit or loss €000**	**Balance at end of year €000**
Year ended 31 March 2018			
Unutilised notional interest deduction	**-**	**2,867**	**2,867**

In view of the application of notional interest deduction rules, the Group's effective rate has been modified from 5% to 35%. This has impacted the balance of deferred tax assets recognised as reflected in the tables above.

14. Prepayments and accrued income

	Group	
	2018	2017
	€000	€000
Prepayments	**2,296**	2,319
Accrued income	**15,982**	16,830
	18,278	19,149

15. Other assets

	Group		Company	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Amounts receivable from:				
- immediate parent company	**-**	216	**-**	-
- ultimate parent company	**2,296**	2,205	**2,020**	1,965
- subsidiary company	**-**	-	**950**	-
- other related companies	**13,846**	15,107	**-**	5
Dividend related refund	**1,678**	12,790	**1,578**	7,282
Deferred customer contract costs	**1,075**	-	**-**	-
Other assets	**517**	1,364	**6**	-
	19,412	31,682	**4,554**	9,252

Amounts receivable from immediate parent company and subsidiary company are unsecured, interest free and repayable on demand.

Amounts receivable from ultimate parent company amounting to €1.8 million as at 31 March 2018 (2017: €1.8 million) are unsecured, subject to interest at 3% per annum and repayable in November 2018. The residual amounts are unsecured and repayable on demand. In May 2018 this amount receivable from ultimate parent company was assigned to the subsidiary MeDirect Malta in the form of a shareholder contribution.

Amounts receivable from other related companies are unsecured, interest free and repayable on demand. However, the repayment of these balances amounting to €13.8 million (2017: €15.1 million) is not expected within the next twelve months.

No impairment indicators existed in respect of these assets at 31 March 2018 and 2017.

16. Capital and reserves

Share capital

	2018 No.	2017 No.
Authorised:		
Ordinary ‘A’ shares of €1 each	**99,999,999**	99,999,999
Ordinary ‘B’ shares of €1 each	**1**	1
	100,000,000	100,000,000
Issued and fully paid up:		
Ordinary ‘A’ shares of €1 each	**56,406,546**	56,406,546
Ordinary ‘B’ shares of €1 each	**1**	1
	56,406,547	56,406,547

Issued share capital is stated net of share issue expenses amounting to €0.7 million.

Rights and entitlements attached to ordinary shares

The holders of the Ordinary ‘A’ shares shall be entitled to receive dividends as declared from time to time and are entitled to one vote per share in general meetings of the Company. Ordinary ‘B’ shareholders are not entitled to vote and do not carry any dividend entitlement. The holders of the Ordinary ‘A’ shares and the holders of the Ordinary ‘B’ shares shall be equally entitled to receive notice of general meetings of the Company.

Share premium

Share premium as at the reporting date represents the issue of shares in prior periods as follows:

Issue date	Number of shares	Premium per share €	Share premium 2018 €000	Share premium 2017 €000
5 August 2009	39,520,969	0.3407	**13,464**	13,464
31 March 2010	1,214,991	0.2400	**292**	292
			13,756	13,756

Shareholders’ contribution

By virtue of board resolutions dated 20 September 2017, 27 September 2017, 1 November 2017 and 7 November 2017 MDB Group Limited accepted capital contributions from its shareholder, Medifin Finance Limited, amounting to €6.0 million, €5.0 million, €12.0 million and €54.6 million respectively.

16. **Capital and reserves** - continued

Shareholders' contribution - continued

The terms and conditions of the contributions granted render these instruments equity in nature in accordance with the requirements of IAS 32: Financial Instruments - Presentation:

- The Company has no obligation to bear any servicing cost or transfer any economic benefits of any kind to the Contributor or any other person in return; and

- The Company has no obligation to repay the contributions.

The contributions are also eligible as own funds in terms of the Capital Requirements Regulation.

Reserve for general banking risks

Banking Rule ("BR") 09 - Measures addressing credit risk arising from the assessment of the quality of asset portfolios of credit institutions authorised under the Maltese Banking Act (Cap. 371), 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 retained earnings. As at 31 March 2018, the reserve for general banking risks of the Group was equivalent to €1.7 million (2017: €1.7 million). This reserve, which is distributable subject to the formal consent of the Banking Regulator, represents 100% of the regulatory allocation by virtue of paragraph 38 of the Banking Rule.

Other reserves:

Fair value reserve

The fair value reserve of the Group amounting to negative €1.9 million (2017: negative €3.8 million) is attributable to the to the cumulative net change in the fair value of available-for-sale investments, excluding impairment losses, until the investment is derecognised, net of deferred taxation.

Adjustment on acquisition of non-controlling interest in subsidiary

On 6 May 2015, the Group entered into an agreement to acquire the remaining 35% shareholding of Charts Investment Management Service Ltd for a cash consideration of €1.7 million, of which €0.2 million was contingent upon the achievement of certain predefined targets. The contingent consideration has been deemed to have materialised in 2018 and was paid in May 2018. The subsidiary is principally engaged in providing stockbroking and corporate finance services and other authorised investment services under a Category 3 licence.

As a result of the acquisition of the non-controlling interest, during the financial year ended 31 March 2016, the carrying amount of the non-controlling interest of €0.4 million has been derecognised. The difference between proceeds and the carrying amount of the non-controlling interest has been reflected as an adjustment to equity.

All reserves at the reporting date, except for the Company's retained earnings and shareholders' contribution, are non-distributable.

17. Amounts owed to financial institutions

	Group	
	2018	2017
	€000	€000
Repayable on call and at short notice	**21,428**	19,183
Term deposits	**105,000**	340,000
	126,428	359,183

An amount of €105 million (2017: €340 million) from the Group's term deposits are secured by a pledge over MeDirect Malta's investments (refer to Note 8).

18. Amounts owed to customers

	Group	
	2018	2017
	€000	€000
Repayable on call and at short notice	**477,735**	482,916
Term deposits	**1,501,424**	1,418,596
	1,979,159	1,901,512

19. Subordinated liabilities

	Group	
	2018	2017
	€000	€000
Year ended 31 March		
At beginning of year	**46,993**	47,380
Debt securities issued	**20,000**	-
Foreign exchange differences	**(106)**	(481)
Transaction costs incurred	**(87)**	-
Transaction costs amortised to profit or loss	**99**	94
Other movements	**50**	-
At end of year	**66,949**	46,993
Analysed as follows:		
7.5% Subordinated Bonds 2019	**22,276**	22,291
6% Subordinated Unsecured Bonds 2019 - 2024	**24,745**	24,702
5% Subordinated Unsecured Bonds 2022 - 2027	**19,928**	-
	66,949	46,993

19. Subordinated liabilities - continued

During June 2013, MeDirect Malta issued an additional euro equivalent of €10 million of 7.50% Subordinated Bonds due to mature in December 2019. The debt securities are unsecured, mature on 30 December 2019 and are listed on the Malta Stock Exchange. Interest payable on these bonds is fixed at 7.5% per annum (effective interest rate of 7.6%) and the bonds are redeemable at their nominal value. During December 2013 these subordinated bonds were merged with the euro equivalent of €12.5 million bonds that were originally issued on 21 November 2012.

On 3 November 2014, MeDirect Malta announced the issue of €15 million 6% Subordinated Unsecured Bonds maturing on 28 November 2024 with a November 2019 early redemption option held by the issuer. These bonds were issued in euro and pound sterling. The interest payable is fixed at 6% (effective interest rate 6.23%) and the bonds are redeemable at their nominal value. This was increased to a euro equivalent of €25 million as a result of an over subscription. As a result of MeDirect Malta's allotment methodology, MeDirect Malta issued £1.4 million (equivalent to €1.7 million) for bonds in pound sterling and euro bonds amounting to €23.3 million. Interest on these bonds commenced on 28 November 2014.

On 16 October 2017, MeDirect Malta announced the basis of acceptance for the issue of Euro equivalent of €20 million 5% Subordinated Unsecured Bonds 2027 ("the Bonds"). In terms of the Prospectus, the Bonds were available for subscription in the Intermediaries' Offer which was held on 13 October 2017. Amounts subscribed for by Authorised Financial Intermediaries amounted to £1.2 million (equivalent to €1.3 million) and €18.7 million for the GBP Bonds and EUR Bonds respectively. Interest on the Bonds commenced on 13 October 2017. The Bonds were admitted to listing on the Official List of the Malta Stock Exchange on 20 October 2017 and are redeemable in 2027 with a 2022 early redemption option held by the issuer.

The above liabilities will, in the event of the winding up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer. The Bank has not had any defaults of interest or other breaches with respect to its subordinated debt securities during the years ended 31 March 2018 and 31 March 2017. As at 31 March 2018, the euro equivalent contractual amount due at maturity is €67.2 million (2017: €47.2 million). The carrying amount of the subordinated debt securities in issue is €0.2 million (2017: €0.2 million) lower than the contractual amount due at maturity.

20. Accruals and deferred income

	Group		Company	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Accrued interest expense	**5,770**	6,202	**-**	-
Other accrued expenses	**7,132**	5,876	**10**	15
Deferred income	**21,511**	18,421	**-**	-
	34,413	30,499	**10**	15

21. Other liabilities

	Group		Company	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Amounts due to immediate parent company	**2,729**	2,292	**-**	-
Amounts due to group company	**-**	-	**394**	8,687
Amounts due to related parties	**-**	3	**-**	6
Indirect taxes payable	**1,079**	891	**16**	14
Other liabilities	**8,706**	2,852	**207**	1
	12,514	6,038	**617**	8,708

Amounts due to immediate parent company, group company and related parties are unsecured, interest free and repayable on demand.

22. Net interest income

	Group		Company	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Interest income				
Loans and advances to financial institutions	**(273)**	(188)	**-**	-
Loans and advances to customers	**93,701**	91,331	**-**	-
Amounts owed by ultimate parent company	**55**	55	**55**	55
Investment securities	**(2,589)**	(1,276)	**-**	-
Total interest income	**90,894**	89,922	**55**	55
Interest expense				
Amounts owed to financial institutions	**1,791**	1,349	**-**	-
Amounts owed to customers	**22,386**	27,686	**-**	-
Subordinated liabilities	**3,725**	3,264	**-**	-
Total interest expense	**27,902**	32,299	**-**	-
Net interest income	**62,992**	57,623	**55**	55

An amount of €2.9 million (2017: €2.6 million) relating to impaired financial assets is included within interest income from loans and advances to customers for the year ended 31 March 2018.

Fair value losses of €2.3 million (2017: €0.9 million) arising on derivatives designated in fair value hedge relationships and €1.9 million (2017: €0.4 million) representing net increases in the fair value of the hedged items attributable to the hedged risk are included within the Group's interest income. These hedging relationships comprise interest rate swaps hedging interest rate risk on fixed rate available-for-sale debt securities. The gains and losses are reflected within interest income arising from investment securities, where interest income on the hedged item is presented.

22. Net interest income - continued

	Group	
	2018	2017
	€000	€000
Losses on hedging instruments	**(2,256)**	(941)
Gains on hedged items attributable to the hedged risk	**1,917**	444
Net losses representing ineffective portion of fair value hedges	**(339)**	(497)

23. Net fee and commission income

	Group	
	2018	2017
	€000	€000
Fee and commission income		
Corporate secured lending fee income	**141**	711
Banking transactions fee income	**2,271**	1,548
Investment services fees	**4,265**	3,259
Total fee and commission income	**6,677**	5,518
Fee and commission expense		
Corporate secured lending fee expense	**244**	282
Banking transactions fee expense	**225**	276
Investment services transaction and custody fees	**1,011**	1,041
Other fee expense	**85**	65
Total fee and commission expense	**1,565**	1,664
Net fee and commission income	**5,112**	3,854

The Group's net fee and commission income excludes income and expenses that form an integral part of the effective interest rates on financial assets and financial liabilities that are not at fair value through profit or loss, but includes income of €0.1 million (2017: €0.7 million) and expenses of €0.2 million (2017: €0.3 million) relating to such financial assets and liabilities.

24. Net trading income and other operating income

24.1 Net trading income

	Group	
	2018	2017
	€000	€000
Net income from foreign exchange activities	**4,002**	2,008
Net (expense)/income from held for trading financial instruments	**(74)**	170
	3,928	2,178

24.2 Realised gains on disposal of other investments

	Group	
	2018	2017
	€000	€000
Available-for-sale investments	**43**	800

24.3 Other income

	Group		Company	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Dividend received from subsidiaries	**-**	-	**12,801**	-
Others	**197**	17	**1,543**	-
	197	17	**14,344**	-

25. Personnel expenses

Personnel expenses incurred, including directors' remuneration and emoluments are analysed as follows:

	Group	
	2018	2017
	€000	€000
Directors' emoluments		
- salaries	**3,080**	2,894
- defined contribution social security costs	**119**	118
- fees	**457**	344
- other emoluments	**27**	50
Staff costs		
- salaries	**14,951**	12,273
- defined contribution social security costs	**1,073**	1,198
- other emoluments	**67**	549
Staff costs capitalised within Intangible assets	**(1,738)**	-
	18,036	17,426

As per above, salary costs amounted to €18.0 million (2017: €15.2 million), with variable remuneration accounting for 14% (2017: 14%) of these amounts.

25. Personnel expenses - continued

The weekly average number of persons employed during the year, including executive directors, was as follows:

	Group	
	2018	2017
	No.	No.
Executive and senior management	**16**	19
Other managerial, supervisory and clerical	**273**	232
Other	**14**	16
	303	267

The number of persons employed as at the reporting date, including executive directors, was as follows:

	Group	
	2018	2017
	No.	No.
Management and administration	**318**	283

26. Other administrative expenses

Other administrative expenses are analysed as follows:

	Group		Company	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Operating lease charges (Note 30)	**6,385**	5,511	**-**	-
IT support and telecommunication costs	**4,395**	3,562	**-**	-
Legal and professional fees	**5,144**	3,471	**8**	9
Regulatory expenses	**3,361**	3,314	**1**	1
Indirect taxation	**3,677**	2,247	**4**	-
Other expenses	**7,144**	7,196	**4**	-
	30,106	25,301	**17**	10

Included in other administrative expenses are fees charged by the Group's independent auditors for the year as follows:

	Group		Company	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Audit services	**435**	222	**5**	5
Other assurance services	**36**	56	**-**	-
Tax advisory services	**64**	35	**1**	1
Other non-audit services	**382**	351	**-**	-

26. Other administrative expenses - continued

Other assurance services comprise mainly reviews of interim financial information and assurance reports in respect of increases in CET 1 capital. Other non-audit services consist of regulatory advisory services in respect of the Group's compliance with elements of the regulatory framework it is exposed to and in respect of submissions to the regulatory authorities. These non-audit services have no linkage whatsoever to audited financial statements.

27. Net impairment charges

	Group		Company	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Write-downs				
Loans and advances to customers				
- specific impairment allowances (Note 7)	**7,160**	6,489	**-**	-
- collective impairment allowances (Note 7)	**5,641**	5,134	**-**	-
- bad debts written off (Note 7)	**6,827**	671	**-**	-
Investment in subsidiary (Note 9)	**-**	-	**2,649**	-
Reversal of write-downs				
Loans and advances to customers				
- specific impairment allowances (Note 7)	**(6,192)**	(2,248)	**-**	-
- collective impairment allowances (Note 7)	**(5,134)**	(4,439)	**-**	-
Net impairment charges	**8,302**	5,607	**2,649**	-

28. Taxation

	Group		Company	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Current tax (income)/expense				
- current year tax charge/(credit)	**1,167**	1,099	**1,851**	22
- overprovision of tax in preceding financial year attributable to application of notional interest deduction	**(207)**	-	**-**	-
Deferred tax (income)/expense (Note 13)				
- current year tax (credit)/charge	**(5,192)**	747	**(2,866)**	-
- impact of change in effective tax rate	**(4,533)**	-	**-**	-
Income tax (credit)/expense	**(8,765)**	1,846	**(1,015)**	22

28. Taxation - continued

The tax recognised in profit or loss on the Group's and the Company's profit before tax differs from the theoretical amount that would arise using the applicable tax rate in Malta, which is the Company's country of incorporation, as follows:

	Group		Company	
	2018	2017	**2018**	2017
	€000	€000	**€000**	€000
Profit before tax	**14,613**	19,113	**11,732**	45
Tax at the applicable rate of 35%	**5,114**	6,690	**4,106**	16
Tax effect of:				
Non-deductible expenses	**36**	27	**6**	6
Impairment of subsidiary	**-**	-	**927**	-
Losses on sale of loans by subsidiary reversed on consolidation	**-**	(2,525)	**-**	-
Application of lower effective tax rate and tax refund	**(225)**	(1,736)	**(3,169)**	-
Impact of changes in Group's effective tax rate on deferred tax assets (Note 13)	**(4,533)**	-	**-**	-
Impact of new notional interest deduction rules attributable to MeDirect Malta (Note 13)	**(10,509)**	-	**(2,886)**	-
Notional interest deduction attributable to Belgium	**-**	(507)	**-**	-
Impact on deferred tax of changes in tax rates in Belgium	**1,353**	-	**-**	-
Others	**(1)**	(103)	**1**	-
Income tax (credit)/expense	**(8,765)**	1,846	**(1,015)**	22

29. Cash and cash equivalents

Balances of cash and cash equivalents as shown in the statements of cash flows are analysed below:

	Group	
	2018	2017
	€000	€000
Analysis of cash and cash equivalents:		
Cash in hand	**196**	299
Call deposits	**82,132**	89,306
Target 2 overnight deposits	**88,545**	51,771
Amounts owed to financial institutions with original maturity of less than 3 months	**(21,428)**	(39,183)
Per Statement of cash flows	**149,445**	102,193
Adjustments to reflect:		
Balance with Central Banks	**15,300**	193,376
Deposits with original maturity of over 3 months	**31,220**	17,388
Amounts owed to financial institutions with with original maturity of over 3 months	**(105,000)**	(320,000)
Per Statement of financial position	**90,965**	(7,043)

29. Cash and cash equivalents - continued

		Group	
		2018	2017
	Notes	**€000**	€000
Analysed as follows:			
Balances with Central Banks and cash	4	**103,739**	245,195
Loans and advances to financial institutions	6	**113,654**	106,945
Amounts owed to financial institutions	17	**(126,428)**	(359,183)
		90,965	(7,043)

	Company	
	2018	2017
	€000	€000
Analysis of cash and cash equivalents:		
Repayable on call and at short notice	**31**	50
Per Statement of cash flows	**31**	50

30. Capital and lease commitments

Capital commitments

Capital commitments of the Group as at 31 March 2017 amounted to €0.4 million and mainly related to the improvement of leased premises.

Operating leases

The Group leases a number of branches and office premises under operating leases. The leases typically run for 4 to 5 years, with an option to renew the lease after that date. Some operating lease agreements provide for additional rent payments that are based on changes in a local price index.

During the year, the Group leased IT infrastructure and software from Medifin Leasing Limited, a related party.

As at the end of the reporting year, future minimum lease payments under non-cancellable operating leases are payable as follows:

	Group	
	2018	2017
	€000	€000
Within one year	**1,434**	1,034
After one year but less than five years	**5,225**	5,142
More than 5 years	**817**	-
	7,476	6,176

The amount of operating lease expense recognised in profit or loss for the year is disclosed in Note 26.

31. Contingent liabilities

The tax authorities in Belgium are currently reviewing the transfer of tax losses from the former Belgian branch of MeDirect Malta to MeDirect Belgium amounting to €12.3 million and will likely challenge the transfer of these losses. As at 31 March 2018 the Group has a deferred tax asset of €3.1 million in relation to the unutilised tax losses of MeDirect Belgium. On the basis of specialist advice obtained from a number of independent tax advisors in Belgium, the Group is confident that this transfer of tax losses was justified and believe that no adjustment to the deferred tax asset is deemed necessary at the end of the reporting year as it is of the opinion that the position of the Group will be ultimately upheld.

As at 31 March 2018, the Group had cash secured guarantee obligations amounting to €5.2 million (2017: €7.9 million).

32. Commitments to lend

Commitments to lend represent undrawn formal standby facilities, credit facilities and other similar commitments to lend. As at 31 March 2018, undrawn facilities on term loans amounted to €74.7 million (2017: €49.5 million). In addition, the Group had commitments of €361.8 million (2017: €288.3 million) under revolving credit facilities.

As at 31 March 2018, Charts had entered into a placement agreement whereby it had undertaken to subscribe for and purchase an amount of €12 million out of a bond issue by an unrelated party of which €6.4 million were placed prior to the end of the reporting period. After the end of the reporting period, these bonds amounting to €12 million were eventually issued in the name of the underlying customers of Charts.

As at 31 March 2017, Charts had entered into a placement agreement whereby it had undertaken to subscribe for and purchase an amount of €17.5 million out of a bond issue by an unrelated party. In April 2017, these bonds were eventually issued in the name of the underlying customers of Charts.

The above commitments exclude commitments in relation to capital expenditure and operating leases which are disclosed in Note 30.

33. Related parties

Immediate and ultimate parent company

The ultimate controlling party of the Company is AnaCap Financial Partners II L.P.

The ultimate parent company of the Company is Medifin Investments Limited, which is a company incorporated and registered in Guernsey.

The immediate parent company of the Company is Medifin Finance Limited, which is a company incorporated and registered in Guernsey.

Related parties of the Group and the Company include subsidiaries, the ultimate controlling party, the ultimate parent company, all entities controlled by the ultimate parent company, Key Management Personnel, close family members of Key Management Personnel and entities which are controlled or jointly controlled by Key Management Personnel or their close family members.

33. **Related parties** - continued

Transactions with Key Management Personnel

Key Management Personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the Group, being the directors of the respective MDB Group companies.

Key Management Personnel compensation consisting of directors' remuneration is disclosed in Note 25. The Group also provides non-cash benefits to its Key Management Personnel, relating to gross rent payable on accommodation based in Malta and health and life insurance premiums paid by the Group amounting €0.1 million (2017: €0.1 million).

Related party balances and transactions

During the course of its activities, the Group conducted business on commercial terms with various related parties, comprising subsidiaries, the ultimate controlling party and entities controlled by the ultimate controlling party.

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

31 March 2018

Related party	Income from related parties	Expenses charged by related parties	Amounts owed by related parties	Amounts owed to related parties	Transaction/ balance type
	€000	€000	€000	€000	
Ultimate controlling party					
	-	178	-	-	Monitoring fees
Ultimate parent company					
	-	-	2,296	-	Other assets
	55	-	-	-	Interest income
Immediate parent company					
	-	-	-	2,729	Other liabilities
Other group companies					
	-	-	13,846	-	Other assets
	-	5,047	-	-	IT support
	-	5,113	-	-	Operating lease charge
	5	-	-	-	Other income
Key management personnel					
	-	-	125	-	Loans and advances to customers
	-	-	-	255	Amounts owed to customers

33. **Related parties** - continued

Related party balances and transactions - continued

31 March 2017

Related party	Income from related parties	Expenses charged by related parties	Amounts owed by related parties	Amounts owed to related parties	Transaction/ balance type
	€000	€000	€000	€000	
Ultimate controlling party					
	-	178	-	-	Monitoring fees
Ultimate parent company					
	-	-	2,205	-	Other assets
	55	-	-	-	Interest income
Immediate parent company					
	-	-	216	-	Other assets
	-	-	-	2,292	Other liabilities
Other group companies					
	-	-	15,107	-	Other assets
	-	-	-	3	Other liabilities
	-	4,077	-	-	IT support
	-	4,593	-	-	Operating lease charge
	5	-	-	-	Other income
Key management personnel					
	-	-	-	51	Amounts owed to customers
	-	1	-	-	Interest expense
Other companies controlled by key management personnel					
	-	-	-	1	Amounts owed to customers

The directors' fees and personnel expenses in relation to key management personnel are disclosed in note 25 to these financial statements.

Furthermore, as detailed in Note 16:

- By virtue of board resolutions dated 20 September 2017, 27 September 2017, 1 November 2017 and 7 November 2017 MDB Group Limited accepted capital contributions from its immediate parent company, Medifin Finance Limited, amounting to €6.0 million, €5.0 million, €12.0 million and €54.6 million respectively.
- At an extraordinary general meeting held on 23 March 2018, the MeDirect Bank Malta approved an interim dividend to MDB Group Limited of €10 million. Moreover, Charts distributed €0.95 million to the Company as a final dividend which was executed on 29 March 2018.

The related party transactions of the Company consist of interest income on amounts owed by the ultimate parent company amounting to €55 thousand (2017: €55 thousand).

34. Investor compensation scheme

In accordance with the provisions of the Investor Compensation Scheme Regulations, 2003, issued under the Maltese Investment Services Act (Cap. 370), 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. Throughout the current financial year, MeDirect Malta was not required to pay any variable contribution to the Scheme.

35. Trust and custody activities

The Group provides trust and custody services to individuals, trusts, and other institutions, whereby it holds and manages assets or invests funds received in various financial instruments at the direction of the customer. The Group receives fee income for providing these services. Trust assets and assets held in custody are not assets of the Group and are not recognised in the statements of financial position. The Group is not exposed to any credit risk relating to such placements, as it does not guarantee these investments.

As at 31 March 2018, the total assets held by the Group on behalf of customers amounted to €838.2 million (2017: €625.4 million).

36. Merger of MeDirect Malta's subsidiary into MeDirect Malta

On 21 November 2016, MeDirect Malta announced that the boards of directors of MeDirect Malta and MedCorp have each voted to merge MedCorp into MeDirect Malta, subject to receipt of all applicable regulatory approvals and completion of all legal requirements. With effect from 1 April 2017, the merger between MeDirect Malta and MedCorp became effective for accounting purposes. Thus all the transactions of MedCorp have been treated as being those of MeDirect Malta with effect from 1 April 2017.

37. Events after the reporting date

<u>Transfer of shareholding in Charts to MeDirect Malta and subsequent merger of Charts into MeDirect Malta</u>

On 1 February 2018, MeDirect Malta announced that the boards of directors of MeDirect Malta and Charts, a subsidiary of MDB Group Limited, have each voted to merge Charts into MeDirect Malta, subject to receipt of all applicable regulatory approvals and completion of all legal requirements. On 1 April 2018 the shares held by MDB Group Limited in Charts were transferred to MeDirect Malta for a consideration of €0.7 million. With effect from 1 April 2018, the merger between MeDirect Malta and Charts became effective for accounting purposes. Thus all the transactions of Charts have been treated as being those of MeDirect Malta with effect from 1 April 2018.

37. Events after the reporting date - continued

The assets and liabilities that will be reflected by MeDirect Malta as a result of the merger are as follows:

	As at 1 April 2018 €000	As at 1 April 2017 €000
Property and equipment	**-**	7
Investments	**-**	281
Deferred tax assets	**-**	8
Trade and other receivables	**220**	280
Current tax assets	**132**	31
Cash and cash equivalents	**1,565**	1,012
Trade and other payables	**(1,093)**	(67)

The following tables provide an overview of Charts' financial performance and cash flows for the financial years ended 31 March 2018 and 2017.

	Year ended 31 March	
	2018 €000	2017 €000
Revenue	**895**	1,125
Direct costs	**(7)**	(8)
Gross contribution	**888**	1,117
Administrative expenses	**(552)**	(533)
Operating income	**336**	584
Investment income	**16**	6
Gain on sale of available-for-sale financial assets	**74**	-
Profit before tax	**426**	590
Tax expense	**(121)**	(203)
Profit for the year	**305**	387
Other comprehensive income		
Items that may be subsequently reclassified to profit or loss		
Fair valuation of available-for-sale financial assets:		
- Net changes in fair value arising during the year, before tax	**(9)**	29
- Net amount reclassified to profit or loss, before tax	**(74)**	-
Total comprehensive income for the year	**222**	416

37. Events after the reporting date - continued

	Year ended 31 March	
	2018 **€000**	2017 €000
Cash generated from operating activities	**479**	549
Taxation paid	**(214)**	(390)
Net cash generated from operating activities	**265**	159
Cash flows from investing activities	**288**	6
Net movement in cash and cash equivalents	**553**	165
Cash and cash equivalents at beginning of year	**1,012**	847
Cash and cash equivalents at end of year	**1,565**	1,012

Dividends paid

By virtue of a shareholders' resolution dated 30 May 2018, the Company approved and paid an interim dividend of €7.23 million.

Shareholder contributions effected

By virtue of a board resolution dated 30 May 2018, the Company provided capital contributions to its direct subsidiary company, MeDirect Malta, amounting to €3.1 million.

There were no other events after the reporting date that would have a material effect on the financial statements.

38. Statutory information

MDB Group Limited is a limited liability company and is incorporated in Malta.

The ultimate controlling party of MDB Group Limited is AnaCap Financial Partners II L.P., the registered office of which is Carinthia House, 9 - 12 The Grange, St Peter Port, GY1 4BF, Guernsey.

The ultimate parent company of MDB Group Limited is Medifin Investments Limited, a company incorporated and registered in Guernsey, with its registered address being 1st and 2nd Floors, Elizabeth House, Les Ruettes Brayes, St Peter Port, GY 11EW.

The immediate parent company of MDB Group Limited is Medifin Finance Limited, which is incorporated and registered in Guernsey, with the registered address which is 1st and 2nd Floors, Elizabeth House, Les Ruettes Brayes, St Peter Port, GY 11EW.

MDB Group Limited
(formerly MeDirect Group Limited)

Additional Regulatory
Disclosures
31 March 2018

Contents

1 Introduction

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

These Additional Regulatory Disclosures (the “Disclosures”) have been prepared in accordance with the requirements of EU Regulation 575/2013 (Capital Requirements Regulation – “CRR”) and the Malta Financial Services Authority (“MFSA”) Banking Rule (“BR”) 07, “Publication of Annual Report and Audited Financial Statements of Credit Institutions Authorised under the Maltese Banking Act (Cap. 371)”. During this financial year, the EBA released guidelines on disclosure requirements which aim to improve the comparability and consistency of Pillar 3 disclosures across the banking industry. These guidelines provide detailed disclosure requirements for credit risk, counterparty credit risk, market risk and capital requirements.

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

These disclosures are in respect of MDB Group Limited (the “Regulatory Parent” or “MDB Holding”), formerly MeDirect Group Limited, and its subsidiaries, together referred to as the “Group”, which is supervised on a fully consolidated basis by the European Central Bank (“ECB”). The subsidiaries forming part of the Group include MeDirect Bank (Malta) plc (“MeDirect Malta”), formerly Mediterranean Bank p.l.c., that is the parent company of MeDirect Bank SA (“MeDirect Belgium”), together with Charts Investment Management Service Limited (“Charts”), a stockbroking firm authorised to carry out investment services under a Category 3 licence. MeDirect Belgium carries out all of the Group’s activities in Belgium.

MDB Holding’s subsidiary, MeDirect Malta has been authorised to waive their its requirement to comply with Part Eight of the CRR on an individual basis, in terms of Article 6 (3) of the CRR. On the other hand MeDirect Belgium is exempt from full disclosure requirements laid down in Part Eight of the CRR, however being a significant subsidiary of an EU parent institution, it is subject to limited disclosure requirements in terms of Article 13 of the CRR.

These disclosures present information about the Group’s exposure to risks and the Group’s objectives, policies and processes for measuring and managing risks and the Group’s management of capital.

These risks principally relate to the MeDirect Malta Group and are managed by MeDirect Malta’s Board of Directors. As a result, these disclosures present information about the financial risk management of MeDirect Malta and its principal subsidiary MeDirect Belgium.

Disclosures are updated on an annual basis as part of the Annual Report preparation. Consistent with the banking regulations, these Disclosures are not subject to external audit except where they are included within the Financial Statements. These Disclosures have been appropriately verified internally by the Group’s management.

The disclosure requirements emanating from Articles 441, 449, 452, 454 and 455 of the CRR are not applicable to the Group.

The consolidation of the Group’s financial statements is based on the IFRS requirements, whereas the prudential consolidation in the statement of capital is based on the CRR 575/2013. All entities within the Group are subject to full consolidation both for accounting and regulatory purposes.

1 **Introduction** - continued

The Group is required to disclose its return on assets pursuant to paragraph 31 of BR 07, "Publication of Annual Report and Audited Financial Statements of Credit Institutions Authorised under the Maltese Banking Act (Cap. 371)". In this respect, the Group's return on assets for the financial year ended 31 March 2018 amounted to 0.9%.

2 Risk management, objectives and policies

2.1 General information on risk management, objectives and policies

Risk management is an integral part of the Group's strategic planning and management processes. In order to ensure a sustainable and viable business strategy that remains within the parameters of the Board approved risk appetite and regulatory requirements, the Group relies on a number of risk management tools and methodologies, including both forward-looking and backward-looking tools. The tools used by the Group allow identification and assessment of the risks faced by the Group while enabling it to aggregate the risks across business lines and support the identification of risk concentrations. The Group operates with a "three lines of defence" model as a core part of its approach to Enterprise Risk Management ("ERM"). Each of these three lines plays a distinct role within the Group's wider governance framework.

2.1.1 Risk management function

The responsibilities of the risk management function are to protect and enable the Group to deliver sustainable income through facilitating and monitoring the implementation of effective risk management practices and assisting risk owners in defining and controlling risk exposures.

The Group's risk management function is composed of a number of sub-functions, including credit risk, operational risk, risk analytics, regulatory risk, IT security risk, and Market risk, all reporting to the Chief Risk Officer ("CRO"). The Group's risk management function, within the second line of defence, falls under the responsibility of the CRO who is responsible for a number of sub-teams that represent different risk areas.

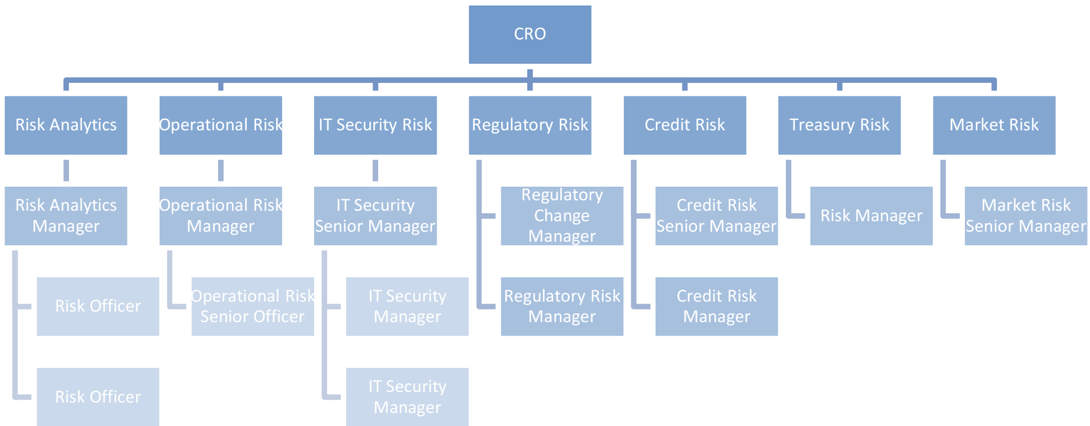

FIGURE 1: THE GROUP RISK MANAGEMENT FUNCTION

2 Risk management, objectives and policies - continued

2 .1 General information on risk management, objectives and policies - continued

2.1.1 Risk management function - continued

As at 31 March 2018, the Group's risk management function comprised fourteen full time positions under the management of the CRO. Their responsibilities were divided as follows:

- Credit risk (2 staff members) – analysis and review of credit risk and contingent liquidity risk associated with the corporate Lending portfolios.

- Operational risk (2 staff members) – responsible for the ongoing management of the Group's operational risk management framework covering six main pillars, namely: operational risk policies, operational risk awareness, risk and control self-assessments ("RCSAs"), operational risk control testing, operational risk reporting, incident management and business continuity.

- IT security (3 staff members) – development of IT security policies, procedures, systems and controls, vulnerabilities testing and coordination of security audit tests.

- Risk analytics (3 staff members) – portfolio-level risk analytics and risk reporting, stress testing, recovery planning, liquidity risk and capital management, and wealth risk oversight.

- Regulatory risk (2 staff members) – responsible for regulatory oversight and risk analysis of implementing changes to key regulation and leading risk related projects.

- Market risk (1 staff member) – managing interest rate risk ("IRR") and foreign exchange (FX) risk across the enterprise, including stress testing and associated market risk models.

- Treasury risk (1 staff member) – responsible for assessment of new treasury instrument originations as well as ongoing oversight of treasury instrument reviews alongside public rating migration and where applicable, deteriorating exposures.

In line with the EBA draft guidelines on internal governance[1] the Group's risk management function has direct access to the management body[2] and the Group risk committee, as well as oversight of all business lines and subsidiaries.

The Group's Risk management function is adequately resourced and possesses the right knowledge and experience to provide relevant independent information, analysis and expert judgement on risk exposures, as well as decision making capabilities on proposals and recommendations made by business lines and other internal units, as well as to the management body. The CRO is fully involved in the oversight of strategy and reputational risks. The CRO is a member of various Executive Committees, holding the role as Chair of the New Products and Services Committee ("NPSC"), the Regulatory Committee; and the Management Credit Committees ("MCCs"); as well as being a standing member of the Group EXCO; Strategy EXCO; and Asset & Liability Committee ("ALCO").

[1] EBA/GL/2017/11 dated 26 September 2017
[2] The terminology '"management body" is referring to the Board of Directors in both its supervisory and management functions, and is used interchangeably with the "Board of Directors" throughout the document.

2 Risk management, objectives and policies - continued

2 .1 General information on risk management, objectives and policies - continued

2.1.2 Overview of the management of key risks

The Group's statement of financial position structurally comprises a deposit-funded portfolio of internationally syndicated and domestic bilateral loans, as well as a portfolio of high-grade treasury securities that is partly repo-funded. In addition, the Group provides a range of core banking services to corporate customers and wealth management services to retail customers. The Group does not hold any instruments that meet the requirements of a material trading book as per CRR.

The Group's core business activities can be summarised as follows:
- deposit taking;
- the provision of wealth management and investment services; and
- the granting of loans to international corporates and local corporates.

In light of the Group's principal business activities, the Group is exposed to a number of risks, which it manages at different organisational levels. The Group has divided its key risks under two main categories: Financial and Non-Financial Risks, each made up of a number of risk sub-categories:

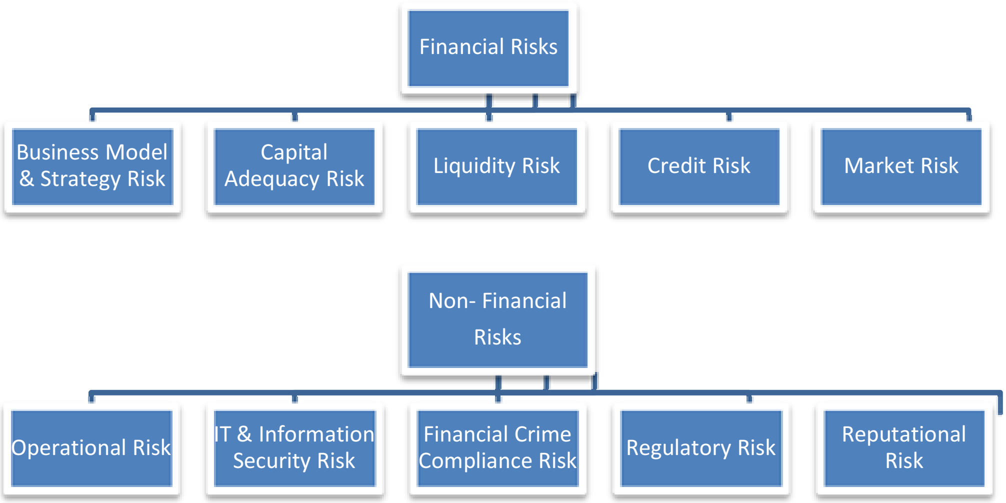

FIGURE 2: FINANCIAL AND NON-FINANCIAL RISKS

The risk management function performs a risk analysis to assess the significance and likelihood of these risks. Risks are also quantified to assess any impacts on capital and liquidity adequacy. Each risk pillar is also managed through policies, risk indicators, and internal controls testing. The Group has also established a robust and extensive risk management reporting framework, placing high importance on regular and transparent reporting mechanisms that enable the management body, its committees and relevant units to understand the key risks and to take corrective action, when required, in a timely and accurate manner. Group policies apply to each of the Group's subsidiaries, although to an extent that subsidiaries may be required to adopt local policies within their respective frameworks that are required in order to reflect the entity's risk appetite, local regulations or specific asset classes they may operate. The risk management process for the principal areas of risk are detailed in section 2.2 – Information on risk management, objectives and policies by category of risks.

2 Risk management, objectives and policies - continued

2 .1 General information on risk management, objectives and policies - continued

2.1.3 Risk appetite

The risk appetite is established by the Board of Directors, and it defines the type and quantum of risks the Group is willing to accept in achieving its strategic objectives. It ensures that business activities provide an appropriate balance of return for the risks assumed, and that they remain within a suitable level for the Group. A risk appetite level has been set for each risk pillar of the Group.

The Group has in place a Risk Appetite Framework ("RAF") that outlines the overall approach, governance, controls and systems through which risk appetite and risk limits are established. The RAF has been produced on a proportionate basis in relation to the Group's size, business model, complexity and corporate strategy. It should be noted that the Group's RAF is embedded in the Group's day-to-day operations and it sets the parameters for risk taking in the context of strategy and business model. The main components of the RAF are the Risk Appetite Statement ("RAS") and the Risk Appetite Limits ("RAL"). The RAS includes qualitative statements covering the key risk pillars and sub-categories. To complement the qualitative risk appetite levels, the Group has also established a number of quantitative risk appetite limits. Risk appetite is operationalised via these risk appetite limits, and governs day-to-day decision making across all businesses and risk types.

2.1.4 Risk appetite limits and risk indicators

The risk appetite limits are designed to be reflective of the risk profile of the Group, with attention given to its defined core business lines, and were set such that they would provide an adequate internal management buffer in order to avoid any regulatory requirement being breached, where applicable. The Group has also established a set of Key Risk Indicators ("KRIs") that are additional risk metrics intended to supplement the risk appetite limits. It is not always possible to establish quantitative risk appetite limits, specifically metrics that are used to monitor non-financial risks are typically qualitative in nature.

Performance and adherence to risk appetite is performed at the Board Committee level (inclusive of Risk Committee, Audit Committee, and Nominations and Remunerations Committee) and at Executive Committee level, including the Management EXCO, MCC, ALCO, and NPSC. The Group has also implemented early warning notification thresholds to allow sufficient notification time for corrective measures being implemented where required.

2.1.5 Risk monitoring and reporting

The Group acknowledges the importance of having a regular and transparent risk reporting mechanism, which enables the management body, its committees and relevant units to understand the key risks enabling it to take corrective action, when required, in a timely and accurate manner. The Group's reporting framework includes various risk reports, which include details about the portfolio performance vis-à-vis its internal risk limits and risk appetite, as well as taking into consideration macro-economic environment trends.

Key risks are discussed during both Board and Risk Committee meetings where risk exposures are tracked against risk appetite and risk limits. The Group's formal risk reporting schedule and processes have been established in accordance with Principle 10 of the Basel Committee's "Principles for effective risk data aggregation and risk reporting", with flash reports produced daily (either system-generated or created by operational departments) and more in-depth reports produced monthly.

2 Risk management, objectives and policies - continued

2 .1 General information on risk management, objectives and policies - continued

2.1.5 Risk monitoring and reporting - continued

Reporting to the Board and Board Risk Committee

The Board and Risk Committee receive a comprehensive Group risk report for each month, compiled by the Risk management function with an executive summary written by the CRO. This CRO executive summary is qualitative in nature and covers the Group's material risks. This commentary is also supported by a much more detailed report, the Group risk management report. This report is prepared on a consolidated basis as well as for MeDirect Malta. The risk management reports are mainly divided into two sections: Risk shaping matters that includes an internal heat map, and external top and emerging risks, and risk oversight, which includes a comprehensive overview of the main risks of the Group of which:

Financial risks

1) **Balance sheet overview (Business model and strategy risk):** provides an overview of the evolution of the Group's asset and liability portfolios over a period of time.

2) **Capital adequacy:** shows the Group's RWA evolution over time and how the Group's capital ratios can be affected by a range of stress and shock scenarios.

3) **Liquidity risk:** primarily two Maximum Cumulative Outflow ("MCO") reports showing stressed liquidity positions of two different severities over a range of time horizons from overnight to twelve months, as well as key assumptions that have been used in deriving these positions. Additional supporting analysis is also included, for example, the impact of credit rating downgrades as well as details of any significant depositors. It also includes a commentary about the historic Liquidity Coverage Ratio ("LCR") and Net Stable Funding Ratio ("NSFR") evolution quarter on quarter.

4) **Credit risk:** this report provides details on a portfolio level, covering each of the asset classes of the Group: international lending, local lending and treasury portfolio. Credit risk information on each portfolio is broken down by internal classification and borrowers classified as other than Regular. It also shows the changes on classification over the month, with focus on those exposures that are classified as "Under Surveillance" and "Doubtful". In order to allow adequate peer analysis, a section on the evolution of the European leveraged loan market is also included in this section.

5) **Market risk:** provides details on the Interest Rate Risk in the Banking Book (IRRBB) covering progression of the IRRBB metrics and the repricing gap, as well as oversight of the level of Foreign Exchange Risk (FX risk) faced by the Group.

2 Risk management, objectives and policies - continued

2 .1 General information on risk management, objectives and policies - continued

2.1.5 Risk monitoring and reporting - continued

Non-Financial Risks

6) **Operational risk:** includes details about operational risk event volume by causal categories and by impact categories, as well as gross operational losses quarter on quarter. This section includes an action log or commentary on each identified KRI, as well as showing the Red Amber Green ("RAG") grading for each risk indicator.
7) **IT security:** this includes a risk commentary and assessment of the major IT security risk areas monitored and reported by the risk management function, covering systems and technology; policies; monitoring and testing; and user awareness.
8) **Financial crime and compliance risk:** primarily a commentary, inclusive of RAG grading, about new regulation and systems enhancements. It also provides information on the compliance monitoring plan and other management information covering requests from the regulator and the number of suspicious transaction reports raised during that month.
9) **Regulatory risk:** provides a runway of the major regulatory changes and regulatory deadlines expected over the next quarters. It also provides a brief overview of the main regulatory updates that have been announced during that month, as well as a calendar of events that shows upcoming supervisory meetings and internal committee meetings.
10) **Reputational risk:** currently the risk management function is introducing a group-wide reputational risk management framework that will also include a number of KRIs and incident management for risk monitoring purposes.

Special reports are also presented to the Risk Committee at each meeting. These special papers cover emerging risks and other hot topics or regulatory announcements that could result in material impact to the Group. Important correspondence from the regulator is also brought to the attention of senior management and the Board members. Items requiring specific attention by the Risk Committee or deeper dives on risk themes are included within such special papers, with actions and decisions taken as necessary as a result.

Other regular reports

Alongside the monthly Group risk management report, the EXCO members also receive a single page report on a weekly basis outlining the status of key risks against the approved risk appetite of the Group, including changes from the previous week. Daily liquidity and capital reports are also shared with the ALCO members and senior management. Aside from internal reporting requirements, the Group is also subject to regulatory reporting such as Common Reporting ("CoRep") and Financial Reporting ("FinRep") as well as public disclosure requirements as stipulated in Part Eight of the CRR.

2.1.6 Internal escalation process

The Group uses a RAG-rating matrix, which is used consistently throughout the risk reports. This matrix highlights any areas which require a heightened level of monitoring prompting actions that might be necessary to revert to business-as-usual.

2 Risk management, objectives and policies - continued

2 .1 General information on risk management, objectives and policies - continued

2.1.6 Internal escalation process - continued

The Group has established a number of key financial and non-financial indicators to monitor the risk profile of the Group relative to its risk appetite in order to be in a position to take appropriate strategic and risk-based decisions. Escalation procedures have been set to ensure that breaches and exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management for action.

The Group has implemented notification thresholds for its critical risk appetite limits to allow sufficient time to avoid breaching the limits. Reporting of these thresholds ensures that performance which is close to the approved risk appetite statement and risk appetite limits is highlighted and discussed at the relevant governance forum and appropriate mitigating actions determined.

2.1.7 Stress testing

Stress testing is an integral element of the Group's risk management process, strategic planning, capital planning and liquidity planning. The Group applies various degrees of severity whilst ensuring the plausibility of the assumptions and scenarios. The stress testing methodology covers both idiosyncratic and macro-economic scenarios.

Stress testing is used to assess the effect of a given scenario, or shock, on the Group's statement of financial position, income statement and regulatory capital, leverage and liquidity ratios, and as a result the Group's ability to sustain any potential loss. In addition, stress testing is also used as a complementary framework to other measures of risk such as Economic Capital ("EC") and Value-at-Risk ("VaR"), where applicable. The outcome of the stress testing determines the Group's capacity to sustain any potential loss in an adverse scenario and circumstances in the context of the Internal Capital Adequacy Assessment Process ("ICAAP") and the Internal Liquidity Adequacy Assessment Process ("ILAAP").

The Group uses reverse stress testing as a regular risk management tool in order to improve the awareness of current and potential vulnerabilities faced by the Group. Reverse stress tests are used as part of the Group's business planning and risk management to understand the viability and sustainability of the Group's business model and strategy.

Since the Group has been identified as an Other Systemically Important Institution ("O-SII") and falls under the supervision of the ECB, it is also subject to supervisory stress testing. The Group uses this exercise as a benchmark for the internal stress testing.

2.1.8 Risk governance structure

The Group has a well-established risk governance structure, with an active and engaged Board of Directors supported by an experienced senior management team and a centralised Risk management function that is independent of the business lines. Decision-making is primarily conducted through the Board of Directors with oversight from a Board level Risk Management Committee and delegated authority within Executive level Committees.

The Board of Directors

The Board of Directors, either directly or through its Committees, ensure that decision-making is aligned with the Group's strategies and risk appetite. For each Board meeting, the members are provided with reports covering the key risks of the Group as well as updates on the Group's financial performance. The Board of Directors approve key risk policies, strategy and risk appetite.

2 Risk management, objectives and policies - continued

2 .1 General information on risk management, objectives and policies - continued

2.1.8 Risk governance structure - continued

The Board has established committees to assist it in carrying out its responsibilities, where each committee must act in accordance with a Charter as approved by the Board setting out matters relevant to the composition, responsibilities, authority and reporting of the committee, and such other matters as the Board considers appropriate. The Board-level committees may only act with delegated authority from the full Board of the Group within the limits of the authority reserved by the Group itself.

The Board has established the following committees:

- Audit Committee;
- Risk Committee; and
- Nominations and Remuneration Committee.

<u>Audit committee</u>

The purpose of the Audit Committee is to oversee the quality and integrity of the Group's financial reports, particularly the key financial judgements made within them. The Audit Committee also reviews accounting policies, the Group's compliance matters and also assesses the effectiveness of Internal Audit. The Group's internal audit function and compliance function report independently to the Audit Committee on the effectiveness of risk management policies, regulatory compliance, procedures and internal controls.

<u>Risk committee</u>

The Risk Committee is responsible for reviewing the Group's risks in sufficient detail that it can assess whether they are consistent with the Group's risk appetite, and for reviewing management's proposed courses of action if not. It may then approve these plans or require them to be altered, as appropriate. It is also responsible for assessing the Group's high-level controls, limits, and risk aggregation and reporting framework to ensure that these are sufficient to maintain its level of risk (including, but of course not limited to, operational risk) within its appetite.

<u>Nominations and remuneration committee</u>

The Nominations and Remuneration Committee is responsible for making recommendations to the Board in respect of key appointments. It also reviews the setting of remuneration levels (fixed and variable) as well as the structure of variable remuneration for senior executives (including Executive Directors) and risk-takers within the Group as defined in the Group's remuneration policy.

A detailed description of the role and responsibilities of each of the board committees is outlined in their respective terms of reference.

Executive management and EXCO

The Board delegates responsibility for the day-to-day management of the Group to the Chief Executive Officer who chairs the Executive Management Committee ("EXCO"). EXCO represents the principal forum for conducting the business of the Bank and takes day-to-day responsibility for the efficient running of the business. In addition, EXCO is responsible for the formulation and implementation of Board approved strategies and plans.

2 Risk management, objectives and policies - continued

2 .1 General information on risk management, objectives and policies - continued

2.1.8 Risk governance structure - continued

EXCO is composed of two different management forums, which are intended to enhance the execution of the Group's business priorities and reinforce the governance of the Group's activities. The Strategy EXCO is made up of a small group of executive management and focuses on the Group's broader growth strategies and new initiatives. The Management EXCO is mainly responsible for the ongoing priorities that underpin the Group's business model and the regulatory environment. EXCO serves as an internal advisory body with feedback to the Board via the Chief Executive Officer.

Whilst retaining the ultimate responsibility for actions taken, EXCO may delegate its responsibilities to a number of sub-committees, each operating under their own terms of reference:

a. Management Credit Committees
b. ALCO
c. New Product & Services Committee
d. Treasury Services Committee
e. Wealth Management and Investment Services Committee
f. Regulatory Committee

Internal control functions

The internal control functions of the Group comprise the risk management function, the compliance function and the internal audit function. The risk management and compliance functions represent the second line of defence and are subject to review by the internal audit function that is the third line of defence.

Group corporate governance framework

The key elements of the Group's governance infrastructure are described in the Group's corporate governance framework. This framework supports other internal documents such as the Group's articles of association, terms of reference for the Board of Directors and its standing committees. The framework is updated annually and it is expected that it will be reviewed in Q3 2018 to reflect the revised EBA guidelines on internal governance.

Policy framework

The Group has a policy framework in place, which includes a list of all the internal policies as well as policy owners and process for review. The review process for new and updated policies entails internal discussions with different units that are directly impacted by that specific policy. From time to time, and whenever major regulatory changes are announced, the Group may engage external consultants to carry out a gap analysis that may potentially lead to the creation of new policies and review of existing ones to reflect regulatory updates. All internal policies are subject to an internal governance process as outlined in the Group's corporate governance framework.

It is important that the need for proper governance of the Group's licensed subsidiaries is fully respected even though the Group's approach to risk management is largely independent of the legal vehicle within which a particular risk is assumed.

2 Risk management, objectives and policies - continued

2 .1 General information on risk management, objectives and policies - continued

2.1.9 Risk management of the Group's regulated subsidiaries

Using its position as controlling shareholder if necessary, the Group adopts the following key principles when managing the risk of its subsidiaries:

- Subsidiaries will not take on any risk that is outside the Group's consolidated risk appetite, as expressed in its Group RAS, unless prior consent and dispensation is provided by the Group Board;
- The Group's risk reporting and evaluation processes will include risks borne within the Bank's subsidiaries in the same way as risks borne within the Group itself: such reports will be produced and reviewed on a consolidated basis (notwithstanding that additional reports may be produced at subsidiary level as described below);
- The Group will not take any action at subsidiary level without support from the appropriate body of the subsidiary in question; and
- To the extent possible, subsidiaries will adopt risk management policies, processes, and reports that are consistent with those of the Group itself: in particular, subsidiaries will follow the day-to-day operational risk management (i.e. control) processes of the Group, although they may of course supplement these with additional control processes if they feel this is necessary or if local regulations and customs dictate.

Where risk reports are produced for management purposes, or regular analysis is performed, in respect of individual subsidiaries of the Group, the form of these reports and analysis will be kept as close as possible to that of the Group-level equivalents. Where local management, regulations or customs demand that additional or differently-presented information be shown on entity-level reports, the Group will in general aim to produce information in a common format acceptable at both levels.

2.2 Information on risk management, objectives and policies by category of risks

2.2.1 Credit risk

Credit risk is the risk of loss for the Group's business or of an adverse change in the financial position, resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors in the form of default or other significant credit loss event (e.g. downgrade or spread widening).

Credit risk profile

The Group's credit risk emanates from two main sources: from its lending activities and from its treasury activities. The Group's lending activity is mainly composed of its internationally syndicated corporate loans portfolio as well as a much smaller portfolio of domestic corporate lending for which it has a lower risk appetite. Credit risk arises primarily in the form of deterioration in credit quality leading to an obligor defaulting on debt instruments held in the Group's investments portfolio or on senior secured loans extended to corporate counterparties.

While the Group's primary source of credit risk is its portfolio of corporate loans and Treasury securities, it does take on credit risk in other areas too; these are listed in the following table along with the key risk mitigants. To the extent that new products and services are offered to the Group's customers that involve the extension of credit, the Group's approach is to require similar controls and mitigants to be put in place.

2 **Risk management, objectives and policies** - continued

2.2 **Information on risk management, objectives and policies by category of risks** - continued

2.2.1 Credit risk - continued

Source	Mitigant
Secured financing (liquid securities)	Being a securities lender/cash borrower: intrinsically a risk mitigant since correlation leads to a "right-way" exposure.
	Execution under market-standard Global Master Repurchase Agreement ("GMRA") documentation with major counterparties, or at Eurex or CBM; with daily margining.
	Concentration limits embedded in credit policy.
Secured financing (less liquid assets)	Execution only with top-tier international counterparties.
	Limits by counterparty on initial margin amount.
Exposure to hedging counterparties	Execution under market-standard International Swaps and Derivatives Association ("ISDA") documentation with major counterparties; daily margining.
	All hedging instruments are highly liquid and based on easily observable market data.
Lending to retail customers	Currently lending is only extended against cash collateral.
Customer FX forward transactions	Margining required, broadly equivalent to ISDA standards.
Encroachment (Group effects a foreign-currency client payment before euro funds have cleared)	Exposure very short-term in nature.

Counterparty credit risk

The CRR defines counterparty credit risk ("CCR") as the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.

Limits on counterparty exposure are established by the ALCO. Such limits relate to net exposure, after application of cash (and cash equivalent) collateral, as provided in industry-standard documentation such as the ISDA and GMRA agreements, and the Treasury Management Policy.

The Group has not established any credit reserves in relation to counterparty credit risk.

<u>Credit risk quantification and assessment</u>

The Group adopts the standardised approach to credit risk as outlined in the CRD IV in order to apply its capital requirement for credit risk. Given the simplicity of the Group's business model, the Group views the potential benefits of moving towards an Internal Ratings-Based ("IRB") approach as insufficient to justify the associated infrastructure requirements to meet IRB requirements.

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.1 Credit risk - continued

Besides allocating capital against its Pillar I risks that are based on the Group's accounting records, the Group carries out an assessment of the extra capital proportionate to Pillar II risks as part of its annual ICAAP. The Group has developed and implemented an economic capital model that is used to calculate the additional internal capital add-on for credit risk. The credit risk model estimates credit losses based on the correlation between industry shocks and borrower defaults.

Credit risk management and control

The Group's lending activities are governed by the credit risk policy and corporate credit framework, covering the international syndicated loan portfolio and the local lending portfolio.

The Group's credit policy sets out a series of controls on how the Group mitigates its credit risk, covering:

- Credit governance
- Credit approvals
- Credit classifications and staging criteria
- Credit monitoring
- Deteriorating credits and forborne exposures
- Non-performing and default exposures

Internal policies and frameworks are reviewed at least on an annual basis to keep abreast with ever changing market conditions and regulatory landscape. During this financial year, the focus was mainly on the review and update of the credit risk policy, primarily to fine tune the processes following the implementation of the ECB guidance on leveraged transactions (March 2017), and the EBA guidelines on the application of the definition of default[3].

Given the differing nature of the local lending portfolio, the credit risk emanating from these activities is managed and controlled through a number of policies and procedures. Since the Group holds collateral against loans and advance to local customers in the form of hypothecary rights over immovable assets, registered rights over movable assets and guarantees, the Group has in place a collateral policy that governs this process.

Collateral valuation

Collateral values are conservatively estimated, based on current economic conditions. The Group may apply haircuts in respect of the property valuation by the independent valuer. Such a haircut is determined on a case-by-case basis taking into account particular idiosyncrasies such as valuer's expertise and experience, valuation/s of similar collateral and, locations and conditions of property. Haircuts applied are documented in the credit memorandum together with an explanation of the suitability of chosen haircut. The haircut is discussed and ratified at the MCC.

The value of commercial real estate is monitored on a frequent basis, at least once a year, while the value of residential real estate is reviewed once every three years.

[3] EBA Final Report on Guidelines on the application of the definition of default under Article 178 of Regulation (EU) No 575/2013 – EBA/GL/2016/07 dated 28 September 2016

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.1 Credit risk - continued

Net realisable value

For liquidation purposes, the Group carries an assessment to determine whether the 'market value' of the collateral is indeed the best estimate of the net realisable value of the asset. For immovable property, forced sales discounts are applied to reflect the particular characteristics and conditions of the local market (e.g. type of property, time factor to realise collateral and location) so as to arrive at the best prudent estimate of the realisable value of the collateral.

Credit governance and approval process

The Group has in place a governance process outlining roles and responsibilities, authorities, limitations and escalation processes for approving and reviewing credit exposures across the Group's lending portfolios.

Management of the Group's credit risk is the joint responsibility of the departments that originate this risk and of its risk management function, under the oversight of the management credit committees and of the Board risk committee.

The Group adopts a typical three-lines-of-defence approach to credit risk management that utilises an independently run risk function as a second-line of defence as well as the internal audit function acting as an independent third-line of defence for credit audits and reviews.

With these objectives in mind, responsibilities around the origination of new assets are divided as follows:

- Business units are responsible for identifying and sourcing lending opportunities and for all discussion with external parties, whether the proposed borrower itself or an intermediary such as the lead bank in a lending syndicate. They are also responsible for performing primary credit analysis on a proposed extension of credit (to include an impartial summary of all relevant information), for recommending a course of action and for co-ordinating the decision-making process. Where public investment-grade (i.e. BBB-/Baa3) credit ratings are available in respect of a bond issuer or other obligor, business units may reflect the underlying rating agency analysis in lieu of performing their own detailed independent credit analysis where this is permitted by the associated credit framework.

- Risk is responsible for reviewing this primary credit analysis, for ensuring that any open items are discussed and resolved in advance of the formal decision-making forum and for providing its own recommendation on the appropriate course of action. For avoidance of doubt, Risk may not rely on external credit ratings as a substitute for performing its own credit analysis and assessment.

- Internal audit is responsible for periodic and thematic reviews of credit policies and the associated credit processes, in order to assess and review their effectiveness and adherence to them by both the business units (1st line of defence) and the risk team (2nd line of defence). The internal audit team may also, at its own discretion, seek the involvement of third partyu audit firms to support any internal credit audit and review related activities.

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.1 Credit risk - continued

The MCC of the Group are responsible for approving credit recommendations and making other credit decisions under their delegated authority, as defined in each associated credit frameworks. This includes:

- whether to approve an extension of credit, and under what conditions;
- how to classify individual credits for risk and performance monitoring purposes;
- whether to recommend Board approval for extensions of credit beyond its delegated authority;
- consideration of any hedging strategies and whether to recommend them for Board approval;
- review impairments and provisioning; and
- monitor and provide oversight over the risk performance of the portfolio.

All credit decisions, approved or otherwise, are documented and retained, with suitable MCC minutes recorded. Retention of credit decisions are maintained for the lifetime of the credit facility, subject to any data retention regulation as outlined in the Group's data retention policy.

Credit classification and staging criteria

Credit exposures are classified into credit classification categories as part of the credit approval process. The classification decision is ultimately the responsibility of the MCC unless otherwise stated, and should be continuously ratified as part of the credit monitoring process.

The Group adopts a five-scale internal credit classification rating scale. This aligns to the Group's standardised approach to credit risk and for the purpose of adherence of IFRS 9[4] principles, provides alignment and consistency.

Internal Credit Classification		
Internal Rating		Internal Rating Definition
1	Regular	No material credit concerns
2	Focus	No immediate prospect that a credit loss will ultimately be suffered, but worthy of closer credit oversight
3	Under Surveillance	Significant increase in credit risk with identified concerns and some prospect that a credit loss may ultimately be suffered
4	Doubtful	Likely that the contractual terms of the debt will not be met and that a credit loss will be suffered
5	Write-off	Full or partial credit impairment suffered, with little prospect of recovery

[4] The International Financial Reporting Standard (IFRS 9) related to Financial Instruments and replacing International Accounting Standard (IAS) 39, becomes effective for financial periods starting on or after 1 January 2018.

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.1 Credit risk - continued

The Group's IFRS9 general approach will be applicable for all assets that are not credit impaired at the point of investment (initial recognition). The general approach adopts the IFRS9 three-stage methodology that is summarised below:

- **Stage 1 (Performing)** — Stage 1 includes assets that have not had a significant increase in credit risk since the point of initial recognition or that have low credit risk at the reporting date.
- **Stage 2 (Under-Performing)** — Stage 2 includes assets that are seen to have had a significant increase in credit risk since the point of initial recognition but do not have objective evidence of impairment. Generally a significant increase in credit risk will occur before there is objective evidence of impairment or a default occurs. An asset which is deemed to have displayed a significant increase in credit risk must be recognised as "Under Performing".
- **Stage 3 (Non-Performing)** — Stage 3 includes assets where there is objective evidence of impairment at the reporting date. Assets in this stage will be considered as "Non-performing" and generally be assessed individually for provisioning purposes.

Credit hedging

As the Group's operations develop, it may also consider managing credit risk through credit hedges. Entry into any such hedges will also be subject to prior implementation of an appropriate settlement and risk management infrastructure. Exposures to derivative counterparties will be limited through the use of netting and collateralisation agreements. Board approval is required before any credit hedging activity is undertaken, and this approval should consider the infrastructural and counterparty risk management framework as well as the proposed degree of hedging and the approach to be followed.

Throughout the financial year the Group did not enter into any credit derivative hedges.

Credit monitoring

As part of the Group's robust approach to credit risk management, the Group ensures that close and continuous oversight of each of its respective lending and treasury portfolios is undertaken.

The Risk management function is responsible for ensuring that all significant credit risks are appropriately identified and clearly incorporated into the Group's risk management and reporting framework. Additionally, the risk management function is responsible for monitoring the overall credit performance of each lending portfolio, including, amongst other things, monitoring portfolio risk and concentration risk, monitoring credit quality trends and provision levels and reviewing and taking appropriate action in connection with any violations of credit limits and policies.

The CRO will assign ownership and responsibility for the management of such risks and is responsible for ensuring that adequate controls are in place to ensure that risk management is in compliance with regulatory requirements and with the Group's risk appetite as approved by the Board of Directors.

Besides from allocating specific concentration limits for each asset portfolio it manages, the Group has in place a number of quantitative credit risk metrics to monitor its international lending portfolio including:

- Single Name Limits;
- Sector Concentration Limits; and
- Country Concentration Limits.

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.1 Credit risk - continued

Given the nature of the international lending portfolio, the Group also monitors a number of triggers in line with the ECB guidelines on leveraged transactions, that cover the opening leverage, covenant structure and deleveraging profile. The Group has adopted these triggers to govern the overall delegated authority of the International Corporate Loan Management Credit Committee.

The Group has also in place a number of risk metrics to monitor the local lending portfolio:

- Single Name Concentration;
- LTV Limit; and
- Unsecured Lending Limit.

As the local lending portfolio is not a core business line of the Group and has high dependency on Maltese real estate market conditions, the Group has introduced an absolute risk appetite limit for total commitments for the portfolio.

Single issuer concentration limits have also been applied to the Treasury portfolio.

The Internal Audit function is responsible for ensuring that the Group's credit portfolios are regularly reviewed from an audit perspective, as part of the internal audit plan.

<u>Deteriorating credits and forborne exposures</u>

The default internal credit classification at the point of origination is "Regular". This applies across all business lines and all lending portfolios, regardless of the underlying credit risk or probability of default for each instrument. Each respective MCC as outlined in each credit framework is responsible for monitoring the credit performance of each credit exposure. The Group has processes and procedures in place to identify deteriorating credit and forborne exposures.

For the international lending portfolio, the Group uses an external credit risk-modelling provider that is appropriate for benchmarking its corporate lending portfolio. For the local lending assets, the Group does not use external credit ratings (as all exposures are unrated) or rely on an external risk-modelling providers for benchmarking its local lending portfolio as no robust database or provider exists for the asset class. The Group therefore will use the evidence of past-due information as the primary quantitative driver of SICR triggers, alongside qualitative forward-looking SICR assessment.

The Group adopts the usage of external public ratings for Treasury Assets, using public ratings (where available) from Moody's, Standard & Poor's and Fitch. Deterioration in the available public rating from the point of inception to non-investment grade (below BBB-/Baa3) will therefore be the primary quantitative SICR trigger for the treasury portfolio.

Forbearance measures consist of concessions extended to any exposure towards a debtor facing or about to face difficulties in meeting its financial commitments ("financial difficulties"). With reference to paragraph 178 of Annex V of Commission Implementing Regulation (EU) No 680/2014, a forborne exposure can be underperforming (Stage-2) or non-performing (Stage-3).

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.1 Credit Risk - continued

As prescribed by EBA standards, the regulatory forbearance classification shall be discontinued when all the following conditions are met:

- the contract is considered as performing, including if it has been reclassified from the non-performing category after an analysis of the financial condition of the debtor showed it no longer met the conditions to be considered as non-performing;
- a minimum 24-month probation period has passed from the date the forborne exposure was considered as underperforming;
- regular payments of more than an insignificant aggregate amount of principal or interest have been made during at least half of the probation period; and
- none of the exposures to the debtor is more than 30 days past due at the end of the probation period.

The Group recognises that on occasion the application of these tests may be more ambiguous than for typical bilateral loans; the MCC is responsible for any interpretation required.

Non-performing and default exposures

The Group's credit policy outlines the Group's approach to identifying non-performing, impaired and default exposures, as well as provisioning and write-Off criteria as defined in accordance with EBA Guidelines Article 178 of Regulation (EU) No 575/2013, and the more recent ECB guidance to banks on non-performing loans (March 2017).

The Group is required to identify Non-Performing Exposures ("NPEs") and to assess the recoverability of the recognised exposure. Assessment is made at an obligor (rather than facility) level. This implies that in those cases where a particular debtor has multiple facilities with the Group, the Group considers whether there are indications of unlikeliness to pay at the level of the debtor, irrespective of the different levels of losses that can be incurred in respect of the different facilities resulting from different levels of seniority. Therefore, the probability of default is measured at the level of the debtor, while the loss given default measures the loss incurred by the different tranches.

The governance of assessing NPEs and Default triggers is undertaken as part of the ongoing credit monitoring processes. Where NPEs or Default indicators are observed, immediate assessment by the respective MCC is required and a ratification of the internal credit classification conducted.

Definition of default

In accordance with the definition of defaulted exposures provided under Article 178 of the CRR, the Group identifies a "default" where a financial asset is 90-days past due its contractual repayment for any amount of principal, interest or fee that has not been paid at the date it was due. However, the Group relies on the definitions of "Unlikeliness-to-Pay" for additional default criteria in terms of article 178 (3) of the CRR, which aligns closely with the definition of NPEs specified above.

Definition of impaired

Where a non-performing or default trigger has been identified and applied to a financial asset, the obligor's related facilities must also be assessed to determine whether they are also impaired for the same reason and/or are unlikely to pay.

2 **Risk management, objectives and policies** - continued

2.2 **Information on risk management, objectives and policies by category of risks** - continued

2.2.1 ***Credit Risk*** - continued

According to the EBA guidelines on the application of the definition of default, in general one would expect that all exposures treated as credit-impaired.

An impairment allowance requirement is determined based on the Group's provisioning policy.

2.2.2 Capital adequacy

Capital adequacy is a measure of the financial strength of the Group. This is usually expressed as a ratio of its Core Equity Tier 1 Capital (CET1) capital, Tier 1 Capital (Tier 1), or its Total Capital (Tier 1 + Tier 2 capital) to its total risk weighted assets (RWA). Capital adequacy requirements have increased in importance as regulators seek to ensure that banks and financial institutions have sufficient capital to keep them out of difficulty, even during periods of heightened cyclicality. The Group and its subsidiaries are subject to prudential requirements under the ECB Supervision Review and Evaluation Process ("SREP") and are bound by the terms of the capital requirements outlined within the SREP decision. The Group's management has a significant level of control and oversight over its capital ratios. It uses the capital base as its main constraint for curbing asset growth in reaction to market changes whilst aiming to strike an appropriate balance between risk and sustainable returns.

The Group has defined an ICAAP to consider the capital required given its businesses and risk profile, both from a normative and economic perspective. This is defined by sound, effective and comprehensive strategies and processes to assess and maintain on an ongoing basis the amounts, types and distribution of internal capital that the Group considers adequate to cover its nature and level of risks to which it is or might be exposed to.

The Group's ICAAP is aligned with regulatory requirements, as well as best commercial and governance practice, and are demonstrated through the Group's internal reporting.

The Group's risk appetite covers capital adequacy and has established a number of risk appetite limits and KRIs in order to manage and monitor this risk. Actual performance is monitored against these pre-set limits and are also disclosed in the weekly and monthly risk reports.

The Group actively monitors the following capital ratios and leverage ratios, allocating specific risk appetites supported by quantitative risk appetite limits:

- CET 1 Ratio;
- Tier 1 Capital Ratio;
- Total Capital Ratio; and
- Leverage Ratio.

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.3 Liquidity risk

During 2017, the EBA issued a set of guidelines (EBA/GL/2017/01) which aim to harmonise the disclosures in line with CRR 575/2013 Article 435(1) in relation to liquidity risk. Additional disclosures on liquidity risk can be found under note 2 to the financial statements.

Liquidity risk is the risk of the Group being unable to generate sufficient funding resources to meet financial obligations as they fall due in business as usual and stress scenarios. Funding risk arises from higher funding costs or lack of availability of funds. The Group actively manages stable and efficient access to funding and liquidity to support its ongoing operations. The Group's appetite for liquidity and funding risk is embedded through the Liquidity Risk Management Policy, which stipulates the funding restrictions of the Group, and the approval thresholds for usage of certain funding instruments.

Liquidity risk identification

The Risk management function is responsible for designing the risk appetite statement that is presented for discussion and challenge by the Risk Committee members, and ultimately approved by the Board of Directors. This process leads to the creation of granular liquidity risk appetite limits and KRIs that are monitored across the internal functions of the Group. Notification and escalation processes are in place in order to ensure timely and adequate flow of information up to Committee and Board levels.

The Group makes use of Risk and Control Self-Assessments ("RCSAs") to identify, document and assess its key risk and controls, as is clearly described within the Group's Risk Register. This bottom-up approach to risk identification is also applied to liquidity risks across the Group. The RCSA results are then used to help identify KRIs and define risk appetite metrics.

The Group has identified the following risk drivers related to liquidity:

- regulatory liquidity risk: a breach to any one of the regulatory liquidity ratios;
- short-term liquidity risk: mainly related to customer deposit flight, drawings on revolving credit facilities and margin calls on secured financing;
- medium-term liquidity risk: a sustained period of deposit outflows and/or an unexpected heavy series of utilisation of committed undrawn credit facilities;
- structural maturity mismatches; and
- deposit volatility and concentration (single name or product).

Liquidity risk quantification and assessment

Following the identification of liquidity and funding risks, the risk management function performs a risk analysis to assess the significance and likelihood of these risks. The Group's assessment of risks to liquidity and funding is primarily done through the ILAAP.

For the ILAAP, the Group models two liquidity stress scenarios on the basis of an idiosyncratic (Severe) and a market-wide (extreme) stress scenario. For the 2017 ILAAP, the Group extended the range of liquidity stress scenarios in order to explore in more detail the range of liquidity sensitivities the Group may experience in stress scenarios.

Principle 12 in the BCBS "Principles for Sound Liquidity Risk Management and Supervision" requires banks to maintain a cushion of unencumbered, high quality liquid assets to be held as insurance against a range of liquidity stress scenarios. The outcome of the liquidity stress testing is used to determine this cushion or liquidity buffer.

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.3 Liquidity risk - continued

In line with Principle 17 in the BCBS guidelines, the Group is also required to maintain a prudent funding structure drawn from diverse funding sources in the short-, medium- and long-term. The Group's funding plan provides a detailed description and quantitative overview of the various funding sources. The Group has also in place a liquidity contingency funding plan that identifies the various funding sources that the Group can rely on during a distressed situation.

An analysis of asset encumbrance is also an important consideration and is critical to assess the ability of the Group to handle funding stress, and its ability to switch from unsecured to secured funding under stressed conditions.

Mismatching of assets and liabilities, and currencies may also lead to a degree of liquidity risk.

Liquidity risk management and controls

The Group has adequate internal controls to ensure the integrity of its liquidity risk management process. As described within the risk management framework, the Group has adopted a risk management and internal control structure, referred to as the Three Lines of Defence. In this model, the treasury function acts as the first line of defence towards liquidity risk, the risk function as the second line, and the internal audit function as the third line.

Funding strategy

For liquidity purposes, the Group's statement of financial position, is managed on a day-to-day basis by the Treasury Team, under the leadership of the Group Head of Treasury and the supervision of the Executive Director of Credit and Investments.

The Group's funding strategy is to maintain a highly diverse funding base mainly composed of retail deposit funding. The Group also has a portion of its funding coming from corporate deposits and wholesale funding sources. The Group's core funding objective is to rely more on stable sources of funding such as customer deposits, whilst ensuring that it can still rely on a number of funding sources such as Eurex exchange repo transactions and secured funding instruments.

The Group's funding strategy for business as usual activities is facilitated by maintaining a positive funding gap and by monitoring the Group's maturity ladder, which is used by the Group to determine the availability of liquid assets to meet the liquidity gaps across a range of time buckets. The Group ensures it maintains a significant buffer of High Quality Liquid Assets ("HQLAs") that can be readily converted into cash or are eligible to be pledged as collateral in order to raise wholesale repo funding to meet liabilities as they fall due. As part of the Group's funding strategy, the Group has more appetite for term funding including evergreen notice accounts, rather than on demand accounts. As a result of the strategy the Group has only 24% of its deposit funding held as on demand savings account, which helps manage and mitigate liquidity risk.

Liquidity risk management buffers

The Group's Liquidity Risk profile is also a key consideration of the Group's risk appetite limits and KRIs. As outlined earlier, the Group controls the appetite it is willing to accept in terms of liquidity risk by ensuring adequate management buffers exist, in conjunction with early notification thresholds, to help avoid the Group taking on liquidity risk outside of its agreed risk appetite. These liquidity management buffers are additionally embedded into the Liquidity Risk Monitoring and Reporting framework to ensure regular oversight is in place.

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.3 Liquidity risk - continued

Liquidity stress testing and Contingency funding planning

In conjunction with the above controls, the Group's risk function performs regular stress testing of its liquidity profile, as well as the availability and viability of contingency funding options through both its ILAAP and monthly Maximum Cumulative Outflow ("MCO") report each month. These reinforce the Group's oversight of liquidity risk, by not only focussing its risk reporting on the 'current' state, but also providing regular and timely reporting of the potential 'stress' liquidity profile of the Group. The monthly MCO reports are also a standing agenda item at Executive level for the Group's ALCO and Board Risk Committee.

Internal policies

Within the Group's overall Risk Policy manual, as outlined earlier within this chapter, the Group includes a specific Liquidity Risk Policy as one of the core pillars of the Risk Policy Manual. These policies, specifically the Liquidity Risk Management Policy, Stress Testing Policy, Contingency Funding Plan Policy, Risk Appetite Policy and ICAAP and ILAAP Policy set the standards and rules around liquidity risk management for the Group. By definition, they provide a cornerstone of the Group's risk management controls.

Liquidity risk monitoring and reporting

The Group's intention is to be able to adhere to its risk appetite limits as well as satisfy any regulatory or statutory minimum liquidity requirements even during times of stress. The Group also seeks to project key liquidity ratios forward through time. While acknowledging that the principal liquidity ratios cover a range of time horizons from one day to one year, the Group does not solely rely on the regulatory liquidity ratios to ensure it has adequate liquidity when these ratios are above their minimum regulatory levels. In part this reflects the fact that the Group's own assumptions on deposit withdrawal or haircuts may differ and are generally more conservative than those mandated by the LCR and NSFR.

Consistent with its practice in other areas of risk analysis and reporting, and also consistent with Principle 10 of the Basel Committee's "Principles for effective risk data aggregation and risk reporting", the Group performs and reports on these projections monthly, to allow for in-depth review and analysis at ALCO and the Board Risk Committee. Reliable management reporting provides the Executive and the Board with timely and forward-looking information on its liquidity position. Reporting of risk measures is done on a frequent basis and compares current liquidity exposures to established limits to identify any emerging pressures and limit breaches.

The Group has in place a number of quantitative risk appetite metrics to be able to monitor liquidity risk:

- LCR;
- Liquid asset ratio;
- Encumbrance ratio; and
- NSFR.

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.3 Liquidity risk - continued

The following table provide an analysis of the data points used in the calculation of the liquidity coverage ratio:

EU LIQ 1 - LCR Disclosure table

MDB Group Limited	**Total unweighted value (average)**				**Total weighted value (average)**			
EUR 000s								
Quarter ending on:	30/06/2017	30/09/2017	31/12/2017	31/03/2018	30/06/2017	30/09/2017	31/12/2017	31/03/2018
Number of data points used in the calculation of averages	3	3	3	3	3	3	3	3
HIGH-QUALITY LIQUID ASSETS								
1 Total high-quality liquid assets (HQLA)					**310,694**	**320,347**	**367,138**	**429,235**
CASH – OUTFLOWS								
2 Retail deposits and deposits from small business customers, of which:	301,846	320,959	330,176	342,323	31,222	33,176	34,271	35,764
3 Stable deposits	1,202	1,373	1,332	1,049	60	69	67	52
4 Less stable deposits	264,920	280,834	280,392	289,210	26,492	28,083	28,039	30,934
7 Non-operational deposits (all counterparties)	199,182	186,073	188,125	182,425	86,233	81,039	75,134	71,283
9 Secured wholesale funding					-	6,667	1,050	700
11 Outflows related to derivative exposures and other collateral requirements	7,905	7,275	13,196	13,552	7,905	7,275	13,196	13,552
13 Credit and liquidity facilities	456,229	441,943	577,271	597,012	79,032	63,497	66,677	81,433
14 Other contractual funding obligations	7,690	10,844	13,081	11,196	4,600	7,429	9,615	7,890
16 TOTAL CASH OUTFLOWS					**208,992**	**199,083**	**199,943**	**210,622**
CASH – INFLOWS								
18 Inflows from fully performing exposures	327,919	309,264	306,441	188,806	319,467	303,559	301,517	182,398
20 TOTAL CASH INFLOWS	**327,919**	**309,264**	**306,441**	**188,806**	**319,467**	**303,559**	**301,517**	**182,398**
EU-20c Inflows subject to 75% cap	327,919	309,264	306,441	188,806	319,467	303,559	301,517	182,398
21 LIQUIDITY BUFFER					**310,694**	**320,347**	**367,138**	**429,235**
22 TOTAL NET CASH OUTFLOWS					**52,248**	**49,771**	**49,986**	**58,065**
23 LIQUIDITY COVERAGE RATIO (%)					**604%**	**648%**	**738%**	**753%**

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.4 Business model and strategy risk

Strategic risk is directly linked to the business model of an institution and how effectively the institution manages to translate its budget and forecasts into actual performance. Another consideration is the challenging environment that banks operate in and the various factors that each bank has to face, such as declining margins, loss of market position or customers, and higher costs such as reorganization costs.

The Group acknowledges that reported earnings inherently carry some level of volatility and seasonality. Hence even though they are not always the best indicator of the Group's performance, they do represent a useful risk metric. The Group has in place a range of KRIs to assess the Group's strategic risk:

- Return on Equity (RoE);
- Return on Assets (RoA);
- Net Interest Income (NII);
- Operational Expenditure (OpEx);
- Significant Operational Losses; and
- Cost-to-Income ratio

These KRI metrics are also used as part of the Group's Recovery Plan indicators and are monitored and reported within the Group's monthly risk management report. The monitoring of these measures ensures that the business model performance is consistent with the expectations of the stakeholders; to withstand unexpected shocks; and earnings (and cash flows) are consistent with funding strategies. Different factors that could affect the business model and strategy of the Group are also taken into consideration in the scenario analysis for the ICAAP.

2.2.5 Market risk

The Group is exposed to the risk of an adverse change in its financial situation, resulting, directly or indirectly, from fluctuations in the level or volatility of market prices of assets and liabilities and from adverse movements in interest rates, credit spreads and FX rates. This can affect the Group's profitability (Net Interest Income ("NII") and capital measures.

The Group has a significant amount of Treasury securities (held mainly as High Quality Liquid Assets - HQLAs) which give rise to the Credit Spread Risk in the Banking Book ("CSRBB"). Exposure to movements in securities prices can be decomposed into the exposure to interest rates and to spreads which fluctuate on a daily basis as a result of the changes in the market demand and liquidity for certain securities.

Additionally, the Group originates loans and gathers funds in foreign currencies (other currencies than Euro) that are not always offset creating the exposure to the FX risk in the Group.

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.5 Market risk - continued

The Group does not run a Trading Book and accordingly has limited exposure to market risk in the normal sense that shifts in market variables drive the Group's income. The Group is, of course, not entirely immune to the effects of market movements and manages this exposure accordingly.

Market risk identification, quantification and assessment

The Group assumes three types of market risk, namely:

i. Interest Rate Risk

Interest Rate Risk in the Banking Book ("IRRBB") refers to the current or prospective risk to the Group's net economic value of equity ("EVE"), capital and Net Interest Income ("NII") earnings arising from adverse movements in interest rates that affect the Group's banking book positions.

The Group's exposure to interest rate risk arises predominantly from repricing risk emanating from its asset/liability structure, specifically the lag which exists between the Group's loans which reprice periodically (generally every three months) and the term structure of customer deposits, as well as from possible impacts on the Mark-to-Market ("MtM") value of its fixed rate instruments if market interest rates increase. The presence of interest rate floors embedded in the majority of the loans enable the Group to mitigate its repricing risk from the Group's asset/liability structure, whilst hedging the repricing risk from its core financial assets, namely the treasury securities, and wholesale repo funding.

The Group considers the materiality of IRRBB to be relevant enough to assess the level of Internal Capital required to mitigate such risks. This risk is assessed separately within the IRRBB Internal Capital section of the Group's ICAAP.

CSRBB is a related risk that banks need to monitor and assess in their interest rate risk management framework. CSRBB refers to any kind of asset/liability spread risk of credit-risky instruments that is not explained by IRRBB and by the expected credit/jump to default risk, and in particular to the risk to EVE represented by a change in the market spreads associated with the Group's assets.

The Group defines credit spread risk as a potential loss in the value of a security, which is caused by changes in credit spreads while the counterparty's rating remains the same. The credit spread of the issuer, for the corresponding term, is quantified through the difference between the security's market yield at the valuation date and the risk free rate. The credit spread is an important market risk category for the Group given the existence of the Treasury securities, mainly held for liquidity purposes

ii. Foreign Exchange (FX) Risk

The Group is mainly exposed to currency risk on foreign exchange movements relating to the GB Pound and US Dollar, originating from the Group's corporate banking business. In the majority of cases, the Group hedges this risk by ensuring that its foreign currency-denominated liabilities are matched with corresponding assets in the same currency. Any mismatches that arise are monitored closely.

2 **Risk management, objectives and policies** - continued

2.2 **Information on risk management, objectives and policies by category of risks** - continued

2.2.5 Market risk - continued

FX risk is not considered sufficiently material to warrant the calculation of economic capital for Pillar II internal capital. The Group's principal deposits and credit portfolio are both concentrated in Euros and the Group's appetite for taking on foreign exchange risk is very-low. The Treasury function is responsible for maintaining FX risk for unhedged positions within tight limits set out in the risk appetite statement of the Group. In substance, in the case of FX risk, the threshold is so tight that the associated economic capital requirement would be negligible.

iii. CVA Risk

Under CRD IV / CRR, institutions are required to hold additional own funds due to the CVA risk arising from Over-The-Counter ("OTC") derivatives, thus resulting in an additional capital charge when entering into such OTC trades. This charge is designed to cover losses arising from the situation where a counterparty's financial position would worsen and thereby the market value of its derivatives obligation would decline, even though there is no actual default. Thus, the CVA charge basically tries to cover the risk of deterioration in the creditworthiness of a counterparty.

Given the negligible level of Pillar-I capital requirements for CVA, no economic capital calculation is performed and hence no add-on assigned. The Group has no trading book and no derivatives of the various forms that led to the importance of CVA risk to be recognised.

Market risk management and controls

Treasury, under the oversight of the Director of Treasury and Investments, are responsible for managing interest rate risk within the prevailing interest rate risk strategy as set by the ALCO, and subject to limits set out in the Group Treasury Management Policy ("TMP"). In order to manage its interest rate risk, the Group may establish trading lines with counterparties that enable it to execute derivatives transactions approved for this purpose.

The Group Risk Function owns the IRRBB policy and IRRBB/CSRBB methodologies. The Group Risk Function is responsible for the model update, calibration and back testing. In addition, it must assure the ALCO that the appropriate IRRBB and CSRBB models have been reviewed and validated by an independent unit on at least an annual basis.

The Group Risk Function ensures that any updates in the IRRBB/CSRBB framework are promptly reflected in the Group's IRRBB policy, metrics and regular reporting as they are approved by ALCO. The Group has in place risk appetite limits and risk indicators to monitor IRRBB. The CRO recommends the Group's Risk Appetite limits in line with the Board of Directors' risk appetite and escalates any potential limit breach to ALCO and Board of Directors.

The Internal Audit function is responsible for periodic and thematic reviews of this policy in order to assess, review effectiveness and adherence to this policy.

Market risk monitoring and reporting

The Group has established a number of metrics related to IRRBB and CSRBB that are monitored and reported to ALCO on a monthly basis. Actual performance is assessed against the pre-set limits of these metrics. These metrics are also included in the monthly Group risk management reports that are circulated to the Risk Committee and Board members. In case of breaches, the Group has in place an internal escalation process.

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.5 Market risk - continued

The Group monitors the following quantitative market risk metrics:

- GBP net exposure;
- Primary FX Net Exposure;
- ∆NII under parallel shock scenarios;
- ∆EVE under 7 shock scenarios; and
- PV01 to Own Funds.

2.2.6 Operational risk

The Group recognises that complete elimination of operational risk is not always feasible. It manages its residual operational risks in the context of its risk appetite statement, whilst allocating risk appetite levels to the different sub-risk categories. Operational risk management encompasses the process of identifying operational risks, measuring the Group's exposures to those risks (where possible), ensuring that effective capital planning and monitoring is in place, taking steps to control or mitigate risk exposures, and reporting the Group's risk exposures and capital positions.

<u>Operational risk identification</u>

As outlined in the Group's Operational Risk Management Framework ("ORMF"), the Group seeks to minimise operational risks through a control environment or complete avoidance when possible. This is primarily achieved through a collaborative approach to managing operational risks between the 1st, 2nd and 3rd lines of defence. The ORMF covers; operational risk awareness, Risk Control Self-Assessments ("RCSAs"), operational risk controls testing, operational risk reporting and incident management and business continuity which are covered in detail in the Group operational risk policy.

Risk Control Self-Assessments

RCSAs are used for identification of the Group's key operational risks. The Operational Risk function is primarily responsible for driving the completion of this process. The ORMF lists the overall objectives of the RCSAs as follows:

- identify the key current and emerging operational risks to the business, with risk identification based on both risks that the business has experienced in the past and plausible risks that the business has yet to experience;
- understand and evaluate the main drivers of the operational risks;
- consider market trends of top and emerging risks across the industry;
- assess the operational risks in terms of their overall significance for the business – based on both the likelihood and impact (frequency and severity) of potential losses;
- drive improvement actions for those operational risks where further controls and monitoring is required; and
- provide consistent information on operational risks that can be aggregated and reported to senior management to inform decision-making.

The outputs from the RCSA process are reviewed by the operational risk function and shared with the CRO, whom provides top-down challenge before collating an operational risk register. This is also shared with the Board Risk Committee annually.

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.6 Operational risk - continued

Following the completion of the 2017 RCSA exercise, the following risk themes were identified:

1. *Fraud risk*, which may arise from a number of activities, either internally or externally. Internal fraud is civil or criminal activity by at least one internal party, such as an employee or distribution associate, often as a result of collusion, rogue trading, insider trading, financial reporting fraud, misappropriation of assets, or identity theft. External fraud is the civil or criminal activity by customers, contractors or third parties (excluding cyber-attacks), for example: collusion, fraud, misuse of position, misappropriation of assets and identity theft.

2. *Infrastructure risk*, which may arise from reduced or non-availability of any aspect of a fully functioning business environment including: corporate facilities, physical assets, human resources and/or technology, security, failures in licence management and insufficient software/application support. The Group has identified two sub-categories within this risk: i) physical safety, which refers to the risk of damage to non-IT physical assets, physical data, corporate facilities or human resources, and ii) business continuity, which is required if the Group experiences business disruption that may be experienced from reduced availability or non-availability of business activity due to issues related to facilities or human capital. The Group is aware that system failures (hardware or software), disruption in telecommunication, power failure and other events impeding the normal day to day operations, can result in interrupted business and financial loss.

3. *Outsourcing risk* referring to inadequate outsourcing arrangements or instances where a third-party provider fails to meet contractual terms or service level agreements, may have serious consequences such as business disruption and reputational impacts. Regulatory oversight of outsourcing arrangements has also become more prominent, particularly if the institution is viewed as systemically important. This risk may arise from external parties where the Group fails to establish and manage adequate outsourcing arrangements, transactions or other interactions with external parties including independent brokers, fund managers, IT providers, insurers and other parties for example: failure to meet agreed quality of service levels, inadequate contracting, poor relationship governance, service provider failure. This risk may also arise from internal parties, where the Group fails to establish and manage adequate outsourcing arrangements, transactions or other interactions with service providers within the Group, for example: failure to meet agreed quality of service levels, inadequate contracting, poor relationship governance, service provider failure.

   The Group's outsourcing policy provides guidelines in line with regulatory requirements which amongst other things, defines responsibilities and what activities can be outsourced.

4. *Legal and regulatory risk* which may arise from non-compliance with specific local or international rules, laws, regulations, prescribed practices or ethical standards as well as civil or criminal litigation against the Group. Basel II operational risk categories covered: inappropriate advice, sale of unauthorised products, money laundering (clients, products and business practices).

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.6 Operational risk - continued

5. *People risk* reflects the ability of the Group to manage both capacity and capability levels of one of its core assets: its employees. The Group assesses this risk in the context of recruitment of people with the right skill-set, development of its employees with the right training and behaviour, being able to retain key employees, as well as maintaining robust succession plans. It also includes remuneration considerations, such as having adequate structures and engagement levels that help align the conduct of employees with the risk and strategic objectives of the Group.

6. *Process risk*, which may arise from inadequate or failed business processes that deliver products and services in order to grow shareholder value. This includes inadequate or failed processes related to aggregation of data and reporting, inadequate or failed transaction processing (including delays as well as errors), governance or general process management, inadequate or failed processes related to financial or risk modelling and from inadequate or failed processes related to product development, product introduction, mergers and acquisitions, and the execution risk of failure to deliver change programmes or key strategic and regulatory projects.

7. *Data and model risk* arises from failure in a process designed to ensure data entry impacting the ability of the management to meet data standards (data governance) and from failures in the maintenance of, and lack of assurance of the accuracy and consistency of the data over its life-cycle (data integrity). Additionally, data used in modelling and the governance of models presents concurrent risks related to the integrity of model construction, validation and oversight.

   Data and model governance management has increased in importance and the Group is aware that inappropriate data and model governance management can have serious consequences, potentially leading to dissatisfied customers, loss of business opportunities, financial losses, reputational damage and legal/regulatory fines.

8. *Project execution risk* arises from failure in delivery significant processes (mostly regulatory related). It has risen in prominence in the past few years, in light of the rapidly changing regulatory and structural environment in recent years, where financial institutions have been obliged to make wholesale changes to strategies, processes, systems, reporting, and even the way they choose to select and maintain relationships with customers.

<u>Operational risk management and internal controls</u>

The operational risk team is responsible for coordinating reviews of the risk register following each RCSA exercise. The different risk themes are also used for ICAAP purposes where a scenario is assigned to each operational risk category. The operational risk team ensures that each scenario corresponds to plausible risk events or issues the Group could expect to face in a stressed environment. The methodology used for the calculation of the internal capital add-on for operational risk is described in the next section on operational risk measurement and assessment.

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.6 Operational risk - continued

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

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

Operational risk measurement and assessment (“RCSA”)

The result of the RCSA analysis is also used to measure and assess the various risks and their corresponding internal controls. The RCSAs are often presented as matrices of operational risks by business unit i.e. heat maps indicating where the greatest areas of operational risk lie at a given point in time. The RCSA results and documentation are leveraged for creating KRIs and developing narratives for scenario analysis e.g. when coordinating the Group’s ICAAP regulatory deliverable. This process facilitates the prioritisation of risks, based on the likelihood of the risk materialising and the potential impact.

Compliance with the Group’s standards is supported by a programme of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of the business unit to which they relate, with summaries submitted to the Audit Committees and senior management of the Subsidiaries.

Operational risk control testing

Operational risk controls testing prioritises monitoring of key controls identified through the operational risk assessment process so that the focus of control effectiveness testing and remediation is on those controls, which materially mitigate inherent operational risks.

Control testing focuses on:

- use of a risk-based approach for most efficient use of effort;
- prioritisation of a more material operational risks and controls over less material ones;
- documentation of roles and responsibilities for designing, implementing and monitoring controls; and
- linkages for material risk controls and business recovery planning and disaster recovery processes.

Control testing responsibilities fall dually within the remit of the risk owner (i.e. 1st line of defence) and the operational risk function (2nd line of defence). Following the periodic RCSA process, controls assigned to the highest risks are prioritised when testing activity occurs. Controls assigned to less material risks are reviewed and tested on a thematic basis.

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.6 Operational risk - continued

Operational risk monitoring and reporting

Measurement and monitoring of operational risks are key to assessing how much the Group could lose in terms of both the income statement and capital cost due to operational risk losses at various levels of certainty.

Operational risk is also monitored through:

i. Control owners alerting risk owners to changes in the operational risk profiles;
ii. Control owners alerting risk owners to any controls which do not operate as anticipated;
iii. Risk and control owners alerting operational risk management of control deficiencies as they see them – both through the RCSA process and general day-to-day process management;
iv. Operational risk management identify changes to operational risk profiles and the effectiveness of controls through the execution of the operational risk management framework; and
v. Internal Audit monitors operational risk and provides assurance both directly through their assessment of operational risk management, and indirectly through their reviews of business areas.

The Group has in place a number of quantitative risk appetite limits to monitor operational risk.

- significant operational losses; and
- single incident down time.

These limits are further supported by a number of KRIs that is used to provide a basis for estimating the loss corresponding to an operational risk or estimate the current level of operational risk exposure.

The actual performance against risk appetite limits and KRIs are tracked on a daily, weekly and monthly basis, and disclosed in the weekly and Group risk management reports.

2.2.7 IT and information security risk

There is a probability that the Group experiences reduced availability or non-availability due to technological issues, which can either emanate from: issues related with internal systems supporting core activities/processes of the business, which could fail or otherwise negatively impact business continuity and scalability required to support the growth and changing needs of the business, or issues resulting from cyber-attacks.

Cyber risk is an increasing risk for banks and the Group remains highly vigilant of cyber risk trends and technologies. The Group is obliged by law to protect the data of its customers, any breach due to inappropriate security systems might result in significant fines as well as major reputational consequences.

The Group has deployed a number of internal controls based on information security best practices to reduce technology risk across all layers, of which internal policies and qualitative risk appetite limits. Since May 2017, the Group is also required to report significant cyber incidents to the ECB. No significant cyber security incidents occurred throughout the financial year.

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.8 Financial crime compliance risk

Financial crime compliance risk arises due to risk of financial costs and reputational damage associated with non-compliance with internal policies, procedures and code of business, as well as consequences from non-compliance with specific local or international rules, regulations, prescribed practices or ethical standards.

The Group has identified four sub-categories for financial crime compliance risk:

1. *Money laundering and sanctions risk* which may arise from a number of sources, such as failure to detect and monitor Politically Exposed Person ("PEP") relationships; inadequate customer due diligence processes both at on-boarding and during the lifetime of the relationship; and lack of AML awareness in staff leading to negligence or failure to escalate suspicious incidents to the necessary regulatory bodies.

2. *Bribery and corruption risk,* which may arise from the Group being used to process bribes funding or from Group officials being bribed into accepting illicit activity. The Group treats such acts as serious in nature and it ensures that staff are abiding by internal policies established to manage this specific risk.

3. *Market abuse and conflicts of Interest risk* that may be triggered from certain types of behaviours, such as insider dealing and market manipulation, can amount to market abuse. Financial institutions are required by law to have safeguards in place to identify and reduce the risk of market abuse and other financial crime. There are various regulations and tools to help firms identify and reduce the risk of market abuse, such as the Market Abuse Regulation ("MAR") and the Suspicious Transaction and Order Reporting ("STOR").

4. *Client assets and client money risk*, which is the risk of not adequately segregating client assets and client money, as well as failures in client money reconciliations. Current regulation, namely MiFID II, already contains high-level obligations requiring firms to have adequate arrangements in place to safeguard clients' rights in a situation where the firm holds financial instruments or funds belonging to the clients.

The Group has measures in place to monitor financial crime compliance risk, of which these are internal policies that are specific for sub-categories within this risk, namely: i) the anti-money laundering policy; ii) sanctions policy; iii) customer risk assessment policy; iv) records retention policy; v) client acceptance policy; and vi) anti-bribery and corruption policy. As part of the Group's qualitative risk appetite, the Group keeps track of all the regulatory deadlines and submissions, in order to prevent supervisory fines, sanctions, penalties and other restrictions that may be imposed by the regulator. The Group also acknowledges that inability or failure to meet regulatory deadlines or misinterpretation of new and updates in regulation, as well as association with AML and financial crime, may result in major repercussions on the reputation of the Group.

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.9 Regulatory risk

Regulatory Risk is the risk of both regulatory actions and reputational damage associated with non-compliance with regulatory obligations and requirements, as well as consequences from non-compliance with specific local or international rules, regulations, laws or standards. It has been observed across international financial markets that adherence to the complex and ever increasing obligations of various regulators is a significant challenge and non-compliance can have significant financial and reputational consequences.

A total of six sub-categories of regulatory risk were identified:

1. *Conduct risk*, which is the risk that arises as a result of how businesses and employees conduct themselves, particularly in relation to their clients and competitors. Poor conduct can often result in problems such as mis-selling or market abuse, which may lead to specific lawsuits or regulatory penalties.

2. *Accounting risk*, which is triggered by the volume, and increasing complexity of new regulatory risk (including updates in accounting standards). The Group believes that the main challenges posed by the regulatory regime are to ensure correct interpretation and timely implementation of new or revised regulation.

3. *Regulatory change risk* that may result from delayed implementation of a new regulation or misinterpretation of the requirements of a new regulation or an update to existing regulation.

4. *Regulatory reporting risk*, which arises from failing to meet regulatory reporting requirements and deadlines. Reporting requirements are becoming more extensive, more frequent, and more complex, with regulators demanding more timely and accurate reporting.

5. *Data leakage and data protection*, which is the risk of data leakage, otherwise known as information security, is a prominent area of risk for banks to manage, both in terms of electronic data; such as customer databases or market sensitive internal reporting; and physical information; such as printed copies of customer details or physical copies of confidential documents or contracts. The risk of leakage of such information, either through malicious intent or collusion; or through negligence of employees, systems or behaviour, requires active and ongoing management and controls.

6. *Legal risk* that may result from inadequate legal framework and documentation.

The Group has established a Regulatory Updates Committee ("RUC") to ensure changes to regulations are captured, reviewed and embedded within the Group's policies and processes. This new sub-committee of the EXCO oversees all regulatory compliance matters, thereby ensuring that all regulatory requirements and updates are adhered to. The scope of the RUC includes changes which need to be announced, ad hoc requests made to the group, for example by the regulator, and oversight of existing regulatory change work streams. It also includes other matters relating to the Group's external environment.

2 Risk management, objectives and policies - continued

2.2 Information on risk management, objectives and policies by category of risks - continued

2.2.9 Regulatory risk - continued

The Group assesses conduct risk within its operational risk management framework. The Group acknowledges that conduct risk has increased in prominence over the past few years and intends to establish a conduct risk framework during the next financial year. The Group has in place a number of qualitative risk appetite limits to monitor the sub-categories of regulatory risk.

2.2.10 Reputational risk

The Group does not knowingly conduct business or organise its operations to put its reputation at risk. It seeks to mitigate these risks by primarily avoiding activities that inherently attract higher risk of reputational damage. The Group also has internal policies in place listing permitted actions and consequences for failure to comply with these internal standards. The Group's reputational risk management framework is based on four main pillars: i) a chapter within the Operational risk policy that outlines the principles, classification, assessment and risk drivers; ii) scenario assessment that is mainly driven by scenario workshops, RCSAs or other Bank events (lessons learnt); iii) monitoring of a number of KRIs involving social media diagnostics and account notice figures; and iv) promoting a Group-wide risk culture and increase risk awareness.

The Group also safeguards its reputation when considering launching new products (which are discussed thoroughly in the New Products and Services Committee) and governed by the product approval and product sales policy.

Reputational risk may also arise from external dependencies such as external service providers. The Group has an outsourcing policy to help it manage and mitigate the risk arising from these activities, as well as the TMP listing approved counterparties and associated limits.

2.3 Risk statement

The Board is committed to set the tone from above by instilling a risk-aware culture across the Group where everyone is aware of the different risks that the Group faces as well as the risk management processes that should be embedded in key decision-making.

The Board of Directors, after considering: (1) the strategies and processes to manage risks to which the Group is exposed; (2) the structure and organisation of the risk management function, its authority and statute; (3) the scope and nature of risk reporting and measurement systems; and (4) the policies for hedging and mitigating risk, together with the strategies and processes for monitoring the continuing effectiveness of hedges; is of the opinion that the risk management arrangements of the Group are adequate and provide assurance that the risk management systems put in place are appropriate with regard to the Group's profile and strategy. The Board believes that the risk management process includes adequate policies, procedures, risk limits and risk controls that ensure timely and continuous identification, measurement and assessment, management, monitoring and reporting of these risks at the business line, consolidated and sub-consolidated levels.

3 Credit risk and credit risk mitigation (“CRM”)

Both the treasury management policy and the corporate credit framework include a list of permitted asset classes, countries and currencies, whilst a high degree of diversification is implemented through single issuer, industry and geography concentration limits.

3.1 Credit risk exposure – analysis by exposure class

The following table shows the net exposure values as at 31 March 2018 by exposure classes and the average net exposure value of this financial year; based on the last 4 end of quarter observations.

EU CRB-B Total and average net amount of exposures

	Net value of exposures at end of year[5] €000	Average net exposures over the year €000
15 **Total IRB approach**	-	-
16 Central governments or central banks	136,035	238,230
17 Regional governments or local authorities	67,350	48,384
18 Public sector entities	109,999	110,562
19 Multilateral development banks	113,866	114,250
20 International organisations	28,524	35,453
21 Institutions	104,817	106,332
22 Corporates	2,122,947	1,985,499
23 of which SMEs	*809*	*8,529*
24 Retail	9,445	9,103
25 of which SMEs	*4,936*	*6,809*
26 Secured by mortgages on immovable property	55,156	32,600
27 of which SMEs	*21,336*	*9,185*
28 Exposures in default	53,870	40,338
29 Items associated with particular high risk	47,479	51,545
30 Covered bonds	240,394	272,146
34 Other items	12,457	15,936
35 **Total standardised approach**	3,102,339	3,060,378
36 **Total**	**3,102,339**	**3,060,378**

[5] **Net value of exposures**: For on-balance-sheet items, the net value is the gross carrying value of the exposure less allowances/impairments. For off-balance-sheet items, the net value is the gross carrying value of exposure less provisions.

3 Credit risk and credit risk mitigation ("CRM") - continued

3.2 Credit risk exposure – analysis by geographical distribution

The following table shows the distribution of the exposures (net values of on-balance sheet and off balance sheet balances) as at 31 March 2018 by geographical distribution broken down by exposure classes.

EU CRB-C: Geographical breakdown of exposures

		Net value of exposures								
		Malta €000	**United Kingdom €000**	**Germany €000**	**Italy €000**	**Netherlands €000**	**France €000**	**United States €000**	**Other countries €000**	**Total €000**
6	**Total IRB approach**	-	-	-	-	-	-	-	-	-
7	Central government or central banks	97,906	-	-	-	-	-	-	38,129	136,035
8	Regional governments or local authorities	-	-	67,350	-	-	-	-	-	67,350
9	Public sector entities	961	-	-	-	-	109,038	-	-	109,999
10	Multilateral development banks	-	-	-	-	-	-	-	113,866	113,866
11	International organisations	-	-	-	-	-	-	-	28,524	28,524
12	Institutions	3,261	36,920	563	47	10	2,448	30,873	30,695	104,817
13	Corporates	51,851	578,807	249,823	194,495	190,228	352,620	152,768	352,355	2,122,947
14	Retail	9,245	200	-	-	-	-	-	-	9,445
15	Secured by mortgages on immovable property	44,836	10,189	-	-	-	-	-	131	55,156
16	Exposures in default	6,582	26,536	14,454	3,644	-	-	-	2,654	53,870
17	Items associated with particular high risk	47,479	-	-	-	-	-	-	-	47,479
18	Covered bonds	-	133,473	-	-	33,323	-	-	73,598	240,394
22	Other items	12,457	-	-	-	-	-	-	-	12,457
23	**Total standardised approach**	274,578	786,125	332,190	198,186	223,561	464,106	183,641	639,952	3,102,339
24	**Total**	**274,578**	**786,125**	**332,190**	**198,186**	**223,561**	**464,106**	**183,641**	**639,952**	**3,102,339**

Note to EU CRB-C Table : Other countries account for circa 21% of the total net exposure value and comprise of 17 countries. The main ones being Belgium, Spain and Luxembourg.

3 Credit risk and credit risk mitigation ("CRM") - continued

3.3 Credit risk exposure – analysis by industry distribution

The following table shows the distribution of the exposures (net values of on-balance sheet and off balance sheet balances) as at 31 March 2018 by industry broken down by exposure classes.

EU CRB-D: Concentration of exposures by industry

		Net value of exposures							
		Manufacturing €000	**Financial and insurance activities €000**	**Construction €000**	**Professional, scientific and technical activities €000**	**Information and communication €000**	**Wholesale and retail trade €000**	**Others €000**	**Total €000**
6	**Total IRB approach**	-	-	-	-	-	-	-	-
7	Central government or central banks	-	103,543	-	-	-	-	32,492	136,035
8	Regional governments or local authorities	-	-	-	-	-	-	67,350	67,350
9	Public sector entities	-	-	-	-	-	-	109,999	109,999
10	Multilateral development banks	-	113,866	-	-	-	-	-	113,866
11	International organisations	-	-	-	-	-	-	28,524	28,524
12	Institutions	-	104,817	-	-	-	-	-	104,817
13	Corporates	258,869	1,237,036	43,765	99,465	229,727	25,436	228,649	2,122,947
14	Retail	172	43	2,869	896	-	777	4,688	9,445
15	Secured by mortgages on immovable property	-	7,951	7,801	-	10,189	5,916	23,299	55,156
16	Exposures in default	14,454	6,604	2,911	22,342	-	3,839	3,720	53,870
17	Items associated with particular high risk	-	-	27,306	-	-	-	20,173	47,479
18	Covered bonds	-	240,394	-	-	-	-	-	240,394
22	Other items	-	-	238	-	-	60	12,159	12,457
23	**Total standardised approach**	273,495	1,814,254	84,890	122,703	239,916	36,028	531,053	3,102,339
24	**Total**	**273,495**	**1,814,254**	**84,890**	**122,703**	**239,916**	**36,028**	**531,053**	**3,102,339**

3 Credit risk and credit risk mitigation ("CRM") - continued

3.4 Credit risk exposure – analysis by residual maturity

The following table shows the distribution of the exposures (net values of on-balance sheet and off balance sheet balances) as at 31 March 2018 by residual maturity broken down by exposure classes.

EU CRB-E: Maturity of Exposures

	Net value of exposures					
	On demand €000	**Less than one year €000**	**Over one but less than five years €000**	**Over 5 years €000**	**No stated maturity €000**	**Total €000**
6 **Total IRB approach**	-	-	-	-	-	-
7 Central government or central banks	103,543	7,023	13,494	-	11,975	136,035
8 Regional governments or local authorities	-	31,498	35,852	-	-	67,350
9 Public sector entities	-	961	78,323	30,715	-	109,999
10 Multilateral development banks	-	20,952	92,914	-	-	113,866
11 International organisations	-	-	28,524	-	-	28,524
12 Institutions	38,377	31,295	34,582	563	-	104,817
13 Corporates	26,264	273,364	1,795,567	27,752	-	2,122,947
14 Retail	125	4,005	3,214	2,101	-	9,445
15 Secured by mortgages on immovable property	-	10,701	20,495	23,960	-	55,156
16 Exposures in default	7,370	8,006	38,231	263	-	53,870
17 Items associated with particular high risk	4,478	10,122	29,989	2,890	-	47,479
18 Covered bonds	-	-	229,226	11,168	-	240,394
22 Other exposures	197	6,574	2,696	175	2,815	12,457
23 **Total standardised approach**	180,354	404,501	2,403,107	99,587	14,790	3,102,339
24 **Total**	**180,354**	**404,501**	**2,403,107**	**99,587**	**14,790**	**3,102,339**

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3 Credit risk and credit risk mitigation ("CRM") - continued

3.5 Credit quality analysis

The following tables provide a comprehensive picture of the credit quality of the Group's assets by exposure class as at 31 March 2018 in line with EBA guidelines on disclosures, by exposure class, industry and geography.

EU CR1–A: Credit quality of exposures by exposure class and instrument

	Gross carrying values[6] of					
	Defaulted exposures €000	**Non-defaulted exposures €000**	**Specific credit risk adjustments €000**	**Accumulated write offs €000**	**Credit risk adjustment charges of the period €000**	**Net values[7] €000**
15 **Total IRB approach**	-	-	-	-	-	-
16 Central governments or central banks	-	136,035	-	-	-	136,035
17 Regional governments or local authorities	-	67,350	-	-	-	67,350
18 Pubic sector entities	-	109,999	-	-	-	109,999
19 Multilateral development banks	-	113,866	-	-	-	113,866
20 International organisations	-	28,524	-	-	-	28,524
21 Institution	-	104,817	-	-	-	104,817
22 Corporates	-	2,127,998	5,051	1,600	679	2,122,947
23 of which SMEs	-	*809*	-	-	-	*809*
24 Retail	-	9,550	105	-	88	9,445
25 of which SMEs	-	*5,041*	*105*	-	*91*	*4,936*
26 Secured by mortgages on immovable property	-	55,274	118	-	(59)	55,156
27 of which SMEs	-	*21,353*	*17*	-	*17*	*21,336*
28 Exposures in default	69,420	-	15,550	-	(1,429)	53,870
29 Items associated with particular high risk	7,366	41,927	1,814	-	1,299	47,479
30 Covered bonds	-	240,394	-	-	-	240,394
34 Other exposures	-	12,457	-	-	(2)	12,457
35 **Total standardised approach**	76,786	3,048,191	22,638	1,600	576	3,102,339
36 **Total**	**76,786**	**3,048,191**	**22,638**	**1,600**	**576**	**3,102,339**
37 of which: Loans and advances	76,786	1,686,602	22,638	1,600	576	1,740,750
38 of which: Debt securities	-	570,104	-	-	-	570,104
39 of which: Off-balance-sheet exposures	-	567,380	-	-	-	566,738

[6] **Gross carrying values**: This represents the accounting value before any allowance/impairments but after considering write-offs. Moreover, this amount does not take into account any credit risk mitigation technique in the application of Part Three, Title II, Chapter 4 of the CRR. Off-balance-sheet items are disclosed for their nominal amount gross of any credit conversion factor applicable in accordance with Article 111 and 166 of the CRR or credit risk mitigation techniques, and gross of any provision. Moreover, any accrued interest emanating from the exposure is included as part of the gross carrying value.

[7] **Net values** is the summation of the gross carrying values of defaulted and non-defaulted exposures, less any specific credit risk adjustments.

3 Credit risk and credit risk mitigation (“CRM”) - continued

3.5 Credit quality analysis - continued

EU CR1–B: Credit quality of exposures by industry

	Gross carrying values of					
	Defaulted exposures €000	**Non-defaulted exposures €000**	**Specific credit risk adjustments €000**	**Accumulated write-offs €000**	**Credit risk adjustment charges of the period €000**	**Net values €000**
3 Manufacturing	16,374	259,795	2,674	1,600	471	273,495
6 Financial and insurance activities	7,004	1,810,648	3,398	-	(2,254)	1,814,254
7 Construction	11,231	76,343	2,684	-	(321)	84,890
8 Professional, scientific and technical activities	25,475	100,721	3,493	-	2,603	122,703
10 Information and communication	-	240,449	533	-	(16)	239,916
12 Wholesale and retail trade	5,260	32,271	1,503	-	1,373	36,028
24 Others	11,442	527,964	8,353	-	(1,280)	531,053
25 **Total**	**76,786**	**3,048,191**	**22,638**	**1,600**	**676**	**3,102,339**

EU CR1–C: Credit quality of exposures by geography

	Gross carrying values of					
	Defaulted exposures €000	**Non-defaulted exposures €000**	**Specific credit risk adjustments €000**	**Accumulated write-offs €000**	**Credit risk adjustment charges of the period €000**	**Net values €000**
1 **Europe**	**76,786**	**2,819,257**	**22,323**	**1,600**	**523**	**2,873,720**
2 Malta	16,476	262,633	4,531	-	(1,563)	274,578
3 Belgium	-	71,876	55	-	20	71,821
4 Switzerland	-	36,723	74	-	38	36,649
5 Germany	16,374	318,278	2,462	1,600	301	332,190
6 Denmark	-	44,084	-	-	-	44,084
7 Spain	9,736	67,116	7,245	-	399	69,607
8 France	-	464,945	839	-	386	464,106
9 United Kingdom	29,136	761,290	4,301	-	2,895	786,125
10 Luxembourg	-	74,316	130	-	27	74,186
11 Ireland	-	32,133	103	-	21	32,030
12 Italy	5,064	195,058	1,936	-	1,275	198,186
13 Netherlands	-	223,977	416	-	(3,328)	223,561
14 Sweden	-	56,886	61	-	25	56,825
15 Other	-	209,942	170	-	57	209,772
16 **North America**	**-**	**191,598**	**280**	**-**	**53**	**191,318**
17 United States	-	183,921	280	-	53	183,641
18 Other	-	7,677	-	-	-	7,677
16 **Asia**	**-**	**34,802**	**35**	**-**	**-**	**34,767**
17 Hong Kong	-	34,802	35	-	-	34,767
18 **Other geographical areas**	**-**	**2,534**	**-**	**-**	**-**	**2,534**
19 **Total**	**76,786**	**3,048,191**	**22,638**	**1,600**	**576**	**3,102,339**

3 Credit risk and credit risk mitigation ("CRM") - continued

3.5 Credit quality analysis - continued

The following table provides an overview of non-performing and forborne exposures as at 31 March 2018 as per the Commission Implementing Regulation (EU) No 680/2014.

EU CR1–E: Non-performing and forborne exposures

	Gross carrying values of performing and non- performing exposures						
	€000	Of which performing but past due >30 days and <=90days €000	Of which performing forborne €000	Of which non-performing €000	Of which defaulted €000	Of which impaired €000	Of which forborne €000
1 Debt securities	570,104	-	-	-	-	-	-
2 Loans and advances	1,763,387	92	70,186	76,786	76,786	76,786	58,328
3 Off-balance sheet exposures	566,738	-	-	-	-	-	-

	Accumulated impairment and provisions and negative fair value adjustment due to credit risk				Collaterals and financial guarantees received	
	On performing exposures €000	Of which forborne €000	On non-performing exposures €000	Of which forborne €000	On non-performing exposures €000	Of which forborne €000
1 Debt securities	-	-	-	-	-	-
2 Loans and advances	5,641	244	16,997	8,868	32,044	28,716
3 Off-balance sheet exposures	-	-	-	-	-	-

The table above is presented based on the EBA definitions of 'non-performing' and 'forborne' exposures.

3.6 Impairment loss measurement guidelines

The scope of the impairment loss measurement guidelines are to establish effective provisioning standards, internal controls, reporting requirements and approval processes that will govern the on-going monitoring of credit risk exposures inherent in the investment securities and loan portfolios.

An exposure is "past due" when any amount of principal, interest or fee has not been paid at the date it was due. Past due but not impaired loans are those loans and advances for which contractual interest or principal payments are past due but the Group believes that impairment is not appropriate on the basis of the stage of collection of amounts owed to the Group.

3 Credit risk and credit risk mitigation (“CRM”) - continued

3.6 Impairment loss measurement guidelines - continued

In accordance with the policy, impaired investment securities and loans are either those that are more than 90 days past due, or those for which the Group establishes that it is unlikely that it will collect the full principal and/or interest due in accordance with the contractual terms of the underlying agreement(s).

However, as outlined previously where contractual interest or principal payments are past due, but the Group believes that impairment is not appropriate on the basis of the stage of collection of amounts owed to the Group, such facilities are considered as past due but not impaired loans. Related credit losses, which may arise, are partly covered by collective impairment allowances.

The following table provides an aging analysis of accounting on-balance sheet past due exposures as at 31 March 2018 regardless of their impairment status. The gross carrying values indicated is before impairments and provisions but after the write-offs reported in financial statements.

EU CR1-D: Ageing of past due exposures

	Gross carrying values					
	≤ 30 days €000	> 30 days ≤ 60 days €000	> 60 days ≤ 90 days €000	> 90 days ≤ 180 days €000	> 180 days ≤ 1 year €000	> 1 year €000
1 Loans	516	92	-	276	45	25,491
3 Total exposures	**516**	**92**	**-**	**276**	**45**	**25,491**

All debt securities have no days past due as at end of the financial period 2018.

As per the Article 111 of CRR, the exposure values of assets shall be their accounting values remaining after specific credit risk adjustments while any general credit risk adjustments are treated as part of Tier 2 capital. Regulation 183/2014 defines what should be treated as general or specific credit risk adjustments, which can result from impairments, value adjustments or other provisions.

Such adjustments shall be equal to all amounts by which the Common Equity Tier 1 capital has been reduced in order to reflect losses exclusively related to credit risk according to the applicable accounting framework and recognised as such in the income statement. Losses which are a result of current or past events affecting certain exposures and losses for which historical experience (on the basis of current observable data) indicates that the loss has occurred but it is not yet known which individual exposure suffered these losses, are treated as specific credit risk adjustments.

Amounts which are freely and fully available, as regards to timing and amount, to meet credit risk losses that have not yet materialised and amounts which reflect credit risk losses for a group of exposures for which there is currently no evidence that a loss event has occurred, are treated as general credit risk adjustments.

According to these definitions, the Group's specific and general impairment allowances as calculated under IAS 39, are classified as specific credit risk adjustments and are deducted from the accounting values to determine the exposure amounts.

There are no other amounts apart from the impairment allowances that are classified as specific or general credit risk adjustments.

3 Credit risk and credit risk mitigation ("CRM") - continued

3.6 Impairment loss measurement guidelines - continued

The following table provides an analysis the change in stock of specific credit risk adjustment for the financial year ended 31 March 2018.

EU CR2–A – Changes in the stock of specific credit risk adjustments

	Accumulated specific credit risk adjustment €000
1 Opening balance at 31 March 2017	22,062
2 Increases due to amounts set aside for estimated loan losses during the period	12,801
3 Decreases due to amounts reversed for estimated loan losses during the period	(11,326)
6 Impact of exchange rate differences	(899)
9 **Closing balance at 31 March 2018**	**22,638**
10 Recoveries on credit risk adjustments recorded directly to the statement of profit or loss	-
11 Specific credit risk adjustments recorded directly to the statement of profit or loss	-

The Group does not account for any general credit risk adjustments.

The Group's impaired and past due but not impaired loans and advances to customers were primarily concentrated in Europe

There were no other adjustments including those determined by business combinations, acquisitions and disposals of subsidiaries, and transfers between credit risk adjustments.

3 Credit risk and credit risk mitigation ("CRM") - continued

3.6 Impairment loss measurement guidelines - continued

The following table provides an analysis of the changes in stock of defaulted loans and debt securities throughout the financial year. The gross carrying value is inclusive of accrued interest.

EU CR2– B – Changes in the stock of defaulted and impaired loans and debt securities

	Gross carrying value defaulted exposures €000
1 Opening balance at 31 March 2017	66,097
2 Loans and debt securities that have defaulted or impaired since the last reporting period	34,539
3 Returned to non-defaulted status	(73)
4 Amounts written off	(6,827)
5 Other changes	(16,950)
Closing balance at 31 March 2018	**76,786**

3.7 Credit risk mitigation

It is the Group's practice to lend on the basis of the customer's ability to meet its obligations out of its cash flow resources rather than rely on the value of security offered. In fact, the majority of Group's loans are not secured by any type of collateral, and the amount of collateral received is immaterial in terms of the total exposure of the Group.

However the Group still uses various techniques as allowed by the CRD IV in order to mitigate credit risks such as netting and set off, and in some cases use of collateral. Credit risk mitigation is recognised only when it is legally enforceable and effective, which in order to do so requires adequate monitors and valuation of collateral received.

3.7.1 Capital allocation and capital buffers for credit risk

The Group adopts the standardised approach to calculate its capital requirement for credit risk. The Group's credit framework contains enough detail specifying how the Group calculates the risk weights of the exposures covered by the framework, wherever the regulatory framework permits elections or other choices to be made.

3 Credit risk and credit risk mitigation ("CRM") - continued

3.7 Credit risk mitigation - continued

3.7.1 Capital allocation and capital buffers for credit risk - continued

Besides allocating capital against its Pillar I risks that are based on the Group's accounting records, the Group also carries an assessment of the extra capital proportionate to Pillar II risks as part of its annual ICAAP. The ICAAP chapter on concentration risk, describes the Group's approach for allocating capital for this risk. This chapter explains that the Group's concentration risk may arise from two types of imperfect diversification, namely single-name concentration and sectoral concentration (BCBS 2006)[8].

Banking Rule 09 ("BR 09") 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 retained earnings. During the year the Bank adhered to revised BR 09 which imposes higher allocations for certain past due exposures.

Since the Group is not rated, it is not required to allocate internal capital or allocate collateral in the eventuality of a downgrade in its credit rating.

3.7.2 On and off balance sheet netting and set-off

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

3.7.3 Collateral and other credit enhancements

Collateral received by the Group includes residential and commercial property, as well financial collateral such as debt securities and cash on deposit.

Most of the immovable property collateral received is located in Malta with only one significant commercial property being located in another European jurisdiction. In particular, in relation to the local lending portfolio, 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 Group follows Articles 124 to 126 of the CRR in order to determine whether exposures are fully and completely secured by immovable property, and which risk weight to apply in order to calculate the own funds requirement.

In order to make use of the financial collateral for credit risk mitigation purposes, the Group follows the conditions set out in Chapter 4, Title I, Part Three of CRR, in particular applying Article 222 of the said regulation. Collateral that is not eligible in terms of CRR is not taken into consideration for credit risk mitigation.

The financial collateral is mostly made up of quality debt securities, comprising bonds issued by a Central Government rated A. This collateral is valued daily against statements received from the Central Bank showing bond values after haircuts, in order to determine whether additional collateral is required in respect of the relative exposure. The collateral is placed with the Central Bank of Malta until the maturity of the exposure.

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[8] Basel Committee on Banking Supervision (2006), "Studies on Credit Risk Concentration, Working Paper No.15"

3 Credit risk and credit risk mitigation (“CRM”) - continued

3.7 Credit risk mitigation - continued

3.7.3 Collateral and other credit enhancements - continued

The following table shows an analysis of the on-balance sheet exposure value (carrying amount net of provisions) as at 31 March 2018 that is covered by eligible collateral in line with CRR requirements highlighting the amount of the exposure value which is unsecured and secured:

EU CR3 – CRM techniques - Overview

	Exposures Total unsecured - Carrying amount[9]	Exposures Total secured - Carrying amount[10]	Exposures secured by collateral[11]	Exposures secured by financial guarantees[12]
	€000	€000	€000	€000
1 Total loans and advances	1,650,842	89,908	88,872	1,036
2 Total debt securities	570,104	-	-	-
3 Total exposures	**2,220,946**	**89,908**	**88,872**	**1,036**
4 of which Defaulted	47,686	12,082	12,082	-

[9] **Exposures unsecured – Carrying amount**: The carrying amount of exposures (net of allowances/impairments) that do not benefit from a CRM technique, regardless of whether this technique is recognised under Part Three, Title II, Chapter 4 in the CRR.

[10] **Exposure - secured – Carrying amount**: Carrying amount of exposures that have at least one CRM mechanism (collateral, financial guarantees, credit derivatives) associated with them.

[11] **Exposures secured by collateral**: carrying amount of exposures (net of allowances/impairments) partly or totally secured by collateral.

[12] **Exposures secured by financial guarantees**: Carrying amount of exposures (net of allowances/impairments) partly or totally secured by financial guarantees.

3 Credit risk and credit risk mitigation ("CRM") - continued

3.7 Credit risk mitigation - continued

3.7.3 Collateral and other credit enhancements - continued

The following table details out the types of eligible collateral held for each exposure class as at 31 March 2018:

	Exposure value post CCF and CRM[13]					
	Secured by collateral		Secured by financial guarantees			
	Secured by residential immovable property	Secured by commercial immovable property	Secured by debt securities	Secured by cash on deposit	Other types of secured exposures	Unsecured exposures
	€000	€000	€000	€000	€000	€000
Central governments or central banks	-	-	3,969	-	-	132,066
Regional governments or local authorities	-	-	-	-	-	67,350
Public sector entities	-	-	-	-	-	109,999
Multilateral development banks	-	-	-	-	-	113,866
International organisations	-	-	-	-	-	28,524
Institutions	-	-	-	-	-	104,817
Corporates	-	1,249	-	-	-	1,788,756
Retail	349	1,610	-	-	-	2,056
Secured by mortgages on immovable property	17,262	28,808	-	-	-	1,655
Exposures in default	1,816	4,369	-	-	-	47,685
Items associated with particular high risk	24,148	9,261	-	-	-	-
Covered bonds	-	-	-	-	-	240,394
Other	-	-	-	641	-	9,937
Total	**43,575**	**45,297**	**3,969**	**641**	**-**	**2,647,105**

[13] **Exposure value post CCF and CRM**: This amount represents the exposure value after taking into account specific credit risk adjustments as defined in the Commission Delegated Regulation (EU) No 183/2014 and write-offs as defined in the applicable accounting framework, all credit risk mitigants and CCFs. This is the amount to which the risk weights (according to Article 113 and Part Three, Title II, Chapter 2, Section 2 of the CRR) are applied.

3 **Credit risk and credit risk mitigation ("CRM")** - continued

3.7 Credit risk mitigation - continued

3.7.3 Collateral and other credit enhancements - continued

The following table shows the exposures together with the relevant credit risk mitigation undertaken for each class as at 31 March 2018:

EU CR4 – Standardised approach – Credit risk exposure and CRM effects

	Exposures before CCF and CRM[14]		Exposures post CCF and CRM		RWA and RWA density	
Exposure classes	**On-Balance sheet amount €000**	**Off-Balance sheet amount €000**	**On-Balance sheet amount €000**	**Off-Balance sheet amount €000**	**RWAs €000**	**RWA density %**
1 Central governments or central banks	136,035	-	136,035	-	25,454	19%
2 Regional governments or local authorities	67,350	-	67,350	-	-	0%
3 Public sector entities	109,999	-	109,999	-	481	0%
4 Multilateral development banks	113,866	-	113,866	-	-	0%
5 International organisations	28,524	-	28,524	-	-	0%
6 Institutions	100,369	-	100,369	-	20,074	19%
7 Corporates	1,591,899	535,680	1,586,848	202,738	1,789,585	89%
8 Retail	4,120	5,430	4,015	-	3,011	66%
9 Secured by mortgages on immovable property	47,473	7,801	47,356	369	34,473	71%
10 Exposures in default	69,420	-	53,870	-	74,370	138%
11 Items associated with particular high risk	35,222	14,070	33,409	-	50,113	144%
12 Covered bonds	240,394	-	240,394	-	24,039	10%
16 Other items	8,700	3,757	8,700	1,878	7,926	64%
17 Total	**2,553,371**	**566,738**	**2,530,735**	**204,985**	**2,029,527**	**69%**

The table above does not cover derivative instruments exposures as at 31 March 2018 with an exposure value of €4.9 million post CCF and CRM, of which the respective RWAs amounted to €1,759,305.

[14] **Exposures before CCF and CRM**: This represents the Group's on-balance-sheet and off-balance exposures (respectively) under the regulatory scope of consolidation (in accordance with Article 111 in the CRR), net of specific credit risk adjustments (as defined in the Commission Delegated Regulation (EU) No 183/2014) and write-offs (as defined in the applicable accounting framework), but before (i) the application of CCFs as specified in the same article and (ii) the application of CRM techniques specified in Part Three, Title II, Chapter 4 of the CRR.

3 **Credit risk and credit risk mitigation (“CRM”)** - continued

3.7 ***Credit risk mitigation*** - continued

3.7.3 ***Collateral and other credit enhancements*** - continued

EU CR5 – Standardised approach Exposure Value

	Exposure value post CCF and CRM									
	0% €000	**10% €000**	**20% €000**	**35% €000**	**50% €000**	**75% €000**	**100% €000**	**150% €000**	**250% €000**	**Total €000**
1 Central governments or central banks	125,853	-	-	-	-	-	-	-	10,182	136,035
2 Regional governments or local authorities	67,350	-	-	-	-	-	-	-	-	67,350
3 Public sector entities	109,038	-	-	-	961	-	-	-	-	109,999
4 Multilateral development banks	113,866	-	-	-	-	-	-	-	-	113,866
5 International organisations	28,524	-	-	-	-	-	-	-	-	28,524
6 Institutions	-	-	104,254	-	-	-	563	-	-	104,817
7 Corporates	-	-	-	-	-	-	1,790,005	-	-	1,790,005
8 Retail	-	-	-	-	-	4,015	-	-	-	4,015
9 Secured by mortgages on immovable property	-	-	-	9,019	14,778	-	23,928	-	-	47,725
10 Exposures in default	-	-	-	-	-	-	12,870	41,000	-	53,870
11 Items associated with particular high risk	-	-	-	-	-	-	-	33,409	-	33,409
12 Covered bonds	-	240,394	-	-	-	-	-	-	-	240,394
15 Equity exposures	-	-	-	-	-	-	-	-	-	-
16 Other items	2,652	-	-	-	-	-	7,926	-	-	10,578
17 Total	**447,283**	**240,394**	**104,254**	**9,019**	**15,739**	**4,015**	**1,835,292**	**74,409**	**10,182**	**2,740,587**

3 Credit risk and credit risk mitigation ("CRM") - continued

3.8 Settlement risk

The Group's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of an entity to honour its obligations to deliver cash, securities or other assets as contractually agreed.

Mitigation of settlement risk

For all types of investment transactions the Group mitigates this risk by conducting settlements through a settlement/clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations. Settlement limits form part of the credit approval/limit monitoring process described earlier. Furthermore, the Group has a number of master netting agreements covering repurchase transactions and securities with its counterparties.

3.9 Credit Valuation Adjustment ("CVA")

The CRR requires financial institutions to calculate own funds requirements for CVA risk, in accordance with Article 382, which is a capital charge to reflect potential mark-to-market losses due to counterparty migration risk on bilateral OTC derivative contracts.

Using the regulatory formula, capital required in respect of CVA risk as at 31 March 2018, is calculated to be €755,348 on a total exposure of €755,348.

EU CCR2 – CVA Capital Charge

	Exposure value	RWAs
	€000	**€000**
4 All portfolios subject to the standardised method (€ millions)	755	755

3.10 Exposures in equities

The Group did not hold any equity instruments as at the end of the reporting period. The equity instruments held by the Group throughout the year and not included in the trading book, were accounted for at fair value and consisted of locally quoted equity instruments issued by local well known corporates. These equity instruments were disposed throughout the financial year and the realised gains on the sale of such investments amounted to €0.1 million.

The equity exposures were classified as available-for-sale and were held long term for capital gains purposes. The total Equity holding did not fall under the definition of "qualifying holding"[15] and was below the small trading book business threshold (Article 94 of CRR) given that it was less than 5% of total assets and therefore was not eligible to be part of a trading book.

[15] CRR defines "qualifying holding" as a direct or indirect holding in an undertaking which represents 10% or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that undertaking.

4 Counterparty credit risk

Counterparty credit risk ("CCR") refers to the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. The Group is primarily exposed to counterparty credit risk through derivative exposures, which have largely been limited to interest rate and currency hedges of the Group's investment portfolio, and to other derivatives exposures that can be priced on a real time basis.

The Group was not involved in any credit derivative transactions during the year, and the derivative transactions falling under intermediation activities were immaterial in relation to the total derivative transactions undertaken by the Group. Due to this, the Group does not allocate a capital add-on for counterparty concentration. A description of the methodology used by the Group to allocate internal capital for concentration risk is given in section 3 'Credit Risk and Credit Risk mitigation'.

Counterparty credit risk in respect of currency swaps and forwards, interest rate swaps, options, swaptions and any other derivative instruments that entail credit exposures shall only be entered into with counterparties approved by ALCO. Entry into any derivative exposure will be subject to prior implementation of appropriate settlement and risk management infrastructure pursuant to a signed ISDA Agreement. The Group's RAS clearly states that the Group has no appetite to enter into currency swaps and forwards, interest rate swaps, options and other derivative instruments which create credit exposures with counterparties which are not approved by ALCO. This list of approved derivative counterparties and associated limits is included as appendix in the Group's TMP. Entering into bilateral secured financing transactions bearing any counterparty risk which cannot be executed under a signed GMRA or ISDA agreement is also outside the Group's risk appetite.

The Group's Treasury team ensures that margin calls arising from the Group's repo and derivatives obligations are monitored on a daily basis. Exposure to derivative counterparties and the related credit risk is mitigated through the use of netting and collateralisation agreements.

As the Group is not an externally rated entity, the Group does not carry any exposure to counterparty credit risk impact given a downgrade in its credit rating.

4 Counterparty credit risk - continued

4.1 Analysis of counterparty credit risk exposure

In order to determine the potential future credit exposure, the notional amounts or underlying values, as applicable, are multiplied by the percentages stipulated in the CRR, Table 1 of Article 274(2)(c). These are based on contract type and residual maturities.

EU CCR1 – Analysis of CCR exposure by approach

At 31 March 2018	Replacement cost/current market value €000	Potential future credit exposure €000	EAD post CRM €000	RWAs €000
1 Mark to market	470	4,439	4,909	1,767

Analysed as follows:	Residual maturity	Notional amount (€000)	Applicable percentage[16]	Replacement cost (€000)	Potential future exposure (€000)	Risk-weight	Risk-weighted assets (€000)
Interest rate swaps and other exposures to a Central Clearing Counterparty					562	100%	562
Interest rate swaps	Over one year, not exceeding five years	351,000					
Interest rate swaps	Over five years	45,000					
Foreign currency contracts	One year or less	382,615	1.00%	101	3,826	20%	786
Foreign currency contracts	One year or less	41	1.00%	1	1	100%	1
Contracts concerning equities	Over five years	498	10.00%	368	50	100%	418

[16] Applicable percentages per Table 1 of Article 274(2)(c)

4 Counterparty credit risk - continued

4.1 Analysis of counterparty credit risk exposure - continued

The below table shows the counterparty credit risk exposure split by exposure class:

	Exposure value €000	Risk weighted assets €000
Institutions	4,491	1,349
of which exposure to a qualifying central counterparty	*562*	*562*
Corporates	418	418
	4,909	**1,767**

5 External credit assessment institutions

The Group uses credit assessments issued by External Credit Assessment Institutions ("ECAI's") in order to calculate the risk weighted exposure amounts for certain exposure classes, wherever such a credit assessment is available, in accordance with Part Three, Title II, Chapter 2 of the CRR. During the financial year ended 31 March 2018, the Group used the external ratings issued by the following 3 nominated ECAIs: S&P, Fitch and Moody's. The relevant ratings to use were determined in particular by Article 138 of the CRR, and these were mapped to the credit quality steps according to Regulation 2016/1800 which lays down the *"implementing technical standards with regard to the allocation of credit assessments of external credit assessment institutions…".*

The Group applies the ECAI ratings to the following exposure classes:

- Central governments or central banks
- Regional governments or local authorities
- Public sector entities
- Multilateral development banks
- International organisations
- Institutions
- Covered bonds

There were no changes in the nominated ECAIs and exposures to which the ratings are applied from the prior financial year.

5 External credit assessment institutions - continued

The following table shows the exposure values at 31 March 2018 after credit risk mitigation associated with each credit quality step, gross of off-balance sheet exposures and after removing asset items deducted from Own Funds.

	Credit quality step	Exposure value after credit risk mitigation €000
Central governments or central banks	1	38,130
Central governments or central banks	2	97,905
Regional governments or local authorities	1	67,350
Public sector entities	1	109,038
Public sector entities	Unrated	961
Multilateral development banks	1	113,866
International organisations	1	28,524
Institutions	1	7,893
Institutions	2	20,494
Institutions	3	20,791
Institutions	Unrated	55,639
Corporates	Unrated	1,790,005
Retail	Unrated	4,015
Secured by mortgages on immovable property	Unrated	47,725
Exposures in default	Unrated	53,870
Items associated with particular high risk	Unrated	33,409
Covered bonds	1	240,394
Other	Unrated	10,5798
Total		**2,740,587**

6 Interest rate risk in non-trading book

6.1 Managing Interest rate risk

A summary of the Group's interest rate gap position on non-trading portfolios is as follows:

	Carrying amount €000	Repricing in: Not more Than 3 months €000	Between 3 months to 1 year €000	Between 1 and 3 years €000	Between 3 and 5 years €000	More than 5 years €000
As at 31 March 2018						
Balances with Central Banks	**103,543**	103,543	-	-	-	-
Loans and advances to financial institutions	**113,623**	113,623	-	-	-	-
Loans and advances to customers	**1,701,716**	1,464,646	237,056	14	-	-
Investments	**560,245**	92,715	18,361	338,117	69,338	41,714
	2,479,127	1,774,527	255,417	338,131	69,338	41,714
Amounts owed to financial institutions:						
- Due to clearing houses	**105,000**	40,000	65,000	-	-	-
- Due to other banks	**21,428**	21,428	-	-	-	-
Amounts owed to customers	**1,979,159**	634,114	866,058	372,439	106,241	307
Subordinated liabilities	**66,949**	-	-	47,021	19,928	-
	2,172,536	695,542	931,058	419,460	126,169	307
Interest rate repricing gap		1,078,985	(675,641)	(81,329)	(56,831)	41,407
Impact of hedging interest rate derivatives – notional amounts	**448**	396,000	-	(273,000)	(78,000)	(45,000)
Net interest repricing gap		1,474,985	(675,641)	(354,329)	(134,831)	(3,593)

6 Interest rate risk in non-trading book - continued

6.1 Managing interest rate risk - continued

The management of interest rate risk with respect to interest rate gap limits is supplemented by monitoring the sensitivity of the Group's financial assets and liabilities to various interest rate scenarios. The estimated impact on Net Interest Margin (NIM) as a result of a 100 basis points (bps) movement and on Economic Value as a result of a 100 bps parallel rise/fall in the yield curves, would be as follows:

31 March 2018	**100 bps parallel increase €million**	**100 bps parallel decrease €million**
Impact on NIM	8.9	1.9
Impact on EV	7.1	26.4

The following table provides a further analysis of such results by currency.

	Euro		**British Pound**		**Other currencies in Euro**	
31 March 2018	**100 bps parallel increase €million**	**100 bps parallel decrease €million**	**100 bps parallel increase €million**	**100 bps parallel decrease €million**	**100 bps parallel increase €million**	**100 bps parallel decrease €million**
Impact on NIM	8.5	3.6	0.4	(1.5)	-	(0.2)
Impact on EV	5.6	26.4	1.2	0.4	0.3	(0.4)

These values are presented after taking into account the impact of hedge accounting.

The main assumptions used in the model are:

- Interest bearing assets are assumed to mature on their contractual maturity and are not replaced (static balance sheet);
- Certain senior secured loans have floors and thus are not fully affected by a decrease in interest rate;
- The Group will not change deposit rates in the next 24 months even if there is an increase or decrease in ECB base rate;
- The liability maturity profile is extended to match the assets' maturity profile;
- There is an implicit zero floor option on customer deposits as the Group will not charge negative rates to customers;
- The Δ NIM and Δ EV metrics includes the effect of changes in value of the contractual automatic options embedded in the banking book assets; and
- Customer deposits follow their contractual repricing schedule and are not behavioralised.

7 Operational risk

7.1 Capital allocation and capital buffers for operational risk

The Bank currently uses the basic indicator approach to assess the operational risk capital requirements and accordingly allocates 15% of average gross income for a three year period in accordance with regulatory requirements. The risk weighted assets in relation to operational risk as at 31 March 2018 amounted to €111 million.

In the latest iteration of the Group's ICAAP, the Group assigns a scenario for the identified operational risk themes as identified during the RCSAs. Each of these scenarios are assigned a risk add-on which represents the financial costs the Group could expect to incur if the respective scenarios were to materialise in isolation. This approach is used to inform the final internal capital add-on. Internal data is used to complement the scenario analysis along with expert judgment from within the Group's first line of defence. The following formula is used to calculate the aggregate risk add-on, together with a set of correlation assumptions.

$$Aggregate\ capital\ requirement = \sqrt{\sum\sum_{i,j} \rho_{i,j} \times RA_i \times RA_j}$$

$$\rho_{i,j} = linear\ correlation\ coefficient\ between\ scenarios\ i\ and\ j; with\ RA_i\ and\ RA_j = \ Risk\ add-ons.$$

8 Own funds

8.1 Total available capital

The Group adopts the appropriate processes to ensure that the minimum regulatory requirements are met at all times, through the assessment of its capital resources and requirements given current financial projections. The Group has a strong track record of robust capital ratios and is confident that it will be positioned to maintain its overall capital strength.

For regulatory purposes, the Group's capital base is divided in two main categories, namely Common Equity Tier 1 ("CET1") capital and Tier 2 capital.

8.1.1 Common Equity Tier 1 capital – composition

Common Equity Tier 1 capital includes:

- ordinary share capital;
- share premium;
- shareholders' contribution;
- retained earnings;
- reserve for general banking risks;
- fair value reserve; and
- other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes including deductions relating to reserve for depositor compensation scheme and the carrying amounts of investments in subsidiaries that are not included in the regulatory consolidation and certain other regulatory items.

8 **Own funds** - continued

8.1 **Total available capital** - continued

8.1.2 Common Equity Tier 1 capital – terms and conditions

i. Ordinary share capital includes equity instruments which fall under the definition of Article 28(1) of the CRR, *Common Equity Tier 1 instruments*. The holders of 'A' ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of MDB Holding. 'B' ordinary shareholders are not entitled to vote or to receive any dividends distributed.

ii. Share premium reserve is made up of premium paid by shareholders in excess of the nominal value of the 'A' ordinary shares. This reserve can only be applied in the paying up of unissued shares to be issued to members of MDB Group as fully paid bonus shares.

iii. Shareholders' contributions ("Contributions") are amounts granted by the shareholders to MDB Group whereby MDB Group has no obligation to bear any servicing cost or transfer any economic benefits of any kind to the contributor or any other person in return and has no obligation to repay the Contributions. These terms and conditions of such Contributions render this instrument equity in nature in accordance with the requirements of IAS 32: Financial Instruments – Presentation.

iv. Retained earnings are the part of the distributable items as per the CRR Article (4)(1)(128) definition, which are amounts of the profits at the end of the last financial year plus any profits brought forward and reserves available for that purpose before distributions to holders of own funds instruments less any losses brought forward, profits which are non-distributable pursuant to provisions in legislation or the institution's bye-laws and sums placed to non-distributable reserves in accordance with applicable national law or the statutes of MDB Holding. The balance in this reserve is net of tax.

   Subject to MDB Holding's dividend policy, the directors of MDB Holding, in the annual general meeting, may from time to time recommend dividends to be paid from the retained earnings of MDB Holding. Such dividends may be in the form of capitalisation of retained earnings to 'A' ordinary shares.

v. Reserve for general banking risks – in accordance with BR 09, the Group has allocated from its retained earnings, to a non-distributable reserve, an amount equivalent to 2.5% of the regulatory allocation for positions on which a specific impairment provision has been attributed. Refer to Note 16 "Capital and reserves" to the MDB Group Limited financial statements.

vi. The fair value reserve includes the cumulative net change in the fair value of available-for-sale ("AFS") investments, excluding impairment losses, until the investment is derecognised, net of deferred taxation. These relate to the AFS category of EU-endorsed IAS 39.

8.1.3 Tier 2 capital

Tier 2 capital consists of subordinated liabilities in issue, which rank after the claims of all depositors (including financial institutions) and all other creditors. As at 31 March 2018, subordinated liabilities included within Tier 2 capital comprised the following debt securities issued which are unsecured and in the event of the winding-up of the issuer, these are subordinated to the claims of depositors and all other creditors of the issuer:

- debt securities, bearing interest payable at 7.5%, repayable on 14 December 2019.
- debt securities, bearing interest payable at 6%, repayable on 28 November 2024.
- debt securities, bearing interest payable at 5%, repayable on 13 October 2027.

8 Own funds - continued

8.2 Own funds – other disclosures

The Group does not have items included in the ‘Total capital’ which have values differing from those reported within IFRS compliant Statement of Financial Position.

Retained earnings form part of Own funds only if those profits have been verified by persons independent of the Group that are responsible for the auditing of the Group’s financial statements and the Group has demonstrated to the satisfaction of the competent authority that any foreseeable charge or dividend has been deducted from the amount of those profits.

8.2.1 Composition of Own Funds

MDB Group Limited is the primary provider of equity capital to its subsidiaries. These investments are substantially funded through the issuance of equity, shareholder’s contribution and by profit retention. As part of its capital management process, MDB Group Limited seeks to maintain a balance between the composition of its capital and its investment in subsidiaries. In line with the requirement of Article 436 of the CRR in accordance with directive 2013/36/EU, there is no current or foreseen impediment to MDB Group Limited’s ability to provide funding for such investments. The ability of subsidiaries to pay dividends or advance monies to MDB Group Limited depends on, among other things, their respective local regulatory capital and banking requirements, exchange controls, statutory reserves, and financial and operating performance.

In December 2013 the European Commission published regulation (EU) No 1423/2013 being the ’Implementing Technical Standards with regard to Disclosure for Own Funds Requirements for institutions according to Regulation (EU) 575/2013 (CRR)’. In order to increase transparency regarding the regulatory capital of European institutions the regulation provided a set of templates which will help to facilitate cross-jurisdictional comparisons.

8 **Own funds** - continued

8.2 **Own funds – other disclosures** - continued

8.2.1 ***Composition of Own Funds*** - continued

Below is a table showing the composition of the own funds of the Group in accordance with the CRR and the related captions within the Statement of Financial Position included in the Annual Report 2018.

At 31 March 2018	**€000**
Common Equity Tier 1 (CET1) capital	
CET1 capital: instruments and reserves	
Capital instruments and the related share premium accounts	69,494
Retained earnings	117,325
Accumulated other comprehensive income (and other reserves)	127,629
Funds for general banking risk	1,694
CET1 capital before regulatory adjustments	316,142
CET1 capital deductions:	
Intangible assets (net of related tax liability)	(3,051)
Deferred tax assets that rely on future profitability	(8,788)
Total regulatory adjustments to CET1 capital	(11,839)
CET1 capital	**304,303**
Tier 2 capital	
Subordinated loans	66,949
Deduction:	
Amortisation on subordinated loans	(14,672)
Tier 2 capital	**52,277**
Total capital	**356,580**
Total Risk weighted assets	**2,142,805**

8 Own funds - continued

8.2 Own funds – other disclosures - continued

8.2.1 Composition of Own Funds - continued

	%
Capital ratios and buffers	
Common Equity Tier 1 ratio	14.20
Total capital ratio	16.64
Institution specific buffer requirement	6.76
of which: Capital conservation buffer requirement	1.88
of which: Countercyclical buffer requirement	0.01
of which: Other Systemically Important Institution (O-SII) buffer	0.38
Common Equity Tier 1 available to meet buffers in excess of the CRR 4.5% minimum requirement	9.70

	€000
Items not deducted from own funds in accordance with Article 48 of CRR	-
Items not deducted from own funds in accordance with Articles 47, 56, 66 and 79 of CRR	-

As shown above, there were no other items requiring deduction that were not deducted from the own funds in accordance with Section 3, Chapter 2, Title I, Part Two of CRR. In particular, in terms of article 48 of CRR, the Group's deferred tax assets dependent on future profitability and arising from temporary differences did not exceed the 10% threshold and therefore were not required to be deducted from own funds.

The Group does not have any systemic risk buffer as at 31 March 2018.

In line with Article 2 in the Commission Implementing Regulation (EU) No 1423/2013 and Part Eight Article 437 (1) of the CRR, the following is a full reconciliation of the Group's Own Funds items to the audited financial statements as at 31 March 2018.

Capital Base	**At 31 March 2018 €000**
Shareholders' equity according to the Group's balance sheet	328,983
Anticipated dividend	(7,227)
Market value of assets pledged in favour of Depositor Compensation Scheme	(5,369)
Deferred tax assets that are dependent on future profitability and do not arise from temporary differences (transitional definition)	(8,788)
Intangible assets	(3,051)
Other adjustments	(245)
Common Equity Tier 1 capital/Total Tier 1 capital	**304,303**
Tier 2 instruments: subordinated loans	66,949
Amortisation of tier 2 instruments	(14,672)
Total Tier 2 capital	**52,277**
Total capital base	**356,580**

8 Own funds - continued

8.2 Own funds – other disclosures - continued

8.2.1 Composition of Own Funds - continued

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

Capital instruments' main features

Instruments	MDB Group Limited Ordinary shares	MDB Group Limited Share premium	MeDirect Bank (Malta) plc 7.5% Subordinated Bonds EUR 2019	MeDirect Bank (Malta) plc 7.5% Subordinated Bonds GBP 2019
Issuer	MDB Group Limited	MDB Group Limited	MeDirect Bank (Malta) plc	MeDirect Bank (Malta) plc
Unique identifier	N/A	N/A	MT0000551227	MT0000551235
Governing law(s) of the instrument	Maltese Law	Maltese Law	Maltese Law	Maltese Law
Regulatory treatment				
Transitional CRR rules	Tier 1	Tier 1	Tier 2	Tier 2
Post-transitional CRR rules	Tier 1	Tier 1	Tier 2	Tier 2
Eligible at solo/(sub-) consolidated/solo & (sub-) consolidated	Solo & (Sub) Consolidated	Solo & (Sub) Consolidated	Solo & (Sub) Consolidated	Solo & (Sub) Consolidated
Instrument type	Tier 1 as published in Regulation (EU) No 575/2013 articles 26 and 28	Tier 1 as published in Regulation (EU) No 575/2013 articles 26 and 28	Tier 2 as published in Regulation (EU) No 575/2013 article 63	Tier 2 as published in Regulation (EU) No 575/2013 article 63
Amount recognised in regulatory capital	EUR55.7 million	EUR13.8 million	EUR6.4 million	EUR1.2 million
Nominal amount of instrument	EUR55.7 million	EUR13.8 million	EUR18.7 million	EUR4.1 million
Issue price	EUR1 per share	EUR0.335 per share	EUR100 per EUR bond	GBP100 per GBP bond
Redemption price	N/A	N/A	EUR100 per EUR bond	GBP100 per GBP bond
Accounting classification	Share capital	Share premium	Liability - amortised cost	Liability - amortised cost
Original date of issuance	10 June 2004	10 June 2004	21 November 2012 (Note 1)	21 November 2012 (Note 1)
Perpetual or dated	Perpetual	Perpetual	Dated	Dated
Original maturity date	N/A	N/A	14 December 2019	14 December 2019
Issuer call subject to prior supervisory approval	No	No	N/A (Note 2)	N/A (Note 2)
Optional call date, contingent call dates, and redemption amount	No	No	N/A (Note 2)	N/A (Note 2)
Subsequent call dates, if applicable	No	No	N/A (Note 2)	N/A (Note 2)
Coupons/dividends				
Fixed or floating dividend/coupon	Floating	N/A	Fixed	Fixed
Coupon rate and any related index	N/A	N/A	7.5% per annum	7.5% per annum
Existence of a dividend stopper	No	No	No	No
Fully discretionary, partially discretionary or mandatory - in terms of timing	Fully discretionary	N/A	Mandatory	Mandatory
Fully discretionary, partially discretionary or mandatory - in terms of amount	Fully discretionary	N/A	Mandatory	Mandatory
Existence of step up or other incentive to redeem	N/A	N/A	No	No
Noncumulative or cumulative	Non-cumulative	Non-cumulative	Cumulative	Cumulative
Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible
Write-down features	No	No	No	No
Position in subordination hierarchy in liquidation	Subordinated to MeDirect Bank Malta plc subordinated bonds	Subordinated to MeDirect Bank Malta plc subordinated bonds	Subordinated to senior creditors and depositors	Subordinated to senior creditors and depositors
Non-compliant transitioned features	No	No	No	No

Note (1): The subordinated loan capital in Tier 2 capital represents the subordinated unsecured bonds and are included as part of Tier II Capital as they fully qualify for the provisions listed under CRR (575/2013) Part Two, Title 1, Chapter 4, Article 63. Specifically they rank after the claim of all other creditors and are not to be repaid until all other debts outstanding at the time have been settled. As at 31 March 2018 the subordinated bonds listed above had a remaining maturity of less than 5 years and had all been fully paid up.

Note (2): Redemption of the subordinated loan capital shall take place on 14 December 2019, provided that in the event that a Regulatory Change Event occurs, the Group shall at its sole discretion but subject to the prior approval of the MFSA, have the option to redeem the subordinated loan capital in full prior to the scheduled redemption date.

8 Own funds - continued

8.2 Own funds – other disclosures - continued

8.2.1 Composition of Own Funds - continued

Capital instruments' main features

	Instruments	**MeDirect Bank (Malta) plc 6% Subordinated Unsecured Bonds EUR 2019 - 2024**	**MeDirect Bank (Malta) plc 6% Subordinated Unsecured Bonds GBP 2019 – 2024**
1	Issuer	MeDirect Bank (Malta) plc	MeDirect Bank (Malta) plc
2	Unique identifier	MT0000551268	MT0000551276
3	Governing law(s) of the instrument	Maltese Law	Maltese Law
	Regulatory treatment		
4	Transitional CRR rules	Tier 2	Tier 2
5	Post-transitional CRR rules	Tier 2	Tier 2
6	Eligible at solo/(sub-)consolidated/solo & (sub-)consolidated	Solo & (Sub) Consolidated	Solo & (Sub) Consolidated
7	Instrument type	Tier 2 as published in Regulation (EU) No 575/2013 article 63	Tier 2 as published in Regulation (EU) No 575/2013 article 63
8	Amount recognised in regulatory capital	EUR23.0 million	EUR1.9 million
9	Nominal amount of instrument	EUR23.0 million	EUR1.9 million
9a	Issue price	EUR100 per EUR Bond	Only GBP100 per GBP Bond
9b	Redemption price	EUR100 per EUR Bond	Only GBP100 per GBP Bond
10	Accounting classification	Liability - amortised cost	Liability - amortised cost
11	Original date of issuance	28 November 2014 (Note 1)	28 November 2014 (Note 1)
12	Perpetual or dated	Dated	Dated
13	Original maturity date	28 November 2024	28 November 2024
14	Issuer call subject to prior supervisory approval	N/A (Note 2)	N/A (Note 2)
15	Optional call date, contingent call dates, and redemption amount	N/A (Note 2)	N/A (Note 2)
16	Subsequent call dates, if applicable	N/A (Note 2)	N/A (Note 2)
	Coupons / dividends		
17	Fixed or floating dividend/coupon	Fixed	Fixed
18	Coupon rate and any related index	6% per annum	6% per annum
19	Existence of a dividend stopper	No	No
20 a	Fully discretionary, partially discretionary or mandatory - in terms of timing	Mandatory	Mandatory
20 b	Fully discretionary, partially discretionary or mandatory - in terms of amount	Mandatory	Mandatory
21	Existence of step up or other incentive to redeem	No	No
22	Noncumulative or cumulative	Cumulative	Cumulative
23	Convertible or non-convertible	Non-convertible	Non-convertible
30	Write-down features	No	No
35	Position in subordination hierarchy in liquidation	Subordinated to senior creditors and depositors	Subordinated to senior creditors and depositors
	Non-compliant transitioned features	No	No

Note (1): The subordinated loan capital in Tier 2 capital represents the subordinated unsecured bonds of MDB Group Limited. They are included as part of Tier II Capital as they fully qualify for the provisions listed under CRR (575/2013) Part Two, Title 1, Chapter 4, Article 63. Specifically they rank after the claim of all other creditors and are not to be repaid until all other debts outstanding at the time have been settled. As at 31 March 2018 the subordinated bonds listed above had a remaining maturity of more than 5 years and had all been fully paid up. The full value of these securities are included in the Group's Own Funds figure.

Note (2): Redemption of the subordinated loan capital shall take place on 28 November 2024, provided that in the event that a Regulatory Change Event occurs, the Group shall at its sole discretion but subject to the prior approval of the MFSA, have the option to redeem the subordinated loan capital in full prior to the scheduled redemption date.

8 Own funds - continued

8.2 Own funds – other disclosures - continued

8.2.1 Composition of Own Funds - continued

Capital instruments' main features

	Instruments	**MeDirect Bank (Malta) plc 5% Subordinated Unsecured Bonds EUR 2027**	**MeDirect Bank (Malta) plc 5% Subordinated Unsecured Bonds GBP 2027**
1	Issuer	MeDirect Bank (Malta) plc	MeDirect Bank (Malta) plc
2	Unique identifier	MT0000551284	MT0000551292
3	Governing law(s) of the instrument	Maltese Law	Maltese Law
	Regulatory treatment		
4	Transitional CRR rules	Tier 2	Tier 2
5	Post-transitional CRR rules	Tier 2	Tier 2
6	Eligible at solo/(sub-)consolidated/solo & (sub-)consolidated	Solo & (Sub) Consolidated	Solo & (Sub) Consolidated
7	Instrument type	Tier 2 as published in Regulation (EU) No 575/2013 article 63	Tier 2 as published in Regulation (EU) No 575/2013 article 63
8	Amount recognised in regulatory capital	EUR18.7 million	EUR1.2 million
9	Nominal amount of instrument	EUR18.7 million	EUR1.2 million
9a	Issue price	EUR100 per EUR Bond	GBP100 per GBP Bond
9b	Redemption price	EUR100 per EUR Bond	GBP100 per GBP Bond
10	Accounting classification	Liability - amortised cost	Liability - amortised cost
11	Original date of issuance	27 October 2017 (Note 1)	27 October 2017 (Note 1)
12	Perpetual or dated	Dated	Dated
13	Original maturity date	13 October 2027	13 October 2027
14	Issuer call subject to prior supervisory approval	N/A (Note 2)	N/A (Note 2)
15	Optional call date, contingent call dates, and redemption amount	N/A (Note 2)	N/A (Note 2)
16	Subsequent call dates, if applicable	N/A (Note 2)	N/A (Note 2)
	Coupons / dividends		
17	Fixed or floating dividend/coupon	Fixed	Fixed
18	Coupon rate and any related index	5% per annum	5% per annum
19	Existence of a dividend stopper	No	No
20a	Fully discretionary, partially discretionary or mandatory - in terms of timing	Mandatory	Mandatory
20b	Fully discretionary, partially discretionary or mandatory - in terms of amount	Mandatory	Mandatory
21	Existence of step up or other incentive to redeem	No	No
22	Noncumulative or cumulative	Cumulative	Cumulative
23	Convertible or non-convertible	Non-convertible	Non-convertible
30	Write-down features	No	No
35	Position in subordination hierarchy in liquidation	Subordinated to senior creditors and depositors	Subordinated to senior creditors and depositors
	Non-compliant transitioned features	No	No

Note (1): The subordinated loan capital in Tier 2 capital represents the subordinated unsecured bonds of MDB Group Limited. They are included as part of Tier II Capital as they fully qualify for the provisions listed under CRR (575/2013) Part Two, Title 1, Chapter 4, Article 63. Specifically they rank after the claim of all other creditors and are not to be repaid until all other debts outstanding at the time have been settled. As at 31 March 2018 the subordinated bonds listed above had a remaining maturity of more than 5 years and had all been fully paid up. The full value of these securities are included in the Group's Own Funds figure.

Note (2): Redemption of the subordinated loan capital shall take place on 13 October 2027, provided that in the event that a Regulatory Change Event occurs, the Group shall at its sole discretion but subject to the prior approval of the MFSA, have the option to redeem the subordinated loan capital in full prior to the scheduled redemption date.

9 Capital requirements

Capital requirements represent the amount of capital resources that a bank must hold as required by the regulator. In line with CRR, the Group is placing much of its emphasis and monitoring on Common Equity Tier 1 capital.

The scope of permissible CRR approaches and those adopted by the Group are described below.

- Credit risk – The Group calculates its risk weighted credit risk exposure in accordance with the Standardised Approach, described in Chapter 2 of Title II of Part Three of the CRR. To calculate the risk-weighted exposure amounts, risk weights are applied based on the exposure class and the related credit quality. Credit quality may be determined by reference to the credit assessments of ECAIs that have been determined as eligible by the EBA. In the Group's calculations, senior secured loans and other corporate credit exposures are assigned risk weights corresponding to unrated positions and for the remainder of its securities investment portfolio the Group has nominated well-known risk rating agencies such as Fitch, Standard and Poor's and Moody's. Accordingly, the Group complies with the standard association of the external ratings of ECAIs with the credit quality steps prescribed in CRR.

- Operational risk – The Group calculates its capital requirement using the Basic Indicator Approach, in terms of Article 315 of the CRR. The own funds requirement amounts to 15% of the average three years of the relevant indicator, as defined in Article 316 of the CRR. Elements within the relevant indicator include interest receivable and similar income, interest payable and similar charges, income from shares and other variable/fixed-yield securities, commissions and fees receivable/payable, net profit or net loss on financial operations and other operating income, adjusted for, amongst others stipulated in the CRR, profits on sale of non-trading book items and extraordinary or irregular items.

- Counterparty credit risk – The Group adopted the mark-to-market method in order to determine the potential future credit exposure, in line with Article 274 of the CRR, primarily on its derivative exposures.

- Foreign exchange risk – The Group has adopted the basic method to determine its foreign exchange risk requirement in accordance with Article 351 of the CRR. In terms of this Article, the Group does not calculate the capital requirement for foreign exchange risk as its net foreign exchange position is less than 2% of its own funds.

- Credit valuation adjustment risk – The Group uses the standardised approach, as per Article 384 of the CRR.

9 Capital requirements - continued

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

EU OV1 – Overview of RWAs	2018	2017	2018
Exposure Class	**Risk weighted assets €000**	**Risk weighted assets €000**	**Minimum Capital Requirements €000**
1 Credit risk (excluding CCR)	**2,029,527**	**1,769,774**	**162,362**
2 of which the standardised approach	2,029,527	1,769,774	162,362
Central governments or central banks	25,454	10,642	2,036
Regional governments or local authorities	-	-	-
Public sector entities	481	1,700	38
Multilateral development banks	-	-	-
International organisations	-	-	-
Institutions	20,074	61,067	1,606
Corporates	1,789,585	1,539,209	143,167
Retail	3,011	2,789	241
Secured by mortgages on immovable property	34,473	14,636	2,758
Exposures in default	74,370	63,212	5,950
Items associated with particular high risk	50,113	38,991	4,009
Covered bonds	24,039	30,677	1,923
Equity exposures	-	228	0
Other items	7,926	6,623	634
6 CCR	**2,515**	**2,052**	**201**
7 of which mark to market	1,759	1,343	141
7 of which CVA	755	709	60
23 Operational risk	**110,763**	**84,979**	**8,861**
24 of which the basic indicator approach	110,763	84,979	8,861
27 Amounts below the thresholds for Deduction (subject to 250% risk weight)	25,454	-	2,036
29 Total	**2,142,805**	**1,856,805**	**171,424**

The Group's total capital ratio computation is as follows:

Own funds	
Common Equity Tier 1 capital	304,303
Tier 2 capital	52,277
Total own funds	**356,580**
Total capital ratio	**16.64%**

The Group will be fully implementing the CRD IV capital requirements with effect from January 2019. In respect of the Group, BR 15: *"Capital Buffers of Credit Institutions authorised under the Maltese Banking Act (Cap. 371)"*, 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 Group's CET1 capital falls below the level of its CRD IV combined buffer.

9 Capital requirements - continued

The Group will be required to maintain a capital conservation buffer of 2.5%, made up of CET1 capital, on its risk weighted exposures as from 1 January 2019. This buffer is being phased in over the period from 1 January 2016 to 31 December 2018.

CRD IV also 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. The following table represents the Group's geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer at 31 March 2018.

Country	General credit exposures – exposure value for SA €000	Own funds requirement – of which General credit exposures €000	Own funds requirement weights %	Counter-cyclical capital buffer rate %
Austria	13,594	1,087	0.69	0.00
Belgium	18,435	1,475	0.93	0.00
Brazil	11,168	89	0.06	0.00
Denmark	37,834	756	0.48	0.00
France	317,766	25,421	16.06	0.00
Germany	239,265	19,719	12.46	0.00
Guernsey	2,296	184	0.12	0.00
Hong Kong	10,249	820	0.52	0.00
Ireland	32,030	2,562	1.62	0.00
Italy	187,017	14,961	9.45	0.00
Jersey	14,709	1,177	0.74	0.00
Luxembourg	6,944	555	0.35	0.00
Malta	98,859	8,716	5.51	0.00
Netherlands	147,462	9,398	5.94	0.00
Norway	10,115	81	0.05	2.00
Spain	55,866	4,469	2.82	0.00
Sweden	29,600	872	0.55	2.00
Switzerland	33,826	2,706	1.71	0.00
United Kingdom	689,760	46,221	29.20	0.00
United States	212,550	17,005	10.74	0.00
Total	**2,169,345**	**158,274**		

In view of the above exposure values, the following table identifies the Group's countercyclical capital buffer requirement.

	As at 31 March 2018
Total risk exposure amount (€000)	2,142,805
Institution specific countercyclical buffer rate (%)	0.012%
Institution specific countercyclical buffer requirement (€000)	258

Given the Group's position and its systemic relevance to the financial system in Malta, the Group is also required to maintain an Other Systemically Important Institution ("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.

9 Capital requirements - continued

The Group's O-SII buffer has been set at 0.5% and is being phased-in over the period 1 January 2016 to 1 January 2019. 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%.

Moreover, in light of the fact that the Group is supervised by the ECB as part of the Single Supervisory Mechanism, MDB Group is subject to the Supervisory Review and Evaluation Process ("SREP"), which determines the capital requirement by the ECB.

During 2017, the Group received notification from the ECB on the own funds requirements that it is required to meet as of 1 January 2018, following the results of the SREP of 2017. MDB Group has been subject to a total SREP capital requirement ("TSCR") of 11% on a consolidated level. The TSCR is composed of a 8% minimum own funds requirement in line with Article 92(1) of the CRR, and a 3% Pillar II requirement ("P2R"), which is to be made up of CET1 capital. Thus, the total CET1 capital minimum requirement for 2018 amounts to 7.5%, composed of a minimum Pillar I requirement of 4.5% and the P2R of 3%. In addition, the Group is required to comply with the phased-in capital buffer requirements, consisting of a capital conservation buffer of 1.875% for 2018 and the O-SII buffer of 0.75% for the same year. Thus, this results in a total CET1 capital requirement of 9.75% for 2018. During 2019, the CET1 capital requirement will increase, as the capital conservation buffer is set to increase by 0.625% per annum, whilst the O-SII buffer will increase by 0.125% annually. This will translate into a total CET1 capital requirement of 10.5% in 2019. With a CET1 capital ratio of 14.2% at 31 March 2018, MDB Group comfortably meets its requirements for 2018 and is expected to continue meeting the relative requirements in the coming years. Moreover, the Group complies with the TSCR that implies a Tier 1 capital ratio minimum requirement of 11% and a Total capital ratio minimum requirement of 13%, which when including the requirement for the institution specific countercyclical buffer are topped up to 11.01% and 13.01%, respectively. The latter buffer requirement will increase in view of the Group's UK exposures since the UK countercyclical buffer rate was set at 0.5% on 27 June 2018 and will increase to 1% on 28 November 2018, whereas the countercyclical buffer rate of Denmark, Ireland and France was set at 0.5%, 1% and 0.25% with effect from 31 March 2019, 5 July 2019 and 1 July 2019 respectively.

The Group also conducts an ICAAP to determine a forward looking assessment of the capital requirements given its business strategy, risk profile, risk appetite and capital plan. This process incorporates the risk management processes and governance framework. A range of stress tests are applied to the base capital plan.

The ICAAP ensures that risks faced by the Group are appropriately identified, measured, aggregated and monitored; the capital coverage determined by internal calculations is sufficient for the fundamental risks the Group is exposed to; and the Group has an adequate risk management framework in place, which it continuously develops in accordance with the risk factors identified.

The Group covers Pillar II capital requirements through stress testing processes to forecast the Group's projected capital requirements. Stress testing is a technique used by financial firms to gauge their potential vulnerability to severe but plausible events. This testing process contributes to the strategic planning of the Group by guaranteeing that it can meet its minimum regulatory capital requirements under a stressed environment.

Under the supervision of a dedicated working team consisting of the Group's senior management, the preparation of the ICAAP is carried out by the relevant teams that include: Risk, Finance and Credit and Investments. After the completion of an iterative process of review and feedback, the senior management team present their observations to the Board of Directors for their consideration. The non-executive Directors play a crucial role in providing the Group with an independent evaluation of the document, assisted by the Group's Internal Audit function.

10 Leverage

The CRR requires financial institutions to calculate a non-risk based leverage ratio, to supplement risk-based capital requirements. The leverage ratio measures the relationship between the capital resources of the organisation and its total assets. The leverage ratio is a regulatory supervisory tool for the Regulator, to constrain the build-up of excessive leverage – one of the drivers of the banking crisis – previously not captured within Basel II.

The leverage ratio is calculated by taking capital as a proportion of total exposures at the end of each quarter. Capital is defined as Tier 1 capital in line with Article 25 of the CRR, whilst total exposure relates to the total on and off-balance sheet exposures, less deductions applied to Tier 1 capital.

The initial implementation of the current leverage ratio regime is to be effected as a Pillar II measure. In 2016, the European Banking Authority published its report on the impact assessment and calibration of the leverage ratio, recommending the introduction of a leverage ratio minimum requirement in the EU to mitigate the risk of excessive leverage. The analysis suggests that the potential impact of introducing a Pillar I leverage ratio requirement of 3% on the provision of financing by credit institutions would be relatively moderate, while, overall, it should lead to more stable credit institutions. It is expected that the leverage ratio should be introduced as a binding measure as of 2018. The Group currently complies with the minimum 3% Tier 1 leverage ratio based on fully-transitioned Basel III standards.

The following is the Group's estimated leverage ratio, determined in accordance with the requirements stipulated by Implementing Regulation EU 2016/200.

As at 31 March 2018	**€000**
Tier 1 capital	304,303
Total exposure measure for the purposes of the leverage ratio	2,958,368
Leverage ratio	**10.29%**

The total exposure measure for the purposes of the leverage ratio has been determined as follows:

As at 31 March 2018	**€000**
On-balance sheet exposures (excluding derivatives and SFTs)	
On-balance sheet items (excluding derivatives and SFTs)	2,544,755
Asset amounts deducted in determining Tier 1 capital	(11,839)
On-balance sheet exposures (excluding derivatives and SFTs)	**2,532,916**
Derivative exposures	
Replacement cost associated with all derivatives transactions	470
Add-on amounts for PFE associated with all derivatives transactions	3,834
Total derivative exposures	**4,304**
Other off-balance sheet exposures	
Off-balance sheet exposures at gross notional amount	567,380
Adjustments for conversion to credit equivalent amounts	(146,232)
Other off-balance sheet exposures	**421,148**
Total exposure measure for the purposes of the leverage ratio	**2,958,368**

10 Leverage - continued

The disclosed leverage ratio was calculated using the transitional definition and represents the end-of-quarter leverage ratio.

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

As at 31 March 2018	**€000**
Total assets as per published financial statements	2,552,184
Adjustments for derivative instruments	3,834
Adjustment for off-balance sheet items	421,148
Other adjustments	
Deduction on deferred tax assets	(8,788)
Deduction for intangible assets	(3,051)
Other adjustments	(6,959)
Leverage ratio exposure	**2,958,368**

The following table provides a split-up of the on-balance sheet exposures as at 31 March 2018 in relation to the calculation of the leverage ratio.

EU-1 Total on-balance sheet exposures (excluding derivatives, SFTs and exempted exposures)

		€000
EU-2	Trading book exposures	**-**
EU-3	Banking book exposures, of which:	**2,532,916**
EU-4	Covered bonds	240,394
EU-5	Exposures treated as sovereign	136,035
Eu-6	Exposures to regional government, MDB, international organisations and PSE not treated as sovereigns	319,739
EU-7	Institutions	102,550
EU-8	Secured by mortgages of immovable properties	47,356
EU-9	Retail exposures	4,015
EU-10	Corporate	1,586,848
EU-11	Exposures in default	53,870
EU-12	Other exposures	42,109

The leverage multiple has increased during the financial year ended 31 March 2018. This increase is mainly attributable to the Group's profitability results registered during the period under review, which translates into a movement upwards in the Group's capital base, whilst total assets remained relatively stable, resulting in an increase in the Group's leverage ratio.

The Group's leverage is managed as part of its risk appetite framework and monitored using a leverage ratio metric within the risk appetite statement set by the Group. The risk appetite statement stipulates the level and types of risk that the Group is willing to accept in its business activities. The leverage ratio is reported to the Group's Board and ExCo on a monthly basis.

11 Asset encumbrance

The disclosure on asset encumbrance is a requirement introduced in BR 07 transposing the provisions of the EBA guidelines on disclosure of encumbered and unencumbered assets (EBA/GL/2014/03).

The objective of this disclosure is to facilitate an understanding of available and unrestricted assets that could be used to support potential future funding and collateral needs. An asset is defined as encumbered if it has been pledged as collateral against an existing liability, and as a result is no longer available to the 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

	Carrying amount of encumbered assets 2018 €000	Fair value of encumbered assets 2018 €000	Carrying amount of unencumbered assets 2018 €000	Fair value of unencumbered assets 2018 €000
020 Loans and advances	61,360	-	1,868,325	-
030 Equity instruments	-	-	-	-
040 Debt securities	114,090	114,090	452,107	452,107
120 Other assets	244	-	56,058	-
Assets of the reporting institution[17]	**175,694**	**114,090**	**2,376,490**	**452,107**

The amounts disclosed in the above table represent the median values, being the rolling quarterly medians over the previous twelve months, determined by interpolation, in accordance with the Draft Regulatory Technical Standards on disclosure of encumbered and unencumbered assets under Article 443 of the CRR issued in March 2017.

The encumbered assets consist of investments used for repo funding and pledged securities. There are no encumbered assets held between entities of the Group and no over-collateralisation. Repoed transactions are covered by a Global Repurchase Master Agreement and involve the sale of financial assets with a simultaneous agreement to repurchase at a pre-determined price at a future date. The pledged securities transactions are pledged in favour of the ECB for the purposes of existing and potential long term re-financing operations and also in favour of the depositor compensation scheme.

The unencumbered assets disclosed in the preceding table under item ‘Other assets’ include cash and short term funds, property, plant and equipment, tax assets and other assets.

The Group continues to recognise encumbered assets since all the risks and rewards of the assets will be substantially retained in a manner that does not result in the encumbered assets being derecognised for accounting purposes.

Further details on encumbered assets, including information regarding the evolution of encumbrance throughout the financial year are available in note 2.3.5 to the financial statements.

[17] The terminology “reporting institution” is referring to MDB Group Limited.

11 Asset encumbrance - continued

The Group does not encumber any of the collateral received or any of its own debt securities issued

	Matching liabilities, contingent liabilities or securities lent 2018 €000	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered 2018 €000
010 Carrying amount of selected financial liabilities	3,416	4,449

12 Remuneration policy and practices

Information on remuneration policy and practices is disclosed in the Remuneration Report within the Annual Report.

13 Recruitment and diversity policy statement

The Group recognises that a robust and professional approach to recruitment and selection helps it to attract and appoint individuals with the necessary skills and attributes to support its business goals. All prospective staff members are subject to a rigorous selection process, taking into account the key activities, tasks and skills required for the position. Multiple interviews are conducted, and the candidate's knowledge, experience, skills, temperament and competency are evaluated against other candidates.

The Group's aim is to develop an effective and efficient recruitment process that recruits the best talent, helps employees identify their potential, promotes a transparent, merit-based selection process and develops a cost effective recruitment process. The Group endeavours to ensure that all appointments (at any level) are made based on the actual knowledge, skills, expertise and merit of the individual involved, in compliance with local legislation and in adherence to the Group diversity policy.

The Group's diversity policy states that its objectives are to ensure that the Group:

- has a workforce profile that delivers competitive advantage through the ability to garner a deep understanding of customer needs;
- has an inclusive workplace where every individual can succeed regardless of gender, cultural identity, age, physical ability, religious beliefs, family status and sexual orientation; and
- leverages the value of diversity for all the Group's stakeholders to deliver the best customer experience, improved financial performance and a stronger corporate reputation.

With those goals in mind, the Group aims to promote equal opportunities for all employees and to ensure that they are treated fairly and consistently. All candidates are assessed against various selection criteria designed to match the requirements of the position to the skills and experience of an applicant, including professional qualifications and expertise, any past work experience in relation to the requirements of the job, key capabilities, adaptability and flexibility, cultural fit, open mindedness, level of self-motivation and proactivity. The Group is committed to attracting, developing and retaining diverse leaders. Diversity of thought provides tangible business benefits, including innovation, risk mitigation, better problem solving and improved customer service. To ensure that the Group can foster these talents in an inclusive culture, it continues to recruit and develop the best person for the job, regardless of gender, age, race, family or caring responsibilities, disability and sexual orientation, identity or preference.

13 Recruitment and diversity policy statement - continued

Board Diversity

The Group diversity policy states, in respect of Board diversity, that:

The Group recognises and embraces the benefits of building a diverse and inclusive Board and sees diversity as an essential component in maintaining competitive advantage. A diverse Board will include and make good use of differences in the skills, industry experience, background, race, gender and other distinctions between Directors. The differences will be considered in determining the optimum composition of the Board and when possible should be balanced appropriately. All Board appointments are made on merit, in the context of the skills, experience, independence and knowledge which the Board as a whole requires to be effective.

The Group Chairman, together with Board Nominations and Remuneration Committee (the "Committee"), reviews and assesses the Board's composition and recommends to the Board and the Group's shareholders the appointment of new Directors. In reviewing Board composition, the Committee considers the benefits of all aspects of diversity including, but not limited to, skills, industry experience, background, race, gender, in order to permit it to discharge its duties and responsibilities successfully. In identifying suitable candidates for appointment to the Board, the Committee considers candidates on merit against objective criteria and with due regard of the benefits of diversity on the Board.

In terms of achieving the objectives described above, whilst the Board has not yet been able to achieve gender diversity, it has been able to demonstrate diversity of background and experience, with knowledge and experience in the areas of retail and commercial banking, wealth management, accounting and finance, risk management and governance. In terms of independence, three of the five non-executive directors are classified as independent.

For an overview of the directors and other key officers of the Group, their expertise, actual knowledge and skills, kindly refer to the following link:

https://www.MeDirect Malta.com.mt/about-us/management-team

14 Other directorships

The number of other directorships held by members of MeDirect Malta's Board, not related to MeDirect Bank (Malta) plc, are listed in the table below:

Director		**Number of other directorships held**
Michael Bussey	Independent Non-Executive Chairman	1
John Zarb	Independent Non-Executive Director	3
Michael Walker	Independent Non-Executive Director	3
Dominic Wallace	Non-Executive Director	-
Benjamin Hollowood	Non-Executive Director	2
Mark A. Watson	Executive Director	1
Joaquin Vicent	Executive Director	3

15 CRR References

CRR references	High-level summary	Compliance reference
Scope of disclosure requirements		
431 (1)	Requirement to publish Pillar 3 disclosures	MDB Group Limited "the Group" publishes Pillar 3 disclosures
431 (2)	Firms with permission to use specific operational risk methodologies must disclose operational risk information.	No specific permissions in respect of the calculation of specific operational risk granted to the Group.
431 (3)	Institution must have a policy covering frequency of disclosures, their verification, comprehensiveness and overall appropriateness.	The Group compiles the Additional Regulatory Disclosures in accordance with the requirements emanating from the CRR, BR07 and relevant EBA guidelines.
431 (4)	Explanation of ratings decision upon request	N/A
Non-material, proprietary or confidential information		
432 (1)	Institutions may omit information that is not material if certain conditions are respected.	Certain immaterial information falling outside scope of the articles 437 and 450 has not been disclosed separately
432 (2)	Institutions may omit information that is proprietary or confidential if certain conditions are respected.	
432 (3)	Where 432 (1) and (2) apply this must be stated in the disclosures, and more general information must be disclosed.	No item required to be disclosed was purposely fully omitted.
432 (4)	Use of 432 (1) or (2) is without prejudice to scope of liability for failure to disclose material information	
Frequency of disclosure		
433	Disclosures must be published once a year at a minimum, and more frequently if necessary.	Compliance with this provision is covered by the Group's policy. Refer to Section 1 Introduction.
Means of disclosures		
434 (1)	To include of disclosures in one appropriate medium, or provide clear cross-references.	Most disclosures are contained within this document. Signposting directs the reader to the annual report where appropriate.
434 (2)	Disclosures made under other requirements (e.g. accounting) can be used to satisfy Pillar 3 if appropriate.	Any cross-references to accounting or other disclosures are clearly signposted in this document.

Risk management objectives and policies		
435 (1) (a); 435 (1) (b); 435 (1) (c) & 435 (1) (d)	Disclose information on strategies and processes; organisational structure, reporting systems and risk mitigation/hedging.	General information on risk management, objectives and policies: 2 Risk Management, objectives and policies
		Market Risk: 2 Risk Management, objectives and policies
		Reputational Risk: 2 Risk Management, objectives and policies
		Credit Risk: 3 Credit risk and credit risk mitigation ("CRM")
		Credit Valuation Adjustment ("CVA"): 3 Credit risk and credit risk mitigation ("CRM")
		Counterparty credit risk : 4 Counterparty credit risk
		Operational Risk : 7 Operational Risk
435 (1) (e)	Inclusion of a declaration approved by the Board on adequacy of risk management arrangements.	Refer to 2.3 Risk statement
435 (1) (f)	Concise risk statement approved by the management body succinctly describing the institution's overall risk profile associated with the business strategy	Refer to 2.1.2 Overview of the management of key risks and 2.1.3 Risk appetite. This statement covers the principal risks.
435 (2)	Information on governance arrangements:	See Section 2.1.8 Risk governance structure and 13 Recruitment and diversity policy Statement in this report for a description of the Risk Policies and Governance. See also Statement of Compliance with the principles of good corporate governance of the Annual Report which contains information on Board composition, experience and recruitment. See Section 14 for number of directorships held by the directors.
435 (2) (a)	Number of directorships	
435 (2) (b)	Recruitment policy	
435 (2) (c)	Policy on diversity with regard to selection of the management body, objectives and targets.	
435 (2) (d)	Disclosure of whether a dedicated risk committee is in place, and number of meetings in the year.	Please see 2.1.5 Risk Monitoring and 2.1.8 Reporting on Risk Governance and the Statement of Compliance with the principles of good corporate governance of the Annual Report
435 (2) (e)	Description of information flow on risk to Board.	Please see 2.1.5 Risk Monitoring and Reporting on Reporting to the Board and Board Risk Committee.
Scope of application		
436 (a)	Name of institution	Refer to Section 1 Introduction
436 (b)	Difference in basis of consolidation for accounting and prudential purposes, naming entities that are:	
436 (b) (i)	Fully consolidated;	
436 (b) (ii)	Proportionally consolidated;	
436 (b) (iii)	Deducted from own funds;	See 8.2 Own funds – other disclosures
436 (b) (iv)	Neither consolidated nor deducted.	N/A
436 (c)	Impediments to transfer of funds between parent and subsidiaries	See 8.2 Own funds – other disclosures
436 (d)	Capital shortfalls in any subsidiaries outside of scope of consolidation	No regulated entities fall outside the scope of consolidation of MDB Group Limited "Group"
436 (e)	if applicable, the circumstance of making use of the provisions laid down in Articles 7 and 9 on derogations from a) prudential requirements or b) liquidity requirements for individual subsidiaries/entities	Not applicable

Own funds		
437 (1)	Requirements regarding capital resources table :	
437 (1) (a)	Full reconciliation	See 8.2 Own funds – other disclosures
437 (1) (b)	Description of capital resources	See 8.1 Total available capital and 8.2 Own funds – other disclosures
437 (1) (c)	Full terms and conditions of all Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments	
437(1) (d) (i)	disclosure of the nature and amounts for each prudential filter	
437(1)(d) (ii)	disclosure of the nature and amounts for each deduction made	See 8.2 Own funds – other disclosures
437(1)(d) (iii)	disclosure of the nature and amounts for items not deducted	See 8.2 Own funds – other disclosures
437 (1) (e)	description of all restrictions applied to the calculation of own funds	See 8.2 Own funds – other disclosures
437 (1) (f)	basis on which capital ratios are calculated	Regulation applied - Refer to sections 8.1 Total available capital
437 (2)	EBA to publish implementation standards for points above.	The Group follows the implementation standards.
Capital requirements		
438 (a)	Summary of institution's approach to assessing adequacy of capital levels.	Disclosure of approach on assessing adequacy capital requirements are contained in section 9 Capital requirements
438 (b)	Result of ICAAP on demand from authorities.	Refer to section 9 Capital requirements
438 (c)	Capital requirement amounts for credit risk for each Standardised Approach exposure class.	The Group uses the Standardised Approach - Refer to section 9 Capital requirements
438 (d)	Capital requirements amounts for credit risk for each Internal Ratings Based Approach exposure class.	N/A - IRB is not applied.
438 (d) (i)		
438 (d) (ii)		
438 (d) (iii)		
438 (d) (iv)		
438 (e)	Capital requirements amounts for market risk or settlement risk, or large exposures where they exceed limits.	N/A
438 (f)	Capital requirement amounts for operational risk, separately for the basic indicator approach, the standardised approach, and the advanced measurement approaches as applicable.	The Group uses the Standardised Approach - Refer to section 9 Capital requirements
Exposure to counterparty credit risk (CCR)		
439 (a)	Description of process to assign internal capital and credit limits to CCR exposures.	The Group manages its CCP mainly through margins. Refer to section 4 Counterparty credit risk (analysis of CCP Credit risk exposure)
439 (b)	Discussion of process to secure collateral and establishing reserves.	
439 (c)	Discussion of management of wrong-way exposures.	
439 (d)	Disclosure of collateral to be provided (outflows) in the event of a ratings downgrade.	
439 (e)	Derivation of net derivative credit exposure.	Refer to section 3.7 Credit risk mitigation
439 (f)	Exposure values for mark-to-market, original exposure, standardised and internal model methods.	The Group applies a Standardised method refer to section 4.1 Analysis of counterparty credit risk exposure
439 (g)	Notional value of credit derivative hedges and current credit exposure by type of exposure.	N/A – No credit derivative hedges in place throughout the period
439 (h)	Notional amounts of credit derivative transactions for own credit, intermediation, bought and sold, by product type.	
439 (i)	Estimate of alpha, if applicable.	

Capital buffers		
440 (1) (a)	Geographical distribution of relevant credit exposures.	Refer to section 9 Capital requirements on the Group's relevant CCy by geographical distribution of credit exposures.
440 (1) (b)	Amount of the institution specific countercyclical capital buffer.	
440 (2)	EBA will issue technical implementation standards related to 440 (1)	The Group follows the implementation standards.
Indicators of global systemic importance		
441	Disclosure of the indicators of global systemic importance	N/A to the Group
Credit risk adjustments		
442 (a)	Disclosure of bank's definitions of past due and impaired.	Section 3.6 Impairment loss measurement guidelines provide a complete description of the Impairment loss measurement guidelines, definitions and approaches adopted.
442 (b)	Approaches for calculating credit risk adjustments.	
442 (c)	Disclosure of pre-CRM EAD by exposure class.	Refer to 3.1 – Credit risk exposure – analysis by exposure class
442 (d)	Disclosures of pre-CRM EAD by geography and exposure class.	Refer to 3.2 Credit risk exposure – analysis by geographical distribution
442 (e)	Disclosures of pre-CRM EAD by industry and exposure	Refer to 3.3 Credit risk exposure – analysis by industry distribution
442 (f)	Disclosures of pre-CRM EAD by residual maturity and	Refer to 3.4 Credit risk exposure – analysis by residual maturity
442 (g)	Breakdown by significant industry or CCP amount of:	Refer to section 3.6 Impairment loss measurement guidelines for an analysis of impaired and past due exposures and allowance for impairment by exposure type
442 (g) (i)	Impairment and past due exposures	
442 (g) (ii)	specific and general credit risk adjustments	
442 (g) (iii)	and impairment charges for the period, by exposure class or counterparty type.	
442 (h)	Impaired, past due exposures, by geographical area, and amounts of specific and general impairment for each geography.	Refer to Section 3.6 Impairment loss measurement guidelines
442 (i)	Reconciliation of changes in specific and general credit risk adjustments compromising of:	Refer to Section 3.6 Impairment loss measurement guidelines for an analysis of the Group's specific credit risk adjustments and to note 2.2.5 "Impaired financial assets and impairment allowance" to the Financial statements i.e. specific and collective impairment allowances.
442 (i) (i)	description of the type of specific and general credit risk adjustments	
442 (i) (ii)	the opening balances	
442 (i) (iii)	amounts taken against the credit risk adjustments during the reporting period	
442 (i) (iv)	any other adjustments including those determined by exchange rate differences, business combinations, acquisitions and disposals of subsidiaries, and transfers between credit risk adjustments	
442 (i) (v)	the closing balance	
442 endnote	Specific credit risk adjustments recorded to income statement are disclosed separately.	

Unencumbered assets		
443	Disclosures on unencumbered assets	Refer to Section 11 Asset encumbrance
Use of ECAIs		
444 (a)	Names of the ECAIs used in the calculation of Standardised Approach RWAs, and reasons for any changes	Refer to Section 5 External credit assessment institutions
444 (b)	Exposure classes associated with each ECAI	
444 (c)	Explanation of the process for translating external ratings into credit quality steps	
444 (d)	Mapping of external rating to credit quality steps	The Group compiles mapping of each nominated ECAI with the credit quality steps according to the standard association published by EBA.
444 (e)	Exposure value pre- and post-credit risk mitigation, by credit quality step.	Refer to Section 5 External credit assessment institutions
Exposure to market risk		
445	Disclosure of position risk, large exposures exceeding limits, FX, settlement and commodities risk.	N/A as the Group does not operate a trading book.
Operational risk		
446	Disclosure of the scope of approaches used to calculate operational risk, discussion of advanced methodology and external factors considered.	Refer to Section 7 Operational risk
Exposure in equities not included in the trading book		
447 (a)	Differentiation of exposures based on objectives	Refer to Section 3.10 Exposures in equities
447 (b)	Recorded and fair value, and actual prices of exchange investments traded equity where it differs from fair value.	
447 (c)	Types, nature and amounts of the relevant classes of equity exposures.	
447 (d)	Realised cumulative gains and losses on sales over the period.	
447 (e)	Total unrealised gains/losses, latent revaluation gains/losses, and amounts included within Tier 1 capital.	N/A – No equity exposures at the end of the reporting period
Exposure to interest rate risk on positions not included in the trading book		
448 (a)	Nature of risk and key assumptions in measurement models.	See Section 6 Interest Rate Risk in Non-Trading Book for key assumptions and interest rate risk Reporting and Analysis
448 (b)	Variation in earnings or economic value, or other measures used by the bank from upward and downward shocks to interest rates, by currency.	
Exposure to securitisation positions		
449	Description of the institution's objectives in relation to securitisation activity	N/A to the Group

Remuneration disclosures		
450 (1) (a)	information concerning the decision-making process used for determining the remuneration policy	Refer to "Remuneration policy statement" section in remuneration report.
450 (1) (b)	Information on link between pay and performance	
450 (1) (c)	Information on the criteria used for performance measurement	
450 (1) (d)	The ratios between fixed and variable remuneration	Refer to "Personnel expenses" note in financial statements
450 (1) (e)	Information on the performance criteria on which the entitlement to variable remuneration is based.	Refer to "Remuneration policy statement" section in remuneration report.
450 (1) (f)	The main parameters and rationale for any variable component scheme and any other non-cash benefits	
450 (1) (g)	Aggregate quantitative information on remuneration, broken down by business area	Refer to "Identified staff" section in remuneration report.
450 (1) (h)	Aggregate quantitative information on remuneration, broke down by senior management and members of staff whose actions have a material impact	
450 (1) (i)	The number of individuals being remunerated EUR 1 million	Refer to "Remuneration policy statement" section in remuneration report.
450 (1) (j)	Upon demand from the Member State or competent authority, the total remuneration for each member of the management body or senior management	Not applicable
450 (2)	Quantitative information at the level of members of the management body of the institution.	Refer to "Remuneration – Directors" section in remuneration report.
Leverage		
451 (1) (a)	The Leverage ratio and its application	Refer to Section 10 Leverage
451 (1) (b)	Leverage ratio breakdown of total exposure measure, including reconciliation to financial statements	
451 (1) (c)	Where applicable derecognised fiduciary items amount	
451 (1) (d)	Description of the risk management approach to mitigate excessive leverage, and factors that impacted the leverage ratio during the year.	Refer to Section 10 Leverage
451 (1) (e)	Description of factors that impacted the leverage ratio	
Use of the IRB approach to credit risk		
452	Disclosure for calculating the risk-weighted exposure amounts under IRB Approach	N/A to the Group
Use of credit risk mitigation techniques		
453 (a)	Use of on- and off-balance sheet netting	Refer to Collateral Valuation - Section 2.2.1 Credit risk and Section 3.7 Credit risk mitigation (3.7.2 On- and off-balance sheet netting and set-off and 3.7.3 Collateral and other credit enhancements)
453 (b)	How collateral valuation is managed	
453 (c)	Description of types of collateral used	Refer to Section 3.7 Credit risk mitigation (3.7.3 Collateral and other credit enhancements) for the types of eligible collateral held for each exposure class.
453 (d)	Types of guarantor and credit derivative counterparty, and their creditworthiness	The Group did not enter into any credit derivative hedges and did not receive any guarantees to cover part of its exposures.
453 (e)	Disclosure of market or credit risk concentrations within risk mitigation exposures	Refer to Section 3.7 Credit risk mitigation
453 (f)	For exposures under either the Standardised or Foundation IRB approach, disclose the exposure value covered by eligible collateral	The Group applies Standardised approach, refer to Section 3.7 Credit risk mitigation
453 (g)	Exposures covered by guarantees or credit derivatives	The Group did not enter into any credit derivative hedges and did not receive any guarantees to cover part of its exposures.
Use of the Advanced Measurement Approaches to operational risk		
454	Disclosure of Advanced Measurement Approaches to operational risk	N/A to the Group
Use of internal market risk models		
455	Disclosure of internal market risk models	N/A to the Group

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