

MERKANTI BANK LIMITED

Annual Report and Financial Statements
31 December 2022

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Directors' report

The Board of Directors present their annual report and the audited financial statements of Merkanti Bank Limited (the "Bank") for the year ended 31 December 2022.

Principal activities

The principal activity of Merkanti Bank Limited is the operation of a credit institution under the Banking Act (Cap. 371) of the Laws of Malta, in accordance with the credit institution licence granted by the Malta Financial Services Authority. The Bank does not engage in general retail banking, but provides speciality banking services, focused on merchant banking, to corporate customers and group members located in both domestic and non-domestic markets.

Review of the business

2022 has been characterised by an inflation build-up and market volatility, amid geopolitical tensions. Whilst this environment has compelled the Bank to continue to adopt a prudent and cautious approach with respect to the expansion of its merchant banking activities and credit loan portfolio development, the Bank was positively impacted by the increase in market interest rates.

Net operating income increased by 54% to €4,994,054 (2021: €3,234,999). Operating expenses increased by 8% to €3,009,554 (2021: €2,781,093) mainly originating from increased staff costs. Changes during the year in the credit assessment of the Bank's customer loan portfolio have resulted in a nominal movement of €36,153 on expected credit allowances (2021: ECL write-back profit of €49,148).

Profit after tax for the financial year under review was €1,948,347 (2021: €503,054). Total assets as at 31 December 2022 stood at €56,699,757 (2021: €39,198,107). The Bank's financial position and strong capital base remain satisfactory.

Update on Sparkasse Merge

On 7 March 2022, the Bank's immediate parent company Merkanti Holding p.l.c. announced that it had entered into an agreement to acquire Sparkasse (Holdings) Malta Ltd, a private limited liability company registered in Malta (C 35408) ("Sparkasse Holdings"), the parent of Sparkasse Bank Malta plc ("Sparkasse Bank"). The closing of this transaction is conditional upon the satisfaction of certain customary conditions precedent such as regulatory approval from various regulators, including the European Central Bank, the Malta Financial Services Authority and the Central Bank of Ireland. Following regulatory approval, it is the intention to merge Sparkasse Bank and Merkanti Bank Limited in order to form a larger independent institution.

It is planned that the current business portfolio of the Bank will be retained and absorbed by the merged entity. During the year, the Bank's senior management has engaged on a regular basis with Sparkasse Bank in order to execute a full implementation plan to ensure the seamless integration of both banks and to facilitate the consolidation of customer business portfolios.

As at the approval date of these audited financial statements, the required formal regulatory approval was not yet issued. The long-stop date in the Share Purchase Agreement is in the first half of 2023. Absent an extension, the Directors expect the transaction to be closed or terminated by this time.

Directors' report - continued

Key performance indicators

The Board of Directors tracks the Bank's progress in implementing its strategy with a range of financial measures or key performance indicators ("KPIs"). Progress is assessed by comparison with the Bank's budgets and historical performance. The financial KPIs tracked by the Board of the Bank are presented in the following table.

	2022	2021
<u>Operating performance</u>		
Profit before tax	€1,948,347	€503,054
Cost to income ratio	60.26%	85.97%
Return on equity	12.78%	3.45%
<u>Capital management</u>		
Capital adequacy ratio	82.11%	114.31%
Leverage ratio	27.45%	36.96%
<u>Liquidity management</u>		
Liquidity coverage ratio (LCR)	670%	2120%
Net stable funding ratio (NSFR)	227%	277%

Risk management

Merkanti Bank Limited faces a range of business, financial and operational risks. The Bank adopts a robust corporate governance framework with a bank-wide risk management approach, to understand the risks it is exposed to, to assess whether these risks are in line with its risk appetite, and to be able to manage such risks to create value for shareholders while meeting regulatory requirements ensuring integrity, ethical and transparent behaviour.

At a strategic level, the Bank's financial risk management objectives are:

- i. to ensure appropriate identification of the Bank's significant risks;
- ii. to ensure that the Bank's plans are consistent with its risk appetite;
- iii. to optimise risk/return decisions by taking them as closely as possible to the business, while establishing strong and independent review and challenge structures; and
- iv. to help the Bank's Management improve the control and co-ordination of risk taking across the business.

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

Results and dividends

The income statement is presented on page 17. The Directors do not recommend the payment of a final dividend and propose that the balance of retained earnings amounting to €6,883,602 (2021: €4,935,255) be carried forward to the next financial year.

Directors' report - continued

Going concern assessment

The Directors have assessed the Bank's ability to continue to operate as a going concern, taking into account the Bank's business and profit projections, the current capital and funding resources and the expected timing and impact of the Sparkasse merge.

The Directors have also carefully reviewed the impact of the material uncertainty relating to the timing of the regulatory approval of the Sparkasse merge and have concluded the following:

1. The Sparkasse merge is expected to have long-term strategic benefits on the Bank;
2. Should the Sparkasse merge not be approved, the Bank will continue to focus on the execution and development of its current business strategy.

Taking into account the above, the Directors remain confident on the Bank's ability to continue to operate as a going concern. Furthermore, the Directors are of the view that notwithstanding the material uncertainty surrounding the regulatory approval of the merge, the carrying values of the assets and liabilities reported in the Bank's financial statements as at 31 December 2022 are appropriate.

Future outlook

The Directors, taking into account the ongoing market volatility, as well as its strong capital buffers and liquidity resources, remain optimistic on the continued improvement in the Bank's financial performance for 2023.

Directors

The Directors of the Bank who held office during the period were:

Christian Farrugia - Chairman
Samuel Morrow
Otto Karasek
Friedrich Hondl
George Portanier
Stephen Paris

In accordance with the Bank's articles of association, the Directors remain in office until they resign or are otherwise removed from office.

Directors' report - continued

Statement of Directors' responsibilities for the financial statements

The Directors are required by the Maltese Banking Act (Cap. 371) and the Maltese Companies Act (Cap. 386) to prepare financial statements that give a true and fair view of the state of affairs of the Bank as at the end of each reporting period and of the profit or loss for that period.

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

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

The Directors are also responsible for designing, implementing and maintaining internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and that comply with the Maltese Banking Act (Cap. 371) and the Maltese Companies Act (Cap. 386). They are also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The financial statements of Merkanti Bank Limited for the year ended 31 December 2022 are included in the Annual Report 2022, which is published in hard-copy printed form and may be made available on the Bank's website. The Directors are responsible for the maintenance and integrity of the annual report on the website in view of their responsibility for the controls over, and the security of, the website. Access to information published on the Bank's website is available in other countries and jurisdictions, where legislation governing the preparation and dissemination of financial statements may differ from requirements or practice in Malta.

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.

On behalf of the board



Christian Farrugia
Chairman



Stephen Paris
Director

Registered Office:
Aragon House Business Centre
Dragonara Road
St Julians STJ 3140
Malta

22 April 2023



Independent auditor's report

To the Shareholders of Merkanti Bank Limited

Report on the audit of the financial statements

Our opinion

In our opinion:

- The financial statements give a true and fair view of the financial position of Merkanti Bank Limited (the Bank) as at 31 December 2022, and of the Bank's financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU; and
- The financial statements have been prepared in accordance with the requirements of the Maltese Banking Act (Cap. 371) and the Maltese Companies Act (Cap. 386).

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

What we have audited

Merkanti Bank Limited's financial statements, set out on pages 16 to 80, comprise:

- the statement of financial position as at 31 December 2022;
- the income statement and statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include significant accounting policies and other explanatory information.

Basis for opinion

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

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

Independence

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

Independent auditor's report - continued

To the Shareholders of Merkanti Bank Limited

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

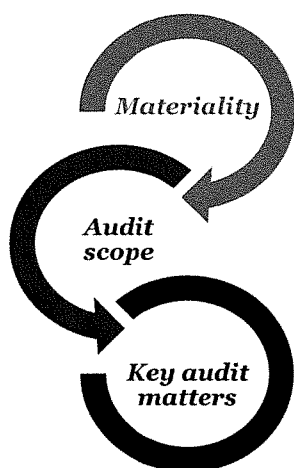
The non-audit services that we have provided to the Bank, in the period from 1 January 2022 to 31 December 2022, are disclosed in Note 24 to the financial statements.

Emphasis of Matter

We draw attention to Note 1.1 to the financial statements, which refers to the fact that on 7 March 2022, the Bank's immediate parent announced that it had entered into an agreement to acquire Sparkasse (Holdings) Malta Ltd, a private limited liability company registered in Malta (C 35408) ("Sparkasse Holdings"), the parent of Sparkasse Bank Malta plc ("Sparkasse Bank"). This matter is considered to be of fundamental importance to the users' understanding of the financial statements because of the potential impact that this transaction may have on the Bank. Our opinion is not modified in respect of this matter.

Our audit approach

Overview



- Overall materiality: €566,000, which represents 1% of total assets

-
- Expected credit loss allowance in respect of loans and advances to customers

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

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



Independent auditor's report - continued

To the Shareholders of Merkanti Bank Limited

Materiality

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

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

<i>Overall materiality</i>	€566,000
<i>How we determined it</i>	1% of total assets
<i>Rationale for the materiality benchmark applied</i>	We chose total assets as the benchmark because, in our view, it is a more appropriate benchmark for this type of bank, given that it is a wholly owned subsidiary of a larger group for which assets held are considered to be the key driver of the business and the determinant of the Bank's value. We chose 1% which is within the range of quantitative materiality thresholds that we consider acceptable.

We have applied a specific lower materiality of €97,000 solely for financial statement line items in the income statement, since we deemed that misstatements of a lower amount than overall materiality in those line items might reasonably influence stakeholders.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above €56,000, as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.



Independent auditor's report - continued

To the Shareholders of Merkanti Bank Limited

Key audit matters

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

Key audit matter	How our audit addressed the Key audit matter
<i>Expected credit loss allowance in respect of loans and advances to customers</i>	
Impairment allowances in respect of loans and advances to customers represent management's best estimate of Expected Credit Losses ('ECLs') within the portfolio at the balance sheet date.	During our audit of the financial statements for the year ended 31 December 2022, we continued to focus on the key drivers of the estimation of ECL.
A considerable level of judgement is required to measure ECLs on loans measured at amortised cost in accordance with IFRS 9.	Our audit procedures in respect of expected credit losses attributable to the Bank's loan portfolios included: • Performing an overall assessment of the ECL provision levels to determine if they were reasonable considering the Bank's portfolio, risk profile, credit risk management practices and the macroeconomic environment. • Testing the completeness and accuracy of the critical data that is utilised within the model for the purposes of the year-end ECL calculation. • Testing the assumptions, inputs and formulas used in the ECL model. This included assessing the appropriateness of the model design and formulas used, and recalculating PDs, LGDs and EADs.
Credit loss allowances relating to all non-defaulted loans and advances (Stages 1 and 2) are determined at an instrument level through the use of an internally developed ECL model based on a number of key parameters including the borrowers' respective financial information to determine an implied internal rating, the calibration of the internal rating to that used by recognised public rating agencies and accordingly the calibration of Through-The-Cycle (TTC) Probability of Defaults ("PDs") attributable by public rating agencies to the respective ratings (peer data), as well as the use of macro-economic modelling to determine Point-in-Time (PiT) PDs.	Since modelling assumptions and parameters are based on peer data, we assessed the reasonableness of the PDs and LGDs generated by the model and the appropriateness of the management's judgements in respect of the calibration of PDs and LGDs.



Independent auditor's report - continued

To the Shareholders of Merkanti Bank Limited

Key audit matter	How our audit addressed the Key audit matter
In the process of determining the ECLs, three main components are considered: i. Probability of Default ("PD"): the likelihood of a borrower defaulting on its financial obligation either over the next 12 months or over the remaining lifetime of the obligation. ii. Loss Given Default ("LGD"): the expected losses taking into account, among other attributes, regulatory guidance as well as the mitigating effect of collateral (if any) at the time it is expected to be realised and the time value of money. iii. Exposure at Default ("EAD"): the expected exposure in the event of a default (including any expected drawdowns of committed facilities).	• Testing a significant sample of loans to independently review the borrower's financial performance and ability to meet loan repayments and assessing the appropriateness of the staging classification assigned by management. • Reviewing the multiple economic scenarios and variables to assess their reasonableness. Based on the evidence obtained, we found the model assumptions, data used within the model, the model calculations and management's judgments to be reasonable.

The methodology used for modelling PDs and LGDs is based on peer data and may limit the reliability to appropriately estimate ECLs.

As at 31 December 2022, none of the Bank's loans and advances to customers were classified as defaulted (Stage 3) exposures. However, judgment is required to determine whether a significant increase in credit risk ('SICR') or default has occurred and as a result, to allocate the appropriate stage classification. Staging is determined based on a combination of criteria including days past due, borrowers' performance and how strategic and economic developments affect borrowers' future payment capabilities.



Independent auditor's report - continued

To the Shareholders of Merkanti Bank Limited

Key audit matter	How our audit addressed the Key audit matter
Under IFRS 9, ECLs are required to incorporate forward-looking information, reflecting management's view of potential future economic developments, into ECL estimates. The complexity involved requires management to develop multiple scenarios entailing the use of significant judgements. Since the estimation of ECLs is subjective in nature and inherently judgemental, the Bank's application of the IFRS 9 impairment requirements is deemed to be an area of focus. Accordingly, summarising the key areas relevant to the Bank's measurement of ECLs would include: • Allocation of loans to Stage 1, 2, or 3 using criteria in accordance with IFRS 9; • Modelling assumptions used to build the models that calculate the ECL; • Completeness and accuracy of data used to calculate the ECL; and • Inputs and assumptions used to estimate the impact of multiple macro- economic scenarios. Relevant references in the Annual Report and Financial Statements: – Accounting policy: Note 1.3; – Credit risk management: Note 2.2; – Note on loans and advances to customers: Note 6; and – Note on changes in expected credit losses: Note 23.	



Independent auditor's report - continued

To the Shareholders of Merkanti Bank Limited

Other information

The directors are responsible for the other information. The other information comprises the Directors' report and the Additional Regulatory Disclosures and the 5 Year Summary (but does not include the financial statements and our auditor's report thereon).

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon except as explicitly stated within the *Report on other legal and regulatory requirements*.

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

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

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

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

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

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



Independent auditor's report - continued

To the Shareholders of Merkanti Bank Limited

Auditor's responsibilities for the audit of the financial statements

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

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

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

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

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

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



Independent auditor's report - continued

To the Shareholders of Merkanti Bank Limited

Report on other legal and regulatory requirements

The Annual Report and Financial Statements 2022 contains other areas required by legislation or regulation on which we are required to report. The Directors are responsible for these other areas.

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

Area of the Annual Report and Financial Statements 2022 and the related Directors' responsibilities	Our responsibilities	Our reporting
Directors' report (on pages 1 to 4) The Maltese Companies Act (Cap. 386) requires the directors to prepare a Directors' report, which includes the contents required by Article 177 of the Act and the Sixth Schedule to the Act.	We are required to consider whether the information given in the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements. We are also required to express an opinion as to whether the Directors' report has been prepared in accordance with the applicable legal requirements. In addition, we are required to state whether, in the light of the knowledge and understanding of the Company and its environment obtained in the course of our audit, we have identified any material misstatements in the Directors' report, and if so to give an indication of the nature of any such misstatements.	In our opinion: - the information given in the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and - the Directors' report has been prepared in accordance with the Maltese Companies Act (Cap. 386). We have nothing to report to you in respect of the other responsibilities, as explicitly stated within the <i>Other information</i> section.



Independent auditor's report - continued

To the Shareholders of Merkanti Bank Limited

Area of the Annual Report and Financial Statements 2022 and the related Directors' responsibilities	Our responsibilities	Our reporting
	Other matters prescribed by the Maltese Banking Act (Cap. 371) In terms of the requirements of the Maltese Banking Act (Cap. 371), we are also required to report whether: • we have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit; • proper books of account have been kept by the bank, so far as appears from our examination of those books; • the bank's financial statements are in agreement with the books of account; • in our opinion, and to the best of our knowledge and according to the explanations given to us, the financial statements give the information required by any law which may from time to time be in force in the manner so required.	In our opinion: • we have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit; • proper books of account have been kept by the bank, so far as appears from our examination of those books; • the bank's financial statements are in agreement with the books of account; and • to the best of our knowledge and according to the explanations given to us, the financial statements give the information required by any law in force in the manner so required.



Independent auditor's report - continued

To the Shareholders of Merkanti Bank Limited

Area of the Annual Report and Financial Statements 2022 and the related Directors' responsibilities	Our responsibilities	Our reporting
	Other matters on which we are required to report by exception We also have responsibilities under the Maltese Companies Act (Cap. 386) to report to you if, in our opinion, adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us.	We have nothing to report to you in respect of these responsibilities.

Other matter – use of this report

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

Appointment

We were first appointed as auditors of the Bank on 10 August 2016 for the year ended 31 December 2016. Our appointment has been renewed annually by shareholder resolution representing a total period of uninterrupted engagement appointment of 7 years.

PricewaterhouseCoopers

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

Norbert Paul Vella
Partner

22 April 2023

Statement of financial position

		As at 31 December	
	Notes	2022 €	2021 €
ASSETS			
Balances with Central Bank of Malta and cash	4	14,572,689	9,959,793
Loans and advances to banks and other financial institutions	5	6,969,817	3,779,362
Loans and advances to customers	6	13,958,012	15,773,875
Financial assets mandatorily measured at fair value through profit or loss	7	792,600	792,600
Financial assets measured at fair value through other comprehensive income	8	18,153,403	7,495,000
Property, plant and equipment	9	200,339	300,854
Intangible assets	10	942,660	646,935
Accrued income and other assets	11	1,110,237	449,688
Total assets		56,699,757	39,198,107
EQUITY AND LIABILITIES			
Equity			
Share capital	12	10,000,000	10,000,000
Fair value reserve	13	(587,930)	48,706
Retained earnings		6,883,602	4,935,255
Total equity		16,295,672	14,983,961
Liabilities			
Amounts owed to banks	14	4,966,000	-
Amounts owed to customers	15	30,457,884	19,045,858
Subordinated liabilities	16	4,500,000	4,500,000
Other liabilities	17	480,201	668,288
Total liabilities		40,404,085	24,214,146
Total equity and liabilities		56,699,757	39,198,107
MEMORANDUM ITEMS			
Commitments	18	866,583	1,845,904

The notes on pages 21 to 80 are an integral part of these financial statements.

The financial statements on pages 16 to 80 were authorised for issue by the board on 22 April 2023 and were signed on its behalf by:

Christian Farrugia
Director

Stephen Paris
Director

Income statement

		Year ended 31 December	
	Notes	2022 €	2021 €
Interest and similar income	19	2,160,484	1,864,757
Interest and similar expense	20	(463,383)	(436,837)
Net interest income		1,697,101	1,427,920
Fee and commission income	21	2,300,243	1,692,807
Fee and commission expense	21	(2,864)	(126)
Net fee and commission expense		2,297,379	1,692,681
Net trading gains	22	964,920	79,904
Realised losses on disposal of financial assets measured at fair value through other comprehensive income		(216)	(423)
Other operating income		34,870	34,917
Operating income		4,994,054	3,234,999
Changes in expected credit losses	23	(36,153)	49,148
Administrative expenses	24	(3,009,554)	(2,781,093)
Profit for the year		1,948,347	503,054

The notes on pages 21 to 80 are an integral part of these financial statements.

Statement of comprehensive income

		Year ended 31 December	
	Note	2022 €	2021 €
Profit for the year		1,948,347	503,054
Other comprehensive income			
<i>Items that may be reclassified subsequently to profit or loss:</i>			
Fair valuation of financial assets measured at fair value through other comprehensive income:			
Net changes in fair value arising during the year, before tax	8	(636,800)	(43,216)
Reclassification adjustments - net amounts reclassified to profit or loss, before tax		216	423
Changes in expected credit losses attributable to debt instruments measured at fair value through other comprehensive income		(52)	1,472
Other comprehensive income for the year, net of tax		(636,636)	(41,321)
Total comprehensive income for the year		1,311,711	461,733

The notes on pages 21 to 80 are an integral part of these financial statements.

Statement of changes in equity

	Notes	Share capital €	Fair value reserve €	Retained earnings €	Total equity €
Balance at 1 January 2021		10,000,000	90,027	4,432,201	14,522,228
Comprehensive income					
Profit for the year		-	-	503,054	503,054
Other comprehensive income:					
<i>Fair valuation of financial assets measured at fair value through other comprehensive income:</i>					
Net changes in fair value arising during the year, net of tax	8	-	(43,216)	-	(43,216)
Reclassification adjustments - net amounts reclassified to profit or loss		-	423	-	423
Changes in expected credit losses attributable to debt instruments measured at fair value through other comprehensive income		-	1,472	-	1,472
Total comprehensive income		-	(41,321)	503,054	461,733
Balance at 31 December 2021		10,000,000	48,706	4,935,255	14,983,961
Balance at 1 January 2022		10,000,000	48,706	4,935,255	14,983,961
Comprehensive income					
Profit for the year		-	-	1,948,347	1,948,347
Other comprehensive income:					
<i>Fair valuation of financial assets measured at fair value through other comprehensive income:</i>					
Net changes in fair value arising during the year, net of tax	8	-	(636,800)	-	(636,800)
Reclassification adjustments - net amounts reclassified to profit or loss			216	-	216
Changes in expected credit losses attributable to debt instruments measured at fair value through other comprehensive income			(52)	-	(52)
Total comprehensive income		-	(636,636)	1,948,347	1,311,711
Balance at 31 December 2022		10,000,000	(587,930)	6,883,602	16,295,672

The notes on pages 21 to 80 are an integral part of these financial statements.

Statement of cash flows

		As at 31 December	
		2022	2021
	Note s	€	€
Operating activities			
Interest and commission income received		4,908,341	3,512,797
Interest and commission expense paid		(457,141)	(511,596)
Cash payments to employees and suppliers		(2,979,346)	(2,312,757)
Cash flows generated from operating activities before changes in operating assets and liabilities		1,471,854	688,444
Changes in operating assets and liabilities:			
Net (increase)/decrease in reserve deposit with Central Bank	4	(153,841)	13,418
Net increase in loans and advances to banks and other financial institutions	5	(4,971,919)	-
Net decrease in loans and advances to customers	6	1,786,988	237,662
Net increase in amounts owed to banks	14	4,966,590	-
Net increase/(decrease) in amounts owed to customers	15	11,412,026	(2,018,087)
Net cash generated from/(used in) from operating activities		14,511,698	(1,078,563)
Cashflows from investing activities			
Purchase of financial assets measured at fair value through other comprehensive income	8	(11,454,000)	(1,119,300)
Proceeds from disposal of financial assets measured at fair value through profit or loss	7	-	592,345
Proceeds from disposal of financial assets measured at fair value through other comprehensive income		132,900	600,423
Purchase of property, plant and equipment	9	(13,277)	(28,355)
Purchase of intangible assets	10	(295,725)	(629,235)
Net cash used in investing activities		(11,630,102)	(584,122)
Cashflows from financing activities			
Repayment of finance leases		(79,381)	(87,207)
Net cash used in financing activities		(79,381)	(87,207)
Net movement in cash and cash equivalents		2,802,215	(1,749,892)
Effect of exchange rate changes on cash and cash equivalents		(116,594)	9,942
Cash and cash equivalents at beginning of year		13,678,142	15,418,092
Cash and cash equivalents at end of year	26	16,363,763	13,678,142

The notes on pages 21 to 80 are an integral part of these financial statements.

Notes to the financial statements

1. Summary of significant accounting policies

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

1.1 Basis of preparation

The Bank's financial statements have been prepared in accordance with the requirements of International Financial Reporting Standards ('IFRSs') as adopted by the EU and with the requirements of the Banking Act (Cap. 371) and the Maltese Companies Act (Cap. 386) enacted in Malta. These financial statements are prepared under the historical cost convention, as modified by the fair valuation of financial assets and financial liabilities measured at fair value through profit or loss, including derivative financial instruments, and financial assets measured at fair value through other comprehensive income.

The preparation of financial statements in conformity with IFRSs as adopted by the EU requires the use of certain accounting estimates. It also requires the directors to exercise their judgment in the process of applying the Bank's accounting policies (see Note 3 - Critical accounting estimates, and judgments in applying accounting policies).

Assessment of going concern assumption

The financial statements have been prepared on a going concern basis which assumes that the Bank will continue in existence for the foreseeable future. The directors believe that the use of the going concern assumption is appropriate.

Significant events

On 7 March 2022, the Bank's immediate parent announced that it had entered into an agreement to acquire Sparkasse (Holdings) Malta Ltd ("Sparkasse Holdings"), the parent of Sparkasse Bank and declared that it is intended that the Bank will be merged with Sparkasse Bank to form a larger independent institution. Should the merger take place, certain assets of the Bank, including intangible assets and items of property, plant and equipment, may need to be written off as they will not be used by the merged institution.

The acquisition transaction and the eventual merger is precedent upon satisfaction of certain standard conditions, including approval by various regulatory authorities, which decision is still outstanding as at the date of issuance of these financial statements and which will be taken subsequent to the date of signing of these financial statements.

1. Summary of significant accounting policies - continued

1.1 Basis of preparation - continued

Standards, interpretations and amendments to published standards effective in 2022

In 2022, the Bank adopted a number of interpretations and amendments to existing standards that are mandatory for the Bank's accounting period beginning on 1 January 2022. These changes did not have a significant impact on the Bank's accounting policies and on the financial performance and financial position. There were no new standards adopted during the year.

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

Certain new standards, interpretations and amendments to existing standards have been published by the date of authorisation for issue of these financial statements, that are mandatory for the Bank's accounting periods beginning on or after 1 January 2023. The Bank has not early adopted these revisions to the requirements of IFRSs as adopted by the EU and the Bank's directors are of the opinion that there are no requirements that will have possible significant impacts on the Bank's financial statements in the period of initial application.

1.2 Foreign currency transactions

a) Functional and presentation currency

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

b) Transactions and balances

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

1.3 Financial assets

1.3.1 Initial recognition and measurement

The Bank recognises a financial asset in its statement of financial position when it becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of financial assets are recognised on the trade date, which is the date on which the Bank commits to purchase or sell the asset. Accordingly, the Bank uses trade date accounting for regular way contracts when recording financial asset transactions.

At initial recognition, the Bank measures a financial asset at its fair value plus or minus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset, such as fees and commissions. Transaction costs of financial assets carried at fair value through profit or loss are expensed in profit or loss. Immediately after initial recognition, an expected credit loss allowance ('ECL') is recognised for financial assets measured at amortised cost and investments in debt instruments measured at FVOCI, which results in an accounting loss being recognised in profit or loss when an asset is newly originated.

1. Summary of significant accounting policies - continued

1.3 Financial assets - continued

1.3.1 Initial recognition and measurement - continued

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

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

1.3.2 Classification and subsequent measurement

The Bank has applied IFRS 9 and classifies its financial assets in the following measurement categories:

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

Debt instruments

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

Classification and subsequent measurement of debt instruments depend on:

- (i) the Bank's business model for managing the asset; and
- (ii) the cash flow characteristics of the asset.

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

- *Amortised cost:* Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ('SPPI'), and that are not designated at FVTPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any expected credit loss allowance recognised and measured as described in Note 1.4. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method.

1. Summary of significant accounting policies - continued

1.3 Financial assets – continued

1.3.2 Classification and subsequent measurement – continued

Debt instruments – continued

- *Fair value through other comprehensive income ('FVOCI')*: Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent solely payments of principal and interest, and that are not designated at FVTPL, are measured at FVOCI. Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortised cost which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in 'Net trading gains/(losses)'. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method.
- *Fair value through profit or loss ('FVTPL')*: Assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of a hedging relationship is recognised in profit or loss and presented in the profit or loss statement within 'Net trading income' in the period in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately in 'Net trading gains/(losses)'. Debt instruments that contain contractual terms that give rise on specified dates to cash flows that are not consistent with a basic lending arrangement and thus fail the solely payments of principal and interest test are 'mandatorily' measured at FVTPL. Interest income from these financial assets, including those that are 'mandatorily' measured at FVTPL, is included in 'Interest and similar income' using the effective interest rate method.

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

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset (i.e. its amortised cost before any impairment allowance) or to the amortised cost of a financial liability.

The calculation does not consider expected credit losses and includes transaction costs, premiums or discounts and fees and points paid or received that are integral to the effective interest rate, such as origination fees. For purchased or originated credit-impaired ('POCI') financial assets - assets that are credit-impaired at initial recognition - the Bank calculates the credit-adjusted effective interest rate, which is calculated based on the amortised cost of the financial asset instead of its gross carrying amount and incorporates the impact of expected credit losses in estimated future cash flows.

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

The Bank reclassifies debt instruments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent and none occurred during the period.

1. Summary of significant accounting policies - continued

1.3 Financial assets - continued

1.3.2 Classification and subsequent measurement - continued

Debt instruments - continued

(a) Business model assessment

Key management personnel determine the Bank's business model by considering the way financial instruments are managed in order to generate cash flows. That is, whether the Bank's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of 'other' business model and measured at FVTPL. Such assessment is performed at a 'portfolio level' as it best reflects the way the business is managed and information is provided to management.

The information that will be considered in such assessment includes:

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

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

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

1. Summary of significant accounting policies - continued

1.3 Financial assets - continued

1.3.2 Classification and subsequent measurement - continued

Debt instruments - continued

(b) Cash flows that represent solely payment of principal and interest ('SPPI')

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

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

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

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

1. Summary of significant accounting policies - continued

1.3 Financial assets - continued

1.3.2 Classification and subsequent measurement - continued

Equity instruments

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

The Bank subsequently measures all equity investments at fair value through profit or loss, except where the Bank's management has elected, at initial recognition, to irrevocably designate an equity investment at fair value through other comprehensive income. The Bank's policy is to designate equity investments as FVOCI when those investments are held for purposes other than to generate investment returns. When this election is used, fair value gains and losses are recognised in OCI and are not subsequently reclassified to profit or loss, including on disposal.

Impairment losses (and reversal of impairment losses) are not reported separately from other changes in fair value. Dividends, when representing a return on such investments, continue to be recognised in profit or loss as other income when the Bank's right to receive payments is established.

Gains and losses on equity investments at FVTPL are included in the 'Net trading gains/(losses)' line in the income statement.

1.4 Impairment of financial assets

The Bank assesses on a forward-looking basis the expected credit losses ('ECLs') associated with its debt instruments carried at amortised cost and FVOCI and with the exposure arising from loan commitments and financial guarantee contracts. The Bank recognises a loss allowances for such losses at each reporting date. The measurement of ECLs reflects:

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

Note 2.2.3 provides more detail of how the expected credit loss allowance is measured.

1. Summary of significant accounting policies - continued

1.4 Impairment of financial assets - continued

Expected credit loss allowances are presented in the statement of financial position as follows:

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

1.5 Write-off policy

The Bank writes off financial assets when it determines that these are uncollectible and it has exhausted all practical recovery efforts and has concluded there is no reasonable expectation of recovery. This is generally the case when the Bank determines that the counterparty does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-offs.

1.6 Offsetting financial instruments

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

1.7 Derivative financial instruments

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

Derivative financial instruments, including currency forward swaps, are initially recognised at fair value on the date on which a derivative contract is entered into, and are subsequently re-measured at their fair value. Fair values for currency swaps are determined using forward exchange market rates at the end of the reporting period. Discounting techniques, reflecting the fact that the respective exchange or settlement will not occur until a future date, are used when the time value of money has a significant effect on the fair valuation of these instruments.

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

1. Summary of significant accounting policies - continued

1.8 Property, plant and equipment

All property, plant and equipment are stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

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

Depreciation is calculated using the straight-line method to allocate the cost of the assets to their residual values over their estimated useful lives, as follows:

	%
Computer equipment	25
Office improvements and equipment	10-25

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 1.10).

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

1.9 Intangible assets

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use specific software. These costs are amortised over their estimated useful lives of ten years. Costs associated with maintaining computer software programme are recognised as an expense as incurred.

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

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

At the end of each reporting period, intangible assets are reviewed for indications of impairment or changes in estimated future economic benefits. If such indications exist, the intangible assets are analysed to assess whether their carrying amount is fully recoverable (Note 1.9).

1. Summary of significant accounting policies - continued

1.10 Impairment of non-financial assets

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows (cash-generating units). The impairment test can also be performed on a single asset when the fair value less cost to sell or the value in use can be determined reliably.

1.11 Current and deferred tax

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

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

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

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

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

1.12 Share capital

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

1. Summary of significant accounting policies - continued

1.13 Financial liabilities

1.13.1 Initial recognition and measurement

The Bank recognises a financial liability on its statement of financial position when it becomes a party to the contractual provisions of the instrument. Financial liabilities not at fair value through profit or loss are recognised initially at fair value, being the fair value of consideration received, net of transaction costs that are directly attributable to the acquisition or the issue of the financial liability.

1.13.2 Classification and subsequent measurement

Financial liabilities are classified as subsequently measured at amortised cost, except for:

- financial liabilities at fair value through profit or loss: this classification is applied to derivatives, financial liabilities held for trading (e.g. short positions in the trading booking) and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at fair value through profit or loss are presented partially in other comprehensive income (the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability, which is determined as the amount that is not attributable to changes in market conditions that give rise to market risk) and partially profit or loss (the remaining amount of change in the fair value of the liability). This is unless such a presentation would create, or enlarge, an accounting mismatch, in which case the gains and losses attributable to changes in the credit risk of the liability are also presented in profit or loss;
- financial liabilities arising from the transfer of financial assets which did not qualify for derecognition, whereby a financial liability is recognised for the consideration received for the transfer. In subsequent periods, the Bank recognises any expense incurred on the financial liability; and
- financial guarantee contracts and loan commitments (see note 1.15).

Financial liabilities measured at amortised cost comprise principally amounts owed to customers, subordinated liabilities and other liabilities.

1.13.3 Derecognition

The Bank derecognises a financial liability from its statement of financial position when the obligation specified in the contract or arrangement is discharged, cancelled or expired.

The exchange between the Bank and its original lenders of debt instruments with substantially different terms, as well as substantial modifications of the terms of existing financial liabilities, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10% different from the discounted present value of the remaining cash flows of the original financial liability.

1. Summary of significant accounting policies - continued

1.13 Financial liabilities - continued

1.13.3 Derecognition - continued

In addition, other qualitative factors, such as the currency that the instrument is denominated in, changes in the type of interest rate, new conversion features attached to the instrument and change in covenants are also taken into consideration. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.

1.14 Other payables

Other payables comprise obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities.

Other payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

1.15 Financial guarantee contracts and loan commitments

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 issued by the Bank to financial institutions and other entities on behalf of customers to secure micro-loans and other credit related products.

Financial guarantee contracts are initially measured at fair value and subsequently measured at higher of:

- the amount of the loss allowance (calculated as described in note 1.4); and
- the premium received on initial recognition less income recognised in accordance with the principles of IFRS 15.

For loan commitments and financial guarantee contracts, the loss allowance is recognised as a provision. However, for contracts that include both a loan and an undrawn commitment and the Bank cannot separately identify the expected credit losses on the undrawn commitment component from those on the loan component, the expected credit losses on the undrawn commitment are recognised together with the loss allowance for the loan. To the extent that the combined expected credit losses exceed the gross carrying amount of the loan, the expected credit losses are recognised as a provision (Note 1.4).

1. Summary of significant accounting policies - continued

1.16 Interest income and expense

Interest income and expense for all interest-bearing financial instruments are recognised within 'Interest and similar income' and 'Interest and similar expense' in the profit or loss using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset (i.e. its amortised cost before any impairment allowance) or to the amortised cost of a financial liability.

The calculation does not consider expected credit losses and includes transaction costs, premiums or discounts and fees and points paid or received that are integral to the effective interest rate, such as origination fees. For purchased or originated credit-impaired ('POCI') financial assets - assets that are credit-impaired at initial recognition - the Bank calculates the credit-adjusted effective interest rate, which is calculated based on the amortised cost of the financial asset instead of its gross carrying amount and incorporates the impact of expected credit losses in estimated future cash flows.

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for:

- POCI financial assets, for which the original credit-adjusted effective interest rate is applied to the amortised cost of the financial asset;
- financial assets that are not 'POCI' but have subsequently become credit-impaired (or 'Stage 3'), for which interest revenue is calculated by applying the effective interest rate to their amortised cost (i.e. net of the expected credit loss provision).

1.17 Fee and commission income and expense

Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income, including account servicing fees and investment management fees are recognised in the accounting period in which the services are rendered. For fixed-price contracts, revenue is recognised based on the actual service provided to the end of the reporting period as a proportion of the total services to be provided because the customer receives and uses the benefits simultaneously.

Where the contracts include multiple performance obligations, the transaction price will be allocated to each performance obligation based on the stand-alone selling prices. Where these are not directly observable, they are estimated based on expected cost plus margin.

Estimates of revenues, costs or extent of progress toward completion are revised if circumstances change. Any resulting increases or decreases in estimated revenues or costs are reflected in profit or loss in the period in which the circumstances that give rise to the revision become known by management.

1. Summary of significant accounting policies - continued

1.17 Fee and commission income and expense - continued

In case of fixed-price contracts, the customer pays the fixed amount based on a payment schedule. If the services rendered exceed the payment, a contract asset is recognised. If the payments exceed the services rendered, a contract liability is recognised.

1.18 Customer contract assets and liabilities

The timing of revenue recognition may differ from customer invoicing. Trade receivables presented in the statement of financial position represent an unconditional right to receive consideration (primarily cash), i.e. the services and goods promised to the customer have been transferred.

By contrast, contract assets mainly refer to amounts allocated per IFRS 15 as compensation for goods or services provided to customers for which the right to collect payment is subject to providing other services or goods under that same contract. Contract assets, like trade receivables, are subject to impairment for credit risk. The recoverability of contract assets is also verified, especially to cover the risk of impairment should the contract be interrupted.

Contract liabilities represent amounts paid by customers before receiving the goods and/or services promised in the contract. This is typically the case for advances received from customers or amounts invoiced and paid for goods or services not transferred yet, such as contracts payable in advance or prepaid packages (previously recognised in deferred income).

1.19 Leases

The Bank is the lessee

The Bank has lease agreements in place related to the leases of property used as office space.

At the inception of a contract, the Bank assesses if the contract is or contains a lease and hence conveys the right to control the use of an identified asset for a period of time in exchange for consideration. For leases of property, the Bank has elected not to separate lease and non-lease components and instead accounts for these as a single lease component.

Lease liabilities arising from such contracts are measured at the present value of the remaining lease payments, discounted using the incremental borrowing rate, which is the rate that the Bank would have to pay to borrow the funds necessary to obtain an asset of a similar value in a similar economic environment with similar terms and conditions. Lease payments to be made under reasonably certain extension options are also included in the measurement of the liability.

Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease term so as to produce a constant period rate of interest on the remaining balance of the liability.

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

Right-of-use assets relating to items of property are presented within these financial statements with 'Property, plant and equipment'. The corresponding lease liabilities are similarly presented within these financial statements with 'Other liabilities'.

1. Summary of significant accounting policies - continued

1.19 Leases - continued

The Bank elects not to recognise right-of-use assets and lease liabilities for low value leases or leases with a term shorter than 12 months. Lease payments relating to these leases are expensed to profit or loss on a straight-line basis over the lease term.

1.20 Cash and cash equivalents

Cash and cash equivalents are carried in the statement of financial position at face value less expected credit loss allowances. In the statement of cash flow, cash and cash equivalents include cash in hand, deposits held at call with banks and other financial institutions and other short-term highly liquid investments with original maturities of three months or less.

1.21 Dividend distributions

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

2. Financial risk management

2.1 Introduction

The Bank's activities expose it to a variety of financial risks and these activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. The Bank's aim is to achieve an appropriate balance between risk and return and minimise potential adverse effects on the entity's financial performance.

The Board of directors oversees credit, market, funding and liquidity, operational and strategic business risks. The Bank has developed an integrated risk management framework to identify, assess, manage and report risks and risk adjusted returns.

The Bank's risk management policies are designed to identify and analyse risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The Board is responsible for the overall effectiveness of the risk management function, which function is however carried out by all the members of the Bank's management.

The Bank's treasury function is responsible for managing assets, liabilities and the overall financial position and is also responsible for the management of funding and liquidity risks. The Bank's risk oversight function has the overall responsibility for the development of the entity's risk strategy and the implementation of risk principles, framework, policies and related limits.

2. Financial risk management

2.2 Credit risk

2.2.1 Introduction

The Bank takes on exposure to credit risk, which is the risk that a counterparty will cause a financial loss for the Bank by failing to discharge an obligation. Credit risk is the most important risk for the Bank's business. Accordingly, management carefully manages its exposure to this risk. Credit exposures arise principally through the Bank's participation in credit transactions primarily with entities within the Scully Royalty group, through the Bank's transactions with correspondent banks, and through its investments in debt securities and other exposures arising from its investing activities.

During the financial year ended 31 December 2022, the impact of the COVID-19 outbreak which has dominated the previous two financial years has subsided. Despite the disruptions brought to business' worldwide, the Bank did not experience any defaults during the preceding financial years, which showed the resilience of the Bank's counterparties to these disruptions.

Notwithstanding the above, the level of economic uncertainty during the financial year ended 31 December 2022 was exacerbated by the military conflict between Russia and Ukraine, as well as widespread supply chain disruptions experienced globally.

In view of the above, the Bank continued to monitor and assess its credit exposures from loans and advances to customers to determine any credit deterioration within its portfolio. Further, as part of its ICAAP, the Bank has stress tested its credit exposures under potential forward looking adverse scenarios, which show despite the slow global economic recovery following the COVID-19 outbreak, the Bank would still be in a position to withstand the stress.

2.2.2 Credit risk measurement

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

The Bank measures credit risk using Probability of Default ('PD'), Exposure at Default ('EAD') and Loss Given Default ('LGD').

The Bank's financial assets primarily comprise the following three portfolios upon which credit risk is assessed: investments in debt securities, loans and advances to banks and other financial institutions and loans and advances to customers. Where published ratings are issued by recognised external rating agencies, such as Standard & Poor's, Fitch and Moody's, mainly in respect of issuers of debt securities and other banks, the Bank refers to such ratings to determine the probability of default of individual counterparties. These published grades are continuously monitored and updated. Where published ratings are not available, a credit risk modelling solution, developed by an external vendor, is used to determine implied credit ratings. Implied credit ratings are determined on the basis of exposure-specific characteristics, including financial performance and qualitative characteristics captured through a scorecard. The implied ratings are calibrated with the rating scales as defined by the recognised external rating agencies, which in turn allow for the determination of the probability of default attributable to each individual unrated counterparty.

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.2 Credit risk measurement - continued

In determining the probability of default of individual counterparties, the Bank distinguishes between exposures considered 'investment-grade' defined by recognised external rating agencies as a rating between AAA to BBB- (Standard & Poor's, Fitch) and Aaa to Baa3 (Moody's), and 'non-investment grade' exposures.

2.2.3 Expected credit loss ('ECL') measurement

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

- i. A financial instrument that is not credit-impaired on initial recognition is classified in 'Stage 1' and has its credit risk continuously monitored by the Bank.
- ii. If a significant increase in credit risk ('SICR') since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit - impaired. Please refer to note 2.2.3.1 for a description of how the Bank determines when a significant increase in credit risk has occurred.
- iii. If the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'. Please refer to note 2.2.3.2 for a description of how the Bank defines credit-impaired and default.
- iv. Financial instruments in 'Stage 1' have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in 'Stage 2' or 'Stage 3' have their ECL measured based on expected credit losses on a lifetime basis. Please refer to note 2.2.3.3 for a description of inputs, assumptions and estimation techniques used in measuring the ECL.
- v. A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward looking information. Note 2.2.3.4 includes an explanation of how the Bank has incorporated this in its ECL models.
- vi. Purchased or originated credit-impaired financial assets are those financial assets that are credit-impaired on initial recognition. Their ECL is always measured on a lifetime basis ('Stage 3').

The expected credit loss 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 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 'Stage 1'. Financial assets which are considered to have experienced a significant increase in credit risk would be classified as 'Stage 2' and financial assets for which there is objective evidence of impairment, thus considered to be in default or otherwise credit-impaired, would be classified as 'Stage 3'.

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.3 Expected credit loss measurement - continued

The Bank recognises loss allowances at an amount equal to 12-month ECL for debt securities measured at amortised cost and FVOCI and counterparty banks that are determined to have low credit risk at the reporting date. The Bank considers a debt security to have low credit risk when it is considered 'investment-grade', defined by recognised external rating agencies as a rating between AAA to BBB- (Standard & Poor's and Fitch) and Aaa to Baa3 (Moody's).

2.2.3.1 Significant increase in credit risk

The Bank's assessment to determine the extent of increase in credit risk of a financial instrument since initial recognition is performed by considering the change in the risk of default occurring over the remaining life of the financial instrument.

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

A backstop is applied and the financial instrument considered to have experienced a significant increase in credit risk if the counterparty is more than 30 days past due on its contractual repayments.

2.2.3.2 Definition of default and credit impaired assets

The Bank applies the definition of default in a consistent manner with internal credit risk management practices for the relevant instruments and the definition considers qualitative and quantitative factors where appropriate.

The Bank defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the criteria below.

The Bank determines that a financial instrument is credit-impaired (in default and in Stage 3 for IFRS 9 purposes) by considering relevant objective evidence, when it meets one or more of the below criteria:

- contractual payments of either principal or interest are past due for more than 90 days for any material credit obligations to the Bank;
- there are other indications that the borrower is unlikely to pay such as that a concession has been granted to the borrower for economic or legal reasons of an enduring nature relating to the borrower's financial condition, which indicates the borrower is in significant financial difficulty (unlikelihood to pay criteria); and
- the loan is otherwise considered to be in default. If unlikelihood to pay is not identified at an earlier stage, it is deemed to occur when an exposure is more than 90 days past due.

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

The default definition has been applied consistently to model the PD, EAD and LGD throughout the Bank's expected loss calculations.

The Bank considers certain financial assets, mainly loans and advances to banks and other financial institutions and investments in debt securities respectively, to be in default when a payment due (including a coupon payment) is not effected.

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.3 Expected credit loss measurement - continued

2.2.3.2 Definition of default and credit impaired assets - continued

In the case of certain portfolio of financial assets (specially loans and advances to banks and other financial institutions and investment in debt securities), the Bank applies the low credit risk simplification to all its exposures considered 'investment grade', thus they are not subject to the SICR assessment. Moving from investment grade does not automatically mean that there is SICR.

2.2.3.3 Measuring ECL – Explanation of inputs, assumptions and estimation techniques

The ECL is measured on either a 12-month (12M) or on a lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether an asset is considered to be credit-impaired. Expected credit losses are the discounted product of the PD, EAD, and LGD. These three components are multiplied together effectively calculating the forward-looking ECL, which is then discounted back to the reporting date. The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

The 12-month ECL is calculated by multiplying the 12-month PD, LGD, and EAD. Lifetime ECL is calculated on a similar basis for the residual life of the exposure.

The PD, EAD and LGD parameters are estimated through the use of internally developed statistical models on the basis of market available data, adjusted to reflect forward-looking information as described below.

The PD represents the likelihood of a borrower defaulting on its financial obligation (as per "definition of default and credit-impaired" above), either over the next 12 months ('12M PD'), or over the remaining lifetime ('Lifetime PD') of the obligation. Accordingly, the 12-month and lifetime PDs represent the probability of default occurring over the next 12 months and the remaining maturity of the instrument, respectively.

Market data is used in order to develop the PDs in respect of the Bank's portfolios of financial assets, including loans and advances to banks and other financial institutions, loans and advances to customers and investment securities. If a counterparty or exposure migrates between internal rating grades or external credit ratings, then this will lead to a change in the associated PD.

The conditional PD is adjusted to consider forward-looking information through macroeconomic modelling. In this respect, and as described in further detail in section 2.2.3.4, during the year, PDs used in the calculation of expected credit loss adjustments were re-aligned to reflect the change in macro-economic variables.

EAD is based on the amounts the Bank expects to be owed at the time of default, over the next 12 months ('12M EAD') or over the remaining lifetime ('Lifetime EAD').

EAD represents the expected exposure in the event of a default (including any expected drawdowns of committed facilities). The Bank derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract. The EAD of a financial asset is the gross carrying amount at default.

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.3 Expected credit loss measurement - continued

2.2.3.3 Measuring ECL – Explanation of inputs, assumptions and estimation techniques - continued

The 12-month and lifetime EADs are determined based on the expected payment profile, which varies by product type:

- for amortising products and bullet repayment loans, this is based on the contractual repayments owed by the borrower over a 12month or lifetime basis;
- for revolving products, the exposure at default is predicted by taking current drawn balance and adding a "credit conversion factor" which allows for the expected drawdown of the remaining limit by the time of default. These assumptions vary by product type and current limit utilisation band, based on analysis of the Bank's recent default data.

The LGD represents the Bank's expectation of the extent of loss on a defaulted exposure. Hence, the LGD represents expected credit losses on the EAD given the event of default, taking into account, among other attributes, the mitigating effect of collateral values (if any) at the time it is expected to be realised and the time value of money. The LGD is determined based on the factors which impact the recoveries made post default.

Given that its portfolio of loans and advances to banks and other financial institutions and investments in debt securities is generally unsecured, and in respect of loans and advances to customers, the Bank has no history of defaults, the LGD for the Bank's exposures is set at levels based on market available data for similar exposure classes.

The ECL is measured from the initial recognition of the financial asset. The maximum period considered when measuring ECL (be it 12-month or lifetime ECL) is the maximum contractual period over which the Bank is exposed to credit risk. With respect to non-revolving credit facilities, the contractual life of the facility is considered. In the case of revolving credit facilities, provided that such facilities do not have a fixed term or repayment structure, the Bank defines the lifetime of such exposures as 12 months, in case the next substantive credit review is within the next 12 months.

Forward-looking economic information is also included in determining the 12-month and lifetime PD and LGD. Refer to note 2.2.3.4 for an explanation of forward-looking information and its inclusion in ECL calculations.

There have been no significant changes in estimation techniques or significant assumptions made during the reporting period.

The calculation of ECL incorporates forward-looking information. The Bank performs a historical analysis to identify the key economic variables affecting credit risk and expected credit losses for each portfolio. These economic variables and their associated impact on the PD, EAD and LGD may vary by portfolio.

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.3 Expected credit loss measurement - continued

2.2.3.3 Measuring ECL – Explanation of inputs, assumptions and estimation techniques – continued

In this respect, as part of its methodology for the application of forward looking economic information into the calculation of ECL, the Bank has identified key drivers of credit risk and credit losses for each portfolio of financial instruments (namely, loans and advances to banks and other financial institutions, loans and advances to customers and investment securities) and, using an analysis of historical data, has analysed relationships between macro-economic variables, credit risk and credit losses. The key drivers, for both 2022 and 2021, are predominantly EEA-average gross domestic product (GDP) at constant prices, world-average gross domestic product (GDP) at constant prices, and EEA-average terms of trade of goods and services (ToD).

The impact of these economic variables on the PD, EAD and LGD has been determined by performing statistical regression analyses to understand the impact changes in these variables have had historically on default rates and on the components of LGD and EAD.

2.2.3.4 Forward-looking information incorporated in the ECL model

Three possible scenarios are considered to capture non-linearity across credit portfolios. The 'Base' scenario represents the most-likely outcome. It is based on authoritative sources forecasting these economic variables referred to above and providing the best estimate view of the economy. Apart from the base scenario, the Bank considers two other macro-economic scenarios – 'Upside' and 'Downside' scenarios – which respectively represent a more optimistic and a more pessimistic outcome. The upside and downside scenarios are economically plausible and will not necessarily be as severe as scenarios used in stress testing.

Each scenario is weighted by a probability of occurrence, determined by a combination of macroeconomic research and expert credit judgment, taking account the range of possible outcomes each chosen scenario represents. The Bank measures ECL as either a probability weighted 12-month ECL (Stage 1), or a probability weighted lifetime ECL (Stages 2 and 3). These probability-weighted ECLs are determined by running each scenario through the relevant ECL model and multiplying it by the appropriate scenario weighting (as opposed to weighting the inputs).

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.3 Expected credit loss measurement - continued

2.2.3.4 Forward-looking information incorporated in the ECL model - continued

The following tables present the macro-economic variables referred to above for the following 3 forecasted years and the probabilities assigned to each of the Base, Upside and Downside scenarios.

As at 31 December 2022:

Macro-economic variables	ECL Scenario	Probability	2022 (actual)	2023	2024	2025
EEA-average gross domestic product (GDP) at constant prices	Base	50%	3.60%	1.00%	1.60%	1.60%
	Upside	25%		1.50%	2.10%	2.10%
	Downside	25%		0.50%	1.10%	1.10%
World-average gross domestic product (GDP) at constant prices	Base	50%	3.19%	2.65%	3.18%	3.35%
	Upside	25%		3.16%	3.68%	3.86%
	Downside	25%		2.16%	2.68%	2.86%
EEA-average terms of trade of goods and services (ToD).	Base	50%	4.29%	2.51%	3.66%	3.74%
	Upside	25%		3.01%	4.16%	4.24%
	Downside	25%		2.01%	3.16%	3.24%

As at 31 December 2021:

Macro-economic variables	ECL Scenario	Probability	2021 (actual)	2022	2023	2024
EEA-average gross domestic product (GDP) at constant prices	Base	50%	5.04%	4.43%	1.98%	1.58%
	Upside	25%		4.93%	2.48%	2.08%
	Downside	25%		3.93%	1.48%	1.08%
World-average gross domestic product (GDP) at constant prices	Base	50%	5.88%	4.89%	3.62%	3.37%
	Upside	25%		5.39%	4.12%	3.87%
	Downside	25%		4.39%	3.12%	2.87%
EEA-average terms of trade of goods and services (ToD).	Base	50%	-1.49%	0.43%	0.36%	0.21%
	Upside	25%		0.93%	0.86%	0.71%
	Downside	25%		-0.07%	-0.14%	-0.29%

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.3 Expected credit loss measurement - continued

2.2.3.4 Forward-looking information incorporated in the ECL model - continued

- The base scenario reflects the current economic condition;
- The downside scenario is based on subdued economic activity and consequently GDP and the EEA's average terms of trade ratio will decline by 50 basis points (2021: 50 basis points) from the base scenario; and
- The upside scenario is based on the assumption that economic recovery will be better than anticipated leading to a 50 basis point (2021: 50 basis points) improvement in forecasted GDP and the EEA's average terms of trade ratio from the base case.

The weightings assigned to each economic scenario were 50% for the base scenario, 25% for the downside scenario and 25% for the upside scenario, for both 2022 and 2021. The number of scenarios used is based on the analysis of each major product type to ensure that non-linearities are captured. The number of scenarios and their attributes are reassessed at each reporting date. The economic scenarios were simulated over a full economic cycle.

The Board considers that the above probability weightings assigned to the respective scenarios reflect an unbiased evaluation of a range of possible outcomes.

As with any macro-economic forecasts, the projections and the likelihood of their occurrence are subject to a high degree of uncertainty and therefore, the actual outcomes may be significantly different to those projected. The Bank considers these forecasts to represent its best estimate of the possible outcomes.

As at 31 December 2022, the sensitivity of the ECL outcome to the economic forecasts was assessed by recalculating the ECL under the base and downside scenarios described above for the loan portfolio, applying a 100% weighting to each scenario.

In this respect, if the ECL outcome was estimated solely on the basis of the base and downside scenarios respectively, the credit loss allowances in respect of the loan portfolios would amount to €98,011 (2021: €66,253) and €101,453 (2021: €72,245) respectively, compared to a weighted average credit loss allowances estimated at year end amounting to €94,569 (2021: €65,694). In view of this, as at 31 December 2022, the sensitivity impact was not considered to be significant.

Other forward-looking considerations not otherwise incorporated within the above scenarios, such as the impact of any regulatory, legislative or political changes, have also been considered, but are not deemed to have a material impact and therefore no adjustment has been made to the ECL for such factors. This is reviewed and monitored for appropriateness on an ongoing basis.

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.4 Maximum exposure to credit risk

An 'exposure' is defined as the amount at risk arising from the Bank's assets and off-balance sheet items. The Bank's maximum credit risk with respect to on- and off-balance sheet items can be classified into the following categories:

- Financial assets recognised on-balance sheet comprising principally investments in debt securities and loans and advances to banks and other financial institutions, customers and group companies. The maximum exposure to credit risk of these financial assets equals their gross carrying amounts or fair value.
- Loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities. The maximum exposure to credit risk is the full amount of the committed facilities. However, the likely amount of loss is less than the total unused commitments as most commitments to extend credit are contingent upon customers maintaining specific credit standards. These exposures are monitored in the same manner in respect of loans and advances.

The following table sets out the Bank's credit risk exposures relating to on-balance sheet assets and off-balance sheet instruments, reflecting the maximum exposure to credit risk before collateral held or other credit enhancements, as well as an analysis by staging classification:

	Stage classification	2022 Gross exposure €	ECL allowance €	Stage classification	2021 Gross exposure €	ECL allowance €
Credit risk exposures relating to on-balance sheet assets:						
Financial assets mandatorily measured at FVTPL:						
Non-fixed income instruments		792,600	-		792,600	-
<i>Subject to IFRS 9 impairment allowances</i>						
Financial assets measured at FVOCI:						
Debt securities	Stage 1	18,153,403	(1,843)	Stage 1	7,495,000	(1,895)
Financial assets measured at amortised cost:						
Balances with Central Bank of Malta	Stage 1	14,571,689	-	Stage 1	9,958,793	-
Loans and advances to banks and other financial institutions	Stage 1	7,015,428	(45,611)	Stage 1	3,816,943	(37,581)
Loans and advances to customers	Stage 1	2,650,000	(24,463)	Stage 1	15,839,569	(65,694)
Loans and advances to customers	Stage 2	11,402,581	(70,106)	Stage 2	-	-
Accrued income and other assets	Stage 1	995,492	-	Stage 1	315,201	-
Credit risk exposure		55,581,193	(142,023)		38,218,106	(105,170)
Credit risk exposures relating to off-balance sheet instruments:						
Undrawn commitments to lend	Stage 2	866,583	-	Stage 1	1,845,904	(700)
Credit risk exposure		866,583	-		1,845,904	(700)

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.4 Maximum exposure to credit risk - continued

As at 31 December 2022 and 31 December 2021, there were no purchased or credit-impaired assets which are subject to the IFRS 9 impairment requirements.

In addition, the undrawn commitments to lend amounting to €866,583 (2021: €1,212,796) are fully secured with cash collateral. No ECL allowances were recognised in respect of these undrawn commitments. As at 31 December 2021, the ECL allowance amounting to €700 relates to a credit facility provided to a related party amounting to €633,108, which was fully undrawn at year-end.

2.2.5 Credit risk mitigation techniques

The Bank's approach when granting credit facilities is based on the customer's capacity to repay rather than placing primary reliance on credit risk mitigants. Notwithstanding, in certain cases, as part of the Bank's credit risk mitigation techniques, the Bank holds collateral against loans and advances to customers, the nature and level of which generally depends on the amount of the exposure, the type of facility provided, the term of the facility and the level of credit risk involved. Collateral utilised to secure loans and advances includes cash collateral. As at 31 December 2022, the Bank had cash collateral amounting to €2,000,000 (2021: €5,600,000) against loans granted to related parties amounting to €1,133,417 (2021: €4,387,204) and an undrawn credit facility of €866,583 (2022: €1,212,796). The Bank also held other cash collateral amounting to €7,100,000 (2021: €6,000,000) securing the receivables purchased from a related party amounting to €10,269,164 (2021: €8,802,365), the residual exposure of which is to a third party. The remaining loans granted to a related party amounting to €2,650,000 (2021: €2,650,000) are unsecured.

2.2.6 Credit concentration risk

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

In order to manage its principal risk exposures arising from its financial assets, primarily its loans and advances to customers, the Bank compiles and updates credit review reports in respect of these financial assets. Where available, reference is also made to external reviews of primary borrowers.

Credit concentration risk by name

At 31 December 2022 and 2021, loans granted to related parties amounting to €3,783,417 (2021: €7,037,204) and a purchased receivable transaction amounting to €10,269,164 (2021: €8,802,366) referred to in Note 26, were considered to be reportable as large exposures, exceeding 10% of the Bank's Total Own Funds. In this respect, 27% of the Bank's gross lending exposures at 31 December 2022 (2021: 45%) comprised exposures to entities within the Scully Royalty Group, and 73% (2021: 55%) comprised exposures to a single third party.

As at 31 December 2022 and 2021, no loans and advances to customers were deemed to be prohibited large exposures in terms of the CRR.

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.6 Credit concentration risk - continued

Credit concentration risk by geographical region

The geographical concentration of the Bank's financial assets as at the end of the reporting period is analysed below. For the purposes of this table, the Bank has allocated exposures to regions based on the country of domicile of the respective counterparties or customers.

	Malta €	Other EU countries €	Rest of world €	Total €
As at 31 December 2022				
Financial assets measured at FVTPL	-	792,600	-	792,600
Financial assets measured at FVOCI	6,712,225	11,441,178	-	18,153,403
Balances with Central Bank of Malta	14,571,689	-	-	14,571,689
Loans and advances to banks and other financial institutions	6,969,817	-	-	6,969,817
Loans and advances to customers	1,133,417	-	12,824,595	13,958,012
Accrued income and other assets	99,837	389,911	505,744	995,493
	29,486,985	12,623,689	13,330,339	55,441,013
As at 31 December 2021				
Financial assets measured at FVTPL	-	792,600	-	792,600
Financial assets measured at FVOCI	7,495,000	-	-	7,495,000
Balances with Central Bank of Malta	9,958,793	-	-	9,958,793
Loans and advances to banks and other financial institutions	3,779,362	-	-	3,779,362
Loans and advances to customers	4,387,204	-	11,386,671	15,773,875
Accrued income and other assets	58,222	245,261	11,718	315,201
	25,678,581	1,037,861	11,398,389	38,114,831

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.6 Credit concentration risk - continued

Credit concentration risk by industry sector

Loans and advances to customers, gross of allowances, are analysed by industry concentration as follows:

	2022 €	2021 €
Financial activities	3,783,417	7,037,204
Mining activities	10,269,164	8,802,365
	14,052,581	15,839,569

2.2.7 Information on credit quality of other financial assets

As part of its treasury management activities, the Bank invests in listed sovereign bonds issued by local and foreign governments, in listed debt securities issued by foreign and local credit institutions and in other debt securities. These transactions are monitored through the practical use of exposure limits. External ratings such as Moody's rating or their equivalents are used for monitoring these credit risk exposures.

At the end of the reporting period, none of the Bank's financial assets, which are subject to the IFRS 9 impairment requirements, were past due or impaired.

The following table shows the total carrying amount of debt securities held by the Bank analysed by credit rating based on Moody's equivalent ratings:

At 31 December 2022	Central Government €	Institutions €	Total €
A1 to A3	17,934,403	-	17,934,403
Not rated	-	219,000	219,000
Total	17,934,403	219,000	18,153,403

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.7 Information on credit quality of financial assets - continued

At 31 December 2021	Central Government €	Institutions €	Total €
A1 to A3	7,269,452	-	7,269,452
Not rated	-	225,548	225,548
Total	7,269,452	225,548	7,495,000

2.2.8 Loss allowances

Reconciliation of 12-month and lifetime ECL provision

The following disclosure provides a reconciliation by stage of the Bank's on balance sheet gross carrying/nominal amount and allowances for loans and advances to customers, including accrued interest.

Transfers across stages represent the impact of stage transfers upon the gross carrying/nominal amount and associated allowance for ECL of the financial instruments that are outstanding at the beginning of the year.

The 'Net remeasurement of ECL arising from stage transfers' represents the increase or decrease in ECL due to moving, for example, from a 12-month (Stage 1) to a lifetime (Stage 2) ECL measurement basis or vice versa. Net remeasurement excludes the movements resulting from changes in risk parameters such as changes in PDs and LGDs when compared to those used for the previous reporting period. This is captured, along with other credit quality movements in the 'Changes in risk parameters' line item which shows the impact of changes in risk parameters in respect of the allowances specifically for loans and advances to customers outstanding at the beginning of the year. The impact of model overlays is also included within the 'Changes in risk parameters' line item.

The 'Net new and further lending/repayments' represent the gross carrying/nominal amount and associated ECL impact from volume movements within the Bank's lending portfolio, i.e. originations and repayments during the financial reporting period. Accordingly, loans originated during the year are classified in the table below using the respective stage classification as at the end of the reporting period, without the effect of stage transfers from origination. The allowance in respect of these is included using the current year's risk parameters, and therefore no such impact is included within the 'Changes in risk parameters' line item. Similarly, stage transfers in respect of loans and advances originated or repaid during the year are also included within the 'Net new and further lending/repayments' line item.

The movement in ECL is illustrated in the following tables:

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.8 Loss allowances - continued

	Stage 1		Stage 2		Total	
	Gross carrying amount	Allowance for ECL	Gross carrying amount	Allowance for ECL	Gross carrying amount	Allowance for ECL
	€	€	€	€	€	€
At 31 December 2021	15,839,569	65,694	-	-	15,839,569	65,694
Transfers from Stage 1 to Stage 2	(9,589,569)	(51,692)	9,589,569	51,692	-	-
Net remeasurement of ECL arising from stage transfer	-	-	-	15,486	-	15,486
Changes in risk parameters	-	10,461	-	-	-	10,461
Net new and further lending/(repayments)	(3,600,000)	-	1,813,012	2,928	(1,786,988)	2,928
At 31 December 2022	2,650,000	24,463	11,402,581	70,106	14,052,581	94,569

Change in expected credit losses on loans and advances to customers
Change in expected credit losses attributable to:

Loans and advances to banks and other financial institutions

Financial assets measured at fair value through other comprehensive income

Undrawn commitments

Total expected credit loss charge for the year

28,875
8,030
(52)
(700)
36,153

2. Financial risk management - continued

2.2 Credit risk - continued

2.2.8 Loss allowances - continued

	Stage 1	
	Gross carrying amount €	Allowance for ECL €
At 31 December 2020	16,077,232	147,713
Changes in risk parameters	-	(60,379)
Net new and further lending/(repayments)	(237,663)	(22,937)
Changes due to foreign exchange movements	-	1,297
At 31 December 2021	15,839,569	65,694
Change in expected credit losses on loans and advances to customers		(83,316)
Change in expected credit losses attributable to:		
Loans and advances to banks and other financial institutions		31,996
Financial assets measured at fair value through other comprehensive income		1,472
Undrawn commitments		700
Total expected credit loss charge for the year		(49,148)
No stage transfers have occurred during 2021.		

2. Financial risk management - continued

2.3 Market risk

The Bank takes on exposure to market risk, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate and currency products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads, foreign exchange rates and equity prices.

(a) Foreign exchange risk

The Bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. Foreign exchange risk is the risk to earnings and value caused by a change in foreign exchange rates. Foreign exchange risk arises when financial assets or liabilities are denominated in currencies which are different from the Bank's functional currency.

The Bank manages its currency risk on an ongoing basis by ensuring that foreign currency liabilities are utilised to fund assets denominated in the same foreign currency thereby matching asset and liability positions as much as is practicable. To the extent that such matching is not possible, the Bank hedges its open foreign exchange exposures by entering into foreign exchange forward contracts with terms matching those of the hedged items.

The following tables summarise the Bank's exposure to foreign exchange risk at 31 December. Included in the tables are the Bank's financial instruments at carrying amounts, categorised by currency.

	EUR €	USD €	CAD €	GBP €	Total €
As at 31 December 2022					
Financial assets					
Financial assets measured at FVTPL	792,600	-	-	-	792,600
Financial assets measured at FVOCI	18,153,403	-	-	-	18,153,403
Balances with Central Bank of Malta and cash	5,826,647	8,107,416	638,626	-	14,572,689
Loans and advances to banks and other financial institutions	6,094,540	604,977	268,208	2,092	6,969,817
Loans and advances to customers	3,758,954	-	10,199,058	-	13,958,012
Accrued income and other assets	994,470	955	67	-	995,492
Total financial assets	35,620,614	8,713,348	11,105,959	2,092	55,442,013
Financial liabilities					
Amounts owed to banks	4,966,000	-	-	-	4,966,000
Amounts owed to customers	22,112,220	8,136,326	84,065	125,273	30,457,884
Subordinated liabilities	4,500,000	-	-	-	4,500,000
Other liabilities	480,201	-	-	-	480,201
Total financial liabilities	32,058,421	8,136,326	84,065	125,273	40,404,085
Contractual repayment option	10,199,058	-	(10,199,058)	-	-
Net on-balance sheet position	13,761,251	577,022	822,836	(123,181)	

2. Financial risk management - continued

2.3 Market risk - continued

(a) Foreign exchange risk - continued

	EUR €	USD €	CAD €	GBP €	Total €
As at 31 December 2021					
Financial assets					
Financial assets measured at FVTPL	792,600	-	-	-	792,600
Financial assets measured at FVOCI	7,495,000	-	-	-	7,495,000
Balances with Central Bank of Malta and cash	3,596,671	6,363,122	-	-	9,959,793
Loans and advances to banks and other financial institutions	2,072,251	330,392	1,319,539	57,180	3,779,362
Loans and advances to customers	7,023,202	-	8,750,673	-	15,773,875
Accrued income and other assets	311,727	-	3,474	-	315,201
Total financial assets	21,291,451	6,693,514	10,073,686	57,180	38,115,831
Financial liabilities					
Amounts owed to customers	12,218,702	5,886,972	778,023	162,161	19,045,858
Subordinated liabilities	4,500,000	-	-	-	4,500,000
Other liabilities	656,008	-	12,280	-	668,288
Total financial liabilities	17,374,710	5,886,972	790,303	162,161	24,214,146
Contractual repayment option	8,750,673	-	(8,750,673)	-	-
Net on-balance sheet position	12,667,414	806,542	532,710	(104,981)	

Loans and advances to customers include an amount of €10,199,058 (2021: €8,750,673) relating to receivables purchased from a related party denominated in CAD. The seller of the receivables is contractually liable to settle any shortfalls from foreign currency exchange movements between CAD and EUR. Consequently, the Bank is not exposed to any currency risk on these receivables. In the above table, the effect of the contractual repayment provision is represented as a contractual repayment option.

In addition, the net unhedged on-balance sheet exposure to other currencies such as the USD, as at 31 December 2022 and 31 December 2021 respectively, is not considered significant taking into account the amounts reported in the statement of financial position. Accordingly, a sensitivity analysis for foreign exchange risk 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 is not deemed necessary since the directors are of the opinion that the net impact would be insignificant.

2. Financial risk management - continued

2.3 Market risk - continued

(b) Interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates either through the re-pricing of floating rate instruments or through the maturity and replacement of fixed rate instruments. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Bank's exposures analysed by their fixed or floating nature as at 31 December is shown below:

	Floating rates €	Fixed rates €	Total €
At 31 December 2022			
<i>Interest-bearing assets</i>			
Financial assets measured at FVTPL:			
Non-fixed income instrument	-	792,600	792,600
Financial assets measured at FVOCI:			
Debt securities	-	18,153,403	18,153,403
Financial assets measured at amortised cost:			
Balances with Central Bank of Malta	5,825,647	8,746,042	14,571,689
Loans and advances to banks and other financial institutions	4,930,069	-	4,930,069
Loans and advances to customers	2,625,537	11,332,475	13,958,012
	13,381,253	39,024,520	52,405,773
<i>Interest-bearing liabilities</i>			
Subordinated liabilities	-	4,500,000	4,500,000
Amounts owed to customers	-	8,000,000	8,000,000
Lease liabilities	-	177,195	177,195
	-	12,677,195	12,677,195
Net exposure	13,381,253	26,347,325	39,728,578

2. Financial risk management - continued

2.3 Market risk - continued

(b) Interest rate risk - continued

	Floating rates €	Fixed rates €	Total €
At 31 December 2021			
<i>Interest-bearing assets</i>			
Financial assets measured at FVTPL:			
Non-fixed income instrument	-	792,600	792,600
Financial assets measured at FVOCI:			
Debt securities	-	7,495,000	7,495,000
Financial assets measured at amortised cost:			
Balances with Central Bank of Malta	9,958,793	-	9,958,793
Loans and advances to banks and other financial institutions	225,283	-	225,283
Loans and advances to customers	2,635,998	13,137,877	15,773,875
	12,820,074	21,425,477	34,245,551
<i>Interest-bearing liabilities</i>			
Subordinated liabilities	-	4,500,000	4,500,000
Amounts owed to customers	-	11,600,000	11,600,000
Lease liabilities	-	247,471	247,471
	-	16,347,471	16,347,471
Net exposure	12,820,074	5,078,006	17,898,080

As at 31 December 2022 and 31 December 2021, the remaining balance of 'Loans and advances to banks and other financial institutions', 'Amounts owed to customers' and 'Other liabilities', are non-interest bearing and accordingly are not included in the above table. Amounts owed to banks as at 31 December 2022 are non-interest bearing and are not included in the above.

Financial instruments issued at fixed rates potentially expose the Bank to fair value interest rate risk. Balances with Central Bank of Malta, loans and advances to banks and customers, subordinated liabilities, amounts owed to customers and lease liabilities are measured at amortised cost and are therefore not subject to fair value interest rate risk. As at 31 December 2022, these investments included zero-coupon German treasury bills amounting to €11,441,178 that mature on 13 April 2023.

The Bank's instruments which are subject to fixed interest rates and that are fair valued comprise the Bank's investments in non-fixed income instruments and debt securities. This exposes the Bank to the risk of losses arising from fair value interest rate risk.

The Bank manages its interest rate risk by using sensitivity analyses, performing a full revaluation of the portfolio using an instantaneous shock which measures the potential loss in market value arising from a 200 basis-point upward parallel shift in yields. The estimated impact of an immediate 200 basis point increase in yields as at 31 December 2022 on the fair valuation of its investments in non-fixed income instruments and debt securities amounts to a loss of €0.45m (2021: €0.15m).

Financial assets and liabilities issued at variable rates expose the Bank to cash flow interest rate risk. The Bank is also exposed to cash flow interest rate risk principally in respect of financial assets that are subject to floating interest rates as well as those fixed rate financial instruments that mature in the short-term.

2. Financial risk management - continued

2.3 Market risk - continued

(b) Interest rate risk - continued

In this respect, at the end of the reporting period, if interest rates had increased/decreased by 1% (assuming a parallel shift of 100 basis points in yields) with all other variables held constant, in particular foreign currency rates, the pre-tax result for the following one year, excluding changes in fair values, would decrease/increase by €0.30m (2021: €0.13m).

The following table includes the Bank's principal financial instruments at carrying amounts, categorised by re-pricing dates, taking cognisance of the instruments' interest rate terms. The re-pricing period in respect of the Bank's interest-bearing assets and liabilities subject to fixed interest rates is equivalent to the remaining period to maturity.

	Within one month €	Within Three months but over one Month €	Within one year but over three months €	More than one year €	Total €
As at 31 December 2022					
Financial assets					
Financial assets measured at FVTPL	-	-	-	792,600	792,600
Financial assets measured at FVOCI	-	-	11,441,178	6,712,225	18,153,403
Balances with Central Bank of Malta	14,319,254	252,435	-	-	14,571,689
Loans and advances to banks and other financial institutions	-	4,930,069	-	-	4,930,069
Loans and advances to customers	-	9,055,017	4,902,995	-	13,958,012
	14,319,254	14,237,521	16,344,173	7,504,825	52,405,773
Financial liabilities					
Subordinated liabilities	-	-	-	4,500,000	4,500,000
Amounts owed to customers	-	2,000,000	6,000,000	-	8,000,000
Lease liabilities	19,975	-	62,425	94,795	177,195
	19,975	2,000,000	6,062,425	4,594,795	12,677,195
Interest rate gap	14,299,279	12,237,521	10,281,748	2,910,030	
Cumulative gap	14,299,279	26,536,800	36,818,548	39,728,578	

2. Financial risk management - continued

2.3 Market risk - continued

(b) Interest rate risk - continued

	Within one month €	Within Three months but over one Month €	Within one year but over three months €	More than one year €	Total €
As at 31 December 2021					
Financial assets					
Financial assets measured at FVTPL	-	-	792,600	-	792,600
Financial assets measured at FVOCI	-	-	135,492	7,359,508	7,495,000
Balances with Central Bank of Malta	9,958,793	-	-	-	9,958,793
Loans and advances to banks and other financial institutions	225,283	-	-	-	225,283
Loans and advances to customers	-	7,011,334	8,762,541	-	15,773,875
	10,184,076	7,011,334	9,690,633	7,359,508	34,245,55
Financial liabilities					
Subordinated liabilities	-	-	-	4,500,000	4,500,000
Amounts owed to customers	-	-	11,600,00	-	11,600,000
Lease liabilities	18,896	17,370	34,010	177,195	247,471
	18,896	17,370	11,634,010	4,677,195	16,347,471
Interest rate gap	10,066,586	7,092,558	(1,943,377)	2,682,313	
Cumulative gap	10,066,586	17,159,144	15,215,767	17,898,080	

2. Financial risk management – continued

2.4 Other risk attributable to the Bank's investments that are mandatorily measured at FVTPL

As at 31 December 2022 and 31 December 2021, the Bank's financial assets that are mandatorily measured at fair value through profit or loss comprises of a fixed rate loan to a customer that has failed the SPPI test due to a profit participation feature that enables the Bank to participate in any profit earned as a result of the activity being financed.

The interest rate element to which the Bank is exposed by virtue of originating the profit participating fixed income loan, is assessed as part of the Bank's interest rate risk management framework and considered within the respective disclosures in section 2.3. In addition, the Bank is also exposed to model risk, which is the risk of the potential for adverse consequences from business decisions informed by models, which can be exacerbated by errors in methodology, design or the way they are used.

In this respect, the directors have determined that in view of the immateriality of these assets relative to the Bank's asset base, model risk is insignificant. Accordingly, a sensitivity analysis disclosing the effect of changes to key unobservable inputs is not deemed necessary by the directors.

2.5 Liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. The consequence may be the failure to meet obligations to repay depositors and fulfil commitments.

The Bank manages this risk by maintaining a strong base of shareholders' capital considering the stage of its operations. The Bank manages its asset base with liquidity in mind and monitors future cash flows and changes in available liquidity on a regular basis.

The Bank holds a diversified portfolio of cash and high-quality highly-liquid securities to support payment obligations and contingent funding in a stressed market environment. The Bank's assets held for managing liquidity risk comprise:

- short term placements with the Central Bank of Malta; and
- unencumbered Malta Government stocks amounting to €6,712,225 (2021: €7,269,452) and German treasury bills amounting to €11,441,178 (2021: nil) that are readily acceptable as collateral for open market operations with the European Central Bank.

Liquidity is managed by the Bank's treasury function through the Bank's liquidity management process. Liquidity management includes:

- day to day funding, managed by monitoring future cash flows to ensure that requirements can be met including plans for replenishment of funds as they mature;
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
- monitoring the liquidity ratios underlying the statement of financial position against internal and regulatory requirements; and
- managing the concentration and profile of debt maturities.

Moreover, sources of liquidity are regularly reviewed by the treasury function to maintain a diversification by provider, product and term. Monitoring takes the form of cash flow projections for the next day, week and month respectively, as these are key periods for short-term liquidity management. Medium-term liquidity management is a regular subject at the meetings of the Board of directors. Built on cash flow projections on a monthly and quarterly basis, the Board steers the medium-term liquidity position of the Bank and proactively sets actions to avoid any liquidity gaps.

2. Financial risk management - continued

2.5 Liquidity risk - continued

(i) Liquidity Coverage Ratio

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

As at 31 December 2022 and 2021 and during the respective financial years, the LCR ratio was within both the regulatory minimum and the risk appetite set by the Bank.

(ii) Net stable funding ratio

The NSFR requires institutions to maintain sufficient stable funding relative to required stable funding, and reflects a bank's long-term funding profile (funding with a term of more than a year). It is designed to complement the LCR. During 2021, the Bank updated its methodology for the calculation of the NSFR to conform with the provisions of the amendments to Regulation (EU) No.575/2013, known as the Capital Requirements Regulation ('CRR II'), which became effective as from 28 June 2021. CRR II mandates a minimum NSFR requirement of 100%.

As at 31 December 2022 and 2021 and during the respective financial periods, the NSFR was within both the regulatory minimum and the risk appetite set by the Bank.

2. Financial risk management - continued

2.5 Liquidity risk - continued

The following table discloses financial assets and liabilities at the end of the reporting period by remaining period to maturity.

	Within one month €	Within three months but over one month €	Within one year but over three months €	More than one year €	No maturity €	Total €
As at 31 December 2022						
Financial assets						
Financial assets measured at FVTPL	-	-	-	792,600	-	792,600
Financial assets measured at FVOCI	-	-	11,441,178	6,712,225	-	18,153,403
Balances with Central Bank of Malta	14,319,254	-	-	-	252,435	14,571,689
Loans and advances to banks and other financial institutions	2,039,749	-	-	4,930,068	-	6,969,817
Loans and advances to customers	-	6,429,480	7,528,532	-	-	13,958,012
Accrued income and other assets	1,023	497,681	65,145	431,643	-	995,492
	16,360,026	6,927,161	19,034,855	12,866,536	252,435	55,441,013
Financial liabilities						
Subordinated liabilities	-	-	-	4,500,000	-	4,500,000
Amounts owed to banks	-	4,966,000	-	-	-	4,966,000
Amounts owed to customers	21,142,664	2,000,000	7,100,000	215,220	-	30,457,884
Other liabilities	76,256	246,405	62,745	94,795	-	480,201
	21,218,920	7,212,405	7,162,745	4,810,015	-	40,404,085
Maturity gap	(4,858,894)	(285,244)	11,872,110	8,056,521		
Cumulative gap	(4,858,894)	(5,144,138)	6,727,972	14,784,493		

2. Financial risk management - continued

2.5 Liquidity risk - continued

	Within one month €	Within three months but over one month €	Within one year but over three months €	More than one year €	No maturity €	Total €
As at 31 December 2021						
Financial assets						
Financial assets measured at FVTPL	-	-	792,600	-	-	792,600
Financial assets measured at FVOCI		-	135,492	7,359,508	-	7,495,000
Balances with Central Bank of Malta	9,860,199	-	-	-	98,594	9,958,793
Loans and advances to banks and other financial institutions	3,779,362	-	-	-	-	3,779,362
Loans and advances to customers	-	4,375,337	8,762,540	2,635,998	-	15,773,875
Accrued income and other assets	226	15,864	245,637	-	-	261,727
	13,639,787	4,391,201	9,936,269	9,995,506	98,594	38,061,357
Financial liabilities						
Subordinated liabilities	-	-	-	4,500,000	-	4,500,000
Amounts owed to customers	7,230,638	-	11,815,220	-	-	19,045,858
Other liabilities	79,022	216,497	195,574	177,195	-	668,288
	7,309,660	216,497	12,010,794	4,677,195	-	24,214,146
Maturity gap	6,330,127	4,174,704	(2,074,525)	5,318,311		
Cumulative gap	6,330,127	10,504,831	8,430,306	13,748,617		

2. Financial risk management - continued

2.5 Liquidity risk - continued

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

	Within one month €	Within three months but over one month €	Within one year but over three months €	More than one year €	Total €	Carrying amount €
As at 31 December 2022						
Subordinated liabilities	-	-	-	5,400,000	5,400,000	4,500,000
Amounts owed to banks	-	4,966,000	-	-	4,966,000	4,966,000
Amounts owed to customers	21,142,664	2,000,011	7,138,166	215,220	30,496,061	30,457,884
Other liabilities	76,839	247,578	66,623	96,508	487,548	480,201
	21,219,503	7,213,589	7,204,789	5,711,728	41,349,609	40,404,085
As at 31 December 2021						
Subordinated liabilities	-	-	-	5,625,000	5,625,000	4,500,000
Amounts owed to customers	7,230,638	-	11,999,134	-	19,229,772	19,045,858
Other liabilities	79,876	218,215	202,107	184,541	684,739	668,288
	7,310,514	218,215	12,201,241	5,809,541	25,539,511	24,214,146

As at 31 December 2022 and 2021 all of the Bank's assets were unencumbered. Accordingly, all of the Bank's financial assets are available to support potential future funding and collateral needs.

2.6 Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. The Bank's Board of directors is primarily responsible for the development and implementation of policies and procedures to ensure that operational risks are managed effectively.

The Bank mitigates the possibility of impact risk events through the implementation of a business continuity plan, which encompasses risk mitigation achieved through back-up information security infrastructures, back-up disaster recovery sites and insurance covers over particular business risks. Such systems enable the Bank to operate on an ongoing basis and limit losses in the event of severe business disruption.

For regulatory reporting purposes, the Bank currently uses the Basic Indicator Approach to assess the operational risk capital requirements and accordingly allocates 15% of average gross operating income for a three-year period in accordance with regulatory requirements. The operational risk regulatory capital requirement as at December 2022 amounted to €451,188 (2021: €412,885).

2. Financial risk management - continued

2.7 Capital risk management

The Bank's objectives when managing capital, which is a broader concept than the 'equity' as disclosed in the statement of financial position, are:

- to comply with the capital requirements set by the Malta Financial Services Authority ("MFSA");
- to safeguard the Bank's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders; and
- to maintain a strong capital base to support the development of its business.

Capital adequacy and the use of regulatory capital are monitored on an ongoing basis by the Bank's management, employing techniques based on the guidelines developed by the Basel Committee and the European Union Directives and Regulations, as implemented by the MFSA for supervisory purposes.

In terms of its banking licence conditions, the Bank is required to maintain at all times a minimum ratio of total regulatory capital to risk-weighted assets ("Capital requirements ratio") of 17.5%. This consists of an overall capital requirement ("OCR") of 16.5%, together with a Pillar 2 Guidance ("P2G") of 1%. During the year, the Bank has met all externally imposed capital requirements.

The minimum capital requirements are calculated for credit, market and operational risks. During the year, the Bank utilised the Standardised Approach for credit risk, the Basic Indicator Approach for operational risk and the Basic Method for foreign exchange risk in order to calculate the Pillar 1 minimum capital requirements. For credit risk, under the standardised approach, risk weights are determined according to credit ratings provided by internationally recognised credit agencies such as Moody's or their equivalents and by using the applicable regulatory risk weights for unrated exposures. The Basic Indicator Approach requires that the Bank allocates capital for operational risk by taking 15% of the average gross income, while the Basic Method requires the Bank to allocate 8% of its overall net foreign exchange position to calculate the capital requirement for foreign exchange risk.

2. Financial risk management - continued

2.7 Capital risk management - continued

The following table shows the components of own funds and accordingly the basis for the calculation of the Bank's capital adequacy ratio as at the date of authorisation of the financial statements for each year respectively.

	2022 €	2021 €
Common Equity Tier 1 (CET1) capital		
Share capital	10,000,000	10,000,000
Fair value reserve	(587,930)	48,706
Retained earnings	6,883,602	4,935,255
Less:		
Intangible assets	(942,660)	(646,935)
CET1 capital	15,353,012	14,337,026
Subordinated liabilities (Tier 2 capital)	3,253,012	4,152,519
Total capital / own funds	18,606,024	18,489,545

The CET 1 and Total capital disclosed above do not correspond to the capital base used to determine the Bank's CET1 and Total Capital Ratios as at the end of the financial reporting periods due to the exclusion of current year profits from the latter. Current year profits are excluded from the capital ratio calculation until they are verified by the Bank's external auditor.

2.8 Fair value of financial instruments

Financial instruments measured at fair value

The following table analyses financial instruments that are measured in the statement of financial position at fair value, by level of the following fair value measurement hierarchy. The different levels have been defined as follows:

- quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1).
- inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2).
- inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3). If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

2. Financial risk management - continued

2.8 Fair value of financial instruments - continued

Financial instruments measured at fair value - continued

The following table presents the Bank's financial instruments that are measured at fair value.

	Level 1 €	Level 2 €	Level 3 €	Total €
As at 31 December 2022				
Assets				
Financial assets measured at FVTPL	-	-	792,600	792,600
Financial assets measured at FVOCI	18,153,403	-	-	18,153,403
Total financial assets at fair value	18,153,403	-	792,600	18,946,003
As at 31 December 2021				
Assets				
Financial assets measured at FVTPL	-	-	792,600	792,600
Financial assets measured at FVOCI	7,495,000	-	-	7,495,000
Total financial assets at fair value	7,495,000	-	792,600	8,287,600

There were no transfers between levels 1, 2 and 3 during the year.

(a) Financial instruments in level 1

The fair value of financial instruments traded in active markets is based on quoted market prices at the end of the reporting period. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Bank is the current bid price.

As at 31 December 2022, instruments included in level 1 comprise debt instruments issued by the Government of Malta, foreign sovereign treasury bills and debt instruments issued by local credit institutions which are listed on the Malta Stock Exchange. As at 31 December 2021, instruments included in level 1 comprise of debt instruments issued by the Government of Malta and debt instruments issued by local credit institutions which are listed on the Malta Stock Exchange.

(b) Financial instruments in level 2

Fair values of instruments included in level 2 are based on quoted prices but in markets that are not active. As at 31 December 2022 and 31 December 2021, there were no instruments included under this hierarchy.

2. Financial risk management - continued

2.8 Fair value of financial instruments - continued

Financial instruments measured at fair value - continued

(c) Financial instruments in level 3

Fair values of instruments included in level 3 consist of instruments for which a 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 a loan to a customer that has failed the SPPI test and is therefore mandatorily measured at fair value. In view of the absence of quoted market prices or observable inputs for modelling value, the fair value of the instrument held is derived using an internal model. Unobservable inputs and assumptions in this regard include cash inflows under different scenarios, the timing of cashflows, the probability outcomes under the different scenarios and the discount rate.

In view of the immateriality of the Level 3 assets, the disclosure of unobservable inputs to Level 3 financial instruments and the sensitivity of Level 3 fair values to reasonably possible alternatives in respect of significant unobservable assumptions was not deemed necessary by the directors.

Financial instruments not measured at fair value

Loans and advances to banks and customers are carried at amortised cost in the statement of financial position. The directors consider the carrying amounts of loans and advances to customers and banks to be a reasonable estimate of their fair value principally in view of the relatively short periods to repricing or maturity from the end of the reporting periods.

The fair value of amounts owed to customers and amounts owed to banks and other financial institutions are estimated by reference to discounted cash flows, applying current interest rates offered for deposits of similar remaining maturities. The fair value of the Bank's amounts owed to customers and amounts owed to banks at 31 December 2022 and 31 December 2021 are approximately equivalent to their carrying values in view of their short period to maturity. With regards to the subordinated liabilities amounting to €4,500,000, the fair value as at 31 December 2022 was €4,410,000 (2021: €4,589,550). The fair value of these liabilities was determined by reference to the fair value of the €25,000,000 4% Secured Bonds issued by Merkanti Holding p.l.c., and as a result is considered a level 3 fair value estimate.

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

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

In the opinion of the directors, the accounting estimates and judgments made in the course of preparing these financial statements are not difficult, subjective or complex to a degree which would warrant their description as critical in terms of the requirements of IAS 1.

The directors believe there are no areas involving a higher degree of judgment that have the most significant effect on the amounts recognised in the financial statements; and there are no key assumptions and other key sources of estimation uncertainty relating to estimates that require directors' most difficult, subjective or complex judgments.

4. Balances with Central Bank of Malta and cash

	2022	2021
	€	€
Cash in hand	1,000	1,000
Balances held with Central Bank of Malta	14,571,689	9,958,793
	14,572,689	9,959,793

As at 31 December 2022, balances held with Central Bank of Malta include reserve deposits relating to the Minimum Reserve Requirement in terms of Regulation (EC) No 1745/2003 of the ECB amounting to €252,435 (2021: €98,594) bearing interest at 2% (2021: 0%). Deposits with the Central Bank amounting to €5,573,212 (2021: €3,497,303) are withdrawable on demand and were subject to an interest rate of 2% (2021: negative interest of 0.5%) per annum. The remaining deposits of €8,746,042 (2021: €6,362,896) consisted of money market placements in USD and CAD with a contractual maturity of less than seven days and with interest rates of up to 4.24% per annum.

5. Loans and advances to banks and other financial institutions

	2022	2021
	€	€
Repayable on call and at short notice	2,043,509	3,816,943
Term loans and advances	4,971,919	-
Allowances for expected credit losses	(45,611)	(37,581)
	6,969,817	3,779,362

Term loans and advances are unsecured, have been granted for a period of 18 months with a maturity date of 26 March 2024 and bear interest at a rate equal to the ECB deposit facility rate plus margin of 2.38% per annum. As at 31 December 2022, the interest rate was 3.13%. The loans are designated as lower ranking liabilities as referred to in regulation 108(4) of the Recovery and Resolution Regulations (Subsidiary Legislation 330.09).

As at 31 December 2022, the amounts due from other financial institutions amounting to €1,560,053 (2021: €2,089,481) and repayable on call and at short notice from other banks amounting to €483,456 (2021: €1,727,462) have contractual maturities of three months or less and are accordingly included in cash and cash equivalents for the purposes of the statement of cash flows (Note 26).

6. Loans and advances to customers

	2022 €	2021 €
Gross carrying amount	14,052,581	15,839,569
Allowances for expected credit losses	(94,569)	(65,694)
Net carrying amount	13,958,012	15,773,875
	2022 €	2021 €
Credit loss allowances:		
Allowances booked under Stage 1	24,463	65,694
Allowances booked under Stage 2	70,106	-
	94,569	65,694

Gross loans and advances to customers at 31 December 2022 include credit exposures with related parties amounting to €3,783,417 (2021: €7,037,204), and €10,269,164 (2021: €8,802,365) (Note 27), which is attributable to receivables exposing the Bank to credit risk with respect to a third party, which were purchased from a related party.

7. Financial assets mandatorily measured at fair value through profit or loss

	2022 €	2021 €
Loans and advances to customers	792,600	792,600
	792,600	792,600
	2022 €	2021 €
Analysed by issuer:		
- other issuers	792,600	792,600
	792,600	792,600
Listing status:		
- unlisted	792,600	792,600
	792,600	792,600

7. Financial assets measured at fair value through profit or loss - continued

Financial assets mandatorily measured at fair value through profit or loss consist of an exposure to a customer that does not qualify for measurement at either amortised cost or fair value through other comprehensive income on the basis that it failed the SPPI test as a result a profit participation feature that enables the Bank to participate in any residual profit earned from the activity being financed.

The movement in financial assets measured at fair value through profit or loss is summarised as follows:

	2022 €	2021 €
At 1 January	792,600	1,352,118
Disposals	-	(592,345)
Movement in fair value	-	-
Foreign exchange adjustments	-	32,827
At 31 December	792,600	792,600

8. Financial assets measured at fair value through other comprehensive income

	2021 €	2020 €
Treasury bills	11,441,178	-
Debt and other fixed income instruments	6,712,225	7,495,000
	18,153,403	7,495,000

Analysed by issuer:

- foreign general government	11,441,178	-
- local general government	6,493,225	7,269,452
- local credit institutions	219,000	225,548
	18,153,403	7,495,000

Listing status:

- listed on foreign stock exchanges	11,441,178	-
- listed on Malta Stock Exchange	6,712,225	7,495,000
	18,153,403	7,495,000

8. Financial assets measured at fair value through other comprehensive income - continued

The movement in financial assets measured at fair value through other comprehensive income may be summarised as follows:

	2022 €	2021 €
Year ended 31 December		
At 1 January	7,495,000	7,059,549
Acquisitions	11,454,000	1,119,300
Disposals/redemptions	(132,900)	(600,000)
Amortisation	(25,897)	(40,633)
Net fair value movements	(636,800)	(43,216)
At 31 December	18,153,403	7,495,000

As at 31 December 2022, an expected credit loss allowance amounting to €1,843 was accounted for in terms of IFRS 9 (2021: €1,895).

9. Property, plant and equipment

	Computer equipment €	Office improvements and equipment €	Right-of- Use asset €	Total €
At 1 January 2021				
Cost	423,764	84,526	409,512	917,802
Accumulated depreciation	(338,621)	(75,104)	(106,111)	(519,836)
Net book amount	85,143	9,422	303,401	397,966
Year ended 31 December 2021				
Opening net book amount	85,143	9,422	303,401	397,966
Additions	22,962	5,393	-	28,355
Disposals	(1,904)	-	(42,161)	(44,065)
Depreciation charge	(36,995)	(4,411)	(82,990)	(124,396)
Depreciation released on disposals	833	-	42,161	42,994
Closing net book amount	70,039	10,404	220,411	300,854
At 31 December 2021				
Cost	444,822	89,919	367,351	902,092
Accumulated depreciation	(374,783)	(79,515)	(146,940)	(601,238)
Net book amount	70,039	10,404	220,411	300,854

9. Property, plant and equipment - continued

	Computer equipment €	Office improvements and equipment €	Right-of- Use asset €	Total €
At 1 January 2022				
Cost	444,822	89,919	367,351	902,092
Accumulated depreciation	(374,783)	(79,515)	(146,940)	(601,238)
Net book amount	70,039	10,404	220,411	300,854
Year ended 31 December 2022				
Opening net book amount	70,039	10,404	220,411	300,854
Additions	11,131	2,146	-	13,277
Disposals	(83,768)	(13,451)	-	(97,219)
Depreciation charge	(35,713)	(4,609)	(73,470)	(113,792)
Depreciation released on disposals	83,768	13,451	-	97,219
Closing net book amount	45,457	7,941	146,941	200,339
At 31 December 2022				
Cost	372,185	78,614	367,351	818,150
Accumulated depreciation	(326,728)	(70,673)	(220,410)	(617,811)
Net book amount	45,457	7,941	146,941	200,339

On 16 January 2020, the Bank entered into a sub-lease agreement for office space with its immediate parent for a fixed period of 5 years. The right-of-use asset in respect of this lease has been included within the above table.

As at 31 December 2022 and 2021, the Bank does not have leases with contract terms shorter than one year and leases of low-value items, for which the Bank has elected not to recognise right-of-use assets.

10. Intangible assets

	Computer software €
At 1 January 2021	
Cost	263,238
Accumulated amortisation	(245,355)
Net book amount	<u>17,883</u>
Year ended 31 December 2021	
Opening net book amount	17,883
Additions	629,235
Amortisation charge	(183)
Closing net book amount	<u>646,935</u>
At 31 December 2021	
Cost	892,473
Accumulated amortisation	(245,538)
Net book amount	<u>646,935</u>
Year ended 31 December 2022	
Opening net book amount	646,935
Additions	295,725
Closing net book amount	<u>942,660</u>
At 31 December 2022	
Cost	1,188,198
Accumulated amortisation	(245,538)
Net book amount	<u>942,660</u>

As at 31 December 2022, all computer software amounting to €942,660 (2021: €629,235) related to the implementation of a new core banking system which was still in the course of development. As at 31 December 2022, the fully amortised computer software with an original cost of €245,538 is still in use.

11. Accrued income and other assets

	2022 €	2021 €
Accrued interest receivable	447,992	261,727
Other fee receivables	547,500	53,474
Prepayments	114,745	134,487
	<u>1,110,237</u>	<u>449,688</u>

Accrued interest receivables amounting to €8,246 (2021: €8,620) and other fee receivables amounting to €497,500 (2021: €53,474) are due to the Bank from related parties (Note 27).

12. Share capital

	2022 €	2021 €
Authorised		
500,000,000 Ordinary shares of €1 each	500,000,000	500,000,000
Issued and fully paid up		
10,000,000 Ordinary shares of €1 each	10,000,000	10,000,000

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at general meetings of the Bank. All shares rank equally with regard to the Bank's residual assets.

13. Fair value reserve

The fair value reserve reflects the effects of the fair value measurement of financial investments measured at fair value through other comprehensive income, net of any deferred taxes. This reserve is non-distributable.

14. Amounts owed to banks

	2022 €	2021 €
Repayable at short notice	4,966,000	-

Amounts owed to banks are repayable subject to a 35-day prior notice period and are not subject to interest.

15. Amounts owed to customers

	2022 €	2021 €
Repayable at call and short notice	21,142,664	7,230,638
Term deposits	9,315,220	11,815,220
	30,457,884	19,045,858

Amounts owed to customers include amounts of €29,947,970 (2021: €18,624,592) due by the Bank to related parties (Note 27). At 31 December 2022, term deposits amounting to €8,000,000 (2021: €11,600,000) are subject to fixed interest rates while the remaining term deposits and all amounts repayable at call and short notice are not subject to interest.

16. Subordinated liabilities

The Bank had subordinated liabilities amounting to €4,500,000 as at 31 December 2022 and 31 December 2021, which are governed by a Subordinated Loan Agreement dated 27 August 2019 entered into with the Bank's immediate parent entity. The subordinated loan has a maturity of 7 years and is subject to a fixed interest of 5% per annum. Initially, the subordinated loan was issued with a fixed interest rate of 4% per annum. This was amended to 5% per annum on 10 June 2020 in line with the original planned terms of the subordinated loan facility. It is included as Tier 2 capital following approval granted by the Malta Financial Services Authority.

17. Other liabilities

	2022 €	2021 €
Accrued interest payable	87,194	229,351
Other payables and accrued expenses	215,812	190,766
Lease liability	177,195	247,471
Expected credit losses on undrawn commitments	-	700
	480,201	668,288

Accrued interest payable amounting to €87,194 (2021: €229,351) and other payables and accrued expenses amounting to €443 (2021: €364) are due by the Bank to related parties (Note 27). Lease liabilities as at 31 December 2022 amounting to €177,195 (2021: €247,471) relate to an arrangement which the Bank had entered with the parent, Merkanti Holding p.l.c., to sub-lease the premises which the Bank subsequently started operating from during 2020. Both the lease between Merkanti Holding p.l.c. and the landlord of the offices and the sub-lease agreement are for a term of 5 years.

The following table discloses lease liabilities at the end of the reporting period by remaining period to maturity.

	2022 €	2021 €
Within one year	82,400	70,276
Between 1 year and 3 years	94,795	173,327
More than 3 years	-	3,868
At 31 December	177,195	247,471

The lease liabilities were initially measured at the present value of the remaining lease payments, discounted using the Bank's incremental borrowing rate. The movement of the lease liabilities are analysed below:

	Lease liabilities 2022 €	2021 €
As at 1 January	247,471	322,436
Repayments of lease liability	(79,381)	(87,207)
Interest expense on lease liability	9,105	12,242
At 31 December	177,195	247,471

The income statement reflects interest expense of €9,105 (2021: €12,242) in respect of the lease as well as depreciation charges in respect of the right-of-use asset amounting to €73,470 (2021: €82,990).

The total cash payments for leases in 2022 was €79,381 (2021: €87,207).

18. Commitments

	2022 €	2021 €
Undrawn standby facilities	866,583	1,845,904

The undrawn standby facilities as at 31 December 2022 and 2021 comprise entirely of undrawn credit commitments involving related parties (Note 27).

19. Interest and similar income

	2022 €	2021 €
On financial assets classified at fair value through other comprehensive income:		
- coupon interest	41,586	61,227
- net amortisation of premiums and discounts	(25,897)	(40,633)
On financial assets mandatorily measured at fair value through profit and loss	144,650	144,650
On loans and advances to banks and other financial institutions	321,349	9,905
On loans and advances to customers	1,678,796	1,689,608
	2,160,484	1,864,757

20. Interest and similar expense

	2022 €	2021 €
On loans and advances to banks and other financial institutions	11,258	37,888
On amounts owed to customers	218,020	161,707
On subordinated liabilities	225,000	225,000
On lease liabilities	9,105	12,242
	463,383	436,837

21. Fee and commission income and expense

(a) Fee and commission income

The Bank derives revenue from the provision of services, over time, as follows:

	2022 €	2021 €
Merchant banking fees	2,178,827	1,528,838
Fee income on factoring services	12,419	6,741
Account maintenance, payment services and other related fees	108,997	157,228
	2,300,243	1,692,807

(b) Fee and commission expense

	2022 €	2021 €
Other fee expense	2,864	126

22. Net trading gains

	2022 €	2021 €
Net losses on financial instruments classified as at fair value through profit or loss	-	(4,675)
Foreign exchange revaluation gains	478,513	44,792
Income from foreign exchange activities	486,407	39,787
	964,920	79,904

Net trading gains arise mainly from balances and transactions with related parties.

23. Changes in expected credit losses

	2022 €	2021 €
<i>Change in expected credit losses</i>		
- loans and advances to banks and other financial institutions	8,030	31,996
- loans and advances to customers	28,875	(83,316)
- undrawn commitments	(700)	700
- financial assets measured at fair value through other comprehensive income	(52)	1,472
	36,153	(49,148)

24. Administrative expenses

	2022 €	2021 €
Staff costs		
- Other staff salaries	1,353,491	976,481
- Social security costs	35,424	30,850
- Other staff costs	276,631	160,863
Directors' fees	296,806	265,386
Professional fees	244,131	325,620
Information technology	307,955	322,923
Depreciation of property, plant and equipment (Note 9)	113,792	124,396
Repairs and maintenance	44,615	39,504
Licenses	24,997	24,996
Utilities and janitorial expenses	4,791	4,909
Amortisation of intangible assets (Note 10)	-	183
Insurance costs	5,913	5,679
Other administrative expenses	301,008	499,303
	3,009,554	2,781,093

Other administrative expenses mainly comprise maintenance expenditure, marketing expenses and other services or expense items which are incurred during the Bank's operations.

Average number of persons employed by the Bank throughout the financial year:

	2022	2021
- Managerial	8	7
- Clerical	4	6
	12	13

24. Administrative expenses - continued

Auditor's remuneration

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

	2022 €	2021 €
Annual statutory audit	60,000	50,000
Other non-assurance services	8,000	20,000
	68,000	70,000

25. Tax expense

Current taxation

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

	2022 €	2021 €
Profit before tax	1,948,347	503,054
Tax on profit at 35%	681,921	176,069
Tax effect of:		
Expenses not deductible for tax purposes	83,477	34,612
Utilisation of unabsorbed tax losses during the current year	(765,398)	(210,681)
	-	-

Deferred taxation

At 31 December 2022, the Bank had unutilised tax losses amounting to €60.7 million (2021: €62.8 million) on which no deferred tax asset was recognised in the statement of financial position in view of the uncertainty of realisation of these tax benefits. Tax losses have no expiry date.

26. Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise the following balances with contractual maturities of not more than three months and which form an integral part of the Bank's cash management:

	2022 €	2021 €
Cash in hand	1,000	1,000
Balances held with Central Bank of Malta	14,319,254	9,860,199
Loans and advances to banks	483,456	1,727,462
Loans and advances to other financial institutions	1,560,053	2,089,481
	16,363,763	13,678,142

27. Related party transactions

Related parties of the Bank include the ultimate parent company, Scully Royalty Ltd, all entities controlled by the ultimate parent, key management personnel, close family members of key management personnel and entities which are controlled or jointly controlled by key management personnel or their close family members.

Key management personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of Merkanti Bank Limited, being the directors of the Bank.

During the year, the Bank carried out the following transactions with the ultimate parent company, its controlled entities (referred to as other related parties), the Bank's immediate parent company and its subsidiaries referred to as fellow subsidiaries and at year end had the following balances with these entities:

	2022 €	2021 €
Assets		
Loans and advances to ultimate parent company	2,650,000	2,650,000
Loans and advances to immediate parent company	-	3,600,000
Loans and advances to fellow subsidiaries	1,133,417	787,204
Accrued income and other assets	505,746	62,094
Liabilities		
Amounts owed to ultimate parent company	11,487,621	1,562,883
Amounts owed to immediate parent company	2,755,464	5,794,201
Amounts owed to fellow subsidiaries	6,552,903	6,227,186
Amounts owed to other related parties	9,151,982	5,040,322
Subordinated liabilities to immediate parent company	4,500,000	4,500,000
Other liabilities	264,832	477,186
Contingent items		
Undrawn standby facilities	866,583	1,212,796

27. Related party transactions

	2022 €	2021 €
<i>Interest income:</i>		
On loans to ultimate parent company	188,076	188,813
On loans to immediate parent company	45,250	91,250
On loans to fellow subsidiaries	51,176	322,888
On loans to other related parties	1,386,916	1,060,011
<i>Fee and commission income:</i>		
From ultimate parent company	172,234	659,707
From immediate parent company	4,640	5,703
From fellow subsidiaries	7,185	25,099
From other related parties	2,113,304	882,013
<i>Interest expense:</i>		
On amounts owed to immediate parent company	228,828	231,216
On amounts owed to fellow subsidiaries	112,542	112,542
On amounts owed to other related parties	101,650	42,950
On lease liability with immediate parent company	9,105	12,140
<i>Net income from foreign exchange activities:</i>		
On transactions with ultimate parent company	81,280	9,554
On transactions with parent company	2,583	17,278
On transactions with fellow subsidiaries	325	-
On transactions with other related parties	976,873	6,213
Administrative expenses	92,564	94,604

Key management personnel compensation, consisting of directors' remuneration, has been disclosed in Note 24 to these financial statements. Directors' emoluments comprise solely of short-term employee benefits.

As at 31 December 2022, the Group has loans and advances to customers amounting to €10,269,164 (2021: €8,802,365) which is attributable to receivables exposing the Bank to credit risk with respect to a third-party but which were purchased from a related party. The income with respect to the purchased receivable charged to the related party amounting to €1,331,512 (2021: €1,038,764) is included under "Interest income on loans to other related parties" in the table above.

28. Statutory information

Merkanti Bank Limited is a limited liability company and is incorporated in Malta, having its registered address at Aragon House Business Centre, Dragonara Road, St Julian's, STJ 2140, Malta.

The immediate parent company of Merkanti Bank Limited is Merkanti Holding p.l.c., a company registered in Malta that owns all the shares of Merkanti Bank Limited with the exception of one share held by Scully Royalty Ltd. Its registered address is Aragon Business Centre, Dragonara Road, St Julians, Malta.

Merkanti Bank Limited is ultimately owned by Scully Royalty Ltd, a company registered in The Cayman Islands under registration number HS-323455 and having its registered office at Vistra (Cayman) Ltd, P.O. Box 31119, Grand Pavilion, Hibiscus Way, 802 West Bay Road, Grand Cayman Ky1-1205, Cayman Islands. Scully Royalty Ltd is listed under the New York Stock Exchange (NYSE: SRL).

The financial statements of Merkanti Bank Limited are included in the consolidated financial statements of its immediate parent Merkanti Holding p.l.c. and ultimately of Scully Royalty Ltd, which are prepared in accordance with the requirements of International Financial Reporting Standards.

Additional Regulatory Disclosures
31 December 2022

1. Risk management

1.1 Overview of risk disclosures

The Additional Regulatory Disclosures ('ARDs') were prepared by the Bank in accordance with the Pillar 3 quantitative and qualitative disclosure requirements as governed by Banking Rule 07 ('BR/07'): Publication of Annual Report and Audited Financial Statements of Credit Institutions authorised under the Banking Act (Cap. 371), issued by the Malta Financial Services Authority. These Disclosures have been prepared in accordance with the requirements of Part Eight of the EU Regulation 876/2019 of the European Parliament and of the Council of 20 May 2019 amending regulation (EU) No 575/2013 (Capital Requirements Regulation 2 – "CRR 2"). These ARDs will be published on an annual basis as part of the Annual Report of the Bank and seek to increase public disclosure relative to a Bank's capital structure and adequacy as well as its risk management policies and practices.

In line with the banking regulatory requirements, these ARDs are not subject to an external audit, except to the extent that any disclosures are equivalent to those made in the Financial Statements which are prepared in accordance with the requirements of International Financial Reporting Standards ('IFRS') as adopted by the EU. Through internal verification procedures the Bank ensures that these disclosures are presented fairly.

1.2 Risk management framework

Risk Management is an integral part of the Bank's strategy and is embedded in the Bank's Risk Appetite Statement, policies and frameworks, which are approved by the Board of Directors on an annual basis. The Bank monitors its risk profile using a number of metrics as adopted through its Risk Tolerance and Limits Statement that establishes limits for a number of risks, based on both regulatory and internally established thresholds. Such limits and thresholds are monitored on a regular basis and reported to the Board of Directors through the Risk Committee at least on a monthly basis, or more frequently in case of possible breaches in line with the Bank's escalation procedures. The Board of Directors has the overall responsibility for the establishment and oversight of the Bank's risk management framework. The risk management framework is a core component necessary for the financial soundness and stability of the Bank's business model.

The business model adopted by the Bank throughout the years has been primarily based on corporate banking and structured finance transactions consistent with its previous parent group business strategy. Following the change in shareholders in 2016, the Bank maintained its corporate banking business lines, but refocused its main business model on speciality banking services, primarily focused on merchant banking activities.

The Bank is committed to creating added value for its shareholders and in keeping with this mission, the Bank's strategy targets sustainable growth and an acceptable risk profile. In this respect, the Bank's return on assets calculated as its net profit, expressed as a percentage of average total assets, for the reporting period ended 31 December 2022 was 4.18%.

The Bank takes on risk with the aim of generating profits and therefore considers risk management a core competency that helps produce higher returns for its various stakeholders. The Bank bases its risk management objectives and policies on international guidelines, such as the Basel III Accord, corresponding Directives and Regulations of the European Union, including technical standards, as well as contemporary international banking practices. In this respect, the Board of Directors deems the risk management framework adopted by the Bank to be adequate and hence gives assurance to the Bank's stakeholders that the risk management systems adopted by the Bank are appropriate in relation to the Bank's risk profile and strategy.

1. Risk management - continued

1.3 Risk governance structure

The Board of Directors are responsible for all risks emanating from the Bank's business and for all related internal controls applied to mitigate such risks. The Board of Directors has resolved to set up the following Board Committees and Executive Committees to assist it in the oversight of its functions:

Board Committees	Executive Committees
Risk Committee	Business Committee
Audit Committee	IT Steering Committee
Corporate Governance Committee	AML/ATF Executive Committee
Nomination and Remuneration Committee	

The Bank adopts the three lines model, having its business generating unit as the first line, the Risk and Compliance units as the second line and its outsourced Internal Audit function as the third line. The Bank's key personnel have a direct reporting line to the Chairman of their designated committees (as highlighted in the terms of reference of each of the above listed committees) and report to the Chief Executive Officer on an administrative basis.

The Risk management function is responsible for ensuring that the Bank maintains a sound overall risk management programme, the development of appropriate risk management policies together with the Board of Directors of the Bank, developing appropriate reporting mechanisms and tools and monitoring compliance with the various policies and regulatory requirements, evaluating and monitoring the overall quality of the Bank's risks, capital adequacy, identifying any trends related to risk and implementing stress tests.

The Bank's Risk management function is also responsible for the implementation of the risk strategy as approved by the Board of Directors or as delegated through the Risk Committee.

1.4 Risk reporting and risk monitoring

The Bank has in place a robust and extensive risk management reporting framework, which emphasises the importance of regular reporting enabling the directors to have a clear picture on the key risks that the Bank is faced with and to take corrective action in a timely manner.

The Bank has adopted a suite of frameworks and policies based on regulatory requirements and which help it mitigate and monitor its various limits and thresholds that have been established through its Risk Tolerance and Limits Statement and Risk Appetite Statement. It also has systems in place which provide up-to-date information and help to best assess and measure various risks so as to be in a better position to mitigate such risks.

1.5 Risk disclosure and Measurement Systems

The Bank's main objective is to provide responsible and tailor-made finance solutions through its variety of specialty trade and structured products, which include corporate loans and deposits, payment services, guarantees and commitments, factoring services, and merchant banking (also referred to as corporate finance advice, including structured finance solutions and dispute resolution business). The risk management framework and control processes are tailor-made to safeguard against inherent risks emanating from such business and in the markets in which the Bank operates. The Board acknowledges that such controls need to be reviewed periodically and be upgraded to reflect changes in economic developments.

1. Risk management - continued

1.5 Risk disclosure and measurement systems - continued

The Bank's Risk Appetite Statement (RAS) clearly highlights the general principles for the Bank's risk-taking, to raise risk awareness across the organisation, and to guide staff regarding accepted and unacceptable practices. The RAS is embedded in the Bank's everyday processes and affects the operations of the Bank in a holistic way through its various policies and procedures, monitoring metrics, key performance indicators, key risk indicators and internal controls.

The Bank seeks to protect and build up its capital in order to support an enhanced range of activities and enable the Bank to withstand negative impact to its capital due to potential financial losses resulting from credit, market or other financial risks. The Bank follows the MFSA and EBA Regulations and Guidelines and market practice with regards to corporate governance requirements, and banking regulations. Additional reinforcement comes from the wider objectives of the Bank, whereby the Bank wishes to deploy capital appropriately, to achieve adequate overall return on the risks borne, to support its financial sustainability, and to mitigate against potential losses that would deplete its operational capacity.

The Bank's overall framework for identification and management of risks includes risk control activities performed within the functions within the first line roles, and independent checks done by the various roles within the second line functions with control responsibilities for matters falling into their areas of competence, including risk management in respect of the various risks of the Bank which include but are not limited to credit, market, liquidity, capital management, AML/ATF risks, operational risks, conduct and integrity risks. Any deviations from the Bank's RAS are approved by the Board accordingly.

The Bank has a core banking platform, together with various other product specific systems which support the needs of the operations and payments department and other control functions, including Risk, Compliance and AML.

1.6 Management of each separate category of risk and mitigating measures

Credit risk - The Bank is exposed to credit risk primarily through corporate lending, trade finance (which include guarantees and commitments and factoring services) and merchant banking (which includes both structured finance solutions and litigation financing).

The Bank protects itself from idiosyncratic (transaction specific) credit risk related to the above-mentioned credit facilities/transactions by carefully assessing each individual facility and taking CRR eligible and other collateral when deemed necessary, and by requiring specific covenants and reporting obligations. In the case of litigation finance the Bank also uses the outsourced legal advisory assistance and other external legal advice specialised in the field and in the specific jurisdiction to have a better visibility on the success of the proposed litigation case before this is financed.

With regards to systemic (correlated) credit risk, the Bank adopts credit limits for transactions, single obligor counterparties and groups of counterparties with slightly stricter thresholds than those required through regulations. These include also country limits which are approved at Board level.

Market risk - Market risk primarily results from the Bank's investment portfolio. However, there are other aspects of market risk which include but are not limited to interest rate risk and foreign exchange risk.

1. Risk management - continued

1.6 Management of each separate category of risk and mitigating measures - continued

Structural interest rate risk is inherent to banking and is due to the possibility of incurring losses as a result of the impact of interest rate fluctuations on the income statement (revenues and expenses) and on the equity structure (current value of assets, liabilities and off-balance sheet positions that are sensitive to interest rate fluctuations).

The Bank has in place an interest rate management strategy consisting of the following:

- a) measuring the effects on net interest income and the economic value of assets and measures the vulnerabilities to potential losses deriving from the interest rate risks for banking book (IRRBB) under different stress scenarios; and
- b) adhering to the processes, metrics, limits reporting and governance covered by the IRRBB strategy which complies with the regulatory requirements.

The Bank is exposed to foreign exchange (FX) risk as it deals in a number of currencies, which mainly include US Dollar, Sterling, and Canadian dollar. The risk arises from changes in the market exchange rates between the above-mentioned currencies and the Euro, which could result in losses in financial investments or other facilities. FX limits are established and approved at Board level and documented in policies and procedures so as to control and mitigate the exposure to FX. FX hedges are considered when deemed necessary. Foreign exchange risk is monitored daily and reports on current risk levels and on compliance with the above-mentioned established limits are provided to the Board Committees periodically.

Operational risk - exist in the normal course of business and could impact the Bank's clients and/or its ability to serve them. Operational risk could result in financial losses or possibly reputational risk (identified as a separate risk), which could affect the Bank's business performance and may weaken its standing with stakeholders. Sub-classifications of such risks include process risk, fraud risk, conduct risk and people risk.

Merkanti Bank manages incidents through identification, reporting and resolution in order to prevent risk events from recurring. Incidents of a sensitive and serious nature are escalated to the Board of Directors through one of the Board appointed Committees depending on the nature of the issue.

Liquidity risk - The Bank is exposed to liquidity risk due to the possibility of losses being incurred as a result of not being able (even though temporarily) to honour payment commitments when they fall due as a result of a lack of liquid assets or not being able to access the markets to refinance debts at a reasonable cost. The Bank currently has excess liquidity and therefore such risk is considered to be low.

2. Credit risk

2.1 Credit risk management

In order to minimise the credit risk undertaken in examining a counterparty's creditworthiness, country risk, quantitative and qualitative characteristics, as well as the industry sector in which the counterparty operates are considered. The Bank has also set limits of authority and has segregation of duties in place so as to maintain impartiality and independence during the approval process and to control new and existing credit facilities. Credit review procedures are designed to identify at an early stage exposures which require more detailed monitoring and review.

The Bank's principal credit risk exposures reflecting the maximum exposure to credit risk before collateral held or other credit enhancements in accordance with the regulatory information submitted to the MFSA are as follows:

	2022 Average exposure value €	2022 Year end exposure value €
Central Government or central banks	23,092,239	32,506,092
Institutions	4,248,137	5,628,764
Corporates	17,884,776	16,483,982
Other items	1,929,476	996,492
	47,154,628	55,615,330

The exposures set out in the preceding table are based on the sum of on-balance sheet exposures and off-balance sheet exposures adjusted for the credit conversion factors stipulated within Article 111(1) of the CRR. The off-balance sheet exposures comprise undrawn standby credit facilities.

Credit risk exposures analysed by residual maturity

	Within one month €	Within three months but over one month €	Within one year but over three months €	More than one year €	No maturity €	Total €
As at 31 December 2022						
Central Government or central banks	14,319,254	-	-	17,934,403	252,435	32,506,092
Institutions	5,409,764	-	-	219,000	-	5,628,764
Corporates	1,733,370	7,700,283	7,050,329	-	-	16,483,982
Other items	2,023	497,681	65,145	431,643	-	996,492
Total	21,464,411	8,197,964	7,115,474	18,585,046	252,435	55,615,330

2. Credit risk - continued

2.2 Concentration risk

Concentration risk arises as a result of the concentration of exposures within the same category, whether it is geographical location, business product or counterparty type. These risks are managed through adherence to Board approved lending criteria.

The Bank has a concentration of credit risk with respect to its loans and advances to customers since €10,269,164 (2021: €8,802,365) of the total loans and advances are due from a single counterparty. This concentration risk is however mitigated through cash collateral amounting to €7,100,000 (2021: €6,000,000). As at 31 December 2022, an amount of €14,419,164 (2021: €17,052,365) included in loans and advances to customers were deemed to be large exposures for regulatory reporting purposes in accordance with the requirements the CRR. This amount includes on-balance sheet and off-balance sheet exposures before credit risk provisions and credit conversion factors.

Exposures analysed by location/geographical region

The Bank monitors concentrations of credit risk by location. The geographical concentration of the Bank's exposure classes as at the end of the reporting period is analysed in the following table. For the purposes of this table, the Bank has allocated exposures classes to regions based on the country of domicile of the counterparties or customers.

Exposures analysed by location/geographical region

As at 31 December 2022	Malta	Other EU countries	Rest of world	Total
	€	€	€	€
Central Government or central banks	21,064,914	11,441,178	-	32,506,092
Institutions	5,628,764	-	-	5,628,764
Corporates	2,866,787	792,600	12,824,595	16,483,982
Other items	100,837	389,911	505,744	996,492
Total	29,661,302	12,623,689	13,330,339	55,615,330

Exposures analysed by industry

The following is an analysis of the industry concentrations relating to the Bank's exposure classes.

	Central Government or central banks	Institutions	Corporates	Other items	Total
	€	€	€	€	€
As at 31 December 2022					
Government	32,506,092	-	-	5,553	32,511,645
Financial and insurance activities	-	5,628,764	5,492,324	52,529	11,173,617
Activities relating to mining lease royalties	-	-	10,199,058	-	10,199,058
Professional, scientific and technical activities	-	-	792,600	389,910	1,182,510
Others	-	-	-	548,500	548,500
Total	32,506,092	5,628,764	16,483,982	996,492	55,615,330

2. Credit risk - continued

2.2 Concentration risk - continued

As outlined previously, the Bank monitors these exposures on an individual basis throughout the different stages of the cycle from approval upon origination to ongoing monitoring until maturity. The Bank focuses on the compilation, together with ongoing and event-driven updating, of credit review analyses taking cognisance of actual account developments, repayment history, ability to meet commitments, collateral measurement, credit reviews and country risk.

Counterparty banks' risk

The Bank runs the risk of loss of funds due to the possible delay in the repayment of existing and future obligations by counterparty banks. Within its daily operations the Bank transacts with banks and other financial institutions which are pre-approved and subject to a limits framework. In the normal course of business, the Bank places deposits and enters into foreign exchange derivative contracts with credit institutions of international repute. By conducting these transactions, the Bank is running the risk of losing funds due to the possible delays in the repayment to the Bank of the existing and future obligations of the counterparty banks. The positions are checked against the limits on a regular basis.

Country risk

The Bank runs the risk of loss of funds due to the possible political, economic and other events in a particular country where funds have been placed or invested with several counterparties. Countries are assessed according to their size, economic data and prospects and their credit ratings from international rating agencies. Existing country risk exposures are monitored and reviewed periodically.

2.3 Use of external credit assessment institutions

The Bank uses external credit assessment institutions ("ECAIs") in calculating its risk-weighted exposure amounts for Central governments or central banks, Institutions and Corporates for which a credit assessment is available. The credit quality of such exposures is determined by reference to credit ratings applicable to issuers published by the Bank's nominated rating agencies (Moody's, Standard & Poors and Fitch). The Bank then derives the applicable rating using a second-best basis. The Bank maps the derived rating to the credit quality steps prescribed under CRR Regulation (EU) 2016/1799. The following table represents the exposure values for which an ECAI is used:

At 31 December 2022	Credit quality step	Central governments or central banks	Institutions	Corporates	Total
		€	€	€	€
AAA to AA-	1	11,441,178	-	-	11,441,178
A+ to A-	2	21,064,914	-	-	21,064,914
BBB+ to BBB-	3	-	386,277	-	386,277
B+ to B-	5	-	-	-	-
CCC+ and below	6	-	-	10,199,058	10,199,058
Not rated		-	5,242,487	6,284,924	11,527,411
Total		32,506,092	5,628,764	16,483,982	54,618,838

2. Credit risk - continued

2.4 Credit quality of the Bank's financial assets

Loans and advances to customers

The Bank's Treasury and Operations Department monitors loans and advances to customers on an individual basis throughout the different stages of the cycle, from approval upon origination until maturity. As highlighted previously, the Bank focuses on the compilation, together with ongoing and event-driven updating of credit review analyses taking cognisance of actual account developments, repayment history, ability to meet commitments and collateral measurement.

With respect to loans and advances to customers, the Bank reviews and grades loans and advances in accordance with internal credit gradings. The Bank's internal credit system is based on a number of different qualitative and quantitative data, which takes into consideration the following criteria:

- financial strength and profitability;
- servicing of interest;
- market position, dependence and industry environment; and
- other criteria e.g. management organisation and access to capital markets/other financing.

In addition to the above, the Bank also grades its loan and advances portfolio into two main external reporting categories: 'performing' and 'non-performing'. 'Performing' customers represent those customers with exposures which are less than 90 days past due, whilst 'Non-performing' customers are those customers with exposures which are past due by 90 days or more. The 'Performing' category is further sub-divided into sub-categories based on (a) past due days and (b) renegotiated loans.

Loans are considered past due when a counterparty has failed to make a payment when contractually due. Past due but not impaired loans comprise loans and advances where contractual interest or principal payments are past due, but the Bank believes that impairment is not appropriate on the basis of the level of security available and/or the stage of collection of amounts owed to the Bank.

As at 31 December 2022 and 31 December 2021, loans and advances to corporate customers were deemed to be fully performing. The Bank did not hold any renegotiated financial assets as at the end of the reporting period.

Impaired loans and advances to customers represent those advances which are either more than 90 days past due, or for which the Bank has determined that it is probable that it will be unable to collect all principal and interest due as prescribed within the contractual terms of the loans and advances agreement(s). During the period under review, there were no write offs on any loans and advances to customers (2021: nil).

Financial investments

As part of its treasury management activities the Bank invests in debt instruments issued by local and foreign governments. Such instruments are listed and accordingly the quality of these assets is monitored through the use of external ratings (see note 2.4 above). These transactions are also monitored through the practical use of exposure limits, and by utilising industry standard pricing tools currently subscribed to by the Bank.

2. Credit risk - continued

2.5 Credit risk mitigation techniques

The Bank's approach when granting credit facilities is based on the customer's capacity to repay rather than placing primary reliance on credit risk mitigants. Notwithstanding, as part of the Bank's credit risk mitigation techniques, the Bank generally holds collateral against loans and advances to customers, the nature and level of which generally depends on the amount of the exposure, the type of facility provided, the term of the facility and the level of credit risk involved. Collateral utilised to secure loans and advances generally includes guarantees and the assignments of receivables.

As at 31 December 2022, the Bank held €8,233,417 (2021: €10,387,204) eligible collateral in terms of CRD IV collateral eligibility requirements on the total customer loan exposure of €13,958,012 (2021: €15,773,875).

3. Market risk

Market risk for the Bank consists of the following elements:

- Interest rate risk, which is the risk of losses because of changes in interest rates; and
- Foreign exchange risk, which is the risk of losses on the Bank's positions in foreign currency because of changes in exchange rates.

3.1 Interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates.

The Bank's exposure to interest rate risk is analysed in the table below:

	Floating rates €	Fixed rates €	Total €
At 31 December 2022			
Financial assets	13,381,253	39,024,520	52,405,773
Financial liabilities	-	12,677,195	12,677,195
Net exposure	13,381,253	26,347,325	39,728,578

The Bank's Senior Management is responsible for the management of interest rate risk and for actively monitoring the interest rate risk measures used by the Bank, by reporting on a regular basis to the Board. Responsibility for day-to-day interest rate risk management is allocated to the Treasury function. The Bank's risk oversight function provides oversight with respect to the interest rate risk management process, by ensuring its design is appropriate and functioning properly.

Financial instruments issued at fixed rates potentially expose the Bank to fair value interest rate risk. Loans and advances to customers and to banks, and amounts owed to customers are measured at amortised cost and are therefore not subject to fair value interest rate risk.

The Bank's instruments that are fair valued comprise principally of debt securities measured at fair value through other comprehensive income. As at 31 December 2022 and 31 December 2021, all of the Bank's debt securities were subject to fixed interest rates. The debt securities as at 31 December 2022 include zero-coupon German treasury bills amounting €11,441,178 that mature on 13 April 2023.

3. Market risk - continued

3.1 Interest rate risk - continued

The Bank manages interest rate risk by utilising sensitivity analysis based on modified duration, which measures the potential loss in market value arising from a 200 basis-point upward parallel shift in yields. The estimated impact of an immediate 200 basis point increase in yields as at 31 December 2022 amounts to a loss of €0.45m (2021: loss of €0.15m).

The Bank is exposed to cash flow interest rate risk principally in respect of certain financial instruments which were subject to floating interest rates. Financial assets and liabilities issued at variable rates expose the Bank to cash flow interest rate risk. Cashflow interest rate risk is measured and monitored by reference to a sensitivity analysis in respect of interest rate changes in relation to the Bank's net floating rate assets or liabilities.

At the end of the reporting period, if interest rates had increased by 1% (assuming a parallel shift of 100 basis points in yields) with all other variables held constant, in particular foreign currency rates, the post-tax result for the year would increase by €0.30m (2021: increase by €0.13m).

The following table summarises the Bank's exposures to interest rate risk. It includes the entity's financial instruments at carrying amounts, categorised by re-pricing dates, taking cognisance of the instruments' interest rate terms. For the entity's interest-bearing assets and liabilities that are mainly subject to fixed interest rates, the re-pricing periods are generally equivalent to the remaining period to maturity.

	Within one month €	Within three months but over one month €	Within one year but over three months €	More than one year €	Total €
As at 31 December 2022					
Financial assets	14,319,254	14,237,521	16,344,173	7,504,825	52,405,773
Financial liabilities	19,975	2,000,000	6,062,425	4,594,795	12,677,195
Interest rate gap	14,299,279	12,237,521	10,281,748	2,910,030	
Cumulative gap	14,299,279	26,536,800	36,818,548	39,728,578	

3.2 Currency risk

The Bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. Foreign exchange risk is the risk to earnings and value caused by a change in foreign exchange rates. Foreign exchange risk arises when financial assets or liabilities are denominated in currencies which are different from the Bank's functional currency.

The Bank manages its currency risk on an ongoing basis by ensuring that foreign currency liabilities are utilised to fund assets denominated in the same foreign currency thereby matching asset and liability positions as much as is practicable. When it is not possible to match the asset and liability currency positions, the Bank normally hedges its open foreign exchange exposures arising from customer loans by entering into forward foreign exchange contracts with terms which match those of the hedged items, with a view to reducing exposures within a limit management framework.

3. Market risk - continued

3.2 Currency risk - continued

The Bank's treasury function is responsible for the effective management of foreign exchange risks, ensuring exposures to foreign currencies are maintained within the limits set by the Bank's Board. The Board sets these limits on the level of exposure by currency and in aggregate for both overnight and intra-day positions, which are actively monitored and reported on a regular basis. The Bank's risk oversight function provides oversight with respect to the foreign exchange risk management process, by ensuring its design is appropriate and functioning properly.

The following table summarises the Bank's exposure to foreign currency exchange rate risk at 31 December. Included in the table are the Bank's financial instruments at carrying amounts, categorised by currency.

	EUR €	USD €	CAD €	GBP €	Total €
As at 31 December 2022					
Financial assets	35,620,614	8,713,348	11,105,959	2,092	55,442,013
Financial liabilities	32,058,421	8,136,326	84,065	125,273	40,404,085
Contractual repayment option	10,199,058	-	(10,199,058)	-	-
Net open foreign currency position	13,761,251	577,022	822,836	(123,181)	

3.3 Trading book risks

The Bank does not maintain any trading book positions and consequently, exposure to trading book risks is negligible.

4. Liquidity risk

4.1 Management of liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. The consequence may be the failure to meet obligations to repay depositors and fulfil commitments.

The Bank manages this risk by maintaining a strong base of shareholders' capital. The Bank manages and monitors future cash flow requirements and changes in available liquidity on a regular basis.

The Bank holds a diversified portfolio of cash and high-quality highly-liquid securities to support payment obligations and contingent funding in a stressed market environment. The Bank's assets held for managing liquidity risk comprise:

- short term placements with other banks; and
- unencumbered debt securities amounting to €17,814,291, representing eligible market value before applicable haircuts (2021: €7,191,470) that are readily acceptable for refinancing operations within the Eurosystem's open market operations.

4. Liquidity risk - continued

4.1 Management of liquidity risk - continued

Liquidity is managed by the Bank's treasury and liquidity management process, and includes:

- day to day funding managed by monitoring future cash flows to ensure that requirements can be met including plans for replenishment of funds as they mature;
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
- monitoring the liquidity ratios against internal and regulatory requirements; and
- managing the concentration and profile of debt maturities.

The Bank's liquidity monitoring is centralised, based on the combined liquidity requirements of the Bank's customer loan, deposit and own account investment business lines.

The Bank's liquidity risk is managed in line with the requirements of the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). The table below summarises the LCR and NSFR ratios as at 31 December 2022 and 31 December 2021 respectively:

	2022	2021
Liquidity coverage ratio (LCR)	670%	2120%
Net stable funding ratio (NSFR)	227%	277%

The Bank adopts a system of early warning and recovery indicators for the LCR and NSFR metrics and ensures that it operates above the prescribed early warning indicators. Ongoing liquidity management falls under the responsibility of the Operations and Treasury Department. It analyses known and expected cash flows and uses these to devise liquidity planning whilst always taking into account compliance with regulatory and internal liquidity principles. Strategic liquidity planning falls under the responsibility of the asset and liability management (ALM) function within the Bank's Business Committee, which ultimately reports to the Bank's Board.

4.2 Analysis by residual maturity

The following table discloses financial assets and liabilities at the end of the reporting period by remaining period to maturity.

	Within one month	Within three months but over one month	Within one year but over three months	More than one year	No maturity	Total
	€	€	€	€	€	€
As at 31 December 2022						
Central Government or central banks	14,319,254	-	11,441,178	6,493,225	252,435	32,506,092
Institutions	479,696	-	-	5,149,068	-	5,628,764
Corporates	1,560,053	7,700,283	6,257,729	792,600	-	16,310,665
Other items	1,023	497,681	65,145	431,643	-	995,492
Financial assets	16,360,026	8,197,964	17,764,052	12,866,536	252,435	55,188,578

4. Liquidity risk - continued

4.2 Analysis by residual maturity - continued

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

	Within one month €	Within three months but over one month €	Within one year but over three months €	More than one year €	Total €	Carrying Amount €
As at 31 December 2022						
Subordinated liabilities	-	-	-	5,400,000	5,400,000	4,500,000
Amounts owed to banks	-	4,966,000	-	-	4,966,000	4,966,000
Amounts owed to customers	21,142,664	-	9,138,177	215,220	30,496,061	30,457,884
Other liabilities	76,839	247,578	66,623	96,508	487,547	480,201
Financial liabilities	21,219,503	5,213,578	9,204,800	5,711,728	41,349,608	40,404,085

4.3 Contingency Funding

The Bank's main source of stable funding is predominantly sourced from shareholder's equity and corporate deposits. The following options aim to address a scenario where contingency funding is required:

- a. Shareholder's loans / contributions by the current shareholders of the Bank; and
- b. Open market operations with the European Central Bank (MROs or LTROs).

4.4 Internal liquidity adequacy assessment process (ILAAP)

The ILAAP process is a forward-looking exercise in which the Bank assesses the sufficiency of its liquid assets to services existing and foreseeable commitments as they arise. In addition, the ILAAP process also incorporates liquidity stress testing to assess liquidity adequacy with the purpose to evaluate sensitivity to relevant market and bank specific factors and to ensure adequate liquidity buffers available towards stress.

The Bank submits its ILAAP report to the MFSA on an annual basis. The preparation of the ILAAP is carried out by the Senior Management of the Bank and is ultimately endorsed and approved by the Board. The ILAAP process, together with the level of ongoing internal liquidity management reporting, ensures that the Bank's liquidity risk management systems are adequate taking into account the Bank's liquidity risk profile and business strategy.

5. Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. The Bank's Board of directors is primarily responsible to ensure that (i) approved policies and procedures are in line with laws, regulations and best practice and that (ii) the Bank has adequate internal controls, and that such policies, procedures and internal controls are being adhered to so as to ensure that operational risks are mitigated and managed effectively. The Bank mitigates the possibility of impact risk events through the implementation of a business continuity plan, which encompasses risk mitigation achieved through back-up information security infrastructures, back-up disaster recovery sites and insurance covers over particular business risks. Such systems enable the Bank to operate on an ongoing basis and limit losses in the event of severe business disruption.

The Bank's management of operational risk relies on a framework of policies and procedures implemented across the Bank's operational functions through transaction processing and business execution. The implementation of these policies and procedures is overseen by the Bank's risk oversight function. Regular reporting of operational risk events to the Board of directors is carried when required.

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 operational risk regulatory capital requirement as at December 2022 amounted to €451,188, based on the preceding three financial years 2019, 2020 and 2021 (2021: €412,885 based on the preceding three financial years 2018, 2019 and 2020).

6. Capital risk management

The Bank's objectives when managing capital, which is a broader concept than the 'equity' as disclosed in the statement of financial position, are:

- to comply with the capital requirements set out in the CRD and the CRR;
- to safeguard the Bank's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders; and
- to maintain a strong capital base to support the development of its business.

Capital adequacy and the use of regulatory capital are monitored on an ongoing basis by the Bank's management, employing techniques based on guidelines established by European Union Regulations and Directives, as implemented by the MFSA for supervisory purposes. The Bank's capital risk management is based on the regulatory requirements established within the CRR and by local regulations which are modelled on the requisites of the CRD rules.

The Bank's Senior Management is primarily responsible for the Bank's capital risk management process. Capital adequacy ratios together with the level and quality of own funds are reported on a regular basis to the Board of directors by the Finance function.

In terms of the MFSA's current Supervisory Review and Evaluation Process ("SREP") requirements, the Bank is obliged to maintain an overall capital requirement (OCR) of 16.5%. The Bank is also required to take into account a Pillar 2 Guidance of 1% over and above the OCR of 16.5%, resulting in a total capital requirement ratio of 17.5%.

6. Capital risk management – continued

The minimum capital requirements are calculated for credit, market and operational risks. During the year, the Bank utilised the Standardised Approach for credit risk, the Basic Indicator Approach for operational risk and the Basic Method for foreign exchange risk in order to calculate the Pillar 1 minimum capital requirements. For credit risk, under the standardised approach risk weights are determined according to credit ratings provided by internationally recognised credit agencies such as Moody's or their equivalents and by using the applicable regulatory risk weights for unrated exposures. The Basic Indicator Approach requires that the Bank allocates capital for operational risk by taking 15% of the average gross income, while the Basic Method requires the Bank to allocate 8% of its overall net foreign exchange position to calculate the capital requirement for foreign exchange risk.

6.1 Own funds

The level of own funds represents the Bank's available capital and reserves for the purposes of assessing capital adequacy from a regulatory perspective. The total capital ratio is a measure of the long-term financial strength of a bank, usually expressed as a ratio of its own funds or capital to the measure of the Bank's assets. The Bank has processes to ensure that the minimum regulatory requirements in relation to own funds are met at all times, through the assessment of its capital resources and requirements. During the financial period ended 31 December 2022, the Bank has complied with all the externally imposed capital requirements to which it was subject.

In July 2013, the European Banking Authority ("EBA") issued its Implementing Technical Standards ("ITS") on own funds disclosures. The disclosure requirements of these technical standards have been integrated within the Bank's disclosures set out below.

For regulatory purposes, the Bank's capital base is composed solely of Common Equity Tier 1 ("CET1") capital. The Bank's CET1 capital includes ordinary share capital, retained earnings and other regulatory adjustments relating to items that are included in equity but treated differently for capital adequacy purposes, including deductions relating to intangible assets and transitional adjustments relating to the fair value reserve on fair value through other comprehensive income financial assets. The Bank does not maintain a Reserve for General Banking Risks, since it does not have loans and advances which are classified as "Non-performing".

(a) Share capital

The Bank's share capital as at 31 December are analysed as follows:

	2022 €	2021 €
Authorised		
500,000,000 Ordinary shares of €1 each	500,000,000	500,000,000
Issued and fully paid up		
10,000,000 Ordinary shares of €1 each	10,000,000	10,000,000

The holders of Ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Bank. All shares rank equally with regard to the Bank's residual assets.

(b) Retained earnings

The retained earnings represent earnings not paid out as dividends.

Retained earnings form part of Own funds only if those profits have been verified by the Bank's independent external auditor.

6. Capital risk management - continued

6.1 Own funds - continued

(c) Fair value reserve

This represents the cumulative net change in fair values of financial assets measured at fair value through other comprehensive income held by the Bank.

(d) Subordinated liabilities

The Bank had subordinated liabilities amounting to €4,500,000 as at 31 December 2022 (2021: €4,500,000), which are governed by a Subordinated Loan Agreement dated 27 August 2019 entered into with the Bank's immediate parent entity. The subordinated loan has a maturity of 7 years and is subject to a fixed interest of 5% per annum. It is included as Tier 2 capital following approval granted by the Malta Financial Services Authority. The Tier 2 eligible value of the subordinated liabilities as at 31 December 2022 was €3,253,012 (2021: €4,152,519).

In accordance with Art 437 of the CRR, banks are required to disclose details regarding their own funds, including both a quantitative illustration of the components of own funds and the resulting capital ratios. The required own funds disclosures are set out below:

	As at 31 December 2022 €
Common Equity Tier 1 (CET1) capital	
<i>Common Equity Tier 1 (CET1) capital: instruments and reserves</i>	
Share capital	10,000,000
Investment valuation reserve	(587,930)
Retained earnings	6,883,602
CET1 capital before regulatory adjustments	16,295,672
<i>Common Equity Tier 1 (CET1) capital: regulatory adjustments</i>	
Intangible assets	(942,660)
CET1 capital	15,353,012
Subordinated liabilities (Tier 2 capital)	3,253,012
Total capital / own funds	18,606,024
Total risk weighted assets	22,661,207
Capital ratios	
CET1 capital	67.75%
Tier 1 capital	67.75%
Total capital	82.11%
Institution specific buffer requirement	8.50%
of which: capital conservation buffer	2.50%
of which: countercyclical buffer	0.00%
Common Equity Tier 1 available to meet buffers	64.61%

The retained earnings of €6,883,602 consist of retained earnings as at 31 December 2022 amounting to €6,898,513 less transitional IFRS 9 adjustments of €14,911.

6. Capital risk management - continued

6.1 Own funds - continued

The following table reconciles the risk weighted assets to the positions reported in the financial statements, and also shows the components constituting the Bank's Own Funds:

	2022		2021	
	Carrying Value €	Risk weighted amount €	Carrying Value €	Risk weighted amount €
Balances with Central Bank of Malta and cash	14,572,689	1,749,208	9,959,793	-
Loans and advances to banks and other financial institutions	6,969,817	4,428,262	3,779,362	2,605,291
Loans and advances to customers	13,958,012	7,274,124	15,773,875	5,386,671
Financial assets measured at fair value through profit or loss	792,600	577,380	792,600	577,380
Financial assets measured at fair value through other comprehensive income	18,153,403	108,628	7,495,000	111,876
Intangible assets	942,660	-	646,935	-
Property, plant and equipment	200,339	-	300,854	-
Accrued income and other assets	1,110,237	1,310,575	449,688	750,559
Total on balance sheet exposures	56,699,757	15,448,177	39,198,107	9,431,777
Off-balance sheet items	866,583	173,317	1,212,796	242,559
Total risk-weighted assets		15,621,494		9,674,336
Foreign exchange risk - notional risk-weighted assets		1,399,863		1,339,250
Operational risk - notional risk-weighted assets		5,639,850		5,161,063
Total risk-weighted assets		22,661,207		16,174,649
Own funds	Notes			
<i>Original own funds</i>				
Share capital	12	10,000,000		10,000,000
Fair value reserve	13	(587,930)		48,706
Retained earnings		6,883,602		4,935,255
Intangible assets	10	(942,660)		(646,935)
CET 1 capital		15,353,012		14,337,026
<i>Additional own funds</i>				
Subordinated liabilities	16	4,500,000		4,500,000
Amortisation in terms of CRR Art 64		(1,246,988)		(347,481)
Total capital/own funds		18,606,024		18,489,545
Total capital ratio		82.11%		114.31%

6.2 Capital requirements

The Bank'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 Bank 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.

6. Capital risk management - continued

6.2 Capital requirements - continued

The allocation of capital between specific operations and activities is, to a large extent, driven by optimisation of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily upon the regulatory capital, but in some cases the regulatory requirements do not reflect differing risk profiles, subject to the overall level of capital to support a particular operation or activity not falling below the minimum required for regulatory purposes. The process of allocating capital to specific operations and activities is undertaken independently of those responsible for the operation.

Although maximisation of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Bank to particular operations or activities, it is not the sole basis used for decision making. Account is also taken of synergies with other operations and activities, the availability of management and other resources, and the fit of the activity with the Bank's long-term strategic objectives. The Bank's policies in respect of capital management and allocation are reviewed regularly by the Board of directors.

As outlined previously, minimum capital requirements are calculated for credit, market and operational risks. The Bank utilises the Standardised Approach for credit risk, the Basic Indicator Approach for operational risk and the Basic Method for foreign exchange risk in order to calculate the Pillar 1 minimum capital requirements. As disclosed previously, for credit risk, under the standardised approach risk weights are determined according to credit ratings provided by internationally recognised credit agencies such as Moody's or their equivalents and by using the applicable regulatory risk weights for unrated exposures. Capital charge for foreign exchange risk using the Basic Method is calculated at 8% of the higher of the sum of all the net short positions and the sum of all the net long positions in each foreign currency. The Basic Indicator Approach requires that the Bank allocates capital for operational risk by taking 15% of the average gross income.

The total capital ratio is calculated using the definition of regulatory capital and risk-weighted assets. As required by the CRR, the minimum level of the Capital Requirements Ratio stands at 8%. The Capital Requirements Ratio expresses own funds as a proportion of risk weighted assets and off-balance sheet items, together with notional risk weighted assets in respect of operational risk and market risk. Total risk-weighted assets are determined by multiplying the capital requirements for market risk and operational risk by 12.5 (i.e. the reciprocal of the minimum capital ratio of 8%) and adding the resulting figures to the sum of risk-weighted assets for credit risk. In terms of its banking licence conditions and current SREP requirements the Bank is required to maintain at all times a minimum capital ratio of 17.5%.

The Bank has fully implemented the CRD IV capital requirements with effect from January 2019. In this respect, Central Bank of Malta Directive No. 11: Macro Prudential Policy and Banking Rule BR/15: 'Capital Buffers of Credit Institutions authorised under the Banking Act (Cap. 371)', require additional buffers, namely the 'capital conservation buffer', the 'countercyclical buffer', 'other systemically important institutions (O-SII) buffer' and the 'systemic risk buffer'. Automatic restrictions on capital distributions apply if the local group's CET1 capital falls below the level of its CRD IV combined buffer.

6. Capital risk management - continued

6.2 Capital requirements – continued

The Bank is required to maintain a capital conservation buffer of 2.5%, made up of CET1 capital, on the risk weighted exposures of the Bank as from 1 January 2019. This buffer was phased in over the period from 1 January 2016 to 31 December 2018.

CRD IV contemplates a countercyclical buffer in line with Basel III, in the form of an institution-specific countercyclical buffer and the application of increased requirements to address macro-prudential or systemic risk. This is expected to be set in the range of 0-2.5% of relevant credit exposure RWAs, whereby the rate shall consist of the weighted average of the 'countercyclical buffer' rates that apply in the jurisdiction where the relevant exposures are located.

The O-SII buffer is also institution specific and may be set at a maximum of 2% of a systemically important institution's total risk exposure amount. Given the Bank's position as a non-core domestic bank, in terms of its systematic relevance to the financial system in Malta, the Bank is not currently required to maintain an O-SII buffer.

In addition to the measures above, CRD IV sets out a 'systemic risk buffer' for the financial sector as a whole, or one or more sub-sectors, to be deployed as necessary by each EU member state with a view to mitigating structural macroprudential risk. The 'systemic risk buffer' may range between 0% and 5%. There are currently no indications that the Bank will need to maintain a systemic risk buffer.

The Bank held no credit exposures as at 31 December 2022 that were subject to a countercyclical capital buffer requirement.

The Bank's capital requirements and total capital ratio computation are as follows:

At 31 December 2022	Exposure value €	Risk weighted assets €	Capital required €
Central governments or central banks	32,506,092	1,749,208	139,937
Institutions	219,000	108,628	8,690
Corporates	16,310,665	9,409,325	752,746
Short-term claims on credit institutions	5,409,764	2,870,441	229,635
Other	2,254,236	1,310,575	104,846
Total on balance sheet exposures	56,699,757	15,448,177	1,235,854
Off-balance sheet items	866,583	173,317	13,865
Total credit risk	57,566,340	15,621,494	1,249,720
Foreign exchange risk		1,399,863	111,989
Operational risk		5,639,850	451,188
Total capital required		22,661,207	1,812,897
Own funds			
Common Equity Tier 1 capital			18,606,024
Total own funds			18,606,024
Total capital ratio			82.11%

6. Capital risk management - continued

6.3 Internal Capital Adequacy Assessment Process (ICAAP)

The Bank considers the Internal Capital Adequacy Assessment Process (ICAAP) embedded in Pillar II as a tool that ensures a proper measurement of material risks and capital and allows better capital management and an improvement in risk management. Therefore it facilitates a better alignment between material risks and regulatory capital in order to have better capital deployment and improvements in the risk management and mitigation techniques adopted by the Bank. The ICAAP as required by the MFSA Banking Rule 12 is performed on an annual basis, but measured on a quarterly basis.

The ICAAP is a process that the Bank utilises to ensure that:

- there is adequate identification, measurement, aggregation and monitoring of the Bank's risks;
- adequate internal capital is held by the institution in relation to its risk profile; and
- the Bank uses sound risk management systems and there is the intention to develop them further.

The Board and the Bank's Executive Team take overall responsibility for the conceptual design and technical details of the ICAAP document. Apart from the responsibility for the conceptual design, the Board discusses, approves, endorses and delivers the yearly ICAAP submission. The Bank's independent risk oversight function is involved in the ICAAP with a view to ensuring that the process reflects and takes cognisance of the Bank's risk management activities and processes.

The ICAAP is a revolving management tool which starts with defining risk strategy, identifying, quantifying and aggregating risks, determining risk-bearing ability, allocating capital, establishing limits and leads to ongoing risk monitoring. The individual elements of the tool are performed with varying regularity. All the activities described in the circuit are examined at least once a year to ensure that they are up to date, adequate and also adjusted to current underlying conditions when necessary.

The process involves a quantitative assessment of individual types of risk and an assessment of the existing methods and systems for monitoring and managing risk (qualitative assessment). The risk assessment concept is used as a scoring procedure, thus providing a comprehensive overview of the risk profile of the Bank.

The basis for the quantitative implementation of the ICAAP is the risk bearing capacity calculation which demonstrates that adequate capital is in place at all times to provide sufficient cover for risks that have been entered into and which also ensures such cover is available for the future. The Bank's ICAAP is based upon a "Pillar 1 Plus" approach whereby the Pillar 1 capital requirement for credit and operational requirements is supplemented by the capital allocation for other material risks not fully addressed within Pillar 1. The risks considered for ICAAP include concentration, liquidity, reputational and strategic risks, interest rate risk in the banking book, and risks arising from the macroeconomic environment.

The Bank's ICAAP contains three-year projections as well as the capital plan, and the Board monitors that there are adequate capital resources to support the corporate goals contained within the plan and the associated risks.

The Bank covers the Pillar 2 capital requirements through stress testing processes to forecast the Bank's projected capital requirements and resources in a range of stress scenarios. This enables the Bank to guarantee that it can meet its minimum regulatory capital requirements in a stressed environment.

7. Leverage

The CRR introduced a new regulatory supervisory tool which requires credit institutions to calculate a non-risk based leverage ratio, supplementing the risk-based capital requirements discussed above. This tool has been introduced to deter any possible build-up of excessive leverage, a main factor during the banking crisis in 2008. The leverage ratio measures the relationship between the Bank's capital resources and its total assets.

The leverage ratio is calculated on a three-month average of capital as a proportion of total exposures. 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 the deductions applied to Tier 1 capital.

The current leverage ratio regime has been implemented in the EU for reporting and disclosure purposes but at this stage, has not yet been set as a binding requirement. The Bank is in the meantime abiding by the minimum 3% Tier 1 leverage ratio, based on fully-transitioned Basel III standards.

The following is the Bank's leverage ratio, determined in accordance with the requirements stipulated by implementing regulation EU 2016/200.

	2022 €
Tier 1 capital	15,353,012
Total exposure measure for the purposes of the leverage ratio	55,930,414
Leverage ratio	27.45%

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

	2022 €
On-balance sheet exposures	
On-balance sheet items	56,699,757
Asset amounts deducted in determining Tier 1 capital	(942,660)
On-balance sheet exposures	55,757,097
Off-balance sheet exposures	
Off-balance sheet exposures at gross notional amount	866,583
Adjustments for conversion to credit equivalent amounts	(693,266)
Off-balance sheet exposures	173,317
Total exposure measure for leverage ratio purposes	55,930,414

7. Leverage - continued

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

	2022
	€
Total assets as per published financial statements	56,699,757
Adjustment for off-balance sheet items	173,317
Other adjustments:	
Deduction for intangible assets	(942,660)
Leverage ratio exposure	55,930,414

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

	2022
	€
Total on-balance sheet exposures (excluding intangible assets), of which:	55,757,097
Exposures treated as sovereigns	32,506,092
Institutions	5,628,764
Corporates	16,310,665
Other exposures	1,311,576

8. Key metrics

The Bank's key regulatory metrics are summarised in the following table:

		2022	2021
	Available own funds (amounts)		
1	Common Equity Tier 1 (CET1) capital	15,353,012	14,337,026
2	Tier 1 capital	15,353,012	14,337,026
3	Total capital	18,606,024	18,489,545
	Risk-weighted exposure amounts		
4	Total risk-weighted exposure amount	22,661,207	16174649
	Capital ratios (as a percentage of risk-weighted exposure amount)		
5	Common Equity Tier 1 ratio (%)	67.75%	88.64%
6	Tier 1 ratio (%)	67.75%	88.64%
7	Total capital ratio (%)	82.11%	114.31%
	Additional own funds requirements based on SREP (as a percentage of risk-weighted exposure amount)		
EU 7a	Additional own funds requirements to address risks other than the risk of excessive leverage (%)	6.00%	6.00%
EU 7b	of which: to be made up of CET1 capital (percentage points)	4.50%	4.50%
EU 7c	of which: to be made up of Tier 1 capital (percentage points)	4.50%	4.50%
EU 7d	Total SREP own funds requirements (%)	14.00%	14.00%
	Combined buffer requirement (as a percentage of risk-weighted exposure amount)		
8	Capital conservation buffer (%)	2.50%	2.50%
EU 8a	Conservation buffer due to macro-prudential or systemic risk identified at the level of a Member State (%)	0.00%	0.00%
9	Institution specific countercyclical capital buffer (%)	0.00%	0.00%
EU 9a	Systemic risk buffer (%)	0.00%	0.00%
10	Global Systemically Important Institution buffer (%)	0.00%	0.00%
EU 10a	Other Systemically Important Institution buffer	0.00%	0.00%
11	Combined buffer requirement (%)	2.50%	2.50%
EU 11a	Overall capital requirements (%)	16.50%	16.50%
12	CET1 available after meeting the total SREP own funds requirements (%)	53.75%	72.14%
	Leverage ratio		
13	Leverage ratio total exposure measure	55,930,414	38,793,731
14	Leverage ratio	27.45%	36.96%
	Additional own funds requirements to address risks of excessive leverage (as a percentage of leverage ratio total exposure amount)		
EU 14a	Additional own funds requirements to address the risk of excessive leverage (%)	0.00%	0.00%
EU 14b	of which: to be made up of CET1 capital (percentage points)	0.00%	0.00%
EU 14c	Total SREP leverage ratio requirements (%)	3.00%	3.00%
	Leverage ratio buffer and overall leverage ratio buffer requirement (as a percentage of total exposure measure)		
EU 14d	Leverage ratio buffer requirement	0.00%	0.00%
EU 14e	Overall leverage ratio requirement (%)	3.00%	3.00%
	Liquidity Coverage Ratio		
15	Total high-quality liquid assets (HQLA) (Weighted value -average)	32,255,679	17,130,876
EU 16a	Cash outflows - Total weighted value	6,857,909	3,232,159
EU 16b	Cash inflows - Total weighted value	2,043,510	2,424,119
16	Total net cash outflows (adjusted value)	4,814,399	808,040
17	Liquidity coverage ratio (%)	669.98%	2120.05%
	Net Stable Funding Ratio		
18	Total available stable funding	33,885,146	26,656,340
19	Total required stable funding	14,959,255	9,611,144
20	NSFR ratio (%)	226.52%	277.35%

9. Asset encumbrance

The disclosure on asset encumbrance is a requirement introduced in Banking Rule 07 transposing the provisions of the EBA Guidelines on Disclosure of Encumbered and Unencumbered Assets (EBA/GL/2014/03).

The following is the disclosure of on-balance sheet encumbered assets, represented by median values of monthly data points in 2022 as per CRD IV requirements. 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 facility, and as a result is no longer available to the Bank to secure funding, satisfy collateral needs or be sold to reduce the funding requirement. There were no encumbered assets as at reporting date.

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 unencumbered assets 2022 €	Fair value of unencumbered assets 2022 €
Assets of the reporting institution	42,382,757	-
Loans on demand	19,229,622	-
Debt securities	7,267,049	18,153,403
Loans and advances other than loans on demand	14,908,696	-
Other assets	1,948,399	-

The unencumbered assets disclosed in the above table under 'Loans on demand' include balances held with Central Bank of Malta and loans and advances to banks. Other assets consist of cash, property, plant and equipment and other assets.

10. Remuneration policy

The Bank has an established Remuneration Policy that is implemented and managed by the Nominations and Remuneration Committee. The Committee is composed of three non-executive directors and meets at least four times a year or more often as deemed necessary. The Remuneration Policy is reviewed annually or more frequently depending on statutory and regulatory developments.

Independent non-executive directors of the Bank, in their capacities as directors of the Bank, are entitled to fixed remuneration fees from the Bank. The Bank's Chief Executive Officer is not a director of the Bank. The Bank's staff, including the CEO, are entitled to receive an annual discretionary bonus based on an assessment of one's overall performance, together with the level annual financial results of the Bank, during the previous financial year.

The board of directors considers that the packages offered to senior management ensure that the Bank attracts and retains management staff that is capable of fulfilling its duties and obligations. Furthermore, it is the Bank's policy to engage its senior management staff on the basis of indefinite contracts of employment after a period of probation, rather than on fixed term contracts. Accordingly, the applicable notice periods, after probation, are those provided for in the relevant legislation.

10. Remuneration policy - continued

Share options and profit sharing do not feature in the Bank's processes and the individual contracts of employment of employees within the Bank do not contain provisions for termination payments and/or other payments linked to early termination other than as determined by Law. Currently no pension benefits are payable by the Bank.

As required in terms of the framework for prudential supervision established by EU Directive 2013/36/EU, the Bank is required to identify individuals that are considered as Material Risk Takers ('MRTs') based on qualitative and quantitative criteria set out in EU Delegated Regulation 2021/923. In addition to the Non-Executive directors, the Bank's MRTs consist of three senior management staff members including the Chief Executive Officer.

Senior management is not entitled to contractual annual salary increases. An annual bonus is payable based on an assessment of one's overall performance, together with the level of annual financial results of the Bank, during the previous financial year. Bonus payments do not exceed 25% of the fixed component of the total remuneration for each individual. In addition, the total amount of performance related payments should not exceed 15% of the total staff costs of the Bank.

Total emoluments received by senior management, including the Chief Executive Officer, during the period under review are as detailed below:

Fixed Remuneration	Variable Remuneration
€ 698,561	€ 36,500

Total Non-Executive directors' fees attributable for the financial year ended 31 December 2022 amounted to €296,806 (2021: €265,386).

10.1 Deferred Remuneration

The Bank adopts deferral procedures for variable remuneration payable in cash. The deferral procedures apply to the following:

- variable remuneration payments exceeding 25% of the total remuneration for individual staff members; or
- in case whereby the amount of all variable remuneration payments exceed 20% of the total staff costs of the Bank.

Deferral periods should not exceed three years. For variable remuneration payments falling below the above thresholds, neither a deferred payment nor a split in cash and instruments are applicable. To-date, variable remuneration payments were below the above thresholds and consequently, no deferred remuneration has been awarded or paid by the Bank.

11. Other directorships

According to the “Guide to banking supervision” issued by the European Central Bank in November 2014, a credit institution will be considered significant if any one of the following conditions is met:

- the total value of its assets exceeds €30 billion or – unless the total value of its assets is below €5 billion – exceeds 20% of national GDP;
- it is one of the three most significant credit institutions established in a Member State;
- it is a recipient of direct assistance from the European Stability Mechanism; or
- the total value of its assets exceeds €5 billion and the ratio of its cross-border assets/liabilities in more than one other participating Member State to its total assets/liabilities is above 20%.

Merkanti Bank Limited does not meet any of the above criteria, and therefore is currently not considered significant by banking supervisors. Accordingly, the Bank is exempt from the requirements of Article 91 of CRD IV.

The number of other directorships held by the members of the Bank's Board of directors are listed in the table below:

Director	Position	Number of other directorships held
Christian Farrugia	Chairman	9
Samuel Morrow	Non-executive director	2
Otto Karasek	Non-executive director	1
Friedrich Hondl	Independent Non-executive director	2
George Portanier	Independent Non-executive director	2
Stephen Paris	Independent Non-executive director	11

For the purpose of the above disclosure, the number of other directorships held within the same group are counted as a single directorship.

12. Recruitment and diversity policy

The Bank is aware that a vigorous and professional approach to recruitment and selection of prospective members of the Board of directors and management or other employees within the Bank helps it to attract and appoint those individuals having the necessary skills and attributes compatible with achieving the Bank's overall objectives. Thus, the Bank ensures that appointments at all levels made within the Bank are based on each individual's knowledge, skills, expertise and merit, as required by Maltese legislation and in line with policy.

The Bank undertakes a rigorous selection process for all prospective members of the Board and management together with other employees, bearing in mind the key activities, tasks and skills required for the vacant position. As part of the selection process, multiple interviews are conducted, during which the individual's knowledge, experience, skills and competency are evaluated against those of other individuals.

Bearing its objectives in mind, the Bank endeavours to appoint directors with diverse skills and expertise that allow the Board to create value for shareholders by ensuring that the specific risks pursued by the Bank in trade finance and merchant banking, as well as risks that are intrinsic to banking business in general are appropriately managed and mitigated within the Board's approach. The Bank will continue to promote this diversity by recruiting the ideal individual for the vacant position, regardless of the individual's gender, race, family, disability, sexual orientation, identity or preference.

5 Year Summary

Statement of financial position

	2022 €	2021 €	2020 €	2019 €	2018 €
ASSETS					
Balances with Central Bank of Malta and cash	14,572,689	9,959,793	12,371,996	10,407,301	1,000
Loans and advances to banks and other financial institutions	6,969,817	3,779,362	3,152,523	11,217,954	9,110,673
Loans and advances to customers	13,958,012	15,773,875	15,929,519	5,599,749	2,645,991
Financial assets designated as at fair value through profit or loss	792,600	792,600	1,352,118	2,345,811	684,179
Financial assets measured at FVOCI	18,153,403	7,495,000	7,059,549	6,047,646	4,053,115
Available-for-sale			-	-	-
Property, plant and equipment	200,339	300,854	397,966	138,181	76,636
Intangible assets	942,660	646,935	17,883	25,324	36,475
Accrued income and other assets	1,110,237	449,688	325,905	559,026	749,670
Total assets	56,699,757	39,198,107	40,607,459	36,340,992	17,357,739
EQUITY AND LIABILITIES					
Equity					
Share capital	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000
Fair value reserve	(587,930)	48,706	90,027	50,335	102,680
Retained earnings	6,883,602	4,935,255	4,432,201	4,292,092	3,508,873
Total equity	16,295,672	14,983,961	14,522,228	14,342,427	13,611,553
Liabilities					
Derivative financial instruments	-	-	-	64,952	-
Amounts owed to banks	4,966,000	-	-	-	-
Amounts owed to customers	30,457,884	19,045,858	21,063,945	17,207,959	3,642,224
Subordinated liabilities	4,500,000	4,500,000	4,500,000	4,500,000	-
Other liabilities	480,201	668,288	521,286	225,654	103,962
Total liabilities	40,404,085	24,214,146	26,085,231	21,998,565	3,746,186
Total equity and liabilities	56,699,757	39,198,107	40,607,459	36,340,992	17,357,739
MEMORANDUM ITEMS					
Commitments	866,583	1,212,796	1,955,579	1,700,000	94,695

Income statement

	2022 €	2021 €	2020 €	2019 €	2018 €
Interest income	2,160,484	1,864,757	1,194,555	346,789	211,772
Interest expense	(463,383)	(436,837)	(358,224)	(111,006)	(7,969)
Net interest income	1,697,101	1,427,920	836,331	235,783	203,803
Fee and commission income	2,300,243	1,692,807	1,597,984	2,305,971	2,249,379
Fee and commission expense	(2,864)	(126)	(6,051)	(2,301)	(7,495)
Net fee and commission income	2,297,379	1,692,681	1,591,933	2,303,670	2,241,884
Net trading gains/(losses)	964,920	79,904	(96,322)	749,411	(6,118)
(Losses)/gains on disposal of FVOCI financial assets	(216)	(423)	45,666	8,958	-
Other operating income/(expenditure)	34,870	34,917	34,906	34,737	34,479
Operating income	4,994,054	3,234,999	2,412,514	3,332,559	2,474,048
Changes in expected credit losses	(36,153)	49,148	(63,425)	(90,612)	10,874
Net reversal of impairment charges	-	-	-	-	-
Administrative expenses	(3,009,554)	(2,781,093)	(2,208,980)	(2,458,728)	(1,863,574)
Profit before tax	1,948,347	503,054	140,109	783,219	621,348
Tax expense	-	-	-	-	-
Profit for the year	1,948,347	503,054	140,109	783,219	621,348

Statement of cash flows

	2022 €	2021 €	2020 €	2019 €	2018 €
Cash flows from operating activities					
Interest and commission income received	4,908,341	3,512,797	3,232,080	3,161,479	2,032,042
Interest and commission expense paid	(457,141)	(511,596)	(339,541)	(46,163)	(14,051)
Net expense on foreign exchange transactions	-	-	-	-	-
Cash payments to employees and suppliers	(2,979,346)	(2,312,757)	(2,019,342)	(2,253,196)	(1,848,742)
Cash flows generated from operating activities before changes in operating assets and liabilities	1,471,854	688,444	873,197	862,120	169,249
Changes in operating assets and liabilities:					
Net decrease/(increase) in reserve deposit with Central Bank of Malta	(153,841)	13,418	(53,969)	(58,043)	-
Net (increase)/decrease in loans and advances to banks and other financial institutions	(4,971,919)	-	-	-	-
Net decrease/(increase) in loans and advances to customers	1,786,988	237,662	(10,392,363)	(3,034,842)	(710,654)
Increase in loans and advances to customers measured at fair value through profit or loss	-	-	(792,600)	-	-
Net increase in amounts owed to banks	4,966,590	-	-	-	-
Net (decrease)/increase in amounts owed to customers	11,412,026	(2,018,087)	3,855,986	13,565,735	2,076,109
Net (decrease)/increase in other liabilities	-	-	-	-	(894)
Net cash used in operating activities	14,511,698	(1,078,563)	(6,509,749)	11,334,970	1,533,810
Cash flows from investing activities					
Payments to acquire securities	(11,454,000)	(1,119,300)	(4,824,513)	(5,132,598)	(1,465,821)
Proceeds from disposal and maturity of securities	132,900	1,192,768	5,552,715	2,110,000	-
Purchase of property, plant and equipment	(13,277)	(28,355)	(47,380)	(75,863)	(26,745)
Purchase of intangible assets	(295,725)	(629,235)	-	-	-
Net cash (used in)/generated from investing activities	(11,630,102)	(584,122)	680,822	(3,098,461)	(1,492,566)
Cash flows from financing activities					
Proceeds from issue of subordinated liabilities	-	-	-	4,500,000	-
Principal element of lease payments	(79,381)	(87,207)	(75,392)	(203,177)	-
Net cash (used in)/generated from financing activities	(79,381)	(87,207)	75,392	4,296,823	-
Effect of exchange rate changes on cash and cash equivalents	(116,594)	9,942	(251,940)	(70,654)	(18,801)
Net movement in cash and cash equivalents	2,685,621	(1,749,892)	(5,904,319)	12,533,332	41,244
Cash and cash equivalents at beginning of year	13,678,142	15,418,092	21,574,351	9,111,673	9,089,230
Cash and cash equivalents at end of year	16,363,763	13,678,142	15,418,092	21,574,351	9,111,673