Annual Report 2017

Contents

Chairman's Review

Michael Bussey
CHAIRMAN

HAVING BEEN APPOINTED TO THE ROLE OF CHAIRMAN IN FEBRUARY 2017 I AM PLEASED TO BE PRESENTING MY FIRST SET OF RESULTS FOR MEDIRECT GROUP LIMITED AND ITS SUBSIDIARIES ("MEDIRECT GROUP" OR "THE GROUP")

The financial year 2016/17 produced a satisfactory set of results, as management focused on developing the operating infrastructure to support both our commercial development and our governance obligations towards our various stakeholders. Full year profits before tax are reported at €19.1 million.

During the last financial year and post year end we have made additional changes to the Board structure. As previously reported in June 2016 Dominic Wallace was appointed as a non-executive director, having retired from his role as Chief Risk Officer. We have just announced that Frederick Mifsud Bonnici, our Audit Committee Chairman, will be leaving as he has taken the position of Chairman of another Maltese credit institution. I would like to both congratulate Frederick on his new appointment and thank him for his rigorous and robust contribution from which the Group has benefitted throughout his tenure. He significantly enhanced the Governance structure of the Group particularly as we moved directly under European Central Bank ("ECB") supervision and we were designated as an Other Systemically Important Institution ("OSII"). This change in regulatory status reflects the progress we have made in developing our business in recent years.

I am pleased to announce that John Zarb will replace Frederick, effective July 2017, as an independent non-executive director and Chairman of the Audit Committee. John brings with him a vast set of experience from his long career in professional services and audit work, alongside his Board experience with a number of leading Maltese businesses. As we further build our strategic objectives we will look to further broaden our Board representation enhancing our experience and skill set to support all our stakeholders.

As a business over the last year we have focused on our core strengths of corporate lending, growing our book by some 17% to €1.5 billion in total. This growth is underpinning the stability of income for the Group as we look to develop and broaden our lending capabilities, whilst increasing our funding sources and options through the ongoing growth of our online offerings.

MeDirect Group has a distinct and highly innovative business model, within the realm of European banking. Having consolidated its presence in Malta, the Group has seen the majority of its growth in its Belgian subsidiary, which it largely supports from its Maltese operating hub. This digital business is a highly scalable model and will be replicable in further jurisdictions. Corporate lending is diverse across 14 different jurisdictions and a number of industries, benefitting from the support of a highly analytical team based in London and our operational capabilities in Malta.

The online funding platform has provided ample liquidity for the Group, with its attractive range of savings products combined with a highly innovative digital investment and wealth management offering which in itself has seen remarkable growth as it broadens its appeal both in Malta and Belgium. With further growth in capital, the Group is well positioned to build on its current success and enhance its customer proposition whilst addressing the demands of its various stakeholders.

I am pleased to report that the Group remains satisfactorily capitalised, operating with a Tier 1 ratio of 11.7%, above the thresholds set by the regulatory authorities and the Board intends to operate in this manner on an ongoing basis. Likewise all necessary liquidity ratios have been comfortably met at all times, with the Group being highly liquid throughout the financial year.

The coming period will see continued growth and I am optimistic about the Group's prospects. Notwithstanding the ongoing challenges of executing on all our regulatory and commercial obligations, it is an exciting time to steward the growth of a highly focused and entrepreneurial management team and ensuring our progress is developed in an appropriate and risk aware manner. The coming year should witness significant development of the Group and as a team we look forward to successfully meeting those challenges whilst continuing to realize the undoubted potential of MeDirect Group.

MICHAEL BUSSEY
CHAIRMAN

17 July 2017

Chief Executive Officer's Review

Mark A. Watson
CHIEF EXECUTIVE OFFICER

THE 2016/17 FINANCIAL YEAR WAS FRAMED IN TERMS OF ROBUST PROGRESS IN OUR OPERATING INFRASTRUCTURE COMBINED WITH A SOLID SET OF FINANCIAL RESULTS.

The operating environment of the Group was one in which the dark clouds of the Eurozone economies started to lift, with growth emerging across the EU, underpinning valuations which witnessed stock markets across the world reaching all-time highs as the continuing theme of Quantitative Easing and negative interest rates ensured an ongoing reach for yield amongst the world's investors.

With this improved sentiment broadly emerging we can expect, over the horizon, that we will see a slow normalisation process beginning in the interest rate environment, led by the U.S. and somewhat later by the Eurozone. No doubt, although still some way away this will be welcomed by our core savings customer base.

Significantly in this year we welcome Mike Bussey as our new Chairman. Mike has brought a wealth of international banking experience to the role, which has already proved invaluable to myself and the management team as we explore new strategic opportunities and navigate the challenging regulatory environment in which we operate. Alongside a number of other appointments and changes to the Board, as articulated in the Chairman's review report, we feel that we are well positioned from a governance perspective as we embark on the next phase of our growth strategy.

I am pleased to report that having gone through our first SREP process, under the ECB's supervision, that we were assessed to be appropriately capitalised for our current business model and that no additional regulatory capital was required. Through the financial year our equity base continued to improve, rising from €204 million to €226 million, thus over the last 3 years we have more than doubled this number reflecting ongoing financial success and an ability to raise equity capital against our business plan.

Own Funds of the regulatory group now stand at €253.5 million with the Tier 1 ratio standing at 11.7% and the overall prudential ratio at 13.7%.This capital base has supported the growth in our corporate lending activities which grew from €1.2 billion to €1.5 billion, which underpins the underlying trajectory in our core earnings. We will continue to deploy our capital into this strategy as we build our origination capabilities alongside our analytical and risk management skill sets. The Group continues to operate with highly prudent liquidity ratios, which management deem appropriate, although over the coming months the expectation is that excess liquidity will be deployed appropriately into the loan book.

The overall macro environment has been very supportive for our wealth management businesses both in Malta and Belgium. Overall assets grew from €452 million to €625 million, a very strong performance given the innovative digital nature of the offering. Pleasingly we saw an increase in activity from both new and existing customers, with approximately 30% of our retail base now having multiple relationships across our savings and investment offering. Not only has this been done at significantly reduced rates but the nature of the multiple relationships creates longevity in the customer relationship that few online rivals can match and provides a steady and robust funding source for the expansion of the Group's activities.

Full year profit before tax came in at €19.1 million, an acceptable level given the delay in capital increase as that moves through the regulatory process. Throughout the period management continued to invest in the operating infrastructure of the Group, primarily through people and systems which will enable the Group to scale its capabilities and further enhance both its product offering and business results.

We will look to enhance our capital base throughout the existing financial year, between both Tier 1 and Tier 2 instruments with investments from both Maltese and international investors, whilst we continue to assess our strategic options given the scalability of the business model and the underlying strength of the platform which has been built.

Finally I would like once again to thank all our employees for their continued efforts in creating the business of the MeDirect Group and supporting management in their vision of what MeDirect will become.

MARK A. WATSON
DIRECTOR AND CHIEF EXECUTIVE OFFICER

17 July 2017

Directors' report

The directors present their annual report of MeDirect Group Limited (the "Company" or "MeDirect Holding"), formerly Medifin Holding Limited, and of the Company and its subsidiaries ("the Group") for the year ended 31 March 2017. 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 MeDirect Holding and its principal subsidiaries, namely Mediterranean Bank plc ("MedBank"), MedBank's two wholly owned subsidiaries being MeDirect Bank SA ("MeDirect") and 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 26 October 2016, the shareholders of the Company resolved to change the name of the company from Medifin Holding Limited to MeDirect 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 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.

MedBank 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. MedBank holds a Category 2 licence and a Category 4 licence issued by the MFSA which authorise MedBank 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 MedBank include the following:

- The provision of senior secured loans and of revolving credit facilities to foreign 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.

On 1 June 2015, MedBank's wholly owned subsidiary MeDirect obtained a full banking licence from the National Bank of Belgium. The Group had established a highly competitive online offering for the Belgian market through its Belgian Branch and such operations were transferred to this subsidiary in Belgium on 1 June 2015. MeDirect'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.

MedBank's other principal 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 MedBank.

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.

BUSINESS REVIEW

During the financial year ended 31 March 2017, 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 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 2017 of €17.3 million (2016: €17.0 million). Total operating income for the year ended 31 March 2017 was €68.1 million (2016: €62.2 million).

Profitability has been mainly driven through growth in attracting savings and term deposit products, primarily in the Maltese and Belgian markets, deploying liquidity in the Group's international corporate lending activities and efforts to maintain a low cost base.

The Group continues to fund its portfolios through deposits and through the international wholesale financial markets. The growth of the Group's deposit base, both in Malta and in Belgium, have 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 2017, the Group's deposit base reached €1.9 billion (2016: €1.4 billion). Growth of the Group's deposit base has also provided a potential customer base for investment and wealth management products.

The Group's loans and advances to customers ("Lending Portfolio") largely consists 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 €1.5 billion (2016: €1.2 billion) as of 31 March 2017, net of collective impairment loss allowances of €5.1 million (2016: €4.4 million) and specific impairment loss allowances of €16.9 million (2016: €12.4 million). In addition the Group had commitments of €288.3 million under revolving credit facilities as at 31 March 2017 (2016: €144.1 million) and other undrawn credit facilities of €49.5 million (2016: €33.3 million).

The MedBank Group, which comprises MedBank, MeDirect and MedCorp, also holds a portfolio of liquid assets. As of 31 March 2017, MedBank Group's Treasury portfolio stood at €698.5 million (2016: €851.3 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 respect of 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 also a key driver of the Group's growth. By virtue of board resolutions dated 30 September 2015, 11 December 2015 and 30 March 2016 the Group accepted capital contributions from its immediate parent company, Medifin Finance Limited, amounting to €28.7 million, €14.0 million and €16.0 million respectively.

The Group remains committed to operating with strong regulatory ratios and a robust liquidity position. At 31 March 2017 the Group's Capital Adequacy Ratio stood at 13.7% (2016: 15.6%), whilst the Group's Liquidity Coverage Ratio stood at 576.7% (2016: 270.4%).

Under the Single Supervisory Mechanism ("SSM"), as from January 2016, the Group came under the direct supervision of the European Central Bank ("ECB"). Before taking full supervisory responsibility, the ECB conducted a comprehensive assessment ("CA") of the Group's consolidated statement of financial position. The assessment comprised a supervisory risk assessment, an asset quality review and a stress test. This exercise started in May 2015 and was completed in November 2015. The overall result emanating from the CA confirmed the Group's solid capital position even under the theoretical stress conditions. 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 performance management process.

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

Year ended 31 March 2017

Net interest income (€000)	57,623
Operating expenses (€000)	43,346
Profit before tax (€000)	19,113
Cost to Income ratio (%)	63.7

As at 31 March 2017

Total Lending portfolio (€000)	1,449,970
Total deposits (€000)	1,901,512
Assets under custody (€000)	625,353
Regulatory Group CET 1 ratio (%)	11.7

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.

OUTLOOK AND FUTURE BUSINESS DEVELOPMENTS

The ongoing robustness of capital and liquidity ratios provide 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 and the reduction of interest rates by the ECB 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 above should be construed in light of the fact that the eurozone macroeconomic environment remains challenging, especially following the UK Brexit referendum results, 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.

As a result of the operations previously undertaken by MedCorp, MedBank 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 grown, and plans to continue to grow, its corporate lending activities and therefore the aggregate Lending Portfolio held by MedBank and MeDirect should grow as a percentage of the Group's overall asset base. The Group has been operating at a relatively stable leverage ratio of 7.29% (2016: 7.88%) 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 our 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 principle 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 therefore implicitly 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

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 Code of Conduct.

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) – appointed on 20 February 2017
Mark A. Watson (Chief Executive Officer)
Benjamin Hollowood
Dominic Wallace – appointed on 6 June 2016
Frederick Mifsud Bonnici – appointed on 6 June 2016
Francis J. Vassallo – appointed on 6 June 2016 and resigned on 6 July 2016
Joaquin Vicent – appointed on 6 June 2016
Michael Walker – appointed on 6 June 2016

On 17 July 2017, Mr. Frederick Mifsud Bonnici resigned from his post as a director and chairman of the Audit Committee and on the same day, Mr. John Zarb was appointed as a director and chairman of the Audit Committee.

DIVIDENDS AND RESERVES

At extraordinary general meetings held on 30 September 2015 and 12 July 2016, the Company approved an interim dividend of €28.7 million and €2.5 million respectively.

Retained earnings of the Company amounting to €67.3 million (2016: €69.8 million) and of the Group amounting to €101.2 million (2016: €87.0 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 MeDirect Group Limited for the year ended 31 March 2017 are included in the Annual Report 2017, which is published in hard-copy printed form and will be made available on the Company'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 Company'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 2017, other than the transactions described under Note 34 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 2016. During the financial years ended 31 March 2017 and 2016, 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 16 and 34.

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

On 21 November 2016, MedBank announced that the board of directors of MedBank and MedCorp have each voted to merge MedCorp with MedBank, subject to receipt of all applicable regulatory approvals and to completion of all legal requirements. With effect from 1 April 2017, the merger between MedBank and MedCorp became effective for accounting purposes. Thus all the transactions of MedCorp have been treated as being those of MedBank with effect from 1 April 2017.

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 Company's profitability, financial position, capital adequacy and solvency, the directors declare that the Company 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
10, St. Barbara Bastion,
Valletta, VLT 1961
Malta

17 July 2017

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 Mediterranean Bank plc ("MedBank"). 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 MedBank directors' and the Group's commitment to a high standard of corporate governance.

The MedBank directors report that since MedBank 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 MedBank.

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 MedBank's current organisational set up guarantees the proper and efficient functioning of MedBank and provides adequate corporate governance safeguards.

Compliance with the Code

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

MedBank'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 2017, the MedBank Board consisted of five non-executive members and two executive members. Taking into account certain factors such as the size of MedBank, the size of its Board and the balance of skills and experience represented by its members, the MedBank directors are considered to be appropriate for the requirements of MedBank's business. Mr. Dominic Wallace retired from his executive role as Chief Risk Officer and terminated his employment with the Group on 30 June 2016 but is now serving as a non-executive director of MedBank.

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

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

Principle 2: Chairman and Chief Executive

The positions of MedBank'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 MedBank's business.

MedBank's Chairman is responsible to lead MedBank's Board and he ensures that MedBank'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 MedBank Board decisions are supported by adequate and timely information. On the other hand, MedBank's Chief Executive Officer leads the MedBank 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

MedBank'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

MedBank's Board of Directors reviews and evaluates corporate strategy, major operational and financial plans, risk policy and performance objectives. The MedBank 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 MedBank Board:

- defines MedBank's strategy, policies, management performance criteria and business policies;
- ensures the proper functioning of MedBank's Audit Committee;
- establishes a clear internal and external reporting system so that the MedBank Board has continuous access to accurate, relevant and timely information;
- assesses and monitors MedBank'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 MedBank's corporate strategy and financial objectives using key performance indicators;
- ensures that MedBank has appropriate policies and procedures in place to enable MedBank 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 MedBank'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 MedBank'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 MedBank's Board to allow directors sufficient time to re-arrange their commitments in order to be able to participate. After each MedBank's Board meeting and before the next meeting, minutes that faithfully record attendance, deliberations and decisions of MedBank'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 MedBank's Board of Directors and the members of each of the committees of MedBank's Board.

Board of Directors

Since the date of the previous annual general meeting of MedBank, ten Board meetings were held, including nine regularly scheduled meetings and one ad hoc meeting. One of the board meetings was a telephone conference call.

		Meetings attended %
Michael Adrian Bussey	Chairman and Non-Executive Director (appointed on 20 February 2017)	100
Francis J. Vassallo	Chairman and Independent Non-Executive Director (resigned on 6 July 2016)	67
Frederick Mifsud Bonnici	Independent Non-Executive Director	100
Michael Walker	Independent Non-Executive Director	100
Dominic Wallace	Non-Executive Director (appointed on 6 October 2015 as Executive Director and Non-Executive Director as from 30 June 2016)	100
Benjamin Hollowood	Non-Executive Director	100
Mark A. Watson	Executive Director – Chief Executive Officer	90
Joaquin Vicent	Executive Director – Director of Credit and Investments	100

On 17 July 2017, Mr. Frederick Mifsud Bonnici resigned from his post as a director and on the same day, Mr. John Zarb was appointed as a director.

Committees of the Board

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

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

Board Committees

A. Audit Committee

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

The members of MedBank's Audit Committee are:

Frederick Mifsud Bonnici	Committee Chairman and Independent Non-Executive Director
Michael Bussey	Member and Non-Executive Chairman
Michael Walker	Member and Independent Non-Executive Director

Frederick Mifsud Bonnici has wide-ranging experience in the financial services sector and has been an elected member of the Council of the Malta Institute of Accountants uninterruptedly for 32 years and its president for three years. He is a visiting Senior lecturer in Auditing at the University of Malta. He was an Audit Partner of PricewaterhouseCoopers ("PwC") in Malta, responsible for risk management for many years and Head of Assurance, before his retirement. He was also Deputy Chairman and subsequently Chairman of the Malta Stock Exchange.

In terms of Listing Rules 5.117 and 5.118, Frederick Mifsud Bonnici is the director whom MedBank's Board considers as competent in accounting and/or auditing.

On 17 July 2017 Mr. John Zarb replaced Mr. Frederick Mifsud Bonnici as Chairman of MedBank's Audit Committee. 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.

During the year ended 31 March 2017, eight meetings of MedBank's Audit Committee were held. The Chief Executive Officer, the Chief Risk Officer, the Chief Financial Officer, the Chief Internal Audit Officer and a representative of the External Auditors attend MedBank's Audit Committee meetings by invitation.

B. Nomination and Remuneration Committee

MedBank'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.

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

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

Board Committees - continued

C. Board Risk Committee

MedBank's Risk Committee represents the principal forum for overseeing all risks of MedBank. In addition, it is responsible for recommending MedBank's risk appetite to MedBank's Board, and deciding risk-related policies and recommendations.

The current members of MedBank'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 MedBank's Risk Committee meetings by invitation. MedBank's Chairman of the Audit Committee attends MedBank's Risk Committee meetings as an observer.

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

- reviews and approves changes to MedBank's risk policy and procedures;
- ensures that the risk functions are appropriately resourced and structured to meet their obligations and are working effectively to maintain an effective control environment;
- reviews any violations to the lending limits;
- reviews the product distribution strategy, including product structure, pricing and targeting; and
- monitors:
    - 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 MedBank's Board after each meeting and notifies MedBank's Board of decisions made. The Committee makes whatever recommendations to the main Board that it deems necessary.

Meetings are scheduled quarterly. 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")

As from January 2017, MedBank's ExCo management structure was reformed into two different management forums in order to enhance the execution of MedBank's business priorities and reinforce the governance of MedBank's activities.

- MedBank's Management ExCo meets weekly and will continue to be responsible for the ongoing priorities that underpin MedBank's business model and the regulatory environment in which MedBank operates. The Management ExCo is chaired by the Chief Executive Officer and includes the Director of Credit and Investments, the Chief Risk Officer, the Chief Technology Officer, the Chief Financial Officer, the Head of Corporate Credit, the Chief Strategy Officer, the Head of Treasury, the Head of Human Resources and Administration, the Head of Legal, the 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 MedBank's Management ExCo.

- MedBank's Strategy ExCo is made up of a smaller group, meeting fortnightly, that focuses on MedBank's broader growth strategies and new initiatives and monitors MedBank'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. MedBank's Strategy ExCo is chaired by the Chief Executive Officer and includes the Director of Credit and Investments, the Chief Risk Officer, the Chief Technology Officer, the Chief Financial Officer, the Head of Corporate Credit, the Chief Strategy Officer and the MeDirect Bank SA Chief Executive Officer.

B. Management Credit Committee

MedBank's Management Credit Committee is responsible for approving credit recommendations and making other credit decisions under its delegated authority - this includes decisions on individual credits; reviewing and recommending credit to MedBank's Board; monitoring adherence to large exposure limits; considering credit hedging strategies; and recommending other concentration limits for MedBank's Board approval. It also establishes transactional authority for members of MedBank's Credit and Investments Team. In addition, MedBank's Management Credit Committee reviews provisioning and lending policies, monitors MedBank's investment portfolios and reviews Management Information reports.

The members of MedBank's Management Credit Committee include the Chief Risk Officer (Committee Chairman), the Chief Executive Officer and Director of Credit and Investments. The Committee meets regularly and on an ad hoc basis.

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

Principal Management Committees - continued

C. Asset and Liability Committee ("ALCO")

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

D. New Products and Services Committee

MedBank's New Products and Services Committee has been established to analyse potential new products to be offered by MedBank from a risk, operations, reputation and legal / compliance perspective. The Committee provides its recommendations to MedBank's Management ExCo including the appropriate policies, procedures and controls that should be adopted in relation to any such new product.

The Chief Risk Officer is the Chairman of MedBank'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

MedBank 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, MedBank's management, in consultation with the Board, will designate permanent successors, either from MedBank's existing management team or, if appropriate, by selecting an outside candidate.

As part of succession planning and talent management, MedBank's Board and the Chief Executive Officer ensure that MedBank 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 MedBank's personnel and identify high performing employees with the potential to take on more responsibilities.

The succession plan ensures that MedBank 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 MedBank 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 MedBank's Board previously listed, MedBank's Board actively participates in the appointment of senior management. Board members receive regular updates on MedBank's strategic, operational, corporate governance, compliance, risk management and financial plans and objectives.

MedBank's Board appoints the Chief Executive Officer of MedBank upon guidance and recommendation by the ultimate controlling party. The Board will be engaging a third party consultant to work with it to update and enhance its Board evaluation and training programmes. The training programmes will 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.

MedBank 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 MedBank's expense.

MedBank Directors also have access to the advice and services of the Company Secretary who is responsible for adherence to MedBank'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, MedBank'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

MedBank maintains on-going communication with its shareholders and the market on its strategy and performance in order to enhance trust and confidence in MedBank. During the period under review MedBank 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, MedBank's website, financial reports and interaction with the general media in Malta, MedBank 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 MedBank's listed securities.

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

The Chairmen of MedBank'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 MedBank'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 MedBank.

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

Principle 11: Conflicts of Interest

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

Principle 12: Corporate Social Responsibility

During the financial year ended 31 March 2017, MedBank proudly continued to support and promote Maltese sportive, cultural, and charitable causes and events. MedBank'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

MedBank's patronage of the sporting community was further strengthened with a number of donations to sporting associations and events. MedBank's significant support of the Malta Rugby Football Union ("MRFU") 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 'Mediterranean 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.

MedBank is also present in Gozo where MedBank 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 MedBank 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 MedBank and to this end it has supported a number of organisations and initiatives.

Music and Performing Arts

As part of MedBank'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, MedBank 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"), MedBank donated funds to support the production of certain events.

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 were also supported during one of their events.

MedBank 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 2016 annual Christmas charity campaign reflecting business generated during the month of December. MedBank also maintained its yearly appointment and presented a donation to the President's Community Chest Fund Campaign L-Istrina, on behalf of MedBank and MedCorp.

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

Education

As part of MedBank's collaboration towards the promotion of educational programmes nationwide, MedBank 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 the internet banking and a supermarket app.

Other Disclosures

There were no material contracts to which MedBank, or any of its subsidiaries were a party, and in which any one of MedBank'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

MedBank's Board is responsible for ensuring that MedBank'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. MedBank operates a system of internal control which 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 MedBank.

The management of MedBank 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 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

17 July 2017

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

During the year ended 31 March 2017, the NRC met once and this meeting was 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.

Remuneration report - continued

Remuneration policy statement - continued

The Group does not intend to effect any changes in 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 are no employees within the Group that receive a total remuneration equal to or greater than €1 million.

ii. Members of management and control functions

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

Compensation for employees serving in control functions takes into account broadly based performance measurements, including evaluation of achievements in respect of control function responsibilities. Control function employees are compensated in accordance with their own performance and not in accordance with the performance of the business.

Senior members of management have 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. In addition, the Group had established an employee benefit trust enabling employees who did not participate in the initial purchase of LTIP shares to participate in the LTIP. These shares in the ultimate parent company purchased by senior managers were acquired in the years immediately following the acquisition of the Group by the ultimate controlling party, at which time the employee benefit plan was established. The employee benefit plan has since made allocations to certain other managers in the Group but has made no allocation since 2015. These LTIP shares do not entitle the holder to receive any participation in the profits, assets or distributions of the ultimate parent company except upon exit by the ultimate controlling party from its investment in the Group or a public offering of shares in the Group. The LTIP plan is not subject to any clawback provisions.

This plan was designed to incentivise senior management to maximise the long-term value of the Group. In fact the amount that would be paid to these shares on exit depends on the terms and price of the exit of 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 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 is delivered in the form of cash and such variable pay is never larger than €100,000. The 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 monthly deposits of specified amounts direct from after tax payroll into an employee savings account. At the end of each calendar year, MedBank 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.

Identified staff

The target population defined as Identified Staff for the purposes of this report represents 9% of the total number of employees in the Group. Identified staff was 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 includes 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	Retail and investment banking and Wealth management	Retail banking	Corporate functions	Independent control functions
Senior Management						
Number of identified staff	5	3	3	2	4	2
Total fixed remuneration (€)[1]	264,062	1,895,015	926,363	250,576	625,384	267,074
Total variable remuneration (€) (delivered in cash)	-	290,000	138,172	21,000	91,882	-
Material Risk Takers (non-senior management)						
Number of identified staff	-	-	2	-	1	2
Total fixed remuneration (€)[1]	-	-	163,692	-	163,361	190,649
Total variable remuneration (€) (delivered in cash)	-	-	11,500	-	20,000	10,000
Total						
Number of identified staff		3	5	2	5	4
Total fixed remuneration (€)[1]	264,062	1,895,015	1,090,055	250,576	789,015	457,723
Total variable remuneration (€) (delivered in cash)	-	290,000	149,672	21,000	111,882	10,000

[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 MedBank's non-executive directors, including the Chairman, for the year ended 31 March 2017 amounted to €0.3 million.

Total emoluments earned by the executive directors of MedBank during the year ended 31 March 2017, are reported below:

	€	%
Fixed remuneration	**1,568,928**	85
Variable remuneration	**200,000**	11
Non-cash benefits	**76,744**	4
	1,845,672	100

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 MedBank on behalf of the directors.

All the executive directors as of 31 March 2017 were engaged under indefinite employment contracts. Dominic Wallace ceased to be an executive director as from 30 June 2016 and subsequent to this date he has been serving as a non-executive director. His emoluments are reflected above with both the emoluments earned by executive directors and with non-executive directors' fees accordingly.

Remuneration - senior management

Total emoluments received by 11 senior management (excluding directors), during the year ended 31 March 2017, are reported below:

	€	%
Fixed remuneration	**2,216,579**	85
Variable remuneration	**341,054**	13
Non-cash benefits	**52,161**	2
	2,609,794	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 would form part of the contract of employment of each staff member.

Sign-on and severance payments

During the year ended 31 March 2017, 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

17 July 2017

Independent auditor's report

To the Shareholders of MeDirect Group Limited

Report on the audit of the financial statements

Our opinion

In our opinion:

- MeDirect Group Limited's consolidated and stand-alone parent company financial statements (the "financial statements") give a true and fair view of the financial position of the Group and the Company as at 31 March 2017, and of their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU; and
- The financial statements have been prepared in accordance with the requirements of the Maltese Companies Act (Cap. 386).

What we have audited

MeDirect Group Limited's financial statements, set out on pages 41 to 146, comprise:

- the consolidated and parent company statements of financial position as at 31 March 2017;
- the consolidated and parent company income statements and statements of 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

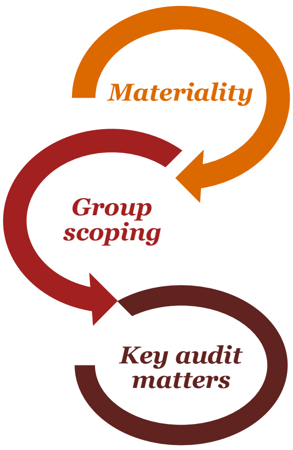
We are independent of the Group and the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements of the Accountancy Profession (Code of Ethics for Warrant Holders) Directive issued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

To the Shareholders of MeDirect Group Limited

Our audit approach

Overview



- Overall group materiality: €1 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 2017 comprising Mediterranean Bank 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.

Independent auditor's report - continued

To the Shareholders of MeDirect Group Limited

Overall group materiality	€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.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above €96,000 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 €1,393.3 million at 31 March 2017, and a significantly smaller local lending portfolio, predominantly consisting of loans to the real estate activities sector in Malta, with a carrying amount of €56.7 million at 31 March 2017.	The policies and methodologies used by the MedBank 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.

Independent auditor's report - continued

To the Shareholders of MeDirect Group Limited

Key audit matter	How our audit addressed the Key audit matter
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 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.	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. 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.

Key audit matter	How our audit addressed the Key audit matter
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 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 28.	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. 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. In the case of certain impairment provisions, we formed a different view from that of management, but in our opinion the differences were within a reasonable range of outcomes.

Key audit matter	How our audit addressed the Key audit matter
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 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 points 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	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; • 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.

Independent auditor's report - continued

To the Shareholders of MeDirect Group Limited

Key audit matter	How our audit addressed the Key audit matter
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. The MedBank Group has historical experience in respect of the international lending portfolio, which is limited to five years, for the purposes of supporting the expected life assumption applied to each loan. Consequently, the MedBank 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.	Based on the results of our audit procedures we concluded that the assumptions used by management were reasonable.

How we tailored our group audit scope

The Group is composed of three components: MeDirect Group Limited (the parent company), and its subsidiaries Mediterranean Bank 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.

which we obtained prior to the date of this auditor's report.

Our opinion on the financial statements does not cover the other information.

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).

Independent auditor's report - continued

To the Shareholders of MeDirect Group Limited

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 Group 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 and 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.

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.

Independent auditor's report *- continued*

To the Shareholders of MeDirect Group Limited

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 and 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 and 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 - continued

To the Shareholders of MeDirect Group Limited

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

F Axisa

Fabio Axisa
Partner

17 July 2017

Statements of financial position

		Group		Company	
		2017	2016	**2017**	2016
	Notes	**€000**	€000	**€000**	€000
ASSETS					
Balances with Central Banks, treasury bills and cash	4	**245,195**	33,281	**-**	-
Derivative financial instruments	5	**1,627**	3,964	**-**	-
Loans and advances to financial institutions	6	**106,945**	60,138	**50**	220
Loans and advances to customers	7	**1,449,970**	1,238,966	**-**	-
Investments					
- Corporate	8	**228**	21,493	**-**	-
- Treasury	8	**698,474**	851,256	**-**	-
- Subsidiaries	9	**-**	-	**194,911**	194,911
Property and equipment	10	**410**	952	**-**	-
Intangible assets	11	**607**	677	**-**	-
Non-current assets classified as held for sale	12	**1,785**	-	**-**	-
Current tax assets		**8,403**	5,457	**-**	-
Deferred tax assets	13	**8,398**	9,598	**-**	-
Prepayments and accrued income	14	**19,149**	17,747	**-**	17
Other assets	15	**31,682**	31,111	**9,252**	12,341
Total assets		**2,572,873**	2,274,640	**204,213**	207,489

The notes on pages 51 to 147 are an integral part of these financial statements.

Statements of financial position - continued

	Notes	Group 2017 €000	Group 2016 €000	Company 2017 €000	Company 2016 €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	**58,700**	58,700	**58,700**	58,700
Reserve for general banking risks	16	**1,694**	1,194	**-**	-
Other reserves	16	**(4,808)**	(12,137)	**-**	-
Retained earnings	16	**101,174**	86,983	**67,277**	69,754
Total equity		**226,254**	204,234	**195,471**	197,948
LIABILITIES					
Derivative financial instruments	5	**2,323**	7,337	**-**	-
Amounts owed to financial institutions	17	**359,183**	541,925	**-**	-
Amounts owed to customers	18	**1,901,512**	1,447,355	**-**	-
Subordinated liabilities	20	**46,993**	47,380	**-**	-
Current tax liabilities		**71**	69	**19**	16
Accruals and deferred income	21	**30,499**	23,366	**15**	7
Other liabilities	22	**6,038**	2,974	**8,708**	9,518
Total liabilities		**2,346,619**	2,070,406	**8,742**	9,541
Total equity and liabilities		**2,572,873**	2,274,640	**204,213**	207,489
Memorandum items					
Commitments to purchase financial assets	7-8	**108,865**	152,962		
Commitments to extend credit, guarantees and other similar commitments	31-33	**352,256**	187,351		

The notes on pages 51 to 147 are an integral part of these financial statements.

The financial statements on pages 42 to 147 were approved and authorised for issue by the Board on 17 July 2017 and were signed by:

Michael Bussey
Chairman

Mark A. Watson
Director and Chief Executive Officer

Income statements

	Notes	Group 2017 €000	Group 2016 €000	Company 2017 €000	Company 2016 €000
Interest income		**89,922**	77,308	**55**	55
Interest expense		**(32,299)**	(36,408)	**-**	-
Net interest income	23	**57,623**	40,900	**55**	55
Fee and commission income					
– Corporate lending fees		**711**	526	**-**	-
– Other		**4,807**	3,640	**-**	-
Fee and commission expense					
– Corporate lending fees		**(282)**	(478)	**-**	-
– Other		**(1,382)**	(1,317)	**-**	-
Net fee and commission income	24	**3,854**	2,371	**-**	-
Net trading income	25.1	**2,178**	2,224	**-**	-
Net income from other financial instruments at fair value through profit or loss	25.2	**-**	1,108	**-**	-
Other operating income					
– Realised gains on disposal of other investments	25.3	**800**	15,712	**-**	-
– Realised gains/(losses) on disposal of loans and advances		**3,594**	(253)	**-**	-
– Other income	25.4	**17**	179	**-**	45,637
Total operating income		**68,066**	62,241	**55**	45,692
Personnel expenses	26	**(17,426)**	(17,228)	**-**	-
Depreciation and amortisation	10-11	**(619)**	(678)	**-**	-
Other administrative expenses	27	**(25,301)**	(26,723)	**(10)**	(33)
Total operating expenses		**(43,346)**	(44,629)	**(10)**	(33)
Net operating income before impairment charges		**24,720**	17,612	**45**	45,659
Net impairment charges	28	**(5,607)**	(3,747)	**-**	-
Profit before tax		**19,113**	13,865	**45**	45,659
Taxation	29	**(1,846)**	3,144	**(22)**	(12,303)
Profit for the year		**17,267**	17,009	**23**	33,356

The notes on pages 51 to 147 are an integral part of these financial statements.

Statements of other comprehensive income

	Group		Company	
	2017	2016	**2017**	2016
	€000	€000	**€000**	€000
Profit for the year	**17,267**	17,009	**23**	33,356
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	**8,528**	(5,204)	**-**	-
- Net amount reclassified to profit or loss, before tax	**(822)**	(15,712)	**-**	-
Income tax relating to other comprehensive income	**(453)**	1,055	**-**	-
Other comprehensive income, net of tax	**7,253**	(19,861)	**-**	-
Total comprehensive income, net of tax	**24,520**	(2,852)	**23**	33,356
Profit attributable to:				
Owners of the Company	**17,267**	16,976	**23**	33,356
Non-controlling interests	**-**	33	**-**	-
Profit for the year	**17,267**	17,009	**23**	33,356
Total comprehensive income attributable to:				
Owners of the Company	**24,520**	(2,885)	**23**	33,356
Non-controlling interests	**-**	33	**-**	-
Total comprehensive income for the year	**24,520**	(2,852)	**23**	33,356

The notes on pages 51 to 147 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	Non-controlling interests €000	Total equity €000
Balance at 1 April 2015	55,738	13,756	-	1,029	8,800	98,872	178,195	876	179,071
Total comprehensive income									
Profit for the year	-	-	-	-	-	16,976	16,976	33	17,009
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	-	-	-		(4,946)	-	(4,946)	-	(4,946)
- Reclassification adjustments – net amounts reclassified to profit or loss, net of tax	-	-	-		(14,915)	-	(14,915)	-	(14,915)
Total other comprehensive income, net of tax	-	-	-		(19,861)	-	(19,861)	-	(19,861)
Total comprehensive income, net of tax	-	-	-		(19,861)	16,976	(2,885)	33	(2,852)
Transactions with owners									
Contribution by shareholders	-	-	58,700	-	-	-	58,700	-	58,700
Dividends paid	-	-	-	-	-	(28,700)	(28,700)	(495)	(29,195)
Total transactions with owners	-	-	58,700	-	-	(28,700)	30,000	(495)	29,505
Changes in ownership interest in subsidiary									
Acquisition of non-controlling interests	-	-	-	-	(1,076)	-	(1,076)	(414)	(1,490)
Transfer to Reserve for general banking risks	-	-	-	165	-	(165)	-	-	-
Balance at 31 March 2016	**55,738**	**13,756**	**58,700**	**1,194**	**(12,137)**	**86,983**	**204,234**	**-**	**204,234**

The notes on pages 51 to 147 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 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	-	-	-	-	8,033	-	8,033
- Reclassification adjustments – net amounts reclassified to profit or loss, net of tax	-	-	-	-	(780)	-	(780)
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 51 to 147 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 2015	55,738	13,756	-	65,098	134,592
Total comprehensive income					
Profit for the year	-	-	-	33,356	33,356
Transactions with owners					
Contributions by shareholders	-	-	58,700	-	58,700
Dividends paid	-	-	-	(28,700)	(28,700)
Total transactions with owners	-	-	58,700	(28,700)	30,000
Balance at 31 March 2016	**55,738**	**13,756**	**58,700**	**69,754**	**197,948**
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**

The notes on pages 51 to 147 are an integral part of these financial statements.

Statements of cash flows

	Group		Company	
	2017	2016	**2017**	2016
	€000	€000	**€000**	€000
Cash flows from operating activities				
Interest and commission receipts	**112,103**	95,392	**-**	-
Interest and commission payments	**(35,772)**	(40,395)	**-**	-
Payments to employees and suppliers	**(43,972)**	(45,623)	**-**	-
Operating profit before changes in operating assets/liabilities	**32,359**	9,374	**-**	-
Increase in operating assets:				
- Reserve deposit with Central Bank of Malta	**(184,630)**	(2,407)	**-**	-
- Loans and advances to financial institutions and customers	**(225,770)**	(210,327)	**-**	-
Increase/(decrease) in operating liabilities:				
- Amounts owed to financial institutions and customers	**357,360**	(96,926)	**-**	-
- Other payables	**1,774**	122	**-**	-
- Derivative financial instruments	**(7,494)**	(1,960)	**-**	-
Tax (paid)/refunded	**(5,248)**	(17,374)	**3,150**	-
Net cash (used in)/from operating activities	**(31,649)**	(319,498)	**3,150**	-

The notes on pages 51 to 147 are an integral part of these financial statements.

Statements of cash flows - continued

	Note	Group 2017 €000	Group 2016 €000	Company 2017 €000	Company 2016 €000
Net cash (used in)/from operating activities		**(31,649)**	(319,498)	**3,150**	-
Cash flows from investing activities					
Acquisition of investment in subsidiary		**-**	(1,500)	**-**	(1,500)
Acquisition of property and equipment		**(7)**	(22)	**-**	-
Acquisition of intangible assets		**-**	(26)	**-**	-
Acquisition of available-for-sale assets and treasury bills		**(26,939)**	(289,592)	**-**	-
Disposal/redemption of available-for-sale assets investment securities and treasury bills		**196,078**	898,484	**-**	-
Disposal of equity investments		**81**	3,637	**-**	-
Dividends received from subsidiaries		**-**	-	**-**	22,918
Net shareholders' contribution advanced to subsidiary		**-**	-	**-**	(58,700)
Net advances (to)/from subsidiary		**-**	-	**(820)**	7,501
Net cash from/(used in) investing activities		**169,213**	610,981	**(820)**	(29,781)
Cash flows from financing activities					
Dividends paid		**(2,500)**	(29,195)	**(2,500)**	(28,700)
Repurchase of debt securities		**-**	(148,000)	**-**	-
Repayment of debt securities on maturity		**-**	(9,255)	**-**	-
Shareholders' contribution		**-**	58,700	**-**	58,700
Loan from ultimate parent		**-**	1,000	**-**	-
Repayment of loan from ultimate parent		**-**	(548)	**-**	-
Receipts from immediate parent company		**1,624**	-	**-**	-
Receipts from group companies		**1,442**	1,586	**-**	-
Net cash (used in)/from financing activities		**566**	(125,712)	**(2,500)**	30,000
Net increase/(decrease) in cash and cash equivalents		**138,130**	165,771	**(170)**	219
Cash and cash equivalents at beginning of year		**(35,937)**	(201,708)	**220**	1
Cash and cash equivalents at end of year	30	**102,193**	(35,937)	**50**	220

The notes on pages 51 to 147 are an integral part of these financial statements.

Notes to the financial statements

1. Summary of significant accounting policies

1.1 Reporting entity

MeDirect 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 2017 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 MeDirect Group Limited for the financial year ended 31 March 2017, including the financial results of Mediterranean Bank plc ("MedBank") and its two subsidiaries namely MeDirect Bank SA ("MeDirect") and Mediterranean Corporate Bank Limited ("MedCorp"), 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 of assets, liabilities and related income and expenditure attributable to GH I, and as such, all assets, liabilities and related income and expenditure attributable to have been reflected within the Group's consolidated financial statements.

MedCorp became a principal subsidiary of MedBank on 25 September 2014, the date of acquisition. On 21 November 2016, MedBank announced that the Boards of Directors of MedBank and MedCorp have each voted to merge MedCorp into MedBank, subject to receipt of all applicable regulatory approvals and completion of all legal requirements. With effect from 1 April 2017, the merger between MedBank and MedCorp became effective for accounting purposes. Thus all the transactions of MedCorp have been treated as being those of MedBank with effect from 1 April 2017 (see Note 37).

MeDirect Bank SA is a credit institution licensed in Belgium. As from May 2015 it took over the operations from the branch that MedBank 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 2013, MedBank issued debt securities to institutional investors through GH I, which were subsequently redeemed during 2015 (Note 19). Throughout the financial year ended 31 March 2017, MedBank and MeDirect transferred a portfolio of syndicated senior secured loans to GH I. GH I was funded through two intragroup loan facilities subscribed to by MedBank and MeDirect. The transaction lead to a transfer of risk from MeDirect to MedBank, without changing the Group's overall risk profile on a consolidated basis. MeDirect and MedBank invested in GH I on a 69% - 31% basis respectively, with the tranche bought by MeDirect (the "Senior Loan") amounting to €474 million having a senior ranking vis-à-vis the tranche acquired by MedBank (the "Junior Loan") amounting to €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 2017

During the financial year ended 31 March 2017, the Group adopted new standards, amendments and interpretations to existing standards that are mandatory for the Group's accounting period beginning on 1 April 2016. 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 2017 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'

In July 2014, the IASB issued IFRS 9 "Financial Instruments", which is the comprehensive standard to replace IAS 39 "Financial Instruments: Recognition and Measurement", and includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting. The European Commission has adopted IFRS 9 Financial Instruments with Regulation (EC) No 2016/2067 of 22 November 2016. The EU effective date is the same as the IASB's effective date (annual periods beginning on or after 1 January 2018).

Classification and measurement

The classification and measurement of financial assets will depend on how these are managed (the entity's business model) and their contractual cash flow characteristics. These factors determine whether the financial assets are measured at amortised cost, fair value through other comprehensive income (FVOCI) or fair value through profit or loss (FVTPL). The combined effect of the application of the business model and the contractual cash flow characteristics tests may result in some differences in the population of financial assets measured at amortised cost or fair value compared with IAS 39. However, based on a preliminary assessment of financial assets held to date and expectations around changes in balance sheet composition, the Group expects that the overall impact of any change will not be significant. The classification of financial liabilities is also essentially unchanged.

The Group plans to conduct a detailed assessment of potential classification and measurement changes to financial assets based on the composition of the balance sheet as at 31 March 2017. This may not be fully representative of the impact as at 1 April 2018 because IFRS 9 requires that business models are assessed based on the facts and circumstances from the date of initial application. In addition, the contractual terms and conditions of the financial assets assessed as at 31 March 2017 may not reflect the contractual terms and conditions of the Group's financial assets at transition. The Group plans to publish the impact of this assessment in its Annual Report and Consolidated Financial Statements for the year ending 31 March 2018.

Impairment

The impairment requirements apply to financial assets measured at amortised cost and FVOCI, and certain loan commitments and financial guarantee contracts. At initial recognition, an impairment allowance (or provision in the case of commitments and guarantees) is required for expected credit losses (ECL) resulting from default events that are possible within the next 12 months (12-month ECL).

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

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

1.2 Basis of preparation - continued

Impairment - continued

The assessment of credit risk and the estimation of ECL are required to be unbiased and probability-weighted, and should incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. As a result, the recognition and measurement of impairment is intended to be forward-looking rather than based on incurred losses such as under IAS 39 and the resulting impairment charge is expected to be more volatile. It will also tend to result in an increase in the total level of impairment allowances, since all financial assets will be assessed for at least 12-month ECL and the population of financial assets to which lifetime ECL applies is likely to be larger than the population for which there is objective evidence of impairment in accordance with IAS 39.

As explained later, the Group is still in the process of assessing the impact that the impairment requirements will have on the financial statements.

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, which are particularly important for banks. As a result, IFRS 9 includes an accounting policy choice to remain with IAS 39 hedge accounting.

The Group expects to exercise the accounting policy choice to continue IAS 39 hedge accounting and therefore is not currently planning to change hedge accounting, although it will implement the revised hedge accounting disclosures required by the related amendments to IFRS 7 'Financial Instruments: Disclosures'.

Transition

The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. The Group does not intend to restate its comparative periods. Accordingly, all adjustments resulting from the transition will be applied by adjusting the opening balance sheet as at 1 April 2018.

IFRS 9 implementation project

Within the Group, an IFRS 9 Implementation Project (the Project) was set up in 2016 to prepare for implementation of IFRS 9 and significant preparatory and design work has taken place. The Project is sponsored by the Group Chief Financial Officer. A Steering Committee comprising senior management from Finance, Risk, Business Development, Treasury, Strategy and Technology has been established.

1. Summary of significant accounting policies - continued

1.2 Basis of preparation - continued

IFRS 9 implementation project - continued

To date, the Project has been directed towards a preliminary impairment model feasibility analysis through which it was concluded that the Group will rely on a third party software application incorporating risk modelling methodologies for the calculation of impairment. In addition, a high level impact assessment of the classification and measurement requirements has been carried out though a more detailed impact assessment is currently being performed. The Project focus is also on selecting and developing a partnership with a globally recognised third party supplier for impairment modelling.

The Group intends to perform a simulation during the last quarter of 2017 and the first quarter of 2018 to gain a better understanding of the potential effect of the new standard and to gain experience in respect of the governance framework. The Group intends to quantify the potential impact of IFRS 9 once it is practicable to provide reliable estimates, which will be subsequent to such simulation but no later than the issuance of the Annual Report and Consolidated Financial Statements 2018.

Reliable estimates of the effects on the interaction with the regulatory capital requirements are not yet available.

Comparison of IAS 39 accounting policies with IFRS 9 requirements

The accounting policies and critical accounting estimates and judgements for the impairment of loans and advances and available-for-sale financial assets (in accordance with IAS 39 'Financial Instruments') are set out in Note 1.6. Their equivalents for financial assets at amortised cost and at FVOCI (in accordance with IFRS 9) are currently being compiled.

The following similarities and differences are likely to be important in understanding the potential effect of the change in accounting policy resulting from the implementation of IFRS 9 'Financial Instruments':

Stage 3 assets

Financial assets will be included in stage 3 when there is objective evidence that the loan is credit impaired. The objective evidence that is used is the same as the criteria used to determine whether an individually significant loan is impaired in accordance with IAS 39. Therefore, the population included in stage 3 is expected to be consistent with impaired loans under IAS 39.

Individual discounted cash flow calculations will continue to be performed. Changes will likely be made to these calculations to ensure the measurement requirements of IFRS 9 are met, for example, to reflect the impact of multiple scenarios.

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

1.2 Basis of preparation - continued

Stage 3 assets - continued

Under IFRS 9, the Group expects to retain its current definition of default which is aligned to the Regulatory Capital CRR Article 178 definition of default, which considers either or both of the following:
- material exposures that are more than 90 days past due;
- borrower is assessed unlikely to pay its credit obligation in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of days past due.

When exposures are identified as credit impaired or purchased or originated as such, IFRS 9 requires separate disclosure and interest income is to be presented on a net basis rather than gross. Credit impairment is expected to occur when the exposure has defaulted which is also anticipated to align to when an exposure is identified as individually impaired under the incurred loss model of IAS 39.

Write-off polices are not expected to change from those applied under IAS 39.

Stage 2 assets and the determination of a significant increase in credit risk since initial recognition

In accordance with IFRS 9, financial assets are considered to be in stage 2 when their credit risk has increased significantly since initial recognition so it is appropriate to recognise lifetime ECL. Since this is not an existing concept within IAS 39, it is likely to result in increased allowances.

The Group expects to estimate when a significant increase in credit risk has occurred since initial recognition based on both quantitative and qualitative criteria. The Group is still in the process of finalising the selection of such criteria to establish the points where the change in credit risk is considered meaningful in risk management terms.

Stage 1 assets

In accordance with IAS 39, incurred but not yet identified impairment is recognised on individually assessed loans for which no evidence of impairment has been specifically identified by estimating a collective allowance determined after taking into account factors including the estimated period between impairment occurring and the loss being identified.

Under IFRS 9, financial assets which are not considered to have experienced significant increase in credit risk have loss allowances measured at an amount equal to 12 months ECL. This 12-month time horizon is likely to be equal to or longer than the period estimated under IAS 39, which will tend to result in IFRS 9 allowances being larger than the current collective impairment allowance charge.

1. Summary of significant accounting policies - continued

1.2 Basis of preparation - continued

Credit loss modelling and forward-looking information

As stated earlier, the Group plans to base ECL calculations on a methodology using a third party software application.

IFRS 9 Probability of Default ('PD') and Loss Given Default ('LGD') estimates also have to be flexed to capture the effects of forward-looking macroeconomic variables. Thus macroeconomic factors may be stressed, given certain risk sensitivities to these factors. The outcome under various scenarios is subsequently used to determine the PD and LGD that incorporate forward looking information. By assigning weights that represent the probability of the various simulations one can arrive at a properly weighted outcome of expected credit losses.

The Group expects that when there is a non-linear relationship between forward-looking economic scenarios and associated credit losses, a range of forward-looking economic scenarios, currently expected to be a minimum of three, will be considered to ensure a sufficient unbiased representative sample of the complete distribution is included in determining the expected loss.

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 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 Other intangible assets

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

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.

1. Summary of significant accounting policies - continued

1.9 Property, plant and equipment - continued

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.

1.10 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, 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.

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

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.

1.26 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. Summary of significant accounting policies - continued

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.

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

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. Financial risk management - continued

2.2 Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Group's loans and advances to customers and financial institutions, together with investment debt securities. For risk management reporting purposes, the Group considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country risk and sector risk).

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. MedBank'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 MedBank'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.

The MedBank Board of Directors has established limits for exposures to individual credits based on the 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.

2. **Financial risk management** - continued

2.2 Credit risk - continued

2.2.1 Management of credit risk - continued

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 Management Credit Committees of the Subsidiaries (MedBank, MedCorp and MeDirect) are responsible for approving credit recommendations and making other credit decisions under their authority delegated by the respective Board of Directors. This includes decisions on individual credits, reviewing and recommending credit exposures, consideration of credit hedging strategies and recommending concentration limits for approval by the Board of Directors.

They are also responsible for delegating transactional responsibility to their Credit and Investment team such that their treasury portfolios are managed on a day to day basis by the Treasury function within the parameters that the Management Credit Committee of the Subsidiaries sets out.

As outlined previously, the Group's credit risk taking activities comprise principally investments in debt securities 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 and Investment team, which manages the 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 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 and thorough surveillance process in order to identify any securities and loans the performance of which requires increased monitoring.

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

MedBank Group	**2017**	2016
	€000	€000
Net exposure:		
Loans and receivables		
Balances with Central Banks, treasury bills and cash	**245,194**	33,280
Loans and advances to financial institutions	**106,895**	59,558
Loans and advances to customers	**1,449,970**	1,238,966
Accrued income	**16,830**	15,110
Loans to related parties (included in other assets)	**24,040**	26,564
	1,842,929	1,373,478
Available-for-sale debt investments	**698,474**	872,415
Held for trading derivative financial instruments	**861**	3,964
Derivative financial instruments designated as hedging instruments	**766**	-
Financial assets at fair value through profit or loss designated upon initial recognition	**-**	82
	2,543,030	2,249,939
Commitments to purchase financial assets	**108,865**	152,962
Commitments to extend credit, guarantees and other commitments (excluding operating leases)	**345,649**	180,772

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.

The four credit quality classifications below describe the credit quality of the Group's key financial assets. 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:

Performing

1. Regular - no material credit concerns.
2. Focus - no immediate prospect that a loss will ultimately be suffered, but worthy of close attention.
3. Under Surveillance - significant credit concerns and some prospect that a loss may ultimately be suffered.

Non-Performing

4. Impaired - exposures have been assessed individually as impaired.

2. **Financial risk management** - continued

2.2 Credit risk - continued

2.2.3 Credit quality of financial assets - continued

The Group defines Non-Performing Exposures as those that satisfy either or both of the following criteria:

a) Material exposures which are more than 90 days past due; and
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.

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

MedBank Group	**Performing**			**Non-performing**		
	Regular	**Focus**	**Under surveillance**	**Impaired**	**Impairment allowances**	**Total**
	€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**
As at 31 March 2016						
Balances with Central Banks and Treasury Bills	32,573	-	-	-	-	32,573
Derivative financial instruments	3,964	-	-	-	-	3,964
Loans and advances to financial institutions	59,558	-	-	-	-	59,558
Loans and advances to customers	825,262	255,800	126,741	47,971	(16,808)	1,238,966
Investments	872,497	-	-	-	-	872,497
Accrued income	11,992	1,333	1,133	652	-	15,110
Loans to related parties (included in other assets)	26,564	-	-	-	-	26,564
	1,832,410	257,133	127,874	48,623	(16,808)	2,249,232

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.3 Credit quality of financial assets - continued

MedBank Group held available-for-sale investment securities (excluding equity instruments) with a carrying amount of €698.5 million as at 31 March 2017 (2016: €872.4 million). For investment securities, the Group's credit quality classifications referred to previously encompass a range of more granular external rating grades attributed by external agencies to debt securities. The following table illustrates this information:

	MedBank Group	
	2017	2016
	€000	€000
National Government securities		
A+ to A	**7,097**	-
A- to BBB-	**-**	7,128
Regional Government securities		
AAA	**42,063**	62,574
Other securities		
AAA	**389,042**	425,566
AA+ to AA-	**196,913**	277,868
A+ to A	**63,359**	78,067
B+ to CCC+	**-**	21,212
Total	**698,474**	872,415

The portfolio of available-for-sale securities is also categorised under the four credit quality classifications used by the Group (i.e. regular, focus, under surveillance and impaired) and these ratings would be determined by MedBank'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 MedBank Group's loans and advances to customers is reflected in the following table:

	MedBank Group	
	2017	2016
	€000	€000
Up to 30 days		
Principal	**15,788**	16,402
Interest	**95**	43
31 to 60 days		
Principal	**3,995**	2,855
Interest	**35**	12
61 to 90 days		
Principal	**-**	26
Total	**19,913**	19,338

MedBank and MeDirect do not have any exposures which are past due but not impaired. All past due but not impaired facilities form part of the local Lending Portfolio 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 individually significant 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

MedBank Group	**Specific impairment allowances €000**	**Collective impairment allowances €000**
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)**
Year ended 31 March 2016		
At beginning of year	9,614	3,977
Exchange differences	(48)	-
Loan impairment charge	2,803	462
At end of year	12,369	4,439
- of which relating to local lending portfolio	7,646	695
New allowances	4,985	4,439
Release of allowances no longer required	(2,182)	(3,977)
Total loan impairment charge	2,803	462
- **of which relating to local lending portfolio**	(888)	(183)

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 €2.6 million (2016: €1.9 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.

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.

The revised terms usually 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.

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:

MedBank 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	**1,269,519**	**92,643**	**24,445**	**1,295**	**1,387,902**
Past due but not impaired:					
- by up to 30 days	**-**	**-**	**10,986**	**4,802**	**15,788**
- between 31 to 60 days	**-**	**-**	**3,504**	**491**	**3,995**
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**
As at 31 March 2016					
Performing					
Neither past due nor impaired	1,098,837	58,855	24,678	6,150	1,188,520
Past due but not impaired:					
- by up to 30 days	-	-	12,480	3,922	16,402
- between 31 to 60 days	-	-	1,428	1,427	2,855
- between 61 and 90 days	-	-	1	25	26
Non-performing					
Impaired, net of specific impairment allowances	11,352	12,078	731	11,441	35,602
Loans and advances, net of specific impairment allowances	1,110,189	70,933	39,318	22,965	1,243,405
Specific impairment allowances	4,000	723	641	7,005	12,369
Collective impairment allowances	3,509	235	458	237	4,439

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

MedBank Group

	2017	2016
	€000	€000
Total forborne loans and advances to customers as a percentage of total gross loans and advances to customers	**10.3%**	8.1%

Interest income recognised by MedBank Group during the financial year ended 31 March 2017 in respect of forborne exposures amounted to €9.2 million (2016: €6.1 million).

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

MedBank Group	**2017**	2016
	€000	€000
Year ended 31 March		
At beginning of year	**101,626**	50,518
Loans to which forbearance measures have been extended during the year without derecognition	**72,231**	59,343
Capitalised interest	**1,322**	1,139
Repayments or disposals	**(24,169)**	(8,716)
Exchange differences	**(206)**	(636)
Amortisation of premium or discount	**107**	(22)
At end of year	**150,911**	101,626

As at 31 March 2017, specific impairment allowances on forborne loans was equivalent to €9.5 million (2016: €7.7 million). Specific impairment allowances on forborne loans reflected in profit or loss during the current year amounted to €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 MedBank Group's holdings of renegotiated loans and advances to customers analysed by industry sector and credit quality classification:

MedBank Group	Neither past due nor impaired €000	Past due but not impaired €000	Impaired €000	Total €000
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**
As at 31 March 2016				
Financial services	9,981	-	300	10,281
Real estate and construction	5,949	-	12,001	17,950
Manufacturing	23,261	-	14,227	37,488
Other	25,814	5,374	4,719	35,907
	65,005	5,374	31,247	101,626

The MedBank 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 Subsidiaries determines 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 €0.7 million (2016: €0.5 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.

The following tables show the carrying amount of 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.

Loans and advances at 31 March	**Forborne**		**Non-forborne**		**Total**	
	2017	2016	**2017**	2016	**2017**	2016
	€000	€000	**€000**	€000	**€000**	€000
Non-impaired						
a) Not collateralised	**-**	-	**67**	1,011	**67**	1,011
b) Fully collateralised						
- Up to 50% LTV	**4,777**	3,854	**22,945**	25,625	**27,722**	29,479
- 51% to 75% LTV	**1,510**	6,250	**12,261**	4,539	**13,771**	10,789
- 76% to 90% LTV	**-**	1,420	**480**	1,380	**480**	2,800
- 91% to 100% LTV	**-**	-	**1,906**	3,497	**1,906**	3,497
c) Partially collateralised						
- greater than 100% LTV	**-**	-	**-**	84	-	84
- of which collateral value	**-**	-	**-**	*15*	-	*15*
	6,287	11,524	**37,659**	36,136	**43,946**	47,660
Impaired						
a) Not collateralised	**-**	116	**481**	185	**481**	301
b) Fully collateralised						
- Up to 50% LTV	**4,126**	535	**231**	224	**4,357**	759
- 51% to 75% LTV	**10,426**	3,978	**-**	-	**10,426**	3,978
- 76% to 90% LTV	**1,063**	13,817	**-**	-	**1,063**	13,817
c) Partially collateralised						
- greater than 100% LTV	**-**	-	**964**	963	**964**	963
- of which collateral value	-	-	***880***	*880*	***880***	*880*
	15,615	18,446	**1,676**	1,372	**17,291**	19,818

2. **Financial risk management** - continued

2.2 Credit risk - continued

2.2.8 Collateral - continued

As at 31 March 2017 MedBank and MeDirect held senior secured loans to international borrowers which amounted to €1.4 billion (2016: €1.2 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 2017, the Group held covered bonds amounting to €303.3 million (2016: €367.7 million) which are backed by a separate group of assets in the form of loans.

2.2.9 Concentration of credit risk exposures

2.2.9.1 Exposure to sovereign debt

The Group's exposure to sovereign Eurozone government bonds as at 31 March 2017 represented 7% (2016: 8%) of the Group's total investment securities (excluding equity instruments). As at 31 March 2017 and 2016, 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 2017 and 2016.

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	
MedBank Group	**2017** **€000**	2016 €000
Concentration by type		
Carrying amount:		
Covered bonds	**303,280**	367,743
Government and regional government securities	**49,160**	69,702
Supranationals and agencies	**265,475**	327,435
Secured corporate lending	**-**	16,844
Unsecured corporate and treasury lending	**80,559**	90,691
Equity instruments	**-**	82
	698,474	872,497

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 below:

MedBank Group	EU €000	Other European countries €000	North America €000	Asia €000	Total €000
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**

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

MedBank Group	**EU €000**	**Other European countries €000**	**North America €000**	**Asia €000**	**Total €000**
At 31 March 2016					
Accommodation and food service activities	143,627	-	-	-	**143,627**
Administrative and support service activities	157,296	-	26,138	-	**183,434**
Arts, entertainment and recreation activities	62,703	2,458	-	-	**65,161**
Construction	9,793	-	-	-	**9,793**
Financial and insurance activities	97,404	6,183	-	5,446	**109,033**
Households and individuals	6,756	-	-	-	**6,756**
Human health and social work activities	49,892	-	-	-	**49,892**
Information and communication	29,876	-	-	-	**29,876**
Manufacturing	254,589	9,793	32,356	-	**296,738**
Professional, scientific and technical activities	43,861	-	-	-	**43,861**
Public administration, defence and compulsory social security	50,000	-	-	-	**50,000**
Real estate activities	39,980	-	-	-	**39,980**
Transport and storage	35,268	-	-	-	**35,268**
Wholesale and retail trade, repairs of motor vehicles and motor cycles	22,796	-	-	-	**22,796**
Other service activities	157,046	-	11,386	-	**168,432**
Other	1,127	-	-	-	**1,127**
	1,162,014	**18,434**	**69,880**	**5,446**	**1,255,774**

The local Lending Portfolio, categorised within EU in the tables above, is mainly attributable to the real estate activities sector.

Exposures to United Kingdom counterparties which are included within the EU categorisation as at 31 March 2017 of the Group amounted to €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 off-setting 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.

MedBank Group	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	Related amounts not offset in the statement of financial position: Financial collateral pledged /(received) (incl. cash)	Net amount
	€000	€000	€000	€000	€000	€000
31 March 2017						
Financial assets						
Derivative financial instruments	**1,627**	**-**	**1,627**	**-**	**(633)**	**994**
Financial liabilities						
Amounts owed to financial institutions	**(359,183)**	**-**	**(359,183)**	**348,265**	**10,918**	**-**
Derivative financial instruments	**(2,323)**	**-**	**(2,323)**	**-**	**2,200**	**(123)**
	(361,506)	**-**	**(361,506)**	**348,265**	**13,118**	**(123)**
31 March 2016						
Financial assets						
Derivative financial instruments	3,964	-	3,964	-	-	-
Financial liabilities						
Amounts owed to financial institutions	(541,925)	-	(541,925)	526,872	15,053	-
Derivative financial instruments	(7,337)	-	(7,337)	-	7,134	(203)
	(549,262)	-	(549,262)	526,872	22,187	(203)

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 MedBank's Treasury Team and is monitored by MedBank's Risk Office, under the oversight of the Management Asset-Liability Committee and the Board Risk Committee of the Subsidiaries, taking into account the approach set out in MedBank's Treasury Management Policy.

Treasury Management Policy ("TMP")

MedBank'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

MedBank, MeDirect and MedCorp 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 MedBank, MeDirect and MedCorp 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 MedBank's Treasury function and is monitored by MedBank's Risk function (under the oversight of ALCO and of the Board Risk Committee of the Subsidiaries), 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 two key metrics:

- Before the relevant liquidity provisions under the Capital Requirements Regulation and Directive became effective in 2014, the Group was required to maintain its liquid asset ratio of net cash to short-term customer liabilities, in excess of 30%. The calculation of this ratio is still used in the normal course of business and as at 31 March 2017 stood at 56.89% (2016: 58.0%) for MedBank and 141.72% (2016: 96.4%) for MedCorp.

- The ratio of liquid assets to wholesale (margin-sensitive) funding was 147.3% as at 31 March 2017 (2016: 37.3%). 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

MeDirect Group and MedBank Group also comply with the Liquidity Coverage Ratio ("LCR") in relation to short term liquidity and monitor 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 and the LCR year-end levels for MedBank and MedCorp on an aggregated basis:

	2017	2016
	%	%
At 31 March		
Actual LCR Ratio	**576.7**	270.4
Regulatory Minimum – Transitional provisions	**80**	70
Regulatory Minimum – Fully phased in	**100**	100

  During the year ended 31 March 2017 and 2016 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.

	2017	2016
	%	%
At 31 March		
Actual NSFR Ratio	**128.9**	120.0

2. **Financial risk management** - continued

2.3 Liquidity risk - continued

2.3.2 Liquidity risk reporting

MedBank'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.

MedBank 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	51,519	-	-	-	-	193,376	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	195,530	45,969	154,824	1,861,140	67,852	217,416	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	(392,629)	(151,778)	(986,303)	1,497,437	42,325		
Cumulative liquidity gap	(392,629)	(544,407)	(1,530,710)	(33,273)	9,052		

2. Financial risk management - continued

2.3 Liquidity risk - continued

2.3.3 Contractual maturity ladder - continued

MedBank 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 2016							
Assets							
Balances with central banks and treasury bills	21,532	-	3,002	-	-	8,039	32,573
Derivative financial Instruments	1,791	2,066	107	-	-	-	3,964
Loans and advances to financial institutions	59,558	-	-	-	-	-	59,558
Loans and advances to Customers	15,179	214	85,318	1,117,069	21,186	-	1,238,966
Investments	-	-	-	667,535	204,880	82	872,497
Accrued income	5,669	6,007	3,434	-	-	-	15,110
Loans to related parties (included in other assets)	-	-	-	-	-	26,564	26,564
Total financial assets	103,729	8,287	91,861	1,784,604	226,066	34,685	2,249,232
Liabilities							
Derivative financial instruments	341	44	107	3,744	3,101	-	7,337
Amounts owed to financial Institutions	61,925	235,000	215,000	30,000	-	-	541,925
Amounts owed to customers	945,533	59,901	76,497	364,250	1,174	-	1,447,355
Subordinated liabilities	-	-	-	22,598	24,782	-	47,380
Accrued interest expense	1,971	3,031	3,356	-	-	-	8,358
Amounts due to related parties (included in other liabilities)	-	-	-	-	-	1,287	1,287
Total financial liabilities	1,009,770	297,976	294,960	420,592	29,057	1,287	2,053,642
Liquidity gap	(906,041)	(289,689)	(203,099)	1,364,012	197,009		
Cumulative liquidity gap	(906,041)	(1,195,730)	(1,398,829)	(34,817)	162,192		

Current accounts and savings deposits payable on demand or at short notice amounted to €483 million at 31 March 2017 (2016: €322 million). This amount is disclosed within the 'Not more than 1 month' maturity grouping. In addition, as at 31 March 2017, savings deposits with a withdrawal notice period of three months amounting to €883 million are disclosed within the 'Between 3 months and 1 year' maturity grouping. However, in practice these deposits are maintained with the MedBank 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

Unencumbered financial assets classified as available-for-sale amounting to €334 million as at 31 March 2017, 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.

MedBank Group	**Carrying amount**	**Total outflows**	**Less than 1 month**	**Between 1 and 3 months**	**Between 3 months and 1 year**	**Between 1 and 5 years**	**More than 5 years**
	€000	**€000**	**€000**	**€000**	**€000**	**€000**	**€000**
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
31 March 2016							
Non-derivative liabilities							
Amounts owed to financial institutions							
- Due to clearing houses	**520,000**	520,832	40,276	235,657	214,935	29,964	-
- Due to other banks	**21,925**	21,925	21,925	-	-	-	-
Amounts owed to customers	**1,447,355**	1,479,396	946,288	60,465	79,737	391,586	1,320
Subordinated liabilities	**47,380**	68,316	-	-	3,265	33,939	31,112
	2,036,660	2,090,469	1,008,489	296,122	297,937	455,489	32,432

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 MedBank Group's principal derivative financial instruments by remaining contractual maturities at the reporting date.

MedBank Group	Carrying amount €000	Inflows/ (Outflows) €000	Less than 1 month €000	Between 1 and 3 months €000	Between 3 months and 1year €000	Between 1 and 5 years €000	More than 5 years €000
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)**	**-**
31 March 2016							
Derivative assets							
Derivative financial instruments							
- Foreign exchange swaps	3,964	3,799	1,771	1,919	109	-	-
Inflows		*275,926*	*145,055*	*128,899*	*1,972*	-	-
Outflows		*(272,127)*	*(143,284)*	*(126,980)*	*(1,863)*	-	-
Derivative liabilities							
Derivative financial instruments							
- Interest rate swaps	6,845	(9,273)	-	-	(2,088)	(6,505)	(680)
- Foreign exchange swaps	492	(474)	(340)	(33)	(101)	-	-
Inflows		*24,024*	*21,481*	*680*	*1,863*	-	-
Outflows		*(24,498)*	*(21,821)*	*(713)*	*(1,964)*	-	-
	7,337	(9,747)	(340)	(33)	(2,189)	(6,505)	(680)

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 MedBank Group to support future funding.

MedBank Group	**Encumbered**		**Unencumbered**		
	Pledged as collateral €000	**Other* €000**	**Available as collateral €000**	**Other** €000**	**Total €000**
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**
31 March 2016					
Balances with Central Banks, treasury bills and cash	33	5,504	27,036	707	33,280
Derivative financial instruments	-	-	-	3,964	3,964
Loans and advances to financial institutions	-	20,683	-	38,875	59,558
Loans and advances to customers – corporate and municipalities	-	-	-	1,225,278	1,225,278
Loans and advances to customers – retail	-	-	-	13,688	13,688
Investments (excluding equity investments)	762,694	6,721	50,537	52,463	872,415
Accrued income	-	-	-	15,110	15,110
Loans and advances to related parties (included in other assets)	-	-	-	26,564	26,564
	762,727	32,908	77,573	1,376,649	2,249,857

**Represents assets that are not pledged for funding purposes but that the MedBank 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 MedBank 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 MedBank's Treasury team and is monitored by MedBank's Risk Office, under the oversight of the Management ALCO and the Board Risk Committee of the Subsidiaries taking into account the approach set out in MedBank'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 MedBank Group into relevant currency groupings.

MedBank 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)**	

2. Financial risk management - continued

2.4 Market risk - continued

2.4.2 Foreign exchange risk - continued

MedBank Group

As at 31 March 2016	Euro currency €000	GBP currency €000	USD currency €000	Other €000	Total €000
Financial assets					
Balances with Central Banks, treasury bills and cash	33,207	44	18	11	33,280
Derivative financial instruments	3,964	-	-	-	3,964
Loans and advances to financial institutions	40,498	11,040	3,984	4,036	59,558
Loans and advances to customers	852,961	373,405	12,600	-	1,238,966
Investments	853,650	18,847	-	-	872,497
Accrued income	13,708	1,399	3	-	15,110
Loans to related parties (included in other assets)	26,564	-	-	-	26,564
	1,824,552	**404,735**	**16,605**	**4,047**	**2,249,939**
Financial liabilities					
Derivative financial instruments	7,337	-	-	-	7,337
Amounts owed to financial institutions	526,992	14,933	-	-	541,925
Amounts owed to customers	1,297,229	95,264	33,253	21,609	1,447,355
Subordinated liabilities	41,808	5,572	-	-	47,380
Accrued interest expense	7,294	1,001	19	44	8,358
Amounts owed to related parties (included in other liabilities)	1,287	-	-	-	1,287
	1,881,947	**116,770**	**33,272**	**21,653**	**2,053,642**
Net on-balance sheet financial position		**287,965**	**(16,667)**	**(17,606)**	
Notional of derivative financial instruments		**(285,927)**	**17,741**	**17,577**	
Residual exposure		**2,038**	**1,074**	**(29)**	

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 MedBank's Treasury team within the prevailing interest rate risk limits approved by Management ALCO. Adherence to these limits is monitored by MedBank's Risk Office.

In fact, Management ALCO of the respective subsidiaries are the oversight body for compliance with the established limit framework and MedBank's Risk Office are 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. MedBank'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, MedBank'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, if earlier, 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.

MedBank 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	**643**	571,000	-	(111,000)	(415,000)	(45,000)
Net interest repricing gap		1,438,665	(845,620)	(175,590)	(207,802)	(17,157)

2. Financial risk management - continued

2.4 Market risk - continued

2.4.3 Interest rate risk - continued

MedBank 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 2016						
Balances with Central Banks and treasury bills	**32,573**	29,571	3,002	-	-	-
Loans and advances to financial institutions	**59,558**	59,558	-	-	-	-
Loans and advances to customers	**1,238,966**	1,113,004	75,359	50,579	24	-
Investments (excluding equities)	**872,415**	72,861	7,129	125,202	482,460	184,763
	2,203,512	1,274,994	85,490	175,781	482,484	184,763
Amounts owed to financial institutions:						
- Due to clearing houses	**520,000**	275,000	215,000	30,000	-	-
- Due to other banks	**21,925**	21,925	-	-	-	-
Amounts owed to customers	**1,447,355**	1,005,433	76,498	211,645	152,605	1,174
Subordinated liabilities	**47,380**	-	-	-	22,598	24,782
	2,036,660	1,302,358	291,498	241,645	175,203	25,956
Interest rate repricing gap		(27,364)	(206,008)	(65,864)	307,281	158,807
Impact of hedging interest rate derivatives – notional amounts	**(6,845)**	-	580,000	-	(417,000)	(163,000)
Net interest repricing gap		(27,364)	373,992	(65,864)	(109,719)	(4,193)

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 core 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. 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.

2. Financial risk management - continued

2.4 Market risk - continued

2.4.3 Interest rate risk - continued

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 2017
- NIM would decrease by €5.7 million / increase by €11.1 million.
- Economic Value would decrease by €13.2 million / increase by €43.5 million.

31 March 2016
- NIM would decrease by €6.7 million / increase by €12.8 million.
- Economic Value would increase by €0.6 million / increase by €25.4 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;
- 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; and
- The liability maturity profile is extended to match the assets' maturity profile.

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 Subsidiaries.

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 2017 was calculated at €85.0 million (2016: €72.2 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 to improve 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.

MeDirect 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.

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

2. Financial risk management - continued

2.7 Fair value measurement - continued

2.7.3 Financial instruments measured at fair value - continued

MedBank Group	As at 31 March 2016			
	Level 1	Level 2	Level 3	Total
	€000	€000	€000	€000
Assets				
Investments				
- Available-for-sale	872,415	-	-	872,415
- Fair value through profit or loss	-	82	-	82
Derivative financial instruments held for risk management	-	3,964	-	3,964
Total financial assets	872,415	4,046	-	876,461
Liabilities				
Derivative financial instruments held for risk management	-	7,337	-	7,337
Total financial liabilities	-	7,337	-	7,337

As at 31 March 2017 and at 31 March 2016, the fair value of the available-for-sale ("AFS") investment securities represents the closing bid price quoted in an active market.

Level 2 assets principally comprise:

- Equity securities that are fair valued on the basis of price quotations in respect of orderly transactions between market participants provided by reputable dealers; and
- 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 2017 and 2016.

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.

MedBank Group

	Level 1 €000	Level 2 €000	Level 3 €000	Total fair values €000	Total carrying amount €000
As at 31 March 2017					
Assets					
Loans and advances to customers	**-**	**1,376,317**	**-**	**1,376,317**	**1,393,251**
Total financial assets	**-**	**1,376,317**	**-**	**1,376,317**	**1,393,251**
Liabilities					
Subordinated liabilities	**49,287**	**-**	**-**	**49,287**	**47,043**
Total financial liabilities	**49,287**	**-**	**-**	**49,287**	**47,043**
As at 31 March 2016					
Assets					
Loans and advances to customers	-	1,141,890	-	1,141,890	1,177,378
Total financial assets	-	1,141,890	-	1,141,890	1,177,378
Liabilities					
Subordinated liabilities	51,561	-	-	51,561	47,380
Total financial liabilities	51,561	-	-	51,561	47,380

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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. As at 31 March 2016, loans and advances to municipalities amounting to €49.8 million, included within the amounts in the table, have been valued by reference to an actively traded instrument of the same issuer with adjustments to reflect lack of active trading in this instrument.

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 MedBank Group amounting to €106.9 million (2016: €59.6 million), which represent 100% of all loans and advances to financial institutions (2016: 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.

The carrying amount for local loans and advances to customers amounting to €56.7 million (2016: €61.6 million) approximates their fair value because these loans are repricable at the Group's discretion.

All trade receivables amounting to €4.5 million (2016: €9.0 million) are stated net of specific impairment allowances, within loans and advances to customers. Hence their fair value is not deemed to differ materially from their carrying amount at the reporting date.

Fair values 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 €359.2 million (2016: €511.9 million) and 'amounts owed to customers' of the Group amounting to €1.6 billion (2016: €1.4 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, treasury bills and cash

	Group	
	2017	2016
	€000	€000
At amortised cost:		
Balances with Central Banks	**244,895**	27,069
Cash	**300**	708
At fair value:		
Malta Government Treasury Bills		
- classified as available-for-sale	**-**	5,504
	245,195	33,281

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 €193.4 million (2016: €8.7. million) bearing interest at 0% (2016: 0%) per annum and overnight deposits amounting to €39.7 million (2016: €18.4 million) subject to a negative interest rate of 0.4% (2016: negative interest rate of 0.4%) per annum.

The balances with Central Banks also include a balance of €52 thousand (2016: €33 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 MedBank, 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 12 months (2016: 6 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 €0.9 million (2016: €5.5 million). The net gain on the hedged items arising during the year attributable to the hedged risk was €0.4 million (2016: €6 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	
	2017	2016
	€000	€000
Derivative financial assets	**1,627**	3,964
Derivative financial liabilities	**(2,323)**	(7,337)

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:

Group	**Notional 2017**	**Fair value 2017**	Notional 2016	Fair value 2016
	€000	**€000**	€000	€000
Derivatives held for trading - Assets				
Instrument type:				
- Foreign exchange swaps	**124,379**	**861**	272,249	3,964
		861		3,964
Derivatives held for trading - Liabilities				
Instrument type:				
- Foreign exchange swaps	**193,325**	**(2,200)**	24,017	(492)
Net held for trading derivatives		**(1,339)**		3,472

5. Derivative financial instruments - continued

Group	Notional 2017 €000	Fair value 2017 €000	Notional 2016 €000	Fair value 2016 €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 5 years	**447,000**	**650**	-	-
More than 5 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 5 years	**79,000**	**(123)**	417,000	(3,744)
More than 5 years	**-**	**-**	163,000	(3,101)
		(123)		(6,845)
Net derivatives designated as hedging instruments in fair value hedges		**643**		(6,845)

6. Loans and advances to financial institutions

	Group 2017 €000	Group 2016 €000	Company 2017 €000	Company 2016 €000
At amortised cost:				
Repayable on call and at short notice	**89,488**	39,455	**50**	220
Term loans and advances	**17,457**	20,683	**-**	-
	106,945	60,138	**50**	220

Loans and advances to financial institutions up to €68 thousand (2016: €53 thousand) are pledged in favour of other banks providing credit card facilities to MedBank's customers.

As at 31 March 2017, an amount of €5.0 million (2016: €5.0 million) has been contributed to a clearing fund held by Eurex Clearing AG, of which MedBank is a member. The clearing fund protects members against losses until they leave the clearing fund.

As at 31 March 2016, the Company's loans and advances to financial institutions included balances amounting to €220 thousand held at MedBank, that were unsecured, interest free and that could be withdrawn on demand.

6. Loans and advances to financial institutions - continued

Loans and advances to financial institutions as at 31 March 2017 and 31 March 2016 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	
	2017	2016
	€000	€000
At amortised cost:		
Repayable on call and short notice: retail	**5,143**	5,857
Repayable on call and short notice: corporate	**3,446**	7,154
Term loans and advances: retail	**7,537**	9,145
Term loans and advances: corporate	**1,455,906**	1,233,618
Gross loans and advances to customers	**1,472,032**	1,255,774
Less allowances for impairment		
- Individually assessed allowances	**(16,928)**	(12,369)
- Collectively assessed allowances	**(5,134)**	(4,439)
	1,449,970	1,238,966

As at 31 March 2017, the acquisition of €108.9 million (2016: €153.0 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 2017 and 2016 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 €64.3 million (2016: €48.0 million) were deemed to be impaired. Specific impairment allowances recorded on the Group's loans and advances to customers amounted to €16.9 million (2016: €12.4 million).

The aggregate amount of impaired loans and advances of the Group and on which interest is reserved is €16.3 million (2016: €19.1 million) gross of impairment allowances, against which €5.4 million (2016: €7.6 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 €3.5 million (2016: €2.7 million).

7. Loans and advances to customers - continued

	Group	
	2017	2016
	€000	€000
Specific allowances for impairment		
At beginning of year	**12,369**	9,614
Exchange differences	**318**	(48)
Impairment allowances (Note 28)	**4,241**	2,803
At end of year	**16,928**	12,369
Collective allowances for impairment		
At beginning of year	**4,439**	3,977
Impairment allowances (Note 28)	**695**	462
At end of year	**5,134**	4,439
Total allowances for impairment	**22,062**	16,808

8. Investments

	Group	
	2017	2016
	€000	€000
Available-for-sale investments	**698,702**	872,667
Equity instruments at fair value through profit or loss	**-**	82
	698,702	872,749

8. **Investments** - continued

Available-for-sale investments

	Group	
	2017	2016
	€000	€000
Debt securities and other fixed income securities		
Issued by public bodies		
- local government	**7,097**	7,128
- foreign national and regional governments	**42,063**	62,574
- supranationals	**156,985**	217,479
Issued by other bodies		
- foreign banks	**446,088**	454,065
- other foreign issuers	**46,241**	131,169
Equity		
Issued by other bodies		
- local issuers	**228**	252
	698,702	872,667
Listing status		
- listed on the Malta Stock Exchange	**7,325**	7,380
- listed on other recognised exchanges	**691,377**	865,287
	698,702	872,667

	Group	
	2017	2016
	€000	€000
Year ended 31 March		
At beginning of year	**872,667**	1,501,086
Additions	**26,988**	286,590
Disposals/Redemptions	**(192,862)**	(898,484)
Gains on hedged items attributable to the hedged risk	**444**	6,026
Amortisation of premium/discount	**(15,563)**	(15,844)
Exchange differences	**(627)**	(1,503)
Changes in fair value	**7,655**	(5,204)
At end of year	**698,702**	872,667

No objective evidence of specific impairment was identified on investment securities during the financial years ended 31 March 2017 and 31 March 2016.

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 €343 million (2016: €103 million) which are free and unencumbered securities as at 31 March 2017.

8. **Investments** - continued

As at 31 March 2017, investment securities held by the Group with a nominal value of €5.8 million (2016: €6.6 million) and a fair value of €5.9 million (2016: €6.7 million) are pledged in favour of the DCS.

The cash value of unutilised borrowing facilities (headroom), which are secured by investment securities, amounted to €312.5 million as at 31 March 2017 (2016: €269.7 million).

As at 31 March 2017 and 31 March 2016, the Group had no commitment to purchase further investment securities.

Equity instruments at fair value through profit or loss

	Group	
	2017	2016
	€000	€000
Unlisted equities issued by a European corporate	**-**	82

9. Investment in subsidiaries

Name of subsidiary	Country of incorporation	Nature of business	Equity interest 2017 %	2016 %	Carrying amount 2017 €000	2016 €000
Mediterranean Bank plc	Malta	Banking	**100**	100	**130,914**	130,914
Charts Investment Management Service Limited	Malta	Investment services	**100**	100	**3,194**	3,194
					134,108	134,108
Shareholders' contribution advanced to Mediterranean Bank plc					**60,803**	60,803
					194,911	194,911

MedBank owns the following subsidiaries:

Name of subsidiary	Country of incorporation /formation	Nature of business	Equity interest 2017 %	2016 %
Mediterranean Corporate Bank Limited	Malta	Banking	**100**	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, MedBank 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, MedBank 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.

On 21 November 2016, MedBank announced that the board of directors of MedBank and MedCorp have each voted to merge MedCorp into MedBank, subject to receipt of all applicable regulatory approvals and to completion of all legal requirements. With effect from 1 April 2017, the merger between MedBank and MedCorp became effective for accounting purposes. Thus all the transactions of MedCorp have been treated as being those of MedBank with effect from 1 April 2017 (refer to Note 37).

MeDirect 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 MedBank's Belgian branch were contributed to MeDirect 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 branches which are then leased to the Group.

By virtue of board resolutions dated 25 November 2015, 22 January 2016 and 30 March 2016, the MedBank Group accepted capital contributions from the Company amounting to €28.7 million, €14.0 million and €16.0 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 during the financial year ended 31 March 2016 (refer to Note 16). The contingent consideration did not materialise due to the fact that the predefined targets were not met.

Charts distributed €0.9 million to the Company as a final dividend which was executed on 6 May 2015.

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 1 April 2015						
Cost	1,132	2,960	325	1,557	279	6,253
Accumulated depreciation	(946)	(2,278)	(325)	(953)	(250)	(4,752)
Net book amount	186	682	-	604	29	1,501
Year ended 31 March 2016						
At beginning of year	186	682	-	604	29	1,501
Additions	1	13	6	2	-	22
Depreciation for the year	(72)	(297)	-	(188)	(14)	(571)
At end of year	115	398	6	418	15	952
As at 31 March 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**

The Group operates from nine immovable properties which are held under operating lease agreements (see Note 31).

There were no capitalised borrowing costs related to the acquisition of property and equipment during the period (2016: 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 2015				
Cost	461	6,168	474	7,103
Accumulated amortisation	-	(6,108)	(237)	(6,345)
Net book amount	461	60	237	758
Year ended 31 March 2016				
At beginning of year	461	60	237	758
Additions	-	26	-	26
Amortisation for the year	-	(59)	(48)	(107)
At end of year	461	27	189	677
As at 31 March 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**

There were no capitalised borrowing costs related to the acquisition of software during the year (2016: 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

Key assumptions used in the calculation of recoverable amounts are discount rates and terminal value growth rates. The discount rate has been assumed to be 13.4% (2016: 13.5%), an average annual growth rate of 3% (2016: 2%) and the terminal value growth rate used of 3% (2016: 3%). There were no changes in the underlying assumptions during the year.

12. Non-current assets classified as held for sale

As at 31 March 2017, the fair value of assets acquired in satisfaction of debt amounted to €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:

	2017	2016
	€000	€000
Group		
Property and equipment	**7**	(6)
Available-for-sale securities	**141**	594
Unutilised tax losses	**4,141**	4,163
Impairment allowances	**4,109**	4,847
Net deferred tax assets	**8,398**	9,598

The Group's deferred tax asset presented within the statement of financial position on a gross basis amounted to €8.4 million (2016: €9.6 million).

Movements in deferred tax during the year:

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	594	-	(453)	141
Unutilised tax losses	4,163	(22)	-	4,141
Impairment allowances	4,847	(738)	-	4,109
	9,598	**(747)**	**(453)**	**8,398**

13. Deferred tax assets and liabilities - continued

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 2016				
Property and equipment	(3)	(3)	-	(6)
Intangible assets	(13)	13	-	-
Available-for-sale securities	(461)	-	1,055	594
Unutilised tax losses	-	4,163	-	4,163
Impairment allowances	4,393	454	-	4,847
	3,916	4,627	1,055	9,598

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. Tax losses have no expiry date and can be carried forward indefinitely.

14. Prepayments and accrued income

	Group		Company	
	2017 €000	2016 €000	**2017 €000**	2016 €000
Prepayments	**2,319**	2,637	**-**	17
Accrued income	**16,830**	15,110	**-**	-
	19,149	17,747	**-**	17

15. Other assets

	Group		Company	
	2017 €000	2016 €000	**2017 €000**	2016 €000
Amounts receivable from:				
- immediate parent company	**216**	548	**-**	-
- ultimate parent company	**2,205**	2,090	**1,965**	1,909
- other related companies	**15,107**	16,552	**5**	-
Dividend related refund	**12,790**	11,580	**7,282**	10,432
Other assets	**1,364**	341	**-**	-
	31,682	31,111	**9,252**	12,341

Amounts receivable from immediate parent company are unsecured, interest free and repayable on demand.

Amounts receivable from ultimate parent company amounting to €1.8 million as at 31 March 2017 (2016: €1.8 million) are unsecured, subject to interest at 3% per annum and repayable in November 2017. The residual amounts are unsecured and repayable on demand.

Amounts receivable from other related companies are unsecured, interest free and repayable on demand. However, the repayment of these balances is not expected within the next 12 months.

No impairment indicators existed in respect of these assets at 31 March 2017 and 2016.

16. Capital and reserves

<u>Share capital</u>

	2017 No.	2016 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 one vote in general meetings for each of such shares held, whilst the holders of the Ordinary 'B' shares shall not be entitled to any vote in respect of those shares. 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.

The Ordinary 'B' shares shall not carry any dividend entitlement.

The holders of the Ordinary 'A' shares shall be entitled to any surplus assets of the Company on a winding up whilst the holders of the Ordinary 'B' shares shall not be entitled to any surplus assets of the Company on a winding up but shall have a prior claim over the holders of the Ordinary 'A' shares for the return of the nominal value of the said Ordinary 'B' shares.

<u>Share premium</u>

Share premium as at the reporting date represents the issue of shares in prior periods as follows:

	Number of shares	Premium per share	Share premium	
Issue type		€	2017 €000	2016 €000
Ordinary 'A' shares	39,520,969	0.3407	**13,464**	13,464
Ordinary 'B' shares	1,214,991	0.2400	**292**	292
			13,756	13,756

16. Capital and reserves - continued

Shareholders' contribution

By virtue of board resolutions dated 30 September 2015, 11 December 2015 and 30 March 2016 the Group accepted a capital contribution from its shareholder, Medifin Finance Limited, amounting to €28.7 million, €14.0 million and €16.0 million respectively.

The terms and conditions of the contributions granted render this instrument to be 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. During the year the Bank adhered to revised BR 09 which imposes higher allocations for certain past due exposures. As at 31 March 2017, the reserve for general banking risks of the Group was equivalent to €1.7 million (2016: €1.2 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 includes 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 were contingent upon the achievement of certain predefined targets during the financial year ended 31 March 2016. The contingent consideration did not materialise due to the fact that the predefined targets were not met. 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, as disclosed within the statement of changes in equity. 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	
	2017	2016
	€000	€000
Repayable on call and at short notice	**19,183**	21,925
Term deposits	**340,000**	520,000
	359,183	541,925

An amount of €340 million (2016: €520 million) from the Group's term deposits are secured by a pledge over MedBank's investments (excluding equity instruments) (refer to Note 8).

18. Amounts owed to customers

	Group	
	2017	2016
	€000	€000
Repayable on call and at short notice	**482,916**	322,140
Term deposits	**1,418,596**	1,125,215
	1,901,512	1,447,355

19. Debt securities in issue

	Group	
	2017	2016
	€000	€000
Year ended 31 March		
At beginning of year	**-**	9,204
Nominal amount of debt securities repurchased and cancelled	**-**	(9,255)
Transaction costs amortised	**-**	51
At end of year	**-**	-

The debt securities, which were unsecured, denominated in euro and listed on the Malta Stock Exchange, matured on 30 October 2015. The interest payable was fixed at 6.25% per annum and the debt securities were redeemable at their nominal value.

In the event of default or insolvency of MedBank, the holders of the above liabilities had a general claim on the assets of MedBank pari passu with other unsecured creditors. Bondholders therefore would have ranked after all interbank funding lines and repurchase agreements that are collateralised by investment securities.

19. Debt securities in issue - continued

The Group has not had any defaults of interest or other breaches with respect to its debt securities in issue during the year ended 31 March 2016.

Debt securities in issue through controlled special purpose entity

	Group	
	2017	2016
	€000	€000
Year ended 31 March		
At beginning of year	**-**	147,933
Nominal amount of debt securities repurchased and derecognised	**-**	(148,000)
Transaction costs amortised to profit or loss	**-**	67
At end of year	**-**	-

During the year ended 31 March 2014, as part of the Group's funding strategy, MedBank set up GH I, a controlled special purpose entity, since the Group retained all the risks and rewards of the structure.

The controlled special purpose entity issued the following notes, maturing in 2026, although MedBank envisaged that the debt securities issued through the controlled special purpose entity would be repaid within five years from date of issue:

- €240 million Class A1 Senior Secured Floating Rate Notes;
- €15 million Class A2 Senior Secured Floating Rate Notes;
- €35 million Class B Senior Secured Deferrable Floating Rate Notes;
- €22.5 million Class C Senior Secured Deferrable Floating Rate Notes;
- €32.5 million Class D Senior Secured Deferrable Floating Rate Notes;
- €10 million Class E Senior Secured Deferrable Floating Rate Notes;
- €48.4 million Subordinated Notes.

During March 2015, MedBank repurchased €70 million of the Senior Secured floating rate notes. The amortisation of transaction costs has been adjusted to reflect these developments.

In the period February to May 2015, MedBank repurchased €121 million Senior Secured Floating rate notes that originally were due to mature by 2026. On 7 July 2015, MedBank as holder of the Subordinated Notes of GH I caused GH I to redeem all remaining outstanding claims.

The Group did not have any defaults of interest or other breaches with respect to its debt securities in issue through the controlled special purpose entity during the years ended 31 March 2016.

20. Subordinated liabilities

	Group 2017 €000	Group 2016 €000
Year ended 31 March		
At beginning of year	**47,380**	47,777
Foreign exchange differences	**(481)**	(498)
Transaction costs amortised to profit or loss	**94**	101
At end of year	**46,993**	47,380
Analysed as follows:		
7.5% Subordinated Bonds 2019	**22,291**	22,598
6% Subordinated Unsecured Bonds 2019 – 2024	**24,702**	24,782
	46,993	47,380

During June 2013, MedBank issued an additional euro equivalent of €10 million of 7.50% Subordinated Bonds due to mature in 2019. The debt securities are unsecured, mature on 30 December 2019 and 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, MedBank announced the issue of €15 million 6% Subordinated Unsecured Bonds maturing on 28 November 2024 with a 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. The 6.25% debt securities in issue due to mature on 30 October 2015 were exchangeable with these bonds at a discount of 4%. As a result, €5.0 million 6.25% debt securities were transferred to MedBank in exchange for the new subordinated unsecured bonds 2019 – 2024. As a result of MedBank's allotment methodology, MedBank 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.

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. MedBank has not had any defaults of interest or other breaches with respect to its subordinated debt securities during the years ended 31 March 2017 and 31 March 2016. As at 31 March 2017, the euro equivalent contractual amount due at maturity is €47.2 million (2016: €47.7 million).

The carrying amount of the subordinated debt securities in issue is €0.2 million (2016: €0.3 million) lower than the contractual amount due at maturity.

21. Accruals and deferred income

	Group 2017 €000	Group 2016 €000	Company 2017 €000	Company 2016 €000
Accrued interest expense	**6,202**	8,358	**-**	-
Other accrued expenses	**5,876**	6,126	**15**	7
Deferred income	**18,421**	8,882	**-**	-
	30,499	23,366	**15**	7

22. Other liabilities

	Group 2017 €000	Group 2016 €000	Company 2017 €000	Company 2016 €000
Amounts due to immediate parent company	**2,292**	1,000	**-**	-
Amounts due to group company	**-**	-	**8,687**	9,497
Amounts due to related parties	**3**	5	**6**	7
Indirect taxes payable	**891**	364	**14**	14
Other liabilities	**2,852**	1,605	**1**	-
	6,038	2,974	**8,708**	9,518

Amounts due to immediate parent company, group company and related parties are unsecured, interest free and repayable on demand.

23. Net interest income

	Group 2017 €000	Group 2016 €000	Company 2017 €000	Company 2016 €000
Interest income				
Loans and advances to financial institutions	**(188)**	98	**-**	-
Loans and advances to customers	**91,331**	71,588	**-**	-
Investment securities	**(1,276)**	5,567	**-**	-
Amounts owed by parent company	**55**	55	**55**	55
Total interest income	**89,922**	77,308	**55**	55
Interest expense				
Amounts owed to financial institutions	**1,349**	2,904	**-**	-
Amounts owed to customers	**27,686**	29,341	**-**	-
Debt securities in issue	**-**	839	**-**	-
Subordinated liabilities	**3,264**	3,324	**-**	-
Total interest expense	**32,299**	36,408	**-**	-
Net interest income	**57,623**	40,900	**55**	55

23. Net interest income - continued

An amount of €2.6 million (2016: €1.9 million) relating to impaired financial assets is included within interest income from loans and advances to customers for the year ended 31 March 2017.

Fair value losses of €0.9 million (2016: €5.5 million) arising on derivatives designated as held in fair value hedge relationships and €0.4 million (2016: €6.0 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.

	Group	
	2017	2016
	€000	€000
Losses on hedging instruments	**(941)**	(5,481)
Gains on hedged items attributable to the hedged risk	**444**	6,026
Net (losses)/gains representing ineffective portion of fair value hedges	**(497)**	545

24. Net fee and commission income

	Group	
	2017	2016
	€000	€000
Fee and commission income		
Banking transactions fee income	**1,548**	1,979
Corporate secured lending fee income	**711**	526
Investment services fees	**3,259**	1,661
Total fee and commission income	**5,518**	4,166
Fee and commission expense		
Banking transactions fee expense	**276**	411
Corporate secured lending fee expense	**282**	478
Investment services transaction and custody fees	**1,041**	847
Other fee expense	**65**	59
Total fee and commission expense	**1,664**	1,795
Net fee and commission income	**3,854**	2,371

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 €0.7 million (2016: €0.5 million) and expenses of €0.3 million (2016: €0.5 million) relating to such financial assets and liabilities.

25. Net trading income and other operating income

25.1 Net trading income

	Group	
	2017	2016
	€000	€000
Net income from foreign exchange activities	**2,008**	2,510
Net income/(expense) from other held for trading financial instruments	**170**	(286)
	2,178	2,224

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

	Group	
	2017	2016
	€000	€000
Gain on disposal of equity instruments at fair value through profit or loss	**-**	1,108

25.3 Realised gains on disposal of other investments

	Group	
	2017	2016
	€000	€000
Available-for-sale investments	**800**	15,712

25.4 Other income

	Group		Company	
	2017	2016	**2017**	2016
	€000	€000	**€000**	€000
Dividend received from subsidiaries	**-**	-	**-**	35,205
Dividend tax refund	**-**	-	**-**	10,432
Other income	**17**	179	**-**	-
	17	179	**-**	45,637

At an extraordinary general meeting held on 30 September 2015, MedBank approved a net interim dividend of €15.0 million. On the same date, MedBank paid the net dividend amounting to €7.0 million that was approved throughout the annual general meeting held on 29 July 2015.

26. Personnel expenses

Personnel expenses incurred, including directors' remuneration are analysed as follows:

	Group	
	2017	2016
	€000	€000
Directors' emoluments		
- salaries	**2,894**	3,063
- defined contribution social security costs	**118**	113
- other emoluments	**394**	367
Staff costs		
- salaries	**12,273**	11,921
- defined contribution social security costs	**1,198**	1,354
- other emoluments	**549**	410
	17,426	17,228

As per above, salary costs amounted to €15.2 million (2016: €15.0 million), with variable remuneration accounting for 14% (2016: 14%) of these amounts.

The weekly average number of persons employed during the year, including executive directors, was as follows:

	Group	
	2017	2016
	No.	No.
Executive and senior management	**19**	18
Other managerial, supervisory and clerical	**232**	231
Other	**16**	16
	267	265

The number of persons employed as at the reporting date, including executive directors, was as follows:

	Group	
	2017	2016
	No.	No.
Management and administration	**283**	270

27. Other administrative expenses

Other administrative expenses are analysed as follows:

	Group		Company	
	2017	2016	**2017**	2016
	€000	€000	**€000**	€000
Operating lease charges (Note 31)	**5,511**	5,009	**-**	-
IT support and telecommunication costs	**3,562**	4,002	**-**	-
Legal and professional fees	**3,471**	4,498	**9**	26
Regulatory expenses	**3,314**	3,159	**1**	-
Indirect taxation	**2,247**	3,097	**-**	5
Other expenses	**7,196**	6,958	**-**	2
	25,301	26,723	**10**	33

Included in other administrative expenses are fees charged by the Group's independent auditors for the year as follows:

	Group		Company	
	2017	2016	**2017**	2016
	€000	€000	**€000**	€000
Audit services	**222**	185	**5**	5
Other assurance services	**56**	43	**-**	-
Tax advisory services	**35**	23	**1**	1
Other non-audit services	**351**	17	**-**	-

28. Net impairment charges

	Group	
	2017	2016
	€000	€000
Write-downs		
Loans and advances to customers		
- specific impairment allowances (Note 7)	**6,489**	4,985
- collective impairment allowances (Note 7)	**5,134**	4,439
- bad debts written off	**671**	482
Reversal of write-downs		
Loans and advances to customers		
- specific impairment allowances (Note 7)	**(2,248)**	(2,182)
- collective impairment allowances (Note 7)	**(4,439)**	(3,977)
Net impairment losses	**5,607**	3,747

29. Taxation

	Group		Company	
	2017	2016	**2017**	2016
	€000	€000	**€000**	€000
Current tax expense	**1,099**	1,483	**22**	12,303
Deferred tax income/(expense) (Note 13)	**747**	(4,627)	**-**	-
Income tax expense/(credit)	**1,846**	(3,144)	**22**	12,303

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	
	2017	2016	**2017**	2016
	€000	€000	**€000**	€000
Profit before tax	**19,113**	13,865	**45**	45,659
Tax at the applicable rate of 35%	**6,690**	4,853	**16**	15,981
Tax effect of:				
Tax exempt income	**-**	(36)	**-**	(3,688)
Non-deductible expenses	**27**	1,909	**6**	10
Recognition of previously unrecognised deferred tax	**-**	(4,459)	**-**	-
Losses on sale of loans by subsidiary reversed on consolidation	**(2,525)**	-	**-**	-
Application of lower effective tax rate	**(1,736)**	(5,350)	**-**	-
Notional interest deduction attributable to subsidiary	**(507)**	-	**-**	-
Others	**(103)**	(61)	**-**	-
Income tax expense/(credit)	**1,846**	(3,144)	**22**	12,303

30. Cash and cash equivalents

Balances of cash and cash equivalents as shown in the statements of cash flows are analysed below:

	Group	
	2017	2016
	€000	€000
Analysis of cash and cash equivalents:		
Cash in hand	**300**	708
Call deposits	**89,306**	52,216
Target 2 overnight deposits	**51,770**	3,064
Amounts owed to financial institutions with original maturity of less than 3 months	**(39,183)**	(91,925)
Per Statement of cash flows	**102,193**	(35,937)
Adjustments to reflect:		
Balance with Central Banks	**193,376**	8,746
Malta Government treasury bills with original maturity over 3 months	**-**	3,002
Deposits with original maturity of over 3 months	**17,388**	25,683
Amounts owed to financial institutions with with original maturity of over 3 months	**(320,000)**	(450,000)
Per Statement of financial position	**(7,043)**	(448,506)

		Group	
		2017	2016
	Notes	**€000**	€000
Analysed as follows:			
Balances with Central Banks, treasury bills and cash	4	**245,195**	33,281
Loans and advances to financial institutions	6	**106,945**	60,138
Amounts owed to financial institutions	17	**(359,183)**	(541,925)
		(7,043)	(448,506)

	Company	
	2017	2016
	€000	€000
Analysis of cash and cash equivalents:		
Repayable on call and at short notice	**50**	220
Per Statement of cash flows	**50**	220

31. Capital and lease commitments

Capital commitments

Capital commitments as at 31 March 2017 amounting to €0.4 million (2016: nil) is 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, the future minimum lease payments under non-cancellable operating leases are payable as follows:

	Group	
	2017	2016
	€000	€000
Within one year	**1,034**	2,282
After one year but less than five years	**5,142**	939
More than 5 years	**-**	51
	6,176	3,272

The amount of operating lease expense recognised in profit or loss for the year is disclosed in Note 27.

32. Contingent liabilities

As at 31 March 2017, the Group had cash secured guarantee obligations amounting to €7.9 million (2016: €6.7 million).

33. Commitments to lend

Commitments to lend represent undrawn formal standby facilities, credit facilities and other similar commitments to lend. As at 31 March 2017, undrawn facilities on term loans amounted to €49.5 million (2016: €33.3 million). In addition, the Group had commitments of €288.3 million (2016: €144.1 million) under revolving credit facilities.

As at 31 March 2017, Charts had entered into a placement agreement whereby Charts undertook to subscribe for and purchase €17.5 million of a bond issue which after the end of the reporting period 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 31.

34. Related parties

Immediate and ultimate parent company

The ultimate controlling party of MedBank 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.

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 Group companies.

Key Management Personnel compensation consisting of directors' remuneration is disclosed in Note 26. 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 (2016: €0.1 million).

Related party balances and transactions

During the course of its business, the Group conducted business on commercial terms with various related parties, comprising subsidiaries, the ultimate parent and entities controlled by the ultimate parent.

34. Related parties - continued

Related party balances and transactions - continued

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

31 March 2017

Related party	Income from related parties €000	Expenses charged by related parties €000	Amounts owed by related parties €000	Amounts owed to related parties €000	Transaction/ balance type
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
	-	344	-	-	Directors' fees
	-	3,062	-	-	Personnel expenses
Other companies controlled by key management personnel					
	-	-	-	1	Amounts owed to customers

34. **Related parties** - continued

Related party balances and transactions - continued

31 March 2016

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					
	-	172	-	-	Monitoring fees
Ultimate parent company					
	-	-	2,090	-	Other assets
	55	-	-	-	Interest income
Immediate parent company					
	-	-	548	-	Other assets
	-	-	-	1,000	Other liabilities
Other group companies					
	-	-	16,552	-	Other assets
	-	4,429	-	-	IT support
	-	4,045	-	-	Operating lease charge
	5	-	-	-	Other income
Key management personnel					
	-	-	-	6	Amounts owed to customers
	-	294	-	-	Directors' fees
	-	3,249	-	-	Personnel expenses
Other companies controlled by key management personnel					
	-	-	-	257	Amounts owed to customers
	4	-	-	-	Fee and commission income
	-	1	-	-	Administrative expenses

Amounts owed by the immediate parent company as at 31 March 2017 and 2016 are unsecured, subject to interest at 3% per annum and repayable in November 2017.

Amounts due by other group companies included within 'Other assets' are unsecured, interest free and repayable on demand. However, the repayment of this balance is not expected within the next 12 months.

The related party transactions of the Company consist of interest income on amounts owed by parent company amounting to €55 thousand (2016: €55 thousand).

35. 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. MedBank was not required to pay any variable contribution to the Scheme.

36. 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 2017, the total assets held by the Group on behalf of customers amounted to €625.4 million (2016: €452.1 million).

37. Events after the reporting date

On 21 November 2016, MedBank announced that the boards of directors of MedBank and MedCorp have each voted to merge MedCorp into MedBank, subject to receipt of all applicable regulatory approvals and to completion of all legal requirements. With effect from 1 April 2017, the merger between MedBank and MedCorp became effective for accounting purposes. Thus all the transactions of MedCorp have been those of MedBank with effect from 1 April 2017.

Within the financial statements for the financial year ending 31 March 2018, this merger will be reflected as if it had already taken place at the beginning of the earliest period to be presented, i.e. 1 April 2016 using predecessor accounting.

The assets and liabilities that will be recognised by MedBank as a result of the merger are as follows:

	As at 1 April 2017 €000	As at 1 April 2016 €000
Balances with Central Bank of Malta and cash	**180**	551
Loans and advances to banks	**14,331**	9,111
Loans and advances to customers	**55,143**	59,137
Current tax assets	**84**	406
Property and equipment	**-**	51
Non-current assets classified as held for sale	**1,785**	-
Deferred tax assets	**3,357**	3,882
Prepayments and accrued income	**550**	854
Other assets	**4**	2
Amounts owed to customers	**(14,877)**	(14,262)
Accruals and deferred income	**(201)**	(1,106)
Other liabilities	**(244)**	(56)

37. Events after the reporting date - continued

The following tables provide an overview of MedCorp's financial performance and cash flows for the financial years ended 31 March 2017 and 2016.

	Year ended 31 March	
	2017	2016
	€000	€000
Net interest income	**2,019**	2,070
Net fee and commission income	**479**	245
Net trading income	**15**	36
Other operating income	**3**	3
Total operating income	**2,516**	2,354
Employee compensation and benefits	**(1,148)**	(1,225)
Depreciation and amortisation	**(51)**	(41)
Other administrative expenses	**(519)**	(626)
Total operating expenses	**(1,718)**	(1,892)
Net operating income before impairment charges	**798**	462
Net reversal of impairment charges	**1,576**	587
Profit before taxation	**2,374**	1,049
Tax expense	**(832)**	(368)
Profit for the year – Total comprehensive income	**1,542**	681

37. Events after the reporting date - continued

	Year ended 31 March	
	2017	2016
	€000	€000
Cash flows from operating activities before changes in operating assets/liabilities	**261**	295
Decrease in operating assets	**3,785**	9,799
Increase in operating liabilities	**803**	5,379
Net cash generated from operating activities	**4,849**	15,473
Net cash generated from investing activities	**-**	4
Net movement in cash and cash equivalents	**4,849**	15,477
Cash and cash equivalents at beginning of year	**9,662**	(5,815)
Cash and cash equivalents at end of year	**14,511**	9,662

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

38. Statutory information

MeDirect Group Limited is a limited liability company and is incorporated in Malta.

The ultimate controlling party of MeDirect 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 MeDirect Group Limited is Medifin Investments Limited, which is incorporated and registered in Guernsey, with the registered address being 1st and 2nd Floors, Elizabeth House, Les Ruettes Brayes, St Peter Port, GY 11EW, Guernsey.

The immediate parent company of MeDirect Group Limited is Medifin Finance Limited, which is incorporated and registered in Guernsey, with the registered address being 1st and 2nd Floors, Elizabeth House, Les Ruettes Brayes, St Peter Port, GY 11EW, Guernsey.

MeDirect Group Limited

Additional Regulatory Disclosures
31 March 2017

Contents

1 Introduction

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)". These disclosures are in respect of MeDirect Group Limited (the "Regulatory Parent" or "MeDirect Holding") 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 Mediterranean Bank p.l.c. ("MedBank"), that is the parent company of MeDirect Bank SA ("MeDirect") and Mediterranean Corporate Bank Limited ("MedCorp"), together with Charts Investment Management Service Limited ("Charts"), a stockbroking firm authorised to carry out investment services under a Category 3 licence. MeDirect carries out all of the Group's activities in Belgium.

MeDirect Holding's subsidiaries have been authorised to waive their requirement to comply with Parts Two to Five and Eight of the CRR on an individual basis, in terms of Article 7(2) 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 MedBank Group and are managed by MedBank's Board of Directors. As a result, these disclosures present information about the financial risk management of MedBank and its principal subsidiaries MeDirect and MedCorp.

These 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 including a review by the Group's internal audit function.

The disclosure requirements emanating from Articles 441, 449, 452, 454 and 455 of the CRR are not applicable to the Group.

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 2017 amounted to 0.7%.

2 Risk Management and Governance

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 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.

2 Risk Management and Governance - continued

2.1 Risk Management Function - continued

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 Group Chief Risk Officer ("CRO"). As at 31 March 2017, the Group's Risk Management function comprised thirteen full time positions under the management of the Group 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 and Treasury portfolios.
- Operational Risk (2 staff members) – authorisation and monitoring of error-related accounting activity, monitoring of activity representing potential operational risk and key risk indicators ("KRIs").
- IT Security (2 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, liquidity risk and capital management, and wealth risk oversight.
- Regulatory Risk (1 staff member) – responsible for regulatory oversight and risk analysis of implementing changes to key regulation.
- 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.
- Other (2 staff members) – MeDirect Bank CRO that reports to the Group CRO and a Securities Analyst that is responsible for the Group's investment portfolio, mainly carrying financial and quantitative analysis of existing and potential investments as well as reporting on the performance of the Group's investment portfolio.

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 Group Chief Risk Officer is fully involved in the oversight of strategy and reputational risks by virtue of his seat on the Group's Management Executive Committee.

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 fit with regard to the Group's profile and strategy.

[1] EBA/CP/2016/16

[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 and Governance - continued

2.2 Management of Key Risks

The Group runs a simple business model: its balance sheet 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 has no Trading Book.

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 and local corporates.

The Group's international lending activities continued to grow together with the Group's wealth management business. These activities are supported by basic retail services such as money transfer, spot currency exchange and currency forward contracts.

The Group also continues to access the international wholesale funding markets through bilateral repo lines and the Eurex Central Counterparty Clearing House ("CCP") platform. Moreover, as part of the Group's risk management activities, its treasury function is involved in interest rate swaps and forward foreign exchange transactions that are entered into for risk management purposes.

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 headings: Financial and Non-Financial Risks, each made up of a number of risk sub-categories. The Financial Risk Management note in the financial statements (note 2), illustrates the process of how the Group identifies and manages its risks and uncertainties. The main categories of risk described in this note are credit risk, market risk, liquidity risk and operational risk. The same note includes extensive detail of the processes undertaken by the Group to manage these risks.

Financial Risks

The majority of the Group's financial risks, namely the management of Capital, Liquidity, Funding, Credit and Market risks, are governed by the Group's Treasury Management Policy ("TMP") and the Group's Credit Policy.

As stated in the Group TMP, the management of the Group's liquidity position and of its market risk is the joint responsibility of the Treasury and the Risk Management Functions (under the oversight of the Asset and Liability Committee ("ALCO") and the Board Risk Committee), as is the credit risk that arises from these activities. The Group Treasury function acts as the first line of defence having 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; whilst the Risk Management Function acts as the second line of defence, with 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.

A similar approach is adopted by the Group for managing credit risk, whereby the Corporate Credit function acts as the first line of defence with responsibility for analysing and presenting recommendations within the context of the inherent credit risks associated with individual lending exposures; whilst the credit risk management function acts as the second line of defence in terms of reviewing lending proposals and providing credit decisions on new and existing lending exposures.

At a more general level, the Group's definition of financial risk is a risk that directly impacts the financial performance of the Group. Five main risk themes were identified, namely: Capital Adequacy, Liquidity & Funding Risk, Earnings Volatility, Credit Risk and Market Risk. A description of how these risks are managed is provided in the following sections.

2 Risk Management and Governance - continued

2.2 Management of Key Risks - continued

Capital Adequacy

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 performs shock analysis to the assumptions underlying its forecasts in order to measure the variability and resilience of the Group's projected business model.

Liquidity & Funding Risk Management

For liquidity purposes, the Bank's balance sheet, is managed on a day-to-day basis by the Treasury Team, under the leadership of the Head of Treasury and the supervision of the Director of Credit and Investments.

The Group's funding strategy is to maintain a highly diverse funding base composed of both retail 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. Alternative sources of funding are generally considered to be contingency funding options.

The Group's funding strategy for Business as Usual ("BAU") 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.

The Group maintains a Contingency Funding Plan ("CFP") for managing and modelling the potential impacts of a liquidity stress scenario for the Group. The CFP sets out the procedures and actions for preparing for and responding to severe disruptions to its ability to fund some or all of its activities. As part of its CFP, the Group retains additional borrowing capacity by having access to alternative funding as a result of the liquidity of the corporate portfolio. The Group invests in a portfolio of international syndicated loans, which are both tradeable on the secondary loan markets, and are also acceptable as collateral in order to raise additional wholesale funding through secured financing instruments.

The CFP considers the Group's liquidity generating capacity as well as associated impacts on profitability and the Group's capital and liquidity ratios. Stress scenario analysis is conducted in light of idiosyncratic and market-wide stress scenarios, which are both aligned with the Group's Recovery Plan. An idiosyncratic stress scenario is modelled, caused by a theoretical material reputational incident, triggering withdrawal of significant amounts of customer deposits, resulting for instance in a reduced access to wholesale funding, increased haircuts or a reduction of the available credit lines and counterparty limits. Secondly, a market-wide stress scenario is included, to reflect the likely hindrance in access to selling marketable securities without accepting a larger haircut, repo markets might be closed, which in turn leads to a liquidity stress situation.

As an outcome of its CFP, the Group has identified a range of concrete contingency funding measures enabling the generation of incremental liquidity should the Group identify an upcoming strain on its liquidity reserve when facing an idiosyncratic stress scenario and a market-wide stress scenario, respectively.

2 **Risk Management and Governance** - continued

2.2 Management of Key Risks - continued

Earnings Volatility Risk Management

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 Bank's performance, they do represent a useful risk metric. The Group has measures in place to monitor its volatility of earnings, such as Return on Equity ("ROE"), Net Interest Income ("NII"), Significant Operational Losses, and the Cost-to-Income ratio. The monitoring of these measures ensures that the volatility of earnings is consistent with the expectations of the stakeholders, that is, to ensure that the Group has adequate earnings (and cash flows) to service debt and expected dividends and to withstand unexpected shocks; and to ensure that earnings (and cash flows) are consistent with funding strategies.

Credit Risk

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.

The Group's credit risk is governed by the Group's Credit Policy and associated Corporate Credit Frameworks. The Group's Credit Policy sets out a series of controls on how the Group mitigates its credit risk, including:

- Abiding by a list of permitted asset classes;
- A high degree of diversification, implemented through single issuer, industry and geography concentration limits;
- High projected recovery values, implemented by lending primarily at the senior secured level;
- Avoiding "FX lending", where the borrower's source of income is inconsistent with the currency in which its debt is denominated;
- Detailed credit due diligence, involving multiple independent contributions to the approval process in the context of both individual credits and of proposals to enter new market segments; and
- Rigorous credit portfolio monitoring and performance review which allows multiple views to be aired and discussed in a common forum and on the basis of a common package of materials.

Other sources of credit risk

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.

2 Risk Management and Governance - continued

2.2 Management of Key Risks - continued

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.

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 (Bank effects a foreign-currency client payment before euro funds have cleared)	Customer limits approved by Head of Corporate Banking plus CRO for larger amounts.
	Exposure very short-term in nature.

Capital is allocated against the Group's credit risk using the Standardised approach to 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. Recognising that the Standardised approach is calibrated to portfolios that are infinitely granular, the Group calculates an internal capital add-on in respect of credit concentration risk as part of its Internal Capital Adequacy Assessment Process ("ICAAP").

Market Risk Management

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 Bank's income. The Group is, of course, not entirely immune to the effects of market movements and manages this exposure accordingly.

The Group's approach to allocation of capital against market risk is to maintain exposures that are below the materiality thresholds set out in the Capital Requirements Directive ("CRD IV") (Article 98, covering interest rate risk in the banking book) and the CRR (Article 351, covering FX risk). It calculates an internal capital allocation in respect of interest rate risk as part of its ICAAP, while for FX risk, it views the CRR threshold as constraining risk to such a low level that no internal capital calculation is required.

2 Risk Management and Governance - continued

2.2 Management of Key Risks - continued

Interest rate risk

Treasury, under the oversight of the Director of Credit 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 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'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.

Credit spread risk

Given the Group's status and intent are those of a buy-and-hold investor, the fact that its net book value at any point in time depends on the value of its asset portfolio, and therefore on the level of credit spreads, is not a primary concern. This is a different situation that applies to the Group's interest rate exposure, and the distinction is that the cost of carrying a position depends on the level of interest rates but not on the level of credit spreads (or at least dependence is only very indirect).

However, the Group is not entirely immune to shifts in market spreads, as a widening of these spreads can adversely impact the Group's liquidity and capital positions. Credit spread risk is reported alongside interest rate exposure, using a term structure of exposure to credit spreads within each portfolio. Additionally, the Group compares the current market value of each instrument in its securities portfolio against its carrying value each month.

Foreign Exchange risk

The Group offers deposits in most major currencies, with the two main foreign currencies being UK Sterling and US dollars. In addition, approximately 30% of the Group's corporate credit portfolio comprises loans and bonds denominated in GBP Sterling, and the Bank provides foreign exchange services to its customers.

Hedging currency mismatches: All of these factors generate exposure to foreign exchange rates if left unhedged, but the Group's appetite for such risk is low and the Treasury function is responsible for maintaining it within tight limits set out in the TMP. The materiality threshold permitted under CRR for capital allocation purposes also serves to ensure that exposures remain small. The Treasury team minimises foreign exchange risk by hedging currency mismatches through the use of currency swaps and foreign exchange forward contracts. Open FX positions are managed within the limits established by the Group's TMP. With respect to GBP, the Bank needs to secure funds to fund its assets. The primary source of funding is deposits; and the shortfall between assets and liabilities is funded through foreign exchange swaps. The Treasury function swaps excess cash in other currencies into GBP. Currency Swaps are traded with a number of different counterparties to ensure business continuity.

2 Risk Management and Governance - continued

2.2 Management of Key Risks - continued

Non-Financial Risks

Non-financial risks faced by financial institutions have risen in prominence over recent years, with many banks experiencing increasing impacts as a result of operational risk and associated risk types such as conduct, compliance, reputation and business model risk. The ECB supervisory statement on governance and risk appetite[3] makes reference to non-financial risks which the Group has identified as a number of non-financial risks which are disclosed in the Group's Risk Appetite Statement ("RAS"). The management approach used for these non-financial risks is outlined in this section.

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 down permitted actions and consequences for failure to comply with these internal standards. The Group also safeguards its reputation when considering launching new products (which are discussed thoroughly in the New Products and Services Committee).

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 down approved counterparties and associated limits.

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 Bank's risk exposures and capital positions.

[3] The ECB' "SSM supervisory statement on governance and risk appetite"- Section 4.1, page 16

2 Risk Management and Governance - continued

2.2 Management of Key Risks - continued

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")

RCSAs are particularly useful in helping the Group identify key operational risks. The Operational Risk function is primarily responsible for driving the completion of this process. The ORMF lists down 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 Group CRO, whom provides top-down challenge before collating an operational risk register. This is also shared with the Board Risk Committee annually.

Following the completion of the 2016 RCSA exercise, the following risk themes were identified:

i) Fraud Risk which may arise from civil or criminal activity by: customers (first party fraud), contractors or other third parties and employees or distribution associates, misappropriation of assets, identity theft, and other breach of law. Basel II Operational Risk categories covered: Breach of accounting standards, Fraud by staff against the Group and Fraud by staff against the Group's customers (Internal Fraud); and Forgery, Impersonation, and Damage from computer hacking (External Fraud).

ii) 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. Basel II Operational Risk categories covered: Customer business continuity failures including loss of data, Customer business continuity failures without loss of data and Disruption to staff (Business Disruption and System Failures); Compromise of client data, Compromise of intellectual capital and Loss of intellectual capital (Execution, Delivery and Process Management); and Damage to Physical Assets.

2 Risk Management and Governance - continued

2.2 Management of Key Risks - continued

iii) 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).

iv) Outsourcing and Other Third Parties Risk which may arise from failure to establish and manage adequate outsourcing arrangements, transactions or other interactions to meet the expected or contracted quality of service level both within the Group and with external parties such as independent brokers, fund managers, insurers and other parties.

v) People Risk which may arise from the Group's inability to: attract, retain, train and develop the right people, perform adequate succession planning, set an appropriate remuneration arrangement, govern human resources. Basel II Operational Risk categories covered: Discrimination Claims, General Liability (Employment Practices and Workplace Safety).

vi) Process Risk which may arise from inadequate or failed business processes that deliver products and services in order to grow shareholder value. Processes may include but aren't restricted to: change management, data aggregation and reporting, product development, product introduction, client administration, risk and financial modelling. Inadequacies can arise from transaction processing, governance, communication or general process management. Basel II Operational Risk categories covered: Data entry errors, Incomplete legal documentation, Errors in regulatory reporting (Execution, Delivery and Process Management).

vii) Conduct Risk which may arise from inadequate or failed processes that threaten customers' fair treatment and constitute inappropriate market practices, including but not limited to inappropriate sales or advice processes, poor or opaque product design or misleading client interactions. Basel II Operational Risk categories covered: Data entry errors, Incomplete legal documentation, Errors in regulatory reporting (Execution, Delivery and Process Management).

viii) Data Risk which may arise from failure to establish and maintain appropriate standards around the handling of the Group's data. The risk is associated with but not limited to: inadequate data management controls, completeness and comprehensiveness of data, accuracy, clarity and integrity of data, governance around data and its distribution, timeliness of production, data review processes and how frequently they are conducted. Basel II Operational Risk categories covered: Data entry errors (Execution, Delivery and Process Management).

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 section 7.1, 'Capital allocation and capital buffers for operational risk'.

2 Risk Management and Governance - continued

2.2 Management of Key Risks - continued

Key risk indicators (KRIs)

KRIs are extracted from the RCSAs and are used as a monitoring tool for operational risk. A KRI is a variable used to provide a basis for estimating the loss corresponding to an operational risk or estimate the current level of operational risk exposure. The 2nd line are responsible for the development and ongoing evolution of the KRI reporting process, with the 1st line of defence facilitating the process by recommending risk measures in the RCSA process and by providing the necessary data.

While the Group manages its exposure to operational risk within its risk appetite through controls and procedures as listed above and in greater detail in the ORMF, losses may still be incurred. It is conceivable that the total of such losses actually incurred may be greater than the Group's Pillar I Capital requirements thereby potentially requiring additional operational risk capital. Where the risk of loss is deemed to be material, the Group computes its own internal estimate of the potential sizes of losses and estimates economic capital required for carrying such risks.

Risk Control Testing

Risk controls testing prioritises the assessment of key controls identified through the operational risk control assessment process so that control effectiveness can be tested and, if necessary, enhancements to controls implemented on those controls which materially mitigate inherent operational risks. The risk control testing exercise is undertaken independently by the Operational risk function, with control assessments and recommendations shared with the respective first line of defence functions.

Regulatory & Compliance Risk

The Group does not tolerate systemic failures to comply with the relevant laws, regulations and codes of conduct applicable to its business activities. The Group adopts a strict internal control system by virtue of the policies and procedures which it has in force and which are tested regularly by both the operational risk function as well as the internal audit function. The Group recognises its responsibilities to its clients under the legal and regulatory requirements applicable to its activities. In order to ensure proper management and mitigation of compliance risk, the Group has established a compliance charter and manual. This framework lists the roles and responsibilities for the management of the Group's compliance risk as well as procedures and controls reflecting regulatory requirements.

Both regulatory and compliance risk is governed by internal policies, including the Prevention of Financial Market Abuse Policy, Bribery & Corruption Policy and Cash Handling Policy. The Group continually reviews its policies as well as establishing new ones as a means to continue strengthening the internal control system and meeting the ever evolving regulatory standards and obligations.

The Head of the Compliance function has the authority and the ability to report directly to the Board of Directors or Board Committees where appropriate. Staff within the compliance function possess the right knowledge to act as advisors to the management body as well as to senior management and other functions within the Bank especially front office employees. In order to ensure that the Compliance function keeps abreast with and enhance their existing knowledge on laws, rules, regulations and standards, they undertake a range of compliance and other relevant training, provided by reputable third parties.

The Compliance function is also responsible for sourcing and where necessary, providing the required training to instil a risk aware culture where all employees feel accountable for their actions.

2 Risk Management and Governance - continued

2.2 Management of Key Risks - continued

The Group is aware that a risk aware culture is key to ensure that operations are compliant with laws and regulations, and in line with internal policies and standards.

A representative from the compliance function sits on the New Products & Services Committee ("NPSC") to ensure the any new products and procedures comply with the current Group legal framework and, where appropriate, any known forthcoming changes to legislation, regulations and supervisory requirements.

Business & Strategy Risk

Business model risk concerns the profile of the profitability drivers of the business and how these affect the balance between revenue and cost structure. The Group seeks to address the level of its business model risk through its Business Model Analysis ("BMA"). A number of assumptions are used in the BMA in order to assess the sustainability of its strategic objectives taking in consideration the Group's risk appetite statement. Further to the key assumptions underlying the Group projections, it also carries a peer analysis which includes estimates for other key metrics used as indicators of viability and sustainability, namely Return on Assets, Pre-provision income ratio, Economic spread and Return on Risk-Weighted Assets. The Group also applies a number of different shock-scenarios to assess the sustainability of the Group's strategy even during unfavourable conditions.

The purpose of such analysis is to enable the Group to identify its strengths and weaknesses, whilst assessing the sustainability of its strategy taking in consideration changes within the Group's specific business environment. In this way, the Group keeps track of its business model, updating the model to reflect shifts in strategy and analysing the impact on different indicators and risk metrics whilst making sure that this is aligned with the risk appetite.

2.3 Risk Management of the Bank's regulated subsidiaries

While some of the Group's consolidated subsidiaries (past and present) have been purely financing vehicles, it is important that the need for proper governance of its 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. 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 Risk Management and Governance - continued

2.4 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 in consideration macro-economic environment trends.

Portfolio monitoring – lending and treasury portfolios

The Group classifies assets according to their perceived credit status, using a five-point scale. They can be moved from one level to another at any time with the agreement of the Corporate Credit (or Treasury) and Risk Management functions; frequently this happens on receipt of borrower-level information. The credit status classifications are set out in the Group's Corporate Credit Framework. This classification is independent of the Performing and Forbearance classification decisions required for supervisory purposes and where highly prescriptive rules exist[4], allowing the Group to base its internal reporting on its genuine assessment of the likely performance of an exposure. Given the differences in credit quality and underwriting standards, there is generally a higher proportion of the corporate book classified other than "Regular" than of the Treasury book.

Monitoring frequencies are set out in the respective Credit Frameworks, but for all the Group's portfolios, news and market information are tracked continuously: as well as specialist research and other market information. For the bulk of the international corporate portfolio, the Group receives non-public information from borrowers monthly allowing it to monitor on-going profitability and liquidity issues, covenant compliance, deterioration in asset values, debt as a proportion of equity and ability on an on-going basis to refinance debts coming due. This information is reviewed as it arrives by the Corporate Credit team and the appropriate analyst's summary and recommendations are in turn reviewed by Risk Management.

As well as the continuous review process described above, the Management Credit Committee ("MCC") reviews the international corporate portfolio quarterly and all decisions on credit classification are evaluated. For all exposures classified as "under surveillance" or worse, senior representatives of the Finance team are invited to join the meeting, and the MCC discusses whether a specific provision is permitted and/or required under the prevailing accounting standards, as well as the amount of any such provision proposed. The Group's independent credit consultant participates in these quarterly portfolio review meetings. The approach to review of the Treasury and domestic lending portfolios is similar, except that review of Treasury assets classified as Regular takes the form of sector-level commentary, and review of some smaller or otherwise less concerning domestic exposures is annual or semi-annual.

Risk Reports

Key risks are discussed during both Board and Risk Committee meetings where risk exposures are tracked against risk appetite and risk capacity. The Bank's formal risk reporting schedule and processes have been designed to comply with the Basel Committee's "Principles for effective risk data aggregation and risk reporting" (June 2012, revised January 2013). In particular, reporting frequencies have been established in accordance with Principle 10, with flash reports produced daily (either system-generated or created by operational teams) and more in-depth reports produced monthly.

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[4] "EBA FINAL draft Implementing Technical Standards On Supervisory reporting on forbearance and non-performing exposures under article 99(4) of Regulation (EU) No 575/2013"

2 Risk Management and Governance - continued

2.4 Risk Monitoring and Reporting - continued

Where possible, the Group incorporates trended analysis into its risk reports, both to draw the reader's attention to developments in the portfolio's risk profile and to increase confidence in the integrity of the information shown.

Reporting to the Board and Board Risk Committee

The Board and Risk Committee receive a comprehensive risk report each month, compiled by the Risk 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 solo. The Risk Management reports are mainly divided into two sections: Risk Shaping Matters which includes an internal heat map, and external top & emerging risks, and Risk Oversight which includes a comprehensive overview of the main risks of the Group of which:

- *Credit risk:* primarily reports showing the classification of the Group's primary credit portfolios, the internationally syndicated and domestic lending books. These reports break the portfolios down by internal classification and list borrowers classified as other than Regular, as well as any changes on classification over the month.

- *Treasury Risk:* primarily reports showing the classification and breakdown of the Group's Treasury portfolio. It also shows changes in market value versus book value.

- *Capital and Risk-weighted Asset ("RWA") Risk:* primarily reports showing the Group's RWA evolution over time and how the Group's capital ratios would be affected by a range of scenarios such as drawdowns on revolving credit facilities or a downturn in the local property market.

- *Liquidity risk:* primarily two maximum cumulative outflow ("MCO") reports showing stressed liquidity positions of two different severities and over a range of time horizons from overnight to twelve months, as well as the key assumptions that have been used in deriving these positions. Supporting analysis is shown that includes, for example, the impact of credit rating downgrades as well as details of the Group's individually significant depositors. It also includes a commentary about the Liquidity Coverage Ratio ("LCR") and Net Stable Funding Ratio ("NSFR") evolution quarter on quarter.

- *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.

- *Information Technology ("IT") Security Risk:* 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.

- *Compliance and Regulatory Risk:* primarily a commentary, inclusive of RAG grading, about each area, namely General Compliance; Regulatory; Anti-Money Laundering, Countering the Financing of Terrorism and Financial Sanctions ("AMLFTR"); Data & Information Security; Anti-Bribery & Corruption; and Environmental, Social & Governance Policy. It also includes a section on the main regulatory changes and other important regulatory deadlines.

2 Risk Management and Governance - continued

2.4 Risk Monitoring and Reporting - continued

- *Interest rate risk:* summary and detail reports showing the portfolio's interest rate sensitivity under various approaches. Simple (parallel shift) stress measures are shown, and value at risk ("VaR") is calculated to ensure that any material yield curve risk is not overlooked. The interest rate risk report also includes equivalent information in respect of the portfolio's exposure to credit spreads.

- *FX Risk:* this report summarises the foreign exchange position net of any hedges against the approved TMP limits for each currency basket held by the Group.

Flash reports are also distributed internally with ALCO members and senior management on a daily and weekly basis. These reports include details on the liquidity position of the Bank such as net cash and liquidity ratios, assets and liabilities, and capital ratios. These reports are prepared on a consolidated basis as well as for MeDirect solo.

2.5 Escalation of internal risk limits and risk appetite

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 back to BAU.

As disclosed in both the Group's Recovery Plan and the Contingency Funding Plan, a "four-scale traffic light approach" includes an escalation process, where indicator breaches trigger a predetermined escalation and information process up to Bank/Group Senior Management and Board. A detailed communication plan, covering internal and where necessary external communication, also supports the escalation process.

2.6 Risk Policies and Governance

In 2016, the Group compiled a corporate governance framework document that along with MedBank's Articles of Association, terms of reference for the Board of Directors and its standing committees, and the Code of Business Conduct and Ethics provide the framework for the corporate governance practices. The purpose of this document is to provide a framework for the creation of an effective Board and Management structure, and to outline how the Group's systems of governance and control should operate. MedBank's Board of Directors adopted a supervisory structure tailored to suite the requirements of the Group's operational needs. This structure grants the required flexibility that leads to the efficient decentralisation of selected decisions while ensuring that responsibility for overall governance rests with the Board. The Corporate Governance Framework documents provides an overview of the responsibilities of the Chairman, the Chief Executive Officer, the other directors and the various committees.

The Group has also implemented a detailed structure of internal policies covering all aspects of its business. The purpose of this policy framework is to outline how the key elements of the Group's governance infrastructure operates in order to provide for effective control of the Group and its direct and indirect subsidiaries.

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2 **Risk Management and Governance** - continued

2.6 Risk Policies and Governance - continued

Risk Governance

The Group's ***Board of Directors*** have a duty to ensure that the Group conducts business in accordance with all relevant statutory and regulatory requirements. Its overall responsibility with regard to risk management is the establishment and oversight of the Group's risk management framework. The Board sets the Group's strategy and ensures an effective system of internal control and management of business risks, safeguarding a strong capital and liquidity base, that is conducted in accordance with the requirements of the MFSA.

The Board has delegated specific powers and authority to the ***Risk Committee*** which is responsible for monitoring compliance with the Group's risk management policies and procedures and for reviewing the adequacy of the Group's risk management framework. The Risk Committee met 6 times during the financial year ended 31 March 2017. The Internal Audit function carries out both regular and ad-hoc reviews of the risk management controls and procedures and reports its findings to the Audit Committee.

The Group's Board has also established the following senior management committees:

- Executive Committees ("EXCOs");
- MCC;
- ALCO; and
- New Products and Services Committee ("NPSC").

The ***EXCOs***, including the Management EXCO and the Strategy EXCO, together

- formulate and implement the Board approved strategies and plans;
- enhance the execution of the Group's business priorities;
- reinforce the governance of the Group's activities;
- monitor the ongoing priorities that underpin the Group Business model and the regulatory environment in which the Group operates;
- focus on the Group's broader growth strategies and new initiatives;
- manage on an ongoing basis the Group's local business and the efficient functioning of local operations; and
- monitor the Group's ability to respond to new regulatory developments.

The ***MCC*** is responsible for approving credit recommendations and making other credit decisions under its delegated authority - this includes decisions on individual credits; reviewing and recommending credit to the Board; monitoring adherence to large exposure limits; consideration of credit hedging strategies; and recommending other concentration limits for Board approval. It also establishes transactional authority for members of the Credit and Investment Team. In addition, the Management Credit Committee reviews provisioning and lending policies; monitors the Bank's investment portfolios and reviews management information reports.

2 Risk Management and Governance - continued

2.6 Risk Policies and Governance - continued

The ***ALCO*** 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; capital usage and efficiency; transfer pricing; risk management; and underwriting, dealing and trading activities according to the risk appetite set by the Board. It also decides on the level of any credit impairments to be taken on the Group's investments, after receiving recommendations from the MCC.

Additionally, the Board has set up a ***NSPC***. The New Products and Services Committee examines potential new products to be offered by the Group from a risk, operations, reputation and legal/compliance perspective. The Committee provides its recommendations to the EXCO including the appropriate policies, procedures and controls that should be adopted in relation to any such new product.

Both MeDirect and MedCorp had the following committees in place throughout the financial year:

- Management EXCO;
- MCC; and
- ALCO.

Internal Policies

The two key components of the Group's risk management framework are:

(1) an efficient separation of the Group's risk management function and its risk taking activities; and
(2) a robust system of formal governance controls including an effective management committee structure, as described above, and a comprehensive set of internal policies.

Key Risk and Compliance Policy Manuals

Risk policies set out specific requirement for the management of, and articulation of the risk appetite for, key risk types. Currently there are four risk policy manuals; Credit Risk Policy, Treasury Management Policy, IT and Information Security Policy, and Operational Risk Policy, with another two policies for compliance.

Credit Risk Policy: This policy governs the terms under which the Group is willing to extend the bulk of its credit risk; it sets out high-level principles and minimum standards across all areas of credit risk, and is supported by product-level Credit Frameworks with more detail.

The Board of Directors has established limits for exposures to individual credits based on the 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 by the Risk, Treasury and Corporate Credit teams.

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.

Treasury Management Policy (TMP): The TMP acts as an umbrella policy covering different market risk and balance sheet risk themes all governed by a number of policy manuals:

Liquidity Risk Management Framework - includes the funding strategy, reporting, market scenario analysis, deposit concentration, stress testing methodology, contingency funding plan and measures, intraday liquidity management and intragroup liquidity management, liquidity management in foreign currencies and maturity mismatches.

2 **Risk Management and Governance** - continued

2.6 Risk Policies and Governance - continued

Interest Rate Risk - outlines how the Group manages interest rate risk, limits applicable to hedging strategies, interest rate stress testing and reporting.

Foreign Exchange Risk - similar to Interest rate risk, outlines how the Group manages foreign exchange risk, limits applicable to hedging strategies and reporting.

Credit Risk - outlines the Treasury-related transactions that are permitted to be entered into with institutions and the associated limits

The TMP includes the following approved limits:

- Deposit limits;
- Investment limits;
- Repo counterparty haircut limits; and
- Foreign exchange settlement limits.

IT and Information Security Policy: This policy establishes the rules necessary to achieve and maintain an adequate level of security in respect of the Group's computer-based data and IT systems, and to satisfy the Group's expectations that such assets will be used in a professional, and safe manner. The policy applies to all full-time and part-time employees, and contractual third-parties that operate Group-owned computers, Group-provided systems and networks, or access Group-provided electronic messaging or Internet services.

Operational Risk Management Policy: The Group is aware that operational risk may not always be eliminated entirely but may be managed within acceptable levels. The Operational Risk Management Policy establishes risk assessments, risk controls, monitoring and business continuity standards which are necessary to achieve and maintain a level of operational risk consistent with the Group's risk appetite for this risk.

Compliance Policy Manual: Compliance is mainly divided into two main areas: Financial Crime and Regulatory Compliance each governed by a number of internal policies that also reflect new regulation and other important updates.

2.7 The Group's Risk Profile

The Group's risk profile is articulated through the RAS. The principal objective of the Group 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 therefore implicitly a material part of the decision-making processes of the Group.

The RAS directly informs` the performance of the Group, both in terms of expected performance such as the Annual Budgeting process; during stress-scenarios analysis of performance, such as the Internal Capital and Liquidity Adequacy Assessment Processes ("ICAAP" & "ILAAP"); as part of strategic decision making, through New Product and Services Committees ("NPSC") or the Business Model Analysis ("BMA") for example; as well as informing Contingency and Recovery Planning options, as outlined as part of the Group CFP or Group Recovery Plan, for example.

Furthermore, the RAS is used as a guide for behaviours across the Group and is communicated with all management in order to provide clarity on the level of risk appetite for their area of responsibility and to help shape the Group's risk culture.

2 Risk Management and Governance - continued

2.7 The Group's Risk Profile - continued

Risk Capacity, Risk Appetite and Risk Limits

In the context of setting the level of risk appetite across each category of risk, the Group also considers the risk capacity of the Group. To achieve this, and in order to provide greater alignment to the interaction of the RAS with internal risk indicators for the Group, the latest iteration of the RAS document introduces the concept of "risk capacity".

Risk capacity is the maximum amount of risk the Group is able to support, taking into account its capital and liquidity requirements, access to financial markets, as well as consideration of the dynamics of the markets and regulatory environments in which it operates. In this way, the RAS seeks to establish a clear reference between the level of risk it has "appetite" for; and the maximum level of risk it has "capacity" for.

To embed risk appetite effectively, the Group also seeks to establish a clear statement of risk appetite, both in terms of qualitative and quantitative metrics, and to regularly monitor the level of risk against these limits.

Monitoring Risk Appetite and Risk Limits

The RAS is designed to align processes embedded within the Group Governance Framework, which allows for regular references to performance against risk appetite as part of the key planning and internal management process. The associated monitoring responsibilities are integrated into the mandates of existing governing bodies, both at the Board level and the Executive level.

Practically, 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, and ALCO, and NPSC.

The Group remains adequately capitalised, operating with a Tier 1 ratio of 11.66%, above the thresholds set by the regulatory authorities and the Board intends to operate in this manner on an ongoing basis. Likewise all necessary liquidity ratios have been comfortably met at all times, with the Group being highly liquid throughout the financial year. The following is a summary of the key regulatory ratios as at 31 March 2017 versus the relevant risk capacity and risk appetite limit.

Risk Categories	Risk Capacity	Risk Appetite Limits	Ratio as at 31/03/2017
Capital Adequacy			
Common Equity Tier 1 ratio	10.2%	10.7%	11.66%
Tier 1 Capital ratio	10.5%	10.7%	11.66%
Total Capital ratio	12.5%	12.7%	13.65%
Leverage ratio	3.0%	4.0%	7.3%
Liquidity			
Liquidity Coverage ratio (LCR)	80%	115%	576.7%
Net Stable Funding ratio (NSFR)	100%	115%[5]	128.9%
MedBank Liquid Asset ratio (short term assets/short term liabilities)	30%	35%	56.9%

[5] The European calibration of NSFR is pending following the European Commission's proposal in November 2016. As a result, the Regulatory Group calculates NSFR in line with Basel Committee on Banking Supervision Publication 295, pending its implementation in Europe.

2 Risk Management and Governance - continued

2.8 Review of the Risk Management Process

Monitoring and measuring extends to the evaluation of the risk management process, where the Group assesses whether the embedding of the risk management process is successful. Evaluation of the existing controls will lead to the identification of risk improvement recommendations. This evaluation is carried out by the Internal Audit function acting as the third line of defence. Their views and findings are then disclosed in an internal audit report which is discussed at Audit Committee, escalating major deficiencies. Any recommendations are included in the risk register by way of a risk action plan setting implementation deadlines.

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

At 31 March 2017	**Exposure value €000**	**Exposure percentage %**
Central governments or central banks	288,809	10.46%
Regional governments or local authorities	42,157	1.53%
Public sector entities	112,807	4.08%
Multilateral Development Banks	117,138	4.24%
International organisations	42,190	1.53%
Institutions	185,245	6.71%
Corporates	1,545,974	55.98%
Retail	4,852	0.18%
Secured by mortgages on immovable property	33,164	1.20%
Exposures in default	49,148	1.78%
Items associated with particular high risk	25,994	0.94%
Covered bonds	306,772	11.11%
Equity exposures	228	0.01%
Other items	7,254	0.26%
Total	**2,761,732**	**100.00**

3.2 Credit risk exposure – analysis by geographical distribution

At 31 March 2017	**Asia €000**	**Europe €000**	**North America €000**	**Oceania €000**	**Total €000**
Central Government or Central Banks	-	288,809	-	-	288,809
Regional governments or local authorities	-	42,157	-	-	42,157
Public sector entities	-	112,807	-	-	112,807
Multilateral Development Banks	-	117,138	-	-	117,138
International organisations	-	42,190	-	-	42,190
Institutions	-	170,886	11,630	2,729	185,245
Corporates	10,243	1,432,429	103,302	-	1,545,974
Retail	-	4,852	-	-	4,852
Secured by mortgages on immovable property	-	33,164	-	-	33,164
Exposures in default	-	49,148	-	-	49,148
Items associated with particular high risk	-	25,994	-	-	25,994
Covered bonds	-	288,016	18,756	-	306,772
Equity exposure	-	228	-	-	228
Other items	-	7,254	-	-	7,254
Total	**10,243**	**2,615,072**	**133,688**	**2,729**	**2,761,732**

3 Credit risk and Credit risk mitigation ("CRM") - continued

3.3 Credit risk exposure – analysis by industry distribution

At 31 March 2017	Construction €000	Financial and insurance activities €000	Manufacturing €000	Professional, scientific and technical activities €000	Information and communication €000	Wholesale and retail and retail trade €000	Others €000	Total €000
Central Government or Central Banks	-	241,831	-	-	-	-	46,978	288,809
Regional governments or local authorities	-	-	-	-	-	-	42,157	42,157
Public Sector Entities	-	-	-	-	-	-	112,807	112,807
Multilateral Development Banks	-	117,138	-	-	-	-	-	117,138
International organisations	-	-	-	-	-	-	42,190	42,190
Institutions	-	185,245	-	-	-	-	-	185,245
Corporates	20,863	863,797	210,985	127,881	162,549	40,048	119,851	1,545,974
Retail	386	-	-	-	-	-	4,466	4,852
Secured by mortgages on residential immovable property	2,322	5,446	144	24	-	675	24,553	33,164
Exposures in default	8,442	15,036	16,242	1,275	-	-	8,153	49,148
Items associated with particular high risk	7,477	-	-	-	-	-	18,517	25,994
Covered bonds	-	306,772	-	-	-	-	-	306,772
Equity exposures	-	-	-	-	-	-	228	228
Other items	10	-	-	-	-	-	7,244	7,254
Total	**39,500**	**1,735,265**	**227,371**	**129,180**	**162,549**	**40,723**	**427,144**	**2,761,732**

3.4 Credit risk exposure – analysis by residual maturity

	Within 3 months €000	**Between 3 months and 12 months €000**	**1 to 5 years €000**	**Over 5 years €000**	**Total €000**
Central Government or Central Banks	244,344	0	38,657	5,808	288,809
Regional governments or local authorities	0	0	42,157	0	42,157
Public sector entities	0	3,401	79,102	30,304	112,807
Multilateral Development Banks	0	0	117,138	0	117,138
International organisations	0	13,191	28,999	0	42,190
Institutions	98,290	5	84,934	2,016	185,245
Corporates	85,933	45,638	1,395,872	18,531	1,545,974
Retail	3,154	889	672	137	4,852
Secured by mortgages on immovable property	13,025	514	6,287	13,338	33,164
Exposures in default	7,492	26,036	15,360	260	49,148
Items associated with particular high risk	1,464	1,861	21,762	907	25,994
Covered bonds	18,756	43,545	223,224	21,247	306,772
Equity exposures	0	0	0	228	228
Other	333	26	4,570	2,325	7,254
Total	**472,791**	**135,106**	**2,058,734**	**95,101**	**2,761,732**

3 **Credit risk and Credit risk mitigation ("CRM")** - continued

3.5 Approval and Escalation Process

The MCC is responsible for approving credit recommendations and making other credit decisions under its delegated authority, as defined in the 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 or Board Risk Committee approval for extensions of credit beyond its delegated authority; and
- consideration of hedging strategies and whether to recommend them for Board approval.

In addition, the MCC will review provisioning policies and Credit Frameworks, monitor the health of the portfolio and review Management Information reports.

The Group's fundamental approach, when approving credit exposures, is to do so at the time of extension of credit and after name-specific review, rather than issuing approvals that are indefinite in time or that apply to all names within an asset class and/or ratings band. However, to recognise the fact that many of the Group's assets are sourced in the international capital markets, MCC approvals (as well as any approvals of the Board or the Board Risk Committee) are valid for a defined period of time.

Detailed credit screening is carried out involving multiple independent contributions to the approval process in the context of both individual credits and of proposals to enter new market segments. This process also includes a "Greenlight" mechanism wherein credit proposals nearing risk appetite levels are discussed to gauge the appetite of the committee members and decide whether to carry on further work and due diligence. The Group takes note of all the declined proposals by listing down the rationale behind these decisions.

Any extension of credit beyond the MCC's authority, as set out in the Group's internal Corporate Credit framework, requires approval from a majority of the Board Risk Committee, except that the MCC may approve de minimis or very short-lived exceptions.

3.6 Credit Quality Analysis

All securities in the portfolio, as well as corporate loans undergo a thorough analytical credit research process. The research process reviews all securities and corporate loans not only from a credit perspective but also from a legal, financial and ratings perspective. The Credit and Investment team, which manages the 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 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 and thorough surveillance process in order to identify any securities and loans the performance of which requires increased monitoring.

All credit exposures are classified into one of the following five categories:

1. Regular: no material credit concerns;
2. Focus: no immediate prospect that a loss will ultimately be suffered, but worthy of close attention;
3. Under Surveillance: significant credit concerns and some prospect that a loss may ultimately be suffered;
4. Doubtful: likely that the contractual terms of the debt will not be met and that a loss will be suffered; and
5. Write-off: full or partial loss suffered, with little prospect of recovery.

3 **Credit risk and Credit risk mitigation ("CRM")** - continued

3.6 Credit Quality Analysis - continued

These internal classifications are distinct from, and independent of, the "forborne" and "non-performing" classifications required by Maltese Banking rules (and set out in the EBA forbearance and non-performing exposures guidelines) and for statutory reporting, although clearly there will be some degree of consistency.

All exposures classified as "Focus" or worse are also subject to enhanced monitoring whilst those classified as "Under Surveillance" or worse are to be individually assessed for impairment, subject to prevailing accounting standards and policies.

The Group also aims to ensure that the majority of its lending portfolio satisfies the ECB guidelines for leveraged transactions which include: leverage considerations, covenant structure and expected amortisation, albeit these can be driven by underlying market trends outside of the control of the Group.

Unlike the Group's corporate credit portfolios, its Treasury portfolio is underwritten to a zero-loss intention: all assets must be investment-grade at the time of purchase, as well as eligible for ECB financing. The first line of defence is the Treasury team. The bulk of the portfolio is composed of covered bonds and bonds issued by supranational agencies or by agencies of core Eurozone countries. In respect of financial-sector exposure, the Group's approach is to focus on securities whose loss given default ("LGD") is expected to be low, generally because of collateral support (hence the concentration in covered bonds) but also because of seniority (hence the Group's investments in senior unsecured instruments have been concentrated in bonds issued at the Bank, rather than holding company level, or otherwise *pari passu* with an issuer's operating liabilities rather than being subject to bail-in).

It should be noted that the Group does not treat external credit ratings as critical (it does not invest in structured securities where these ratings have been most unreliable in the past), and therefore it does not apply ratings-based limits but considers each proposed investment on the merits of the issuer.

The assessment of asset quality, adequacy of provisions, and the disclosure of credit risk are based on the requirements of IFRS and the MFSA BR 09 "Measures Addressing Credit Risks Arising From The Assessment Of The Quality Of Asset Portfolios Of Credit Institutions Authorised Under The Maltese Banking Act (Cap. 371)". These regulations require that a specific provision is created where a review of credit facilities reveals that the creditworthiness of a borrower has deteriorated significantly and as a result recovery of a credit facility is in serious doubt.

The Management Credit Committee determines when financial assets have become impaired individually or collectively and to what extent such impaired assets should be provided for / written down, all in accordance with IFRS and the Group's Impairment Loss Measurement Guidelines. Where impairment decisions are necessary, the Management Credit Committee will always seek attendance from key representatives of the Finance function to assist it with this determination. Furthermore, the Audit Committee reviews and challenges where necessary the judgement of management in relation to the Group's Consolidated Financial Statements.

3.7 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.

3 Credit risk and Credit risk mitigation (“CRM”) - continued

3.8 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.

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.

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

3.8 Impairment Loss Measurement Guidelines - continued

The Group's gross Loans and advances to customers are analysed into impaired, past due and other exposures in the table below. They are primarily made up of Corporates, and therefore an analysis by counterparty type is not deemed necessary.

At 31 March 2017	**€000**
Impaired	64,347
Past due but not impaired	19,783
Neither past due nor impaired	1,387,902
Total	**1,472,032**

The following table provides an analysis of the Group's specific credit risk adjustments, i.e. specific and collective impairment allowances.

	Specific impairment allowances €000	**Collective impairment allowances €000**
Year ended 31 March 2017		
At beginning of year	12,369	4,439
Exchange differences	318	-
Loan impairment charge – net	4,241	695
At end of year	**16,928**	**5,134**
Specific credit risk adjustments recorded directly to the income statement		
New allowances	6,489	5,134
Release of allowances no longer required	(2,248)	(4,439)
Total loan impairment charge	**4,241**	**695**

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

3.9 Credit risk mitigation

It is the Group’s practice to lend on the basis of the customer’s ability to meet their obligations out of their cash flow resources rather than rely on the value of security offered. 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.

3.9.1 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.

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)[6]. Single-name concentration relates to imperfect diversification of idiosyncratic risk in the portfolio because of large exposures to specific individual borrowers. On the other hand, sectoral concentration relates to imperfect diversification across sectoral factors corresponding to systematic components of risks. The Group therefore defines concentration risk as the risk of losses which arise from having an uneven distribution among exposures within its investment portfolio. In practice, the risk is that the Group suffers an unexpectedly large loss in the event that a single large name defaults, or that defaults are concentrated in a sector to which the Group has a disproportionate exposure. The Group analyses concentration risk on three levels, its Treasury portfolio, its International Corporate Lending portfolio and its Local Lending portfolio.

To a lesser extent, geographical concentration is typically an approach Banks will use to explore the lack of diversity they may carry when having a high level of their credit exposures inherently linked to the underlying macroeconomic and geopolitical status of a single or small number of jurisdictions. However, the fact that the Group has in place geographical concentration limits for its International Corporate lending assets as outlined within its RAS, alongside holding relatively well geographically diversified assets in both its Treasury and Corporate Lending portfolios, particularly when compared to virtually all other Maltese incorporated Banking entities, this would suggest there is actually very low geographical concentration risk for the Group relative to almost all other peers. However, acknowledging the specific SREP feedback from the ECB in 2016, for the latest iteration of the Group ICAAP it has adopted a Geographical concentration risk assessment for capital add-on purposes.

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 Banking Rule 09 which imposes higher allocations for certain past due exposures.

[6] Basel Committee on Banking Supervision (2006), “Studies on Credit Risk Concentration, Working Paper No.15”

3 **Credit risk and Credit risk mitigation (“CRM”)** - continued

3.9 Credit risk mitigation - continued

Since the Group is not rated, it is not required to allocate internal capital or allocate collateral in the eventuality of downgrade in its credit rating.

3.9.2 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.

3.9.3 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 of the commercial properties being located in another European jurisdiction. In particular, in relation to lending by MedCorp 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.

3 Credit risk and Credit risk mitigation ("CRM") - continued

3.9 Credit risk mitigation - continued

3.9.3 Collateral and other credit enhancements – continued

The following table details out the types of eligible collateral held for each exposure class:

At 31 March 2017	**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	-	-	13,603	-	-	288,809
Regional governments or local authorities	-	-	-	-	-	42,157
Public sector entities	-	-	-	-	-	99,204
Multilateral Development Banks	-	-	-	-	-	117,138
International organisations	-	-	-	-	-	42,190
Institutions	-	-	-	-	-	185,245
Corporates	-	-	-	49	-	1,545,925
Retail	-	-	-	291	-	4,561
Secured by mortgages on immovable property	12,972	20,192	-	-	-	-
Exposures in default	4,204	6,941	-	-	-	38,003
Items associated with particular high risk	24,823	1,131	-	-	-	40
Covered bonds	-	-	-	-	306,772	-
Equity exposures	-	-	-	-	-	228
Other	-	-	-	-	-	7,254
Total	**41,999**	**28,264**	**13,603**	**340**	**306,772**	**2,370,754**

As at 31 March 2017, MedCorp had gross exposures with a net carrying amount of €59.7 million, that were fully collateralised.

The following table shows the exposures together with the relevant credit risk mitigation undertaken for each class:

	Exposure value €000	**Credit risk mitigation €000**	**Exposure value after credit risk mitigation €000**
Central governments or central banks	275,206	13,603	288,809
Regional governments or local authorities	42,157	-	42,157
Public sector entities	126,410	-13,603	112,807
Multilateral Development Banks	117,138	-	117,138
International organisations	42,190	-	42,190
Institutions	185,245	-	185,245
Corporates	1,546,022	-49	1,545,973
Retail	5,144	-291	4,853
Secured by mortgages on immovable property	33,164	-	33,164
Exposures in default	49,148	-	49,148
Items associated with particular high risk	25,994	-	25,994
Covered bonds	306,772	-	306,772
Equity exposures	228	-	228
Other items	6,914	340	7,254
Total	**2,761,732**	**-**	**2,761,732**

3 Credit risk and Credit risk mitigation ("CRM") - continued

3.10 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.

3.11 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 2017, is calculated to be €56,739 on a total exposure of €709,238.

3.12 Exposures in equities

The Group's Corporate exposures, within the "Loans and advances to customers: corporates" in the Statement of Financial Position, include ordinary shares, that refer to warrants receive by the Group as part of the restructuring of a borrower, which had a nil value on acquisition. Under International Financial Reporting Standards, specifically IAS 39 as adopted by the European Union, de-stapling provisions kick-in and should recognise the ordinary shares separately based on dissimilar economic characteristics and risks.

The equity instruments held by the Group and not included in the trading book, are accounted for at fair value and consist of locally quoted equity instruments issued by local well known corporates. As at 31 March 2017, the carrying amount and fair value of such quoted investments was equivalent to €228,000 based on current bid prices, whereas the unrealised gains on this equity investment portfolio amounted to €83,000. There were no sale or liquidations of investments throughout the financial year, thus no realised gains were recorded throughout the financial year on such investments.

The equity exposures are classified as available-for-sale and are held long term for capital gains purposes. The total Equity holding does not fall under the definition of "qualifying holding"[7] and is below the small trading book business threshold (Article 94 of CRR) given that it is less than 5% of total assets and therefore is not eligible to be part of a trading book.

[7] 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 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.

Below is tabulated the CCR exposure of the Group as at 31 March 2017:

Contract type	*Residual Maturity*	*Notional Amount (€'m)*	*Applicable percentage*[8]	*Replacement cost (€'m)*	*Potential future exposure (€'m)*	*Mark-to-market exposure value (€'m)*	*Risk-weight*[9]	*Risk-weighted assets (€'m)*
Interest rate swaps	Over one year, not exceeding five years	526,000	0.50%	650	2,630	527	13%	436
Interest rate swaps	Over five years	45,000	1.50%	116	675	116	13%	105
Foreign currency contracts	One year or less	313,668	1.00%	858	3,137	(1,341)	20%	799
Foreign currency contracts	One year or less	140	1.00%	3	1	3	50%	2
Foreign currency contracts	One year or less	140	1.00%	0	1	(1)	100%	1
				1,627	**6,444**	**(696)**		**1,343**

The below table shows the counterparty credit risk exposure split by exposure class:

	Exposure value €000	**Risk weighted assets €000**
Institutions	8,070	1,342
of which exposure to a qualifying central counterparty	*4,071*	*542*
Corporates	1	1
	8,072	**1,343**

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 2017, 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…".*

[8] Applicable percentages per Table 1 of Article 274(2)(c)
[9] Based on counterparty ratings

5 External Credit Assessment Institutions - continued

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.

The following table shows the exposure values 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.

At 31 March 2017	**Credit quality step**	**Exposure value after credit risk mitigation €000**
Central governments or central banks	1	1
Central governments or central banks	2	41,892
Central governments or central banks	Unrated	246,916
Regional governments or local authorities	1	42,157
Public sector entities	1	109,406
Public sector entities	Unrated	3,401
Multilateral Development Banks	1	117,138
International organisations	1	42,190
Institutions	1	27,139
Institutions	2	92,233
Institutions	3	20,929
Institutions	Unrated	44,944
Corporates	Unrated	1,545,974
Retail	Unrated	4,852
Secured by mortgages on immovable property	Unrated	33,164
Exposures in default	Unrated	49,148
Items associated with particular high risk	Unrated	25,994
Covered bonds	1	306,772
Equity exposures	Unrated	228
Other	Unrated	7,254
Total		**2,761,732**

5 External Credit Assessment Institutions - continued

The below table details the average exposure values over the year, risk-weighted exposure amounts and the minimum capital requirement of 8% as prescribed by the CRR.

At 31 March 2017	Exposure value €000	Exposure value average €000	Risk weighted assets €000	Capital required €000
Central governments or central banks	288,809	129,730	10,642	851
Regional governments or local authorities	42,157	94,961	-	-
Public sector entities	112,807	111,429	1,700	136
Multilateral Development Banks	117,138	117,025	-	-
International organisations	42,190	50,516	-	-
Institutions	185,245	177,846	62,409	4,993
Corporates	1,545,974	1,446,569	1,539,210	123,137
Retail	4,852	2,920	2,789	223
Secured by mortgages on immovable property	33,164	31,249	14,636	1,171
Exposures in default	49,148	36,091	63,212	5,057
Items associated with particular high risk	25,994	31,892	38,991	3,119
Covered bonds	306,772	341,552	30,677	2,454
Equity exposures	228	238	228	18
Other items	7,254	12,758	6,623	530
Total	**2,761,732**		**1,771,117**	**141,689**

6 Interest Rate Risk in Non-Trading Book

6.1 Scope and Nature of Interest rate risk

The principal risk to which non-trading portfolios are exposed 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.

6.2 Managing Interest rate risk

6.2.1 Interest Rate Risk Management

Interest rate risk arises as a consequence of the Group's core businesses where there is a mismatch between the nature of rates received on the Group's financial assets and the rates paid on the Group's liabilities. For example, fixed-rate term deposits could be used to fund floating-rate loans, or floating-rate secured funding could be used to finance the purchase of fixed-rate securities.

Treasury, under the oversight of the Director of Credit and Investments, manages interest rate risk within the prevailing interest rate risk strategy as set by ALCO, and subject to limits recommended by the Chief Risk Officer and approved by ALCO.

6.2.2 Interest Rate Risk Reporting and Analysis

The Risk team prepares an interest rate risk report of the Group on a monthly basis. This report outlines the effects of potential yield curve moves on:

- Projected Net Interest Margin;
- The Group's capital position;
- The Economic Value ("EV") of the Group's financial assets and liabilities, assuming that no fixed-rate deposits are rolled forward; and
- The Economic Value of the Group's financial assets and liabilities, incorporating assumptions around fixed-rate deposit roll overs.

6 Interest Rate Risk in Non-Trading Book - continued

6.2 Managing Interest rate risk - continued

6.2.2 Interest Rate Risk Reporting and Analysis - continued

A summary of the Group's interest rate gap position on non-trading portfolios is as follows:

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 and treasury bills	**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	**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 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 fall or rise in the yield curves, after taking into account the effect of hedge accounting, and making the assumption that market rates will never become negative, would be as follows:

31 March 2017	**100 bps parallel increase €million**	**100 bps parallel decrease €million**
Impact on NIM	11.1	(5.7)
Impact on EV	43.5	(13.2)

6 Interest Rate Risk in Non-Trading Book - continued

6.2 Managing Interest Rate Risk – risk management - continued

6.2.2 Interest Rate Risk Reporting and Analysis - continued

The following table provides a further analysis of such results by currency.

	Euro		British Pound		Other currencies in Euro	
31 March 2017	**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	8.0	(4.1)	2.7	(1.3)	-	-
Impact on EV	38.6	(12.5)	3.6	0.6	0.7	(1.4)

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;
- Certain senior secured loans have floors and thus not fully affected by a decrease in interest rates;
- The Group will not change deposit rates in the next 24 months even if there is an increase or decrease in ECB base rate; and
- The liability maturity profile is extended to match the assets' maturity profile.

6.2.3 Hedging and mitigation of interest rate risk

Interest rate risk positions are managed by the Credit and Investments team, in conjunction with Risk, by strategically positioning the asset and liability interest rate re-pricing profiles as well as by purchases of interest rate derivatives, primarily swaps. In addition, Treasury uses advances to financial institutions and deposits from financial institutions to manage the overall position arising from the Group's non-trading activities.

7 Operational risk

As referred to previously, operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the 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 objective of operational risk management is to manage the likelihood of material financial losses or reputational damage within the Group's risk tolerance, while aiming to maintain overall cost effectiveness, and avoid the use of control procedures that restrict initiative and creativity while simultaneously maintaining risk taking within a tolerable limit.

The Group recognises the importance of having a strong operational risk management framework and delivers this through its three lines of defence, whose role is to ensure that adequate and appropriate risk management principles are applied across all business lines. The first line of defence is composed of business line management and staff where the primary control is performed. The second line of defence includes the risk management function, HR, finance, IT, legal and compliance, all involved separately in overseeing the business line management. The third line of defence is the audit function which is intended to provide independent assurance.

7 Operational risk - continued

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 2017 amounted to €85 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 **Own funds** – continued

8.1 Total available capital - continued

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.

8.1.2 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 MeDirect 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 MeDirect Group as fully paid bonus shares.

iii. Shareholders' contributions ("Contributions") are amounts granted by the shareholders to MeDirect Group whereby MeDirect 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 Contribution. 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 MeDirect Holding. The balance in this reserve is net of tax.

   Subject to MeDirect Holding's dividend policy, the directors of MeDirect Holding, in the annual general meeting, may from time to time recommend dividends to be paid from the retained earnings of MeDirect 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 further details in Note 16 "Capital and reserves" to the MeDirect Group Limited financial statements.

8 **Own funds** - continued

8.1 ***Total available capital*** - continued

8.1.2 Common Equity Tier 1 capital – terms and conditions - continued

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 2017, 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 18 November 2024.

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

MeDirect 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, MeDirect 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 MeDirect Group Limited's ability to provide funding for such investments. The ability of subsidiaries to pay dividends or advance monies to MeDirect 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. During the period from 1 January to 31 December 2017, which covers the phasing in of the regulatory adjustments, institutions are required to complete the transitional disclosure template

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 2017.

At 31 March 2017	**€000**
Common Equity Tier 1 (CET1) capital	
CET1 capital: instruments and reserves	
Capital instruments and the related share premium accounts	69,494
Shareholders' contribution	58,700
Retained earnings	101,174
Accumulated Other Comprehensive Income and other reserves, to include unrealised gains and losses under the applicable accounting standards	(4,808)
Funds for general banking risk	1,694
CET1 capital before regulatory adjustments	226,254
CET1 capital deductions:	
Intangible assets (net of related tax liability)	(607)
Deferred tax assets that rely on future profitability	(4,141)
Market value of assets pledged in favour of Depositor Compensation Scheme	(5,814)
Other transitional adjustments	828
Total regulatory adjustments to CET1 capital	(9,734)
CET1 capital	**216,520**
Tier 2 capital	
Subordinated loans	46,993
Deduction:	
Amortisation on subordinated loans	(10,028)
Tier 2 capital	**36,965**
Total capital	**253,485**
Total Risk weighted assets	**1,856,805**

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	11.66
Total capital ratio	13.65
Institution specific buffer requirement	6.02
of which: Capital conservation buffer requirement	1.25
of which: Countercyclical buffer requirement	0.02
of which: Other Systemically Important Institution (O-SII) buffer	0.25
Common Equity Tier 1 available to meet buffers in excess of the CRR 4.5% minimum requirement	7.16

	€000
Items not deducted from own funds in accordance with Article 48 of CRR	4,257
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.

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 2017.

Capital Base	**At 31 March 2017 €000**
Shareholders' equity according to the Group's balance sheet	226,254
Anticipated dividend	-
Market value of assets pledged in favour of Depositor Compensation Scheme	(5,814)
Deferred tax assets that are dependent on future profitability and do not arise from temporary differences (transitional definition)	(3,313)
Intangible assets	(607)
Common Equity Tier 1 capital/Total Tier 1 capital	**216,520**
Tier 2 instruments: subordinated loans	46,993
Amortisation of tier 2 instruments	(10,028)
Total Tier 2 capital	**36,965**
Total capital base	**253,485**

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	**MeDirect Group Limited Ordinary shares**	**MeDirect Group Limited Share premium**	**Mediterranean Bank plc 7.5% Subordinated Bonds EUR 2019**	**Mediterranean Bank plc 7.5% Subordinated Bonds GBP 2019**
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	EUR17.9 million	EUR3.9 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 bond	GBP100 per bond
Redemption price	N/A	N/A	EUR100 per bond	GBP100 per 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 Mediterranean Bank plc subordinated bonds	Subordinated to Mediterranean Bank 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 2017 the subordinated bonds listed above had a remaining maturity of less 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 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	**Mediterranean Bank plc 6% Subordinated Unsecured Bonds EUR 2019 - 2024**	**Mediterranean Bank plc 6% Subordinated Unsecured Bonds GBP 2019 – 2024**
Unique identifier	MT0000551268	MT0000551276
Governing law(s) of the instrument	Maltese Law	Maltese Law
Regulatory treatment		
Transitional CRR rules	Tier 2	Tier 2
Post-transitional CRR rules	Tier 2	Tier 2
Eligible at solo/(sub-)consolidated/solo & (sub-)consolidated	Solo & (Sub) Consolidated	Solo & (Sub) Consolidated
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
Amount recognised in regulatory capital	EUR23.0 million	EUR1.9 million
Nominal amount of instrument	EUR23.0 million	EUR1.9 million
Issue price	EUR100 per EUR Bond	Only GBP100 per GBP Bond
Redemption price	100 per cent of Nominal amount	100 per cent of Nominal amount
Accounting classification	Liability - amortised cost	Liability - amortised cost
Original date of issuance	28 November 2014 (Note 1)	28 November 2014 (Note 1)
Perpetual or dated	Dated	Dated
Original maturity date	28 November 2024	28 November 2024
Issuer call subject to prior supervisory approval	N/A (Note 2)	N/A (Note 2)
Optional call date, contingent call dates, and redemption amount	N/A (Note 2)	N/A (Note 2)
Subsequent call dates, if applicable	N/A (Note 2)	N/A (Note 2)
Coupons / dividends		
Fixed or floating dividend/coupon	Fixed	Fixed
Coupon rate and any related index	6% per annum	6% per annum
Existence of a dividend stopper	No	No
Fully discretionary, partially discretionary or mandatory - in terms of timing	Mandatory	Mandatory
Fully discretionary, partially discretionary or mandatory - in terms of amount	Mandatory	Mandatory
Existence of step up or other incentive to redeem	No	No
Noncumulative or cumulative	Cumulative	Cumulative
Convertible or non-convertible	Non-convertible	Non-convertible
Write-down features	No	No
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 MeDirect 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 2017 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.

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 Group's capital requirements and Total capital ratio computation are as follows:

At 31 March 2017	**Exposure value €000**	**Risk weighted assets €000**	**Capital required €000**
Central governments or central banks	288,809	10,642	851
Regional governments or local authorities	42,157	-	-
Public sector entities	112,807	1,700	136
Multilateral Development Banks	117,138	-	-
International organisations	42,190	-	-
Institutions	185,245	62,409	4,993
Corporates	1,545,974	1,539,210	123,137
Retail	4,852	2,789	223
Secured by mortgages on immovable property	33,164	14,636	1,171
Exposures in default	49,148	63,212	5,057
Items associated with particular high risk	25,994	38,991	3,119
Covered bonds	306,772	30,677	2,454
Equity exposures	228	228	18
Other items	7,254	6,623	530
Credit risk	**2,761,732**	**1,771,117**	**141,689**
Foreign exchange risk		-	-
Operational risk		84,979	6,798
Credit Valuation Adjustment risk		709	58
Total capital required		**1,856,805**	**148,545**
Own funds			
Common Equity Tier 1 capital			216,520
Tier 2 capital			36,965
Total own funds			**253,485**
Total capital ratio			**13.65%**

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.

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 2017.

9 Capital requirements - continued

Country	General credit exposure value €000	Own funds requirement for General credit exposures €000	Own funds requirement weights %	Countercyclical capital buffer rate %
Sweden	20,983	168	11.88	2.00
Norway	56,558	1,245	88.12	1.50
Total	**77,541**	**1,413**		

In view of the above exposure values, the following table identifies the Group's countercyclical capital buffer requirement.

	As at 31 March 2017
Total risk exposure amount (€000)	1,856,805
Institution specific countercyclical buffer rate (%)	0.02%
Institution specific countercyclical buffer requirement (€000)	310

The geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer is as follows:

At 31 March 2017	Exposure value €000	Exposure value % of total	Risk weighted assets €000	Countercyclical capital buffer rate %
Austria	13,595	0.7%	13,595	
Belgium	16,293	0.8%	16,293	
Brazil	11,201	0.6%	1,120	
Switzerland	16,429	0.9%	16,429	
Germany	228,255	11.9%	231,806	
Denmark	31,861	1.7%	3,186	
Spain	36,988	1.9%	36,988	
France	195,267	10.1%	187,978	
United Kingdom	578,739	30.1%	455,807	
Hong Kong	10,243	0.5%	10,243	
Ireland	25,429	1.3%	25,429	
Italy	212,002	11.0%	212,002	
Jersey	9,799	0.5%	9,799	
Malta	73,988	3.8%	67,737	
Netherlands	208,061	10.8%	185,219	
Norway	56,558	2.9%	15,564	1.50
Sweden	20,983	1.1%	2,098	2.00
United States	178,532	9.4%	161,652	
	1,924,223	**100.0%**	**1,652,945**	

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. 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.

9 Capital requirements – continued

Moreover, in light of the fact that the Group is supervised by the ECB as part of the Single Supervisory Mechanism, MeDirect Group is subject to the Supervisory Review and Evaluation Process ("SREP"), which determines the capital requirement by the ECB.

During 2016, the Group received notification from the ECB on the own funds requirements that it is required to meet as of 1 January 2017, following the results of the SREP of 2016. MeDirect 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 2017 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 1.25% for 2017 and the O-SII buffer of 0.25% for the same year. Thus, this results in a total CET1 capital requirement of 9% for 2017. During 2018 and 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 11.66% at 31 March 2017, MeDirect Group comfortably meets its requirements for 2017 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 10.5% and a Total capital ratio minimum requirement of 12.5%, which when including the requirement for the institution specific countercyclical buffer are topped up to 10.52% and 12.52%, 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 2017	**€000**
Tier 1 capital	216,520
Total exposure measure for the purposes of the leverage ratio	2,970,122
Leverage ratio	**7.3%**

The total exposure measure for the purposes of the leverage ratio has been determined as follows:

As at 31 March 2017	**€000**
On-balance sheet exposures (excluding derivatives and SFTs)	
On-balance sheet items (excluding derivatives and SFTs)	2,582,200
Asset amounts deducted in determining Tier 1 capital	(3,920)
On-balance sheet exposures (excluding derivatives and SFTs)	2,578,280
Derivative exposures	
Replacement cost associated with all derivatives transactions	861
Add-on amounts for PFE associated with all derivatives transactions	3,139
Total derivative exposures	**4,000**
Other off-balance sheet exposures	
Off-balance sheet exposures at gross notional amount	492,547
Adjustments for conversion to credit equivalent amounts	(104,705)
Other off-balance sheet exposures	**387,842**
Total exposure measure for the purposes of the leverage ratio	**2,970,122**

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 2017	**€000**
Total assets as per published financial statements	2,572,873
Adjustments for derivative instruments	3,139
Adjustment for off-balance sheet items	387,842
Other adjustments	
Deduction for intangible assets	(3,920)
Other value adjustments	10,188
Leverage ratio exposure	**2,970,122**

The following table below shows the difference on balance sheet exposures in relation to the calculation of the leverage ratio.

At 31 March 2017	**€000**
Total on-balance sheet exposures (excluding derivatives, SFTs of which:	
Exposures treated as sovereigns	317,363
Institutions	613,140
Secured by mortgages of immovable properties	32,827
Retail exposures	2,344
Corporate	1,378,276
Exposures in default	49,141
Multilateral Development Banks	117,138
International Organisations	42,190
Other exposures	25,861
Total	**2,578,820**

The leverage multiple has decreased abruptly between 2012 to 2017 in line with the Group's strategy to reduce its Treasury portfolio. As a result, over this horizon, the relative increase in the Group's CET1 capital exceeded the Group's relative increase in total assets. The transition into senior secured corporate lending resulted in higher and more stable interest income but also lower leverage.

Leverage is expected to continue decreasing with the reinvestment of profits in the Group leading to a greater increase in equity than the increase in assets. The deleveraging process supports the Group's approach towards striking the appropriate balance between risk and return. The reduction in gearing leads to lower risk in the Group and thus presents shareholders with a lower cost of equity, which when coupled with return on capital employed generates a positive economic spread.

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 2017 €000	Fair value of encumbered assets 2017 €000	Carrying amount of unencumbered assets 2017 €000	Fair value of unencumbered assets 2017 €000
Loans and advances	21,228	21,228	1,555,769	1,506,214
Debt securities	437,186	437,186	318,312	318,312
Equity instruments	-	-	219	219
Other assets	95	95	58,996	58,996
Assets of the reporting institution[10]	**458,509**	**458,509**	**1,933,296**	**1,883,741**

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 by MedCorp or 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.

[10] The terminology "reporting institution" is referring to MeDirect 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 2017 €000	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered 2017 €000
Carrying amount of selected financial liabilities	413,395	453,104

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 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 policy in this respect and related processes. The Group aims to promote equal opportunities for all employees whether internal or external and ensures that these are treated fairly and consistently. All candidates are assessed against various selection criteria 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 pro-activity.

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 we can foster these talents in an inclusive culture, we continue 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.

The Nomination Committee regularly reviews the Board's structure, size and composition (including skills, knowledge, experience, independence and diversity). It recommends any changes to the Board. An external search consultancy is used in relation to the appointment of non-executive Directors.

13 Recruitment and Diversity Policy Statement - continued

The Group endeavours to appoint directors with diverse skills and expertise that allow the Board of each entity within the Group to create value for shareholders by ensuring that the specific risks pursued by the Group as well as risks that are intrinsic to banking business are appropriately managed and mitigated within the Board's appetite. The Group has just compiled a Diversity Policy and the next Additional Regulatory Disclosures that will be published by the Group will disclose the extent to which the objectives and targets set out by this policy would have been achieved. Our ambition is to introduce greater diversity around the board table whilst improving our collective performance.

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.medbank.com.mt/about-us/management-team

14 Other directorships

The number of other directorships held by members of MedBank's Board, not related to Mediterranean Bank plc, are listed in the table below:

Director		Number of other directorships held
Michael Bussey	Non-Executive Chairman	3
Frederick Mifsud Bonnici	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	MeDirect 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.	Risk management strategy: 2 Risk Management and Governance (pages 3 – 21)
		Market Risk: 2 Risk Management and Governance
		Foreign Exchange Risk: 2 Risk Management and Governance
		Reputation Risk: 2 Risk Management and Governance
		Credit Risk: 3 Credit risk and Credit risk mitigation ("CRM") (pages 22 – 31)
		CVA Risk: 3.11 Credit Valuation Adjustment ("CVA")
		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 Risk Management and Governance (section 2.1 Risk management Function; page 4)
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 2.7 The Group's Risk Profile in report. This statement covers the principal risks.
435 (2)	Information on governance arrangements:	See Section2.6 Risk Policies and Governance (pages 17-20) & 13 Recruitment and diversity Policy Statement(pages 52-53) in this report for a description of the Risk Policies and Governance. See also Pages 14-
435 (2) (a)	Number	
435 (2) (b)	Recruitment policy	
435 (2) (c)	Policy on diversity with regard to selection of the management body, objectives and targets.	

		20 of the Annual Report which contains information on Board composition, experience and recruitment.
435 (2) (d)	Disclosure of whether a dedicated risk committee is in place, and number of meetings in the year.	Please see 2.4 Risk Monitoring and Reporting (pages 15-17) on Risk Governance.
435 (2) (e)	Description of information flow on risk to Board.	Please see 2.4 Risk Monitoring and Reporting (pages 16-17) on Reporting to the Board and Board Risk Committee.
Scope of application		
436 (a)	Name of institution	Refer to Section 1 Introduction 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 MeDirect 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	The MFSA has provided derogation upon waiver of art 7 (1) regarding prudential requirements on an individual basis in terms of article 6(1) and part 6 respectively in respect to Mediterranean Corporate Bank Ltd(Subsidiary).
Own funds		
437 (1)	Requirements regarding capital resources table :	
437 (1) (a)	Full reconciliation	See 8.2 Own funds – other disclosures (pages 41-42)
437 (1) (b)	Description of capital resources	Refer to 8.1 Total available capital
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	No items are deducted in respect to article 36,56 & 66
437 (1) (d) (iii)	disclosure of the nature and amounts for items not deducted	See section 8.2 Own funds – other disclosures (8.2.1 Composition of Own Funds)
437 (1) (e)	description of all restrictions applied to the calculation of own funds	See section 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 and to 2.7 The Group's Risk Profile for ratio's calculation.
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 3.9 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
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 3.8 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 3.8 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 3.8 Impairment Loss Measurement Guidelines
442 (i)	Reconciliation of changes in specific and general credit risk adjustments compromising of:	Refer to Section 3.8 Impairment Loss Measurement Guidelines for an analysis of the Group's specific credit risk adjustments, 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 3.12 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.	The unrealised gains at equity are fully netted off as unrealised losses and therefore the net is deducted from T1 Capital.
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	Remuneration	Information on remuneration policy and practices is disclosed in the Remuneration Report within the Annual Report (pages 25-30)
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 amount of derecognised fiduciary items	
451 (1) (d)	Description of the risk management approach to mitigate excessive leverage, and factors that impacted the leverage ratio during the year.	The current leverage ratio is 7.32% and the leverage of the Group is expected to continue to decrease with the reinvestment of profits in the Group leading to a greater increase in equity than the increase in assets.
451 (1) (e)	Description of the factors that had an impact on the leverage ratio	
451 (2)	EBA to publish implementation standards for points above.	The Group follows the implementation standards
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 Section 3.9Credit risk mitigation (3.9.1 On and off balance sheet netting and set-off & 3.9.2 Collateral and other credit enhancements)
453 (b)	How collateral valuation is managed	
453 (c)	Description of types of collateral used	Refer to Section 3.9Credit risk mitigation (3.9.2 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 3.9Credit 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 3.9 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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