2018
MALTA DEVELOPMENT BANK
ANNUAL REPORT & FINANCIAL STATEMENTS

ISSN 2663-5364 (print)
ISSN 2663-5372 (online)

MISSION & VALUES

The vision of the Malta Development Bank (MDB) is to make a significant contribution towards sustainable economic development by promoting inclusive and environmentally sustainable economic growth and infrastructure development. The MDB will do this by linking entrepreneurship, digitisation, investment and economic growth to improved living conditions, a higher quality of life and better social inclusion.

STRATEGIC OBJECTIVE

The MDB's strategic objective is to address market failures or an evident financial gap by offering financing facilities to support productive and viable operations where the market is unable or unwilling to accommodate such activities on its own in whole or part.

The MDB complements commercial banks through a non-competitive relationship, thereby contributing to additionality and diversifying Malta's financial base in a cost-effective manner.

MDB's goal is to contribute to public policy objectives. It is not driven by purely commercial and profit maximisation considerations. Nonetheless, the MDB supports only bankable investments and assesses proposals on the basis of sound banking principles. It also aims to meet its running costs through its operations while charging a reasonable premium for the risks assumed.

REMIT OF ACTIVITIES

The MDB's remit of activities covers a wide range of possible operations where there is market failure. In general terms, the MDB will be engaged in the following main sectors:

- Private Sector Development, in particular financing SMEs through innovative financing, credit enhancement, venture capital, advisory function;
- Skills and Technology, in particular sustaining competitiveness by investment in innovation, digitisation, skills, knowledge-generation and technology;
- Infrastructure development of national importance, particularly social infrastructure projects;
- Green Economy, in particular supporting clean energy and energy efficiency projects, sustainable transport, and water resources; and
- Community Services, in particular supporting social enterprises operating community services in such sectors as education, health and housing.

BOARD OF DIRECTORS

In exercise of the powers conferred by Article 21 of the Malta Development Bank Act, the Minister for Finance appointed the following Directors on 11 December 2017:

CHAIRMAN

Prof. Josef Bonnici

DIRECTORS

Mr. Paul Abela

Dr. Rose Mary Azzopardi

Mr. Robert Borg

Mr. Paul Cardona

Mr. Godfrey Grima

Mr. Anthony Valvo

These appointments are valid for the periods stipulated in Article 21(4), (5) and (6) of the Act.

Mr. Rene Saliba was appointed Secretary to the Board on 11 December 2017.

THE BOARD OF DIRECTORS

(left to right)

Mr. Anthony Valvo, Mr. Paul Abela, Dr. Rose Mary Azzopardi, Prof. Josef Bonnici, Mr. Rene Saliba, Mr. Paul Cardona, Mr. Godfrey Grima, Mr. Robert Borg.

MALTA DEVELOPMENT BANK

Pope Pius V Street
Valletta, VLT 1041, Malta
T: + 356 2226 1700
info@mdb.org.mt
https://mdb.org.mt/

16 April 2019

The Hon Prof Edward Scicluna B.A. (Hons) Econ, M.A. (Toronto),
Ph.D (Toronto), D.S.S (Oxon) MP
Minister for Finance
Maison Demandols
South Street
Valletta VLT 2000

Dear Minister

LETTER OF TRANSMITTAL

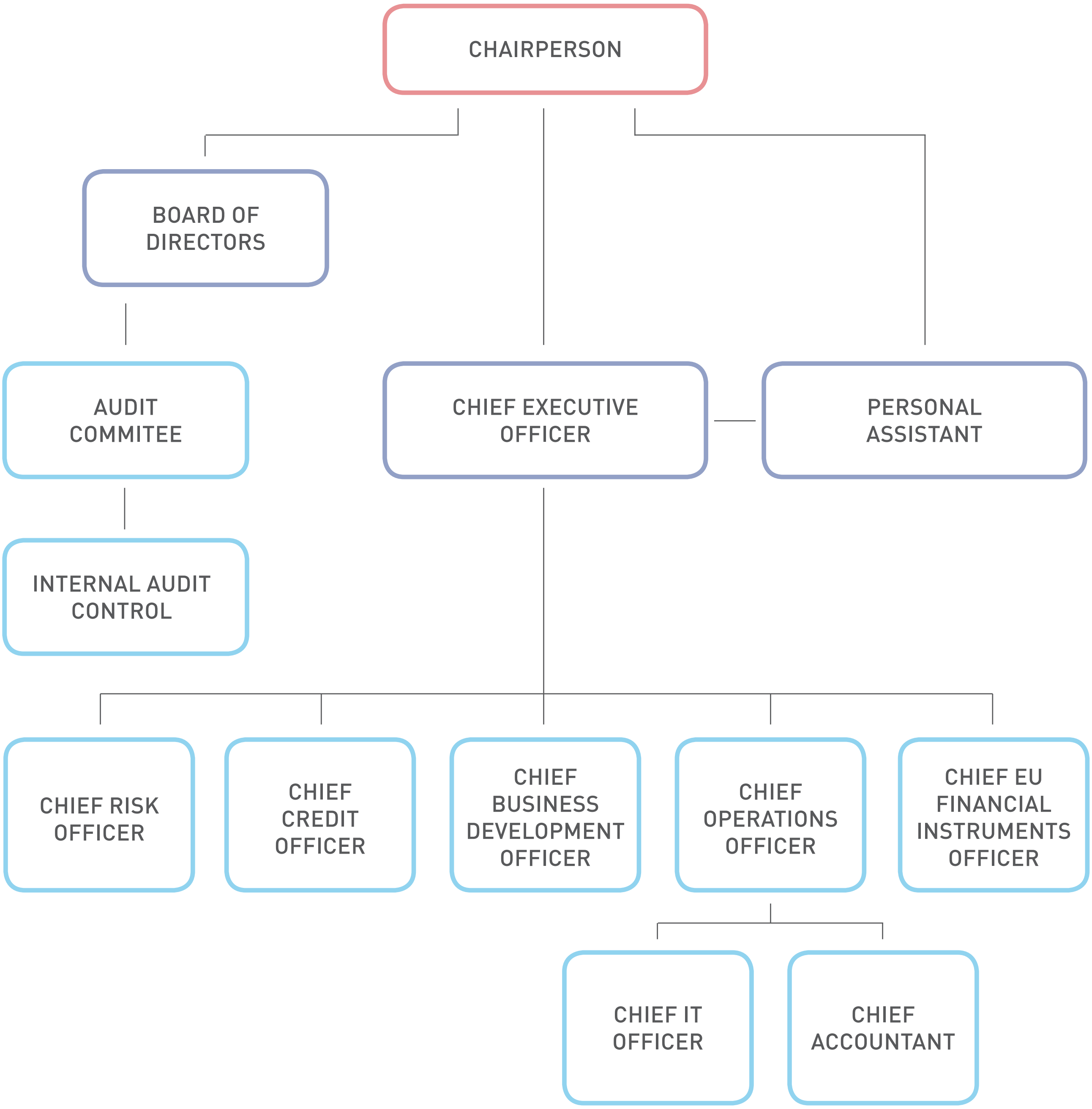
In terms of article 33 of the Malta Development Bank Act, 2016 (Cap 574), I have the honour to transmit to you a copy of the Annual Report of the Malta Development Bank for the year 2018.

In terms of article 33 of the Malta Development Bank Act, I am also transmitting a copy of the audited accounts of the Bank for the financial year ended 31 December 2018.

Yours sincerely

JOSEF BONNICI
Chairman

MALTA DEVELOPMENT BANK ORGANISATION CHART



Organisation as at 31 January 2019.

MALTA DEVELOPMENT BANK TEAM

CONTENTS

CHAIRPERSON'S STATEMENT

BRIDGING THE INVESTMENT GAP

The launch of the Malta Development Bank marks an important event in the evolution of the financial sector in Malta, introducing a new form of intermediation that promotes investment at the enterprise and infrastructural levels by targeting credit market gaps. With the establishment of a Development Bank, Malta follows the path taken by many European economies in setting-up a specialized financial institution that supports public policy objectives. The Malta Development Bank was established by virtue of an Act of Parliament which was passed in May 2017 and which came into force in November 2017. The Bank commenced operations on 11 December 2017 when the Minister for Finance appointed the Board of Directors and the Board held its first meeting. The Bank is fully owned by the State.

In a small economy with limited financial depth, important segments of the economy tend to be underserved by private funding sources. In this context, the Malta Development Bank alleviates the shortage of collateral and promotes entrepreneurship. The Bank thereby provides new funding opportunities for projects and programmes that contribute to Malta's socio-economic development.

Credit gaps are of particular concern when the preponderance of businesses and employers consists of independently-owned SMEs and micro-businesses. Due to limited access to capital market instruments and without recourse to finance from parent companies, SMEs are generally more reliant on bank financing. In Malta as elsewhere, market failure in SME financing became more prominent in the aftermath of the financial crisis. Despite the persistence of excess liquidity in the banking system, reduced risk appetite by banks and tighter banking regulation made it less attractive for banks to lend to SMEs.

Various studies have found evidence of sizeable market gaps in the financing of SMEs and large infrastructure investment in Malta. Research on the transmission of monetary policy indicates that the pass-through of policy rate changes to lending rates paid by non-financial corporations declined after the financial crisis, with estimates suggesting that only around a half of policy rate cuts between 2008 and 2015 were passed on in domestic interest rates offered to businesses.

Even if the crisis and post-crisis problems are set aside, market failure can be of a structural nature and takes the form of the SMEs' inability to access sufficient finance for their investment requirements. Small businesses often lack a sufficient borrowing history and are also unable to offer the necessary collateral, making the lender's assessment of creditworthiness difficult and possibly over-cautious. For such cases, the Malta Development Bank is collaborating with commercial banks in designing guarantee schemes for portfolios of loans to SMEs. In this context, I am glad to state that on 1 October 2018 the Malta Development Bank signed a Risk Sharing Agreement with one of the local major credit institutions and the Family Business Office, designed to enhance access to bank credit in respect of family business transfers within the family. This Guarantee Scheme will complement the fiscal incentives offered by the Government in terms of the Family Business Act 2016. Under this Scheme, the MDB will provide a partial risk protection to the participating bank in respect of a portfolio of up to €10 million. This new facility should enable more family businesses to obtain bank financing to transfer their businesses, thereby ensuring continuity, stability and further growth in the future of such businesses – which in Malta constitute a significant segment of the SME sector.

In addition, the Malta Development Bank is at an advanced stage of negotiations with the commercial banks to launch new loan guarantee schemes to facilitate access to financing by SMEs for new investments. Furthermore, the Bank is also going through a consultation process with commercial banks with a view to developing a scheme which involves a combination of co-financing together with a partial guarantee. In this case, the Bank is aiming to address also enterprises of a moderate size.

The setting up of such schemes exemplifies the desirability of complementarity between promotional and commercial banking. It also enables the Malta Development Bank to hive off operational aspects to credit institutions, thereby assuming a leaner structure, fulfilling its public policy role in a more cost-effective manner. From the commercial bank's point of view, such programmes help commercial banks to expand the size and range of loans. Banks also benefit from credit risk reduction and release of regulatory capital, thereby facilitating higher leverage. In a competitive setting, such benefits are in part passed on to final beneficiaries in the form of reduced collateral requirements and lower interest rates.
The role of this new financial intermediary arrangement

is to invite or "crowd in" additional private sector co-investment through access to business and investor resources, including EU resources.

The Malta Development Bank has access to various funding sources, some of which are quite standard while others are more innovative. The contribution of public resources in the form of paid-in capital can be augmented by borrowing from the market, both from local and foreign sources. In this context, the Bank has been holding consultations to strengthen its relationship with multilateral development banks so as to open up access to international financing. Through the application of prudent risk management, the Malta Development Bank can procure bilateral loans from such institutions which can be used for on-lending to the Maltese economy via intermediation with commercial banks. The Bank can also procure funding through the issue of debt instruments in the domestic market. Such funding can be propagated into a much larger volume of credit operations, thereby multiplying the impact on commerce and the Maltese economy.

Moreover, such financing operations from the market help the Malta Development Bank to meet Eurostat rules in terms of the Bank's statistical classification outside the general government sector for the purposes of ESA 2010. This is also made possible because MDB facilities are provided only to viable, bankable and self-financing operations. As borrowers service their debts, the stream of income ensures the self-financing nature of the approved projects and programmes along with the assurance of commercial viability and bankability.

The Malta Development Bank also envisages an active role as co-investor in the financing of relatively large projects – mostly of an infrastructural nature. Its involvement enables important projects that would otherwise face funding difficulties in the context of the long gestation period that is normally required to make such projects bankable. In this sense, the Bank opens a new horizon of funding sources that can be made available to various projects and in many sectors that fall within its mandate. This includes areas of social infrastructure such as in education, health and housing, as well as environment-friendly sectors such as the green economy, energy efficiency and renewable energy.

Moreover, the Malta Development Bank anticipates a significant role as a vehicle for EU resources in the context of the EU's increased focus on financial instruments and reduced reliance on grants. Financial instruments can achieve a larger impact through leveraging on guarantees that create much larger portfolios. They are also revolving in nature, making them more sustainable in the long-run. The Bank's involvement should contribute to a broader and more effective deployment of financial instruments in Malta. To this effect, the Malta Development Bank also envisages joint efforts with the Managing Authority for EU funds in Malta to develop financial instruments in operational programmes. An example of such instrument could include the allocation of Structural Funds to a guarantee fund to support the creation of a loan portfolio by commercial banks to promote tertiary education. In many cases, development banks possess in-depth understanding of the domestic commercial context to help in prioritizing EU resource allocations in Malta. This can help avoid duplication and maximize value added and complementarity of EU financial instruments. The Bank is also well placed to assist in spreading general awareness about funding opportunities through EU-supported financial instruments, as well as co-investment by the European Investment Bank Group.

To sum up, the Malta Development Bank's role is to complement the commercial banks in stimulating private investment, especially in the SME sector, and to compensate for impediments in the transmission of monetary policy. In addition, the Bank can facilitate more investment in infrastructural projects that are sustainable and self-financing.

Our ultimate contribution to public policy targets and economic growth depends on the maintenance of expert standards, the ability to implement the Bank's defining characteristics, and also on the collaboration at operational and other levels with credit providers.

This being the Bank's first year of operation, the launch has been particularly challenging. Following the first wave of recruitment to fill the managerial posts of the various business areas, the Malta Development Bank embarked on its capacity building. This included an extensive consultation process with stakeholders, product development and engineering, structuring a sustainable mix of funding sources, as well as the setting up of the organisational structure and governance frameworks.

2018 has been quite a challenging year devoted to laying the foundations of this new institution. I am truly confident that with the work achieved so far and the plans for the way forward, the outlook for the Bank's role to support the country's socio-economic development and further growth appears very promising.

On behalf of the Board of Directors, I would like to express our gratitude for the support and assistance provided by various entities to enable the Bank to embark on a successful commencement of operations. I would also like to sincerely thank my fellow members of the Board and the staff for the professional work carried out throughout the year and for their commitment, dedication and ability in delivering to fulfil the Bank's mandate.

ESTABLISHING THE BANK

The launch of the Malta Development Bank (MDB) on 11 December 2017 marks an important event in the development of financial intermediation in Malta. There is broad agreement that the traditional private financial system has played an essential and stable role in supporting economic activity in Malta over the years. However, limitations surfaced in the aftermath of the European sovereign debt crisis when the volume of bank lending to corporate borrowers in Malta remained subdued and lending rates remained relatively elevated, notwithstanding the substantial amount of excess liquidity characterising the local banks. The perceived market gap became more evident, particularly in SME access to finance. The prevalent financial conditions at that stage marked a strong case for a promotional institution that creates further diversification of Malta's financial structure, promotes entrepreneurship and investment and widens the range of public policy instruments to close gaps in credit markets.

The origins of the need to create a new institution to address such an institutional gap go back to the Central Bank of Malta's dialogue with the Authorities during the early part of the decade on the benefits that can be generated through the setting up of a national development bank. The Central Bank also hosted the preparatory groundwork for the establishment of the new institution. In 2012, a delegation from the Central Bank made familiarization visits to the European Association of Public Banks and a number of major development banks in order to obtain a better insight into the institutional and organisational aspects of promotional banks and their business model. In 2013, the Central Bank of Malta presented a proposal to the Government recommending the setting up of a national development bank. At the time, the two major political parties included the establishing of a national development bank in their electoral manifesto, indicating broad political consensus on the subject.

In July 2014, the Deputy Prime Minister created a Working Group with wide representation to prepare recommendations for the setting up of the new institution and the related legislative and operational framework. The Working Group consisted of officials from the Central Bank of Malta, a major credit institution, a legal firm, a financial advisory firm and the Ministry for European Affairs and Implementation of the Electoral Manifesto.

The Working Group focused on a number of intermediate objectives. These included:

- Reviewing international best practice relating to promotional banks especially in the EU.
- Reviewing related EU legislation, particularly state aid rules, the laws governing a number of promotional banks and the prudential regulation of such banks.
- Establishing contacts with a wide range of institutions including various Europe Commission directorates, Eurostat, European Investment Bank and European Investment Fund, Council of Europe Development Bank and associations representing national development banks.
- Conducting public consultations with the Maltese business community to identify funding gaps.
- Liaising with the Malta Bankers' Association with a view to obtaining a better understanding of the nature of market failures and to stress that the objective of the national development bank is to collaborate rather than compete with credit institutions and other financial intermediaries.
- Advising the Ministry on the way forward regarding issues of tenders calling for independent studies on market failures and on the blueprint for the development bank.
- Collaborating with the Ministry in respect of consultations with the European Commission and preparation of documentation to be submitted to the Commission for clearance regarding conformity with the EU internal market.
- Collaborating with the National Statistics Office in respect of consultations with Eurostat relating to the sector classification of the development bank.
- Preparing draft legislation governing the Malta Development Bank.

The Working Group, in conjunction with the Ministry for European Affairs, held a series of consultations with various EU directorates.

These included:

- Eurostat, in connection with the statistical classification of MDB;
- the Directorate-General Competition, in connection with State Aid rules; and
- the Directorate-General for Financial Stability, Financial Services and Capital Markets Union.

At the request of the Commission, the Ministry for European Affairs in 2015 commissioned two studies. The first was a Market Study on Potential Existence of Market Failures in Malta. This study concluded that, taking into account both SME finance and infrastructure financing, the total funding gap was estimated at between 29% and 39% of GDP over a period of five years, equivalent to between €2.3 billion and €3.1 billion. The second report provided a Blue Print describing the role of the Bank, its business model, products and financial projections. These market studies also entailed extensive consultations with a wide range of domestic stakeholders.

On 19 April 2016, Eurostat determined that the Malta Development Bank should be classified outside the general government sector for the purposes of classification by sector under ESA 2010. Eurostat reserved the right to review its opinion should outcomes deviate from the plans and projections proposed by the National Statistics Office.

On 24 August 2016, the EU Commission published its decision that the legislation, business plan and proposed measures pertaining to the Malta Development Bank are in line with State Aid rules and in conformity with the rules on the internal market. The approved state aid envelope of €255 million is subject to review after three years, that is in August 2019.

The Bill on the Malta Development Bank Act was published on 24 June 2016. On 5 May 2017, the Malta Development Bank Act, 2017 (Act XXI of 2017 CAP 574) was passed and came into force on 24 November 2017 through Legal Notice No 340 of 2017.

On 11 December 2017, the Minister for Finance appointed the members of the Board of Directors and the Supervisory Board of the Malta Development Bank. On the same day, the Board of Directors held its first meeting and the Bank officially commenced operations.

Photo courtesy of DOI

CORPORATE GOVERNANCE

BOARD OF DIRECTORS

The MDB is run by a Board of Directors consisting of a Chairperson and four Directors from the private non-bank sector appointed by the Minister as well as two independent Directors appointed by the Minister on the recommendation of the Malta Council for Economic and Social Development. The Board of Directors is composed of Prof. Josef Bonnici as Chairman, Dr. Rose Mary Azzopardi, Mr. Anthony Valvo, Mr. Paul Abela, Mr. Paul Cardona, Mr. Robert Borg and Mr. Godfrey Grima.

Article 21 of the MDB Act provides that the Chairperson shall be appointed after consultation with the Opposition. The Act also provides that the Board of Directors shall exercise its mandate independently and in an autonomous manner and shall not seek or receive instructions from the Government or any other public authority.

In terms of article 21(5) of the MDB Act, the term of the Chairperson is six years. The independent Directors nominated by the Malta Council for Economic and Social Development, Mr Paul Abela and Mr Robert Borg, were also appointed for a term of six years, in line with article 21(6) of the Act. The term of the other Directors is five years in accordance with article 21(4) of the Act.

Twelve Board meetings were held during 2018.

THE SUPERVISORY BOARD

As regards the prudential regulation of promotional banks in the EU, some are subject to regulation and supervision by the national bank supervision competent authority or by the European Central Bank under the Single Supervisory Mechanism, whereas others are exempted from the applicability of the Capital Requirement Directive and the Capital Requirement Regulations and are regulated by ad hoc national legislation.

The MDB Act provides that the MDB is subject to the prudential oversight, regulation and supervision of a Supervisory Board appointed in terms of article 37(1) of the Act. In view of the MDB's public policy mandate, the MDB will thus be exempted from the applicability of Capital Requirement Directive and the Capital Requirement Regulations, and instead will be subject to supervision under ad hoc local regulation which, while ensuring proper and sound banking conduct, should enable the MDB to fulfil its promotional role and public policy mission more effectively.

In terms of article 40 of the Act, the Supervisory Board is composed of officials from the Malta Financial Services Authority, the Central Bank of Malta, the Ministry for Finance, and two independent professionals with banking or regulatory experience. The Chairperson is appointed by the Minister from among the two independent professionals after consultation with the Opposition. The Supervisory Board is chaired by Mr John Cassar White and also includes Mr Oliver Bonello, Deputy Governor Central Bank of Malta, Ms Marianne Scicluna, Director General, Malta Financial Services Authority, Mr Alfred Camilleri, Permanent Secretary, Ministry for Finance, and Dr Chris Cilia, as independent professional. These appointments are for a period of five years with effect from 11 December 2017.

In terms of article 37 of the Act, the role of the Supervisory Board is to oversee the policy pursued by the Bank and its implementation, to review the general state of affairs of the Bank, and to issue directives relating to the prudential conduct of business, capital adequacy, and risk strategy of the Bank. It shall exercise monitoring, advisory and regulatory powers to ensure sound governance and best practices by the MDB. It has the right to request any information deemed necessary, and to supervise the MDB's corporate governance, as well as compliance with regulations, the effectiveness of the Bank's management systems and internal controls, the business performance, asset-liability management, remuneration, and other aspects as specified in Part III of the Act.

The Supervisory Board also has the power to submit analysis and recommendations to the MDB Board of Directors and to the Finance Minister.

The Supervisory Board Regulations are prescribed in the Second Schedule of the Act.

INTERNAL BOARD COMMITTEES

In terms of article 22(d) of the Act, the MDB's governance structure will also include an Audit Committee, a Risk Committee, an Ethics and Governance Committee, a Remuneration Committee and such other committees as the Board of Directors may require.

In 2018, the Board of Directors approved the setting up of the Audit Committee. The role of the Audit Committee is to assist the Board of Directors in fulfilling its oversight responsibilities for the financial reporting process, the system of internal control and audit process and the organisation's process for monitoring compliance with laws and regulations. The Committee is composed of three Board members, namely Mr Robert Borg as Chairperson, Dr Rose Azzopardi and Mr Anthony Valvo.

The functions of the other internal Board committees are currently being carried out by the Board of Directors.

In terms of public accountability, the MDB Act obliges the Bank to present its Annual Report and Financial Statements to Parliament by not later than four months after the end of its financial year. The MDB may also be subject to inquiry by the Auditor General.

BUSINESS MODEL

As a State-owned promotional bank, the Malta Development Bank is focused on supporting the economic and social development of Malta in line with public policy objectives. In pursuit of its objectives, the MDB takes a leadership role in addressing market failures, investment gaps and sub-optimal investment situations to promote investment in new projects and initiatives. It thus fosters additionality by promoting the crowding-in of private and public sector investment and facilitating credit operations which otherwise would not have occurred in the absence of support from the MDB. It therefore acts as catalyst to create economic value to investors while promoting activities in pursuance of national social and economic priorities.

The Bank's business model is two-pronged. On the one hand, the MDB shall develop schemes intermediated via commercial banks to directly support economic growth initiatives at the SME and business proprietor level. On the other hand, it will seek to support larger infrastructural initiatives by facilitating lending for a longer duration than what is typically within the risk appetite of commercial banks, thereby facilitating conditions which will render such projects more bankable and that assure financial viability.

In such infrastructure projects, the MDB also acts as catalyst for loan syndications by helping to pool-in diverse suppliers of credit so as to accommodate the financing needs of larger projects which are likely to be difficult to finance through one single financial intermediary. In essence, the strategy of the MDB is to crowd-in private and public investment by complementing, rather than competing, with commercial banks.

While being driven by public policy objectives rather than profit maximisation, the MDB shall operate appropriate financial practices in line with sound banking principles that make it fully viable as a stand-alone entity. Though it is owned by the Government, the Bank operates on an arm's length basis, and is subject to the appropriate oversight in the form of a dedicated Supervisory Board.

The MDB is expected to achieve the required balance between sustainable profitability and growth against the appropriate risk levels by making sound business decisions and lend or invest funds in projects that are consistent with Malta's development objectives. It will operate with discipline internally and with its stakeholders and will expect timely repayment of its loans and investment.

As a promotional institution, the MDB value is maximized through its ability to carve its role in the economic fabric by engaging with the market stakeholders early on to develop financing opportunities in collaboration with other financial intermediaries.

Within this business model, the following tangible outcomes are envisaged:

- As a new public policy instrument, the MDB will effectively utilise its equity capital to obtain the benefits of financial leverage, primarily for the SME sector and social infrastructure.

- Operating under the prudential discipline of a bank, the MDB is able to achieve capital leverage that a non-financial corporation is unable to achieve. This will enable the MDB to support commercial banks in building up portfolios of loans on the basis of guarantee funds and other promotional vehicles.
- Through the MDB's intervention as a financial intermediary, the SME segment and the smaller projects will be better able to tap the financing resources of multilateral development institutions. Such institutions tend to focus mainly on projects of a certain critical minimum size which are well above the absorptive capacity of large segments of the local economy. The MDB will endeavour to raise wholesale funding from multilateral institutions for on-lending in the form of a portfolio of sub-loans to SMEs and smaller projects.
- MDB will explore new mechanisms how project-financing can be tailored to the needs of the specific project. In particular, the financial viability of large-scale infrastructure investment normally necessitates long-term funding which the MDB will normally be able to provide given the long duration of its funding sources.

FUNDING SOURCES

During 2018, the MDB's operations have been entirely funded from the paid-up capital provided by the Government in terms of Article 10 of the MDB Act. The Bank's initial paid-up capital is €30 million. The Government Budget Estimates for 2019 provide for an increase of €10 million in paid-up capital, in line with the MDB business model. In future, the paid-up capital will be supplemented by long-term funding from a mix of sources, primarily bilateral loans from international development institutions, and to a lesser extent from domestic institutions. At a later stage, the MDB could also resort to bond issuance, mainly in the domestic market.

During the period reviewed, the Bank held consultations with a number of international institutions in connection with the provision of long-term loans at attractive rates for on-lending to local operators, both in the SME segment and for infrastructural projects particularly those with a social dimension.

GOVERNMENT GUARANTEE

In view of their public policy nature, promotional banks are typically supported by a government guarantee in order to be able to fulfil their mandate more effectively.

Article 5 of the MDB Act provides that the Government shall guarantee up to 100% of all the obligations of the Bank and up to 100% of the loans, facilities or guarantees issued by the Bank. According to the MDB's Business Plan, the Bank will rely on the Government guarantee for less than half of its overall operation.

Article 5(2) provides that the Government shall enter into a Memorandum of Understanding (MOU) with the MDB to set the maximum limit of Government guarantees to the MDB. This amount is reviewed on an annual basis in the light of the evolving growth of the MDB's business. On 16 February 2018, the MDB and the Ministry for Finance concluded a MOU in this regard. Pursuant to this MOU, a Government Guarantee was issued on 16 February 2018, with the amount of the guarantee initially set at €50 million for 2018.

In December 2018, agreement was reached in principle between the MDB and the Ministry for Finance for the Government guarantee to be raised to €100 million for 2019, in line with the indicative level specified in the MOU of 16 February 2018.

This Government guarantee as well as the paid-up capital by the Government form part of the State Aid envelope of €255 million approved by the European Commission in its decision of August 2016 covering the three-year period up to August 2019.

FINANCING FACILITIES

In general, the MDB will be offering five types of facilities: in the first phase, loans and guarantees, in the second phase advisory services and, at a later stage, equity participations and underwriting services.
As regards the lending model, the MDB's financing operations will broadly be of two types, focusing on the two main sectors that had been identified in the market failure study:

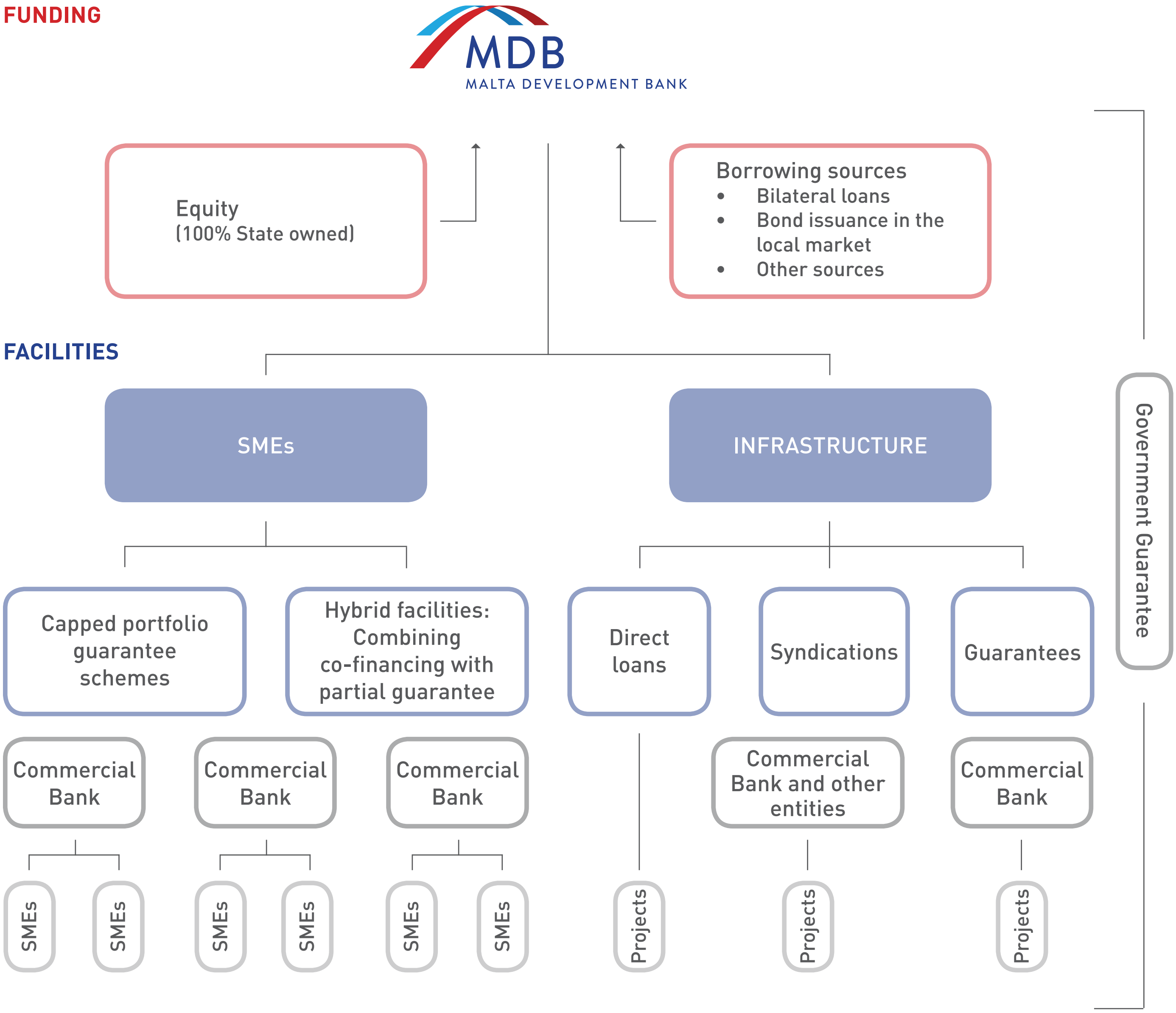
i. SME financing - The frequent shortfall of SME access to finance is a typical example of market failure. Small businesses without a borrowing history and lacking sufficient collateral make the lender's assessment of credit worthiness challenging and the perceived risk higher. Improving SME's access to finance is therefore a priority area for the MDB and is consistent with its objective to provide a remedy for sub-optimal investment situations and market failures.

   Indirect or second-tier facilities in the form of loan guarantee schemes are effective financial instruments to address gaps in SME financing. Through such facilities, the MDB collaborates with commercial banks where the MDB provides a capped guarantee on a portfolio of loans extended by the commercial bank. This set-up ensures the non-competitive nature of the relationship between the MDB and the commercial bank. It also enables the MDB to assume a leaner structure and more cost-effective operations, thereby fulfilling its public policy role more efficiently. In addition, SME loan guarantee schemes contribute to credit enhancement, therefore helping the commercial banks to expand the size and range of loans to eligible SMEs, while benefitting from credit risk reduction and release of regulatory capital, thereby facilitating higher leverage. Through such facilities, final beneficiaries will benefit from reduced collateral requirements and lower interest rates.

ii. Infrastructure financing – Large-scale infrastructure projects can face difficulties in accessing the appropriate financing due to the long repayment period that is normally required to make them bankable. With short-term customer deposits as the main source of funding, commercial banks are often not geared to provide very long-term financing for infrastructure projects. Also, such exposures may be too large for certain commercial banks to finance on their own. MDB funding sources are of a longer tenure and can therefore facilitate the provision of longer-term financing. MDB's facilities for infrastructure investment can take the form of first-tier operations in the form of direct lending and co-financing directed to national social and economic infrastructure by public and private sector entities with whom the MDB will act as co-financier with the commercial banks or possibly also directly. The focus will be on projects with a strong social dimension – especially those related to education, health, elderly care, and affordable housing – as well as those that contribute to the green economy and the circular economy, including renewable energy and energy efficiency, sustainable transport and water resources, as well as other environment-friendly initiatives. Projects that enhance Malta's competitiveness rank also highly within the MDB's priorities.

Figure 1 provides a schematic representation of the MDB financing system and the broad type of business model.

Fig. 1 - Schematic representation of MDB financing system



The MDB Act provides a number of safeguards to mitigate risks to the stability and financial soundness of the Bank. For instance, direct financing by MDB on its own cannot exceed 25% of its total lending. Moreover, MDB's exposure to any single client or group of associated clients cannot exceed 25% of its own funds. Furthermore, investments in the form of equity participations cannot in the aggregate exceed 10% of the MDB's own funds.

Another cornerstone of the MDB's business model is that it will provide financing only for bankable projects. Indeed, the MDB Act requires that MDB facilities are limited to viable projects that have satisfactory revenue-generating potential to meet both the interest and capital repayment requirements. All proposals must be assessed according to sound banking principles.

NATURE OF FINANCING

Lending by the MDB may be on State-aided or non-aided (market) terms. More specifically, in terms of article 6(7) of the Act, the MDB shall limit its activities to the provision of:

1. Aided financing authorised under:
   i. the General Block Exemption Regulation,
   ii. approved aid schemes,
   iii. approved aid under specific Guidelines issued by the European Commission; and
   iv. EU financial instruments funded from EU Funds, where the Bank will act as a vehicle to channel and manage EU funds, or as co-investor.
2. Aid that fulfils the conditions of the de minimis Regulation at the level of the final beneficiaries.
3. Financing on market terms to eligible final beneficiaries covered by the General Block Exemption Regulation, where all the conditions of the relevant articles of the General Block Exemption Regulation are complied with, except the requirements relating to aid intensities or maximum aid amounts, subject that in the case of infrastructure projects participation by private investors shall be at least 50% pari passu with the Bank.
4. Financing of participation in EU financial instruments on market terms.
5. Such other financing subject to prior approval by the European Commission.

LEVERAGING EU RESOURCES

Another priority area of the MDB is to explore how to play a more active role in leveraging EU resources in the context of the increased focus being given by the EU on financial instruments and the trend towards reduced reliance on grants. The greater prominence on financial instruments will be particularly pronounced under the InvestEU programme that is currently being discussed at EU level within the context of negotiations regarding the Multiannual Financial Framework for the period 2021 – 2027 (see Box 1 for a description of the InvestEU programme).

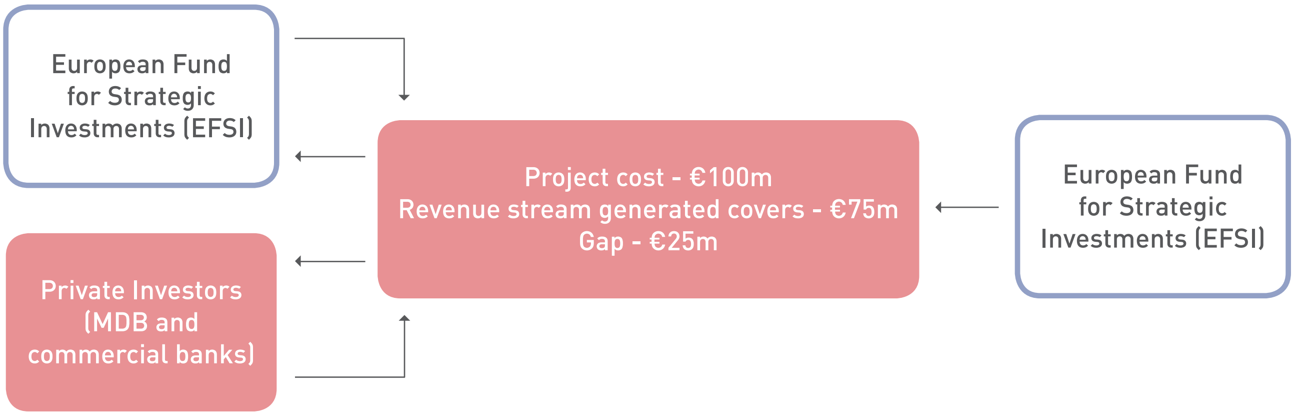
Financial instruments can achieve a larger impact through leveraging, are revolving and hence are more sustainable in the long run. MDB involvement can be instrumental for the increased deployment of financial instruments in Malta. To this effect, the MDB will seek to negotiate joint efforts with the Managing Authority for EU funds in Malta to develop financial instruments in operational programmes under a shared management mode. This can help avoid duplication and maximize value-added and the complementarity of EU financial instruments.

BLENDING OF EUROPEAN FUND FOR STRATEGIC INVESTMENTS (EFSI) AND EUROPEAN STRUCTURAL AND INVESTMENT (ESI) FUNDS

Blending of EU resources can potentially be a critical element in Malta's transition from grant financing to greater use of financial instruments. Blending of guarantees and grants, together with other private investment, can be instrumental in creating attractive financial instruments that promote investment in strategic sectors.

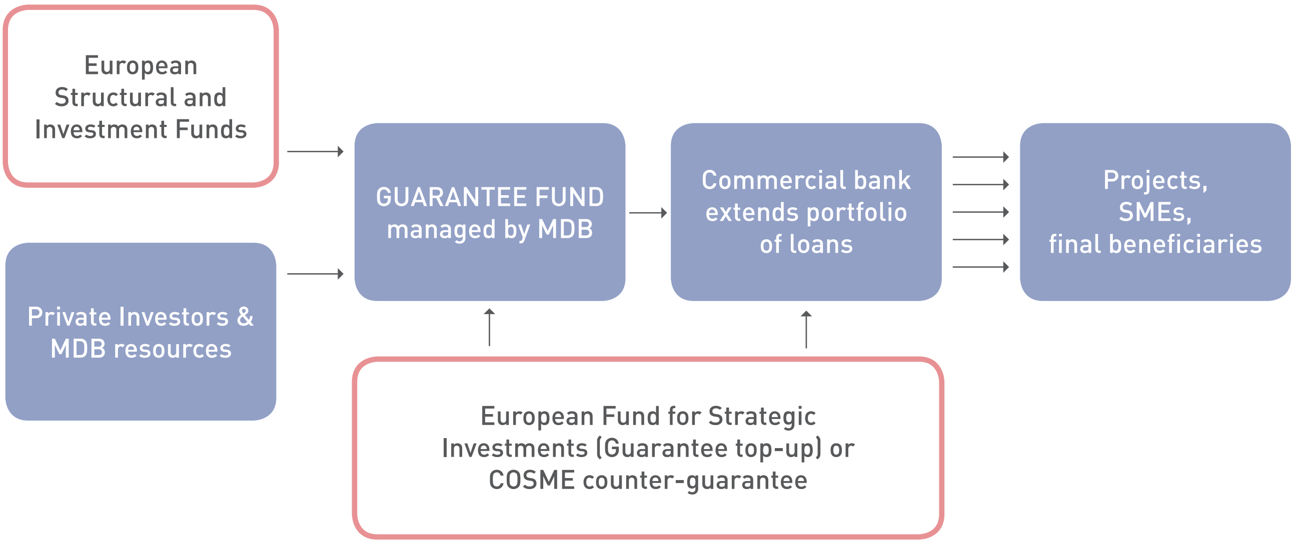
The MDB will explore possible ways of achieving higher value added from EU resources by maximising synergies and complementarities of ESI funds and EFSI. Combination of ESI Funds and EFSI is possible both at the financial instrument level and at the project level.
Combination at the project level could be applicable in sectors or projects where, in the absence of a grant element from ESI funds, the project would be ineligible for EFSI support. In such cases, the ESI funds can make the project investible and eligible for EFSI and as a result, crowding-in of further private investment, including by MDB, is made possible. Such arrangement can increase the scale and impact of projects. As an example, Figure 2 below exhibits a project that is seeking to raise financing to meet a capital expenditure of €100 million. Over a given gestation period, it is assumed that the project can generate a revenue stream that would be able to repay €75 million of the principal and interest of a loan programme to support this investment, leaving a gap of €25 million. In such a scenario, an allocation of €25 million from ESIF can close this gap, making the rest of the project bankable and eligible for EFSI and additional private investment.

Fig 2 - Combination at the project level



ESI Funds and EFSI may also be combined through a financial instrument set up at the national level. Such complementarity can attract further private investment, including by the MDB. For instance, the Managing Authority could set up a financial instrument with ESI Funds programme contributions in which EFSI and other investors such as the MDB would also invest their resources to make the financial instrument more attractive. Figure 3 below provides an illustration of this type of blending.

Fig 3 - Combination at the financial instrument level



The MDB also envisages a potential role as a financial intermediary in respect of financial instruments managed centrally by the EIF and the EIB, such as COSME or Horizon 2020 and going forward, under the Invest EU framework in the post-2020 scenario. The Bank is looking into possible ways how to become engaged in this regard.

Another area that the MDB is looking into in order to be in a position to assist is with respect to the spreading of general awareness about funding opportunities through EU-supported financial instruments, and co-investment by the EIB Group.

BOX: INVEST EU PROGRAMME

The past two decades have witnessed an increasingly important role being given to financial instruments[1] in the EU Budget. Apart from reducing pressure on public resources in a context of budgetary constraints, financial instruments are cost-effective economic development policy instruments. They are particularly suitable in addressing market failures and to promote productive investments in a way that would not be entirely possible through market interactions alone. This shift away from relying almost exclusively on traditional grant-funding towards financial instruments will continue in the 2021-2027 Multi-Annual Financial Framework.

The so-called InvestEU Programme is a key component of the post-2020 EU Budget proposals tabled recently by the European Commission. Building on the success of the Investment Plan for Europe and the European Fund for Strategic Investments (EFSI), the InvestEU Programme will consist of a Fund, an advisory service and a project portal. The InvestEU Fund will merge the multitude of EU financial instruments currently available into a single EU instrument and will target investment in four policy areas: (a) sustainable infrastructure, (b) research, innovation and digitisation, (c) SMEs and (d) social investment and skills.

Financial instruments are intended to complement and leverage EU resources with a view to fill the significant investment gaps that remain in Europe. Although financial instruments are not an answer to all the challenges, their potential as part of an innovative investment approach remains untapped in a number of areas.

Central to the InvestEU Fund is an EU financial guarantee which will be instrumental to draw in private and public financing for viable investments. The Commission proposal foresees an EU guarantee of €38 billion which, together with other financial partners' resources, is expected to mobilise some €650 billion in public and private investment by 2027. The EU guarantee may be used towards risk coverage of a broad range of financing facilities including loans, guarantees, equity and quasi-equity participation and investment platforms – which are, in most cases, similar to those that can be offered by development banks. A novelty in the Commission's proposal is that whereas under the EFSI framework the European Investment Bank (EIB) was fully responsible for the management of the EU guarantee mechanism, under the InvestEU Programme, while the EIB will manage 75 per cent of the EU guarantee, other financial partners such as national development banks will have the possibility to directly access up to 25 per cent of the EU guarantee. This explicit recognition of the more important role being allotted to development banks is welcome since it could help Member States, including Malta, to address local market gaps and sub-optimal investment situations in a more effective manner. In fact, development banks can offer specific expertise, experience and enhanced knowledge of their local market thereby enlarging and diversifying the potential pool of beneficiaries. Access to the EU guarantee by development banks will also partially compensate for the lower allocations in cohesion funds. The Malta Development Bank is in the process of developing and strengthening the appropriate capacities, also through external expertise, which will enable it to be in a position to consider applying for direct access the EU guarantee and at the same time partnering with the European Investment Bank Group.

Such capacity building will enhance the Malta Development Bank's ability to comply with the so-called pillar assessment – a requirement by EU financial regulations that should be fulfilled for any prospective financial partner to be delegated the responsibility of implementing the EU Budget. The assessment consists of an audit that will ascertain the financial partner's readiness in terms of internal control and accounting systems, an independent external audit and rules and procedures for providing finance from EU funds. On the basis of this evaluation, the Commission will then decide whether the partner can be entrusted with EU Budget implementation tasks.

Direct access to the InvestEU Fund would place the MDB in a better position to roll out and implement EU market-based financial instruments tailored to specific local circumstances. The revolving nature of financial instruments means that the Malta Development Bank will be able to recycle and re-use funds over a longer period of time. In addition, the risk-sharing nature of the EU guarantee will foster sustainable financing of investments,

1 Financial instruments are measures of financial support which may take the form of loans, guarantees, equity or quasi-equity investments or other risk-sharing instruments.

while the focus on economically viable projects will help increase access to finance for enterprises which encounter difficulties in obtaining private market funding. Moreover, by accessing the InvestEU Fund, the MDB will be able to leverage additional public or private co-investments to address market failures, while encouraging a move away from grant-dependency.

The legislative process of the proposed InvestEU Programme is well advanced. For the course of 2018, Member States have been engaged in technical negotiations within the Council of the EU with a view to further improve the draft regulation. Stakeholders, including national development and promotional banks, provided their input to this process both through their respective Ministries as well as via their representative European associations. The Malta Development Bank has been actively engaged on both levels to ensure that the InvestEU Programme is also relevant to Malta's economic realities and that, once operational, it will contribute towards better investment prospects that serve local needs.

BANK'S OPERATIONS DURING 2018

CONSULTATION, COLLABORATION AND MARKET INTELLIGENCE

During its first year of operation, the Malta Development Bank embarked on an extensive consultation process with a wide range of domestic stakeholders including banks, public agencies, Ministries and private sector entities with a view to:

- Identify gaps in the financing of viable and productive initiatives;
- Explore financing opportunities with financial intermediaries and other stakeholders;
- develop financial instruments to improve access to financing, in particular instruments that are better suited to the investment needs of SMEs and infrastructure.

Various initiatives have been identified which should contribute significantly to socio-economic development and to the fulfilment of public policy objectives.

The Bank takes an evidence-based and market-compatible approach in the design and operationalization of its programmes. Continuous monitoring of commercial developments based on close collaboration and engagement with market players is a critical ingredient in the Bank's modus operandi.

MOU WITH MALTA ENTERPRISE AND MALTA INDUSTRIAL PARKS LTD.

On 5 April 2018, the MDB signed a Memorandum of Understanding (MOU) with Malta Enterprise and with Malta Industrial Parks Ltd., to facilitate greater collaboration with regard to strengthening assistance and support to enterprises in Malta and to facilitate the financing of new investment. This MOU lays out the principles of cooperation, information sharing and confidentiality. It paves the way for synergies that enable all three entities to expand their reach and effectiveness for the benefit of socio-economic development. This first MOU with strategic partners is an important milestone that bodes well for similar joint initiatives in the future.

CREDIT INSTITUTIONS

The MDB maintains solid cooperation with commercial banks and seeks to leverage on their presence in the Maltese economy. Commercial banks are a valuable source of information in the identification of market gaps. They are also a central point of reference for the MDB in reaching out to SMEs and other potential investors. In fact, the MDB's strategy is that a large part of its financing operations will mainly consist of facilities extended through credit institutions - the so-called second-tier operations. This ensures the fullest possible extent of collaboration between the MDB and the banks. It will also ensure that the MDB does not duplicate the expertise and infrastructure that commercial banks are equipped with. In such facilities, commercial banks would be responsible for the borrower's due diligence process and project appraisal.

MANAGING AUTHORITY (MA)

In line with its remit to act as a vehicle to leverage EU resources, the MDB is committed to collaborate closely with the Managing Authority for EU funds. A number of meetings were held between the two parties with a view to discussing areas of possible collaboration in respect of mobilisation of EU funds. The aim is to seek to establish a framework agreement that takes into consideration each other's role and resources and lays out the principles of cooperation.

Taking full advantage of synergies is crucial in the context of the shift in EU funding approaches, away from one-off grants and towards the greater use of innovative financial instruments. The longer-term sufficiency of funding resources is facilitated by the revolving nature of financial instruments – as the proceeds of loan servicing are available for the next wave of beneficiaries. A further advantage is the opportunity to generate leverage on EU funds by attracting additional national public and private investment and co-financing. The concept of "crowding-in" private investment is strongly emphasized in the search for greater leverage of EU funds. The Investment Plan for Europe, also known as the Juncker Plan, encourages more extensive use of financial instruments, instead of traditional grants from Structural Funds, in areas that include SME support, research and innovation, CO2 reduction, environmental and resource efficiency, information technology and sustainable transport.

Going forward, InvestEU is expected to offer more opportunities for promotional banks to establish themselves as an implementing partner, with the possibility of gaining direct access to the EU guarantee subject to the applicable pillar assessment (see Box 1 on the InvestEU Fund). The Bank is therefore committed to gear up in order to be in a position to possibly act as one of the implementing partners of the EU budget in the next programming period under the InvestEU regime. This would enhance the Bank's ability and potential to fulfil a crucial role in crowding in additional private sector co-investment and complementing the role of the Managing Authority.

NATIONAL DEVELOPMENT AND SOCIAL FUND (NDSF)

MDB recognizes its common interest with the NDSF in pursuance of the respective objectives of the two institutions to support socio-economic development in Malta. Towards this end, the MDB held a number of meetings with the NDSF with a view to exploring areas of possible close collaboration, particularly in respect of projects of national importance and initiatives in the public interest, especially in the social and educational fields

OTHER PUBLIC AND PRIVATE ENTITIES

The MDB has been approached by a number of public and private sector entities in connection with enquiries regarding a broad range of investment initiatives including infrastructural projects in the areas of the green economy, housing, education, health, sustainable industrial investment and SMEs in general.

NATIONAL STATISTICS OFFICE (NSO)

The MDB held a number of meetings with the NSO to seek clarifications on the methodology regarding Eurostat's statistical sector classification of potential transactions relating to the financing of infrastructure projects, and in particular to assess any possible implications of such statistical sector classification on the Government's budgetary operations.

STATE AID MONITORING BOARD (SAMB)

MDB operations require the prior clearance from the SAMB to ensure compliance with the EU's rules on the internal market. MDB and the SAMB share a mutual interest to safeguard market competition and recognise that strict adherence to state aid rules is an important tool in ensuring that enterprises can compete on their merits without any distortion effects on market conditions, to the ultimate benefit of consumers. The MDB held a number of meetings with the SAMB in order to familiarise itself with the institutional procedures and to discuss transactions requiring the prior clearance of the SAMB.

FINANCING FACILITIES FOR SMES

THE FAMILY BUSINESS TRANSFER GUARANTEE SCHEME

The Family Business Transfer Guarantee Facility is the outcome of the first risk-sharing agreement that the MDB signed with a commercial bank. The facility is designed to enhance access to bank credit in respect of family business transfers within the family. It will complement the fiscal incentives offered by the Government in terms of the Family Business Act 2016.

Findings from a market intelligence exercise carried out by the Family Business Office show that it is commonly the case that family businesses planning the continuity of the business are discouraged by the lack of available finance, resulting in certain instances in business closures or take-overs by other interests. Indeed, only a small proportion of family businesses manage to survive in the longer term, with only about 12% of family businesses managing to transfer to the fourth generation.

To date, commercial banks have often been reluctant to provide credit for family business transfers because such transactions were generally perceived to add debt rather than value. This indicates the existence of a market gap and is therefore in line with the remit of the MDB to facilitate access to finance while also complementing the fiscal incentives introduced by the Government in terms of the relevant legislation.

Following extensive consultations with the Family Business Office and Bank of Valletta with the objective of developing a product addressing this market gap, on 1 October 2018, a preliminary risk sharing agreement was signed on the occasion of the conference "A Family Affair – Safeguarding Malta and Europe's Beating Heart". The Family Business Transfer Guarantee Facility should enable more family businesses to transfer their businesses. Such transfers promote continuity, stability and further growth in the future of such businesses – which in Malta constitute a significant segment of the SME sector.

Through this guarantee instrument, the MDB will be contributing partial credit risk protection on the lending portfolio of Bank of Valletta. More specifically, the MDB will provide a guarantee to the commercial bank in respect of a portfolio of up to €10 million with the guarantee capped at €4 million. The MDB will guarantee 80% of each eligible transaction, subject to the capping of 50% at the level of the portfolio. Such risk-sharing will result in better access to finance and more supportive terms and conditions.

On 16 October 2018, the State Aid Monitoring Board issued its opinion that the Scheme is in accordance with the Acquis and provided its clearance. The finalised risk sharing agreement was signed in December 2018.

SME GUARANTEE SCHEMES

Following an initial round of consultation meetings by the MDB with all the core domestic banks to identify the areas where the MDB's collaboration is mainly needed to address the major investment gaps, the MDB conducted more intensive consultations with a view to developing loan guarantee schemes whereby the MDB collaborates with commercial banks to design and provide first-loss portfolio-capped guarantee schemes. A number of banks showed strong interest to develop such schemes in collaboration with the MDB.

Such schemes facilitate higher bank lending to SMEs for new investments, especially in riskier ventures, and are particularly suited to support SMEs with collateral shortage. It is envisaged that these SME schemes will be launched during the course of 2019 and shall provide for broad eligibility, excluding only specific sectors that are outside the remit of the MDB.

SOFT LOANS FUNDED FROM STRUCTURAL FUNDS

During 2018, the MDB has also been holding consultations with the Managing Authority for EU funds with a view to establishing a working relationship in connection with the MDB's potential role as a vehicle for leveraging EU resources. These consultations are intended to explore the possibility of forms of collaboration to develop new financial instruments that would combine a grant element with a guarantee element, funded from EU structural funds Negotiations with the Managing Authority were focused mainly on an initiative to develop such a new financial instrument in the education sector which would be managed by the MDB as a fund of funds manager. Such a financial instrument would enable more students to further their tertiary education by benefitting from enhanced access to banking finance, enjoying longer moratorium periods, better collateral relief and more affordable repayment terms.

This type of setup and collaboration between the MDB and the Managing Authority can be very effective in crowding-in private investment, such as that provided by commercial banks, to generate portfolios of a much larger size. In particular, such collaboration can result in the expansion of the reach and scope of such financial instruments, leaving a larger impact on Malta's socio-economic development.

COMBINED CO-FINANCING WITH PARTIAL GUARANTEE SCHEME

In addition to SME loan guarantee schemes, another area that the MDB has been exploring in 2018 is a hybrid product that combines co-financing and a partial financial guarantee from the MDB. In November 2018, the MDB held a consultation meeting with all the core domestic banks to present and discuss such an innovative SME scheme that would be financed jointly with the participating banks on a pari passu basis and would be intermediated by the commercial banks. The objective is to broaden the range of facilities that the MDB can offer to the banks to support viable operations where the financial market is unable or unwilling to provide the needed funding on its own.

The preliminary response of the commercial banks to this new financial instrument was very positive and the Bank is engaged in consultations with the banks to take the process forward.

The MDB in principle is prepared to offer this type of co-financing plus partial guarantee product to the banks both within a dedicated scheme backed by a fund earmarked specifically for such a scheme, as well as on an ad hoc basis where individual requests from banks can be treated on their own merits.
Such a facility should be instrumental to enable financial intermediaries to expand the range and volume of loans to SMEs and to contribute to additionality in terms of new investment in targeted business activities which otherwise would not have occurred in the absence of such MDB intervention, particularly in respect of riskier business proposals.

DIRECT FINANCING FACILITIES FOR INFRASTRUCTURE

Besides SME credit enhancement programmes, the MDB during 2018 has also been looking into how to engage in first-tier operations in the form of direct lending and co-financing of infrastructural projects – the other major area where there could be significant market failures and investment gaps. The focus has been mostly on infrastructural projects related to education, health, renewable energy, the environment, affordable housing and other initiatives with a social dimension, as well as projects that enhance Malta's competitiveness.

During the year the MDB has been approached by a number of entities, both public and private to enquire on the possible role of the MDB in facilitating the financing of new investment in connection with infrastructural projects. Most consultations in this regard are still at an exploratory stage. The MDB's preference is that such investments would be financed in conjunction with the commercial banks, thereby highlighting the collaborative arrangement that the MDB would like to develop with the banks and also to foster the promotion of a syndicated loan market in Malta – which so far has played a somewhat subdued role.

CAPACITY BUILDING AND ORGANISATIONAL SET UP

MDB is in the process of strengthening its expertise in finance markets for SMEs and infrastructure projects that would allow it to take an evidence-based and market-driven approach in addressing investment gaps. Following the first wave of recruitment to fill the managerial posts of the various business areas, the MDB embarked on its capacity building process to strengthen its organizational and technical capacity.

Towards this end, the MDB has submitted a formal request for support under the Structural Reform Support Programme (SRSP), which is an EU programme that provides tailor-made support to all EU countries for their institutional, administrative and growth-enhancing reforms. Support has been sought in a number of areas with the objective to deepen the Bank's technical knowhow and to gear up in order to be able to consider applying for the Commission's "pillar assessment" for eligibility to gain direct access to the EU Guarantee under the post-2020 Invest EU programme.

In addition, MDB is also holding consultations with the European Investment Advisory Hub (EIAH) and the European Investment Bank with a view to applying for the Call for expression of interest for capacity building support and technical assistance.

SIGNIFICANT EVENTS IN 2018

Photo courtesy of DOI

MDB PRESENTATION TO PRIME MINISTER

On 16 January 2018, the Chairman and Board of Directors held a meeting with the Prime Minister, Hon. Joseph Muscat, who was accompanied by Prof. Edward Scicluna, Minister for Finance, Mr. Louis Grech, Special Advisor to the Prime Minister, and Mr. Keith Schembri, Head of Staff in the Prime Minister's Secretariat.

Prof. Bonnici outlined the MDB's role, the business strategy and the policy thrust of the Bank. The first task of the Bank was to hold a broad consultation process with the banks and other major stakeholders with a view to explaining the functions of the Bank and obtaining a good insight of the main investment gaps that needed to be addressed within the Bank's public policy objectives.

The Prime Minister highlighted a number of priority areas that featured prominently within the Government's economic development programme. The brisk pace of economic growth provided significant opportunities for new investment and there appeared to be considerable scope for the MDB to complement other financial intermediaries to drive the investment process forward where the market might possibly not be willing or able to accommodate in whole or part the relative financing requirement.

As part of its awareness raising programme and to improve visibility, MDB was actively involved in a number of conferences, seminars and events that took place in Malta over the course of the year. Such participation provided the MDB with the opportunity to explain its role and objectives to a wide range of stakeholders from various sectors.

MIA SME FORUM

On 25 May 2018 the MDB participated in the SME Forum organised by the Malta Institute of Accountants. Mr. Rene Saliba, Chief Executive Officer, was part of a Discussion Panel on "Solutions for SMEs" and discussed the MDB's role as a source of new financing opportunities.

Leveraging EU Funds – A Development Bank Perspective – Prof. Josef Bonnici, Chairman, delivered a presentation on how the setting up of the MDB could boost the use of EU funds for Malta during two events that were held to discuss Leveraging EU Funds from a Development Bank perspective.

One event, held in Gozo on 31 May 2018, was organised by the Gozo Business Chamber and Bank of Valletta, and was attended by the Gozo business community, including project promoters, start-ups and business-men interested in EU funding and investment opportunities. Presentations on the latest developments from an EU and Malta Development Bank perspective, together with practical experiences in leveraging EU funding by the Hungarian Development Bank and the Bank of Valletta attracted great interest. The main speaker was Ms. Estelle Goger, team leader for the Investment Plan for Europe. The event was closed by the Hon. Dr. Justyne Caruana, Minister for Gozo.

Another seminar, organised by the Malta Chamber of Commerce and Bank of Valletta on 1 June 2018, saw representatives from the Malta Chamber of Commerce, European Commission's Directorate-General Economic and Financial Affairs, the Malta Development Bank and the European Investment Advisory Hub contribute to the discussion, together with Parliamentary Secretary Aaron Farrugia and the Head of Representation Dr. Elena Grech. The Hungarian Development Bank and Bank of Valletta also presented concrete experiences in leveraging EU funding.

MDB WORKSHOP FOR MGI AND MIMCOL

On 6 September 2018 the MDB held a Workshop organized by Malta Government Investments (MGI) and Malta Investment Management Co Ltd (MIMCOL) for Government-owned enterprises. The Workshop was opened by Prof. Josef Bonnici and Mr. Herald Bonnici, Chief Executive Officer MGI, and included presentations by Bank officials on the role of the Bank, the facilities offered and ways of collaborating with Government-owned enterprises. The Workshop was closed by the Hon Chris Cardona, Minister for the Economy, Investments and Small Businesses.

MDB PRESENTATION TO MHRA

On 28 September 2018, a meeting was held with Mr. Tony Zahra, President, and Mr. George Micallef, Senior Vice President, of the Malta Hotels and Restaurants Association. Prof. Bonnici made a presentation on the functions of the MDB, the business plan and facilities offered. The discussion focused on the main issues being faced by the industry and possible ways how the MDB could provide support.

FAMILY BUSINESS CONFERENCE

On 1 October 2018, Prof. Josef Bonnici, Chairman, participated in the conference 'A Family Affair – Safeguarding Malta and Europe's Beating Heart', the first event marking the SME Week hosted by the Chamber of Commerce. This event saw the signing of the Risk Sharing Agreement between the MDB, Bank of Valletta and the Family Business Office in connection with the MDB-BOV Family Business Transfer Guarantee Scheme. It was explained that this initiative will assist family businesses to benefit from better access to bank finance when transferring their businesses to other members within the family. The President of the Malta Chamber of Commerce, Mr. Frank V Farrugia, announced that the Family Business Office and the Malta Chamber of Commerce signed an agreement whereby a Family Business Committee was established.

In addition, the Family Business Office and Bank of Valletta organised a series of information sessions as well as one-to-one sessions with potential applicants, both in Malta and Gozo, to explain the main features of the Family Business Act and the fiscal incentives to encourage the transfer of family businesses within the family, as well as to describe the objectives and terms and conditions of the Family Business Transfer Guarantee Scheme.

The meeting was opened by an address by Prof. Josef Bonnici, who was followed by presentations on the role of the MDB and the main features of the proposed scheme as well as on the legal aspects of this co-financing arrangement.

The facility is designed to enable financial intermediaries to expand the range and volume of loans to SMEs which will also benefit from lower interest rates, longer maturities and a generally improved access to finance for riskier business proposals.

On 14 November 2018, the MDB held a consultation meeting with the core domestic banks to present and discuss proposals regarding an innovative SME scheme to be intermediated by the participating banks combining co-financing and a partial financial guarantee. The objective is to support productive and viable operations where the financial market is unable to provide such activities on its own.

The well-attended meeting provided an opportunity for the Bank to sound out the preliminary views and insights

of the banking community. The meeting was opened by an address by Prof. Josef Bonnici, who was followed by presentations on the role of the MDB and the main features of the proposed scheme as well as on the legal aspects of this co-financing arrangement.

The facility is designed to enable financial intermediaries to expand the range and volume of loans to SMEs which will also benefit from lower interest rates, longer maturities and a generally improved access to finance for riskier business proposals.

FINANCING ENERGY EFFICIENCY IN MALTA AND ITALY

On 22nd November 2018, the MDB participated in a conference on 'Financing Energy Efficiency in Malta and Italy. This conference aimed to share best practices from Malta and Italy as well as other countries on how to finance energy efficiency investments. It covered, among others, experience gained with the use of private funds and innovative financing instruments, notably in the building and industry sectors. Speakers focused on practical insights into developing and structuring investment programmes. This event was organised by the European Commission in partnership with the UN Environment Finance Initiative, the Ministry for Energy and Water Management of Malta and the Ministry of Transport, Infrastructure and Capital Projects of Malta. Mr Rene Saliba, Chief Executive Officer, delivered a presentation on "Financing energy efficiency opportunities in industry and SMEs".

The Conference was part of the Sustainable Energy Investment Forums, funded by the Horizon 2020 programme of the European Union.


SALIBA
Rene
HERRERA
Karl
SALIBA
Geoffrey


EUROPE
HOUSE
MDB

INTERNATIONAL AFFILIATIONS AND COOPERATION

During 2018, one of the primary goals of the MDB was to establish close cooperation with a number of international associations, multinational development institutions and foreign development banks.

INTERNATIONAL ASSOCIATIONS

EUROPEAN ASSOCIATION OF PUBLIC BANKS (EAPB)

During 2018, the MDB became a member of the EAPB after delivering a presentation on the MDB's role and functions to the members of the EAPB's Administrative Board on 18 April 2018 and to the General Assembly in the Annual Meeting on 5 June 2018.

Malta's relationship with the EAPB dates back to 2012 when a delegation from the Central Bank of Malta had visited the EAPB to familiarise itself with the general functions of promotional banks and the business model of such institutions. The close relationship with the EAPB was also maintained by the MDB Working Group which participated in a number of events and workshops and benefited from the Association's technical expertise.

The EAPB includes around 30 member organizations (mainly promotional financial institutions, funding agencies, public banks, associations of public banks and banks with similar interests) from 15 European Member States. Its members represent directly or indirectly the interests of over 90 financial institutions engaged in promotional operations in the public interest.

EUROPEAN LONG-TERM INVESTORS (ELTI)

During the year, the MDB also became a member of ELTI after the Bank's application was approved by the General Assembly. This organisation represents a Network of long-term investment institutions which comprises 20 Full Members and 7 Associate Members from 27 countries. Its members include national promotional banks, multilateral financial institutions, regional financial institutions, commercial banks as well as non-banking institutions like pension funds, insurance companies and associations.

THE NETWORK OF EUROPEAN FINANCIAL INSTITUTIONS FOR SMES (NEFI)

The MDB also applied for membership of NEFI and on 29 June 2018 delivered a presentation on the MDB to the Permanent Working Group. The NEFI members agreed to recommend that the MDB's application will be accepted by the Network's High-Level Meeting in its next session.

NEFI comprises 19 financial institutions from 19 EU Member States. All NEFI members share a public mission to facilitate the access to finance for SMEs by offering them financial services (mainly loans and guarantees and, to a lesser extent, equity finance and venture capital) and expertise. NEFI members act in a complementary manner to and in cooperation with the national banking system through co-financing, risk-sharing, expertise and advisory services in order to address shortcomings in the SME financial markets.

Membership in these associations provides the MDB with various benefits, including exchange of information, interfacing and sharing of technical experiences and best practices; being part of a strong lobby group representing their Members at a European level; participating in consultations and discussions with EU institutions on financial instruments, regulations and legislative proposals, as well as facilitating dialogue and strategic alliances with other development banks and institutions.

MULTINATIONAL DEVELOPMENT INSTITUTIONS

EIB GROUP (EUROPEAN INVESTMENT BANK AND EUROPEAN INVESTMENT FUND)

The European Investment Bank (EIB) mobilises sound banking resources for projects by acting as a catalyst for private investment by commercial banks, national promotional banks and other financial institutions. Accordingly, there appear to be considerable scope for opportunities for synergies between the EIB Group and the MDB in various policy areas such as climate change, environment, innovation and social and human capital development. Indeed, during the course of 2018, the MDB has conducted a series of extensive consultations with the EIB in connection with various areas of possible close collaboration. These consultations have focused in particular on technical assistance as well as on the possibility of obtaining refinancing facilities for on-lending to local investors both in the private and public sectors.

The MDB during the year also conducted consultations with the European Investment Fund (EIF) to explore possible ways of collaboration. The MDB's role in leveraging EU resources can be significantly enhanced through such collaboration with the EIF, particularly in view of the latter's role as a specialised provider of risk finance for the benefit of SMEs, especially through the provision of loan guarantee arrangements and counter guarantees for the SME sector under the COSME programme

Another form of collaboration with the EIF is through the MDB's membership in the Network of EIF- EU NPBs on Securitisation (ENSI) which is chaired by the EIF. ENSI is a pan-European Securitisation Network which comprises the EIF and promotional banks from Germany, France, Italy, UK, Spain, Portugal and Malta. To date, this Network has launched two pan-EU securitisation platforms to facilitate greater access to finance by SMEs, namely the EIF-NPB Securitisation Initiative (ENSI) in June 2016 and the EFSI Investment Platform in December 2016 (EFSI-IP). The Network communicates mainly through monthly teleconferences and exchange of emails as well as periodic workshops.

EUROPEAN INVESTMENT ADVISORY HUB

During the year, the MDB also held consultations with the European Investment Advisory Hub (EIAH), to seek ways of close collaboration. The EIAH is an important source of advisory services on how to develop financial instruments that address market gaps in various priority sectors. It also provides project development support, advisory services to enhance SMEs' ability to access funding, as well as training and guidance on technical issues related to new investment. The MDB is therefore discussing the possibility of a roadshow being organized by the EIAH in Malta in 2019. Such a roadshow will be an opportunity for the Hub to gain visibility and exhibit its services to potential beneficiaries in Malta. Collaboration with the EIAH will also enable the MDB to develop its potential role in respect of awareness-raising and advisory services on EU financial instruments as well as general support to SMEs. Towards this end, the MDB is discussing the possibility of technical assistance from the Hub in connection with capacity building.

COUNCIL OF EUROPE DEVELOPMENT BANK (CEB)

The CEB promotes social cohesion and integration by providing financing facilities and technical expertise for projects with a high social impact, particularly projects that contribute to sustainable and inclusive growth, integration of refugees, displaced persons and migrants, as well as climate action. In view of the promotional role of the MDB and the priority it gives to projects with a strong social dimension, the Bank sees a lot of potential synergies with the CEB. Accordingly, during 2018 the MDB initiated consultations with CEB to establish a close working relationship and explore possibilities of collaboration particularly in connection with financing facilities for social infrastructure.

FOREIGN DEVELOPMENT BANKS

MDB has developed a solid working relationship with a number of European promotional institutions. Such cooperation will enable operational synergies and knowledge sharing, which are of fundamental importance given the early stage of MDB's development. Besides technical knowledge sharing, such close relationships with other European promotional banks can also be instrumental as a source of long-term financing. There could also be scope to develop strategic alliances and to explore possibilities where such institutions could possibly act as co-financiers or co-investors, for individual schemes, investment platforms or investment vehicles.

RISK AND CAPITAL MANAGEMENT

Pursuant to the MDB Act, the Bank takes risks consciously to support the entrepreneurship and socio-economic development in Malta. Albeit in its early stages, during 2018, the MDB set on working towards achieving the required balance between sustainable profitability and growth against the appropriate risk levels. Rather than profit maximisation, the aim of the MDB is to price its facilities to fully cover its administrative and operational expenses plus an adequate margin in respect of the risks assessed within the Bank's public policy objectives.

Within this context, the MDB is building an organisational structure based upon a framework that promotes a transparent and efficient, enterprise-wide risk management culture wherein the behaviour, attitude and decisions reflect risk awareness and mitigation of the Bank. This involves the establishment of a strong governance structure and a robust risk management framework which includes risk control processes within the Bank's policies relating to the Credit Risk Policy, the Risk Appetite Framework and the Credit Risk Mitigation Policy.

The business philosophy of the Bank is that the risk management framework will also be complemented by a corporate culture based on strong ethical practices and sound integrity, focusing on a good governance oversight structure and a control environment underpinned by reasonable assurance controls and segregation of authorization processes.

RISK GOVERNANCE

During 2018, MDB has been actively engaged on the development of a Risk Appetite Framework (RAF) that articulates the levels of risk which the Bank wishes to take in pursuit of its entrepreneurial and socio-economic objectives. The RAF will be supported by a three lines of defence approach which is in the process of being implemented.

The first line of defence – which will be executed by the Business Development Department and the Credit Department – is responsible to integrate the RAF within the relevant business processes and to properly implement the risk appetite statements on a day to day basis. This will ensure awareness to identify, control and report breaches of the established risk limits and qualitative provisions.

The main responsibility of the second line of defence is to perform a centralised oversight of the Risk Appetite Statement and lead its implementation by conducting risk assessments, monitoring and providing regular reporting and communication to the Board of Directors. This will be executed by the Risk Management Department.

The third line will be carried out by an audit firm that will be commissioned to carry out the internal audit function of the Bank[2]. The selected audit firm is expected to provide independent assurance to the MDB Board of Directors by conducting audits evaluating the first and second lines of defence with regard to efficiency in adhering to the Bank's risk appetite. Through this approach, the responsibility for risk management resides at all levels within the Bank.

This risk governance framework is envisaged to allow for the proper understanding of existing and emerging risks through cooperation between all three lines of defence and to effectively execute the risk management controls. The collective effort across different lines of defence shall ensure that MDB's risk culture is recognised as an essential factor to achieve its entrepreneurship and socio-economic objectives.

2 To this effect, on 18 December 2018 the MDB issued a public call for expression of interest for the provision of internal audit services to the Bank.

RISK MANAGEMENT

During 2018, the Bank identified the following material risks to which mitigation actions are in the process of being implemented:

DESCRIPTION	RISK MANAGEMENT
CREDIT RISK It is the risk of financial loss from the failure of a counterparty to fulfil its contractual obligations, or from the increased risk of default during the term of the transaction.	During 2018, MDB's on-balance sheet credit risk exposure emanated from funds that were deposited with financial intermediaries. The off-balance sheet credit risk exposure was nil in 2018. In 2019, this is expected to increase up to €4 million reflecting the MDB's guarantee fund in respect of the Family Business Scheme. Further credit risk is envisaged in terms of other proposed Guarantee schemes as outline in Section I above. As MDB's primary business functions are the provision of credit and issuing of guarantees, the Risk Management Department is in the process of drafting a Credit Risk Policy and a Credit Risk Mitigation Policy. The Credit Policy will provide clear guidelines to the process of extending credit, such that the assumed credit risk is commensurate to the Bank's risk appetite. Moreover, the Credit Policy will ensure that every department works in a structured and dynamic manner upon extending credit to achieve the Bank's objectives. On the other hand, the Credit Risk Mitigation Policy will set the Bank's credit risk mitigation measures which are ancillary to, and complement, core credit risk considerations to ensure good and responsible lending. Both policies are being drafting with a forward-looking approach and with an objective to act preventively. In order to mitigate credit risk and reduce operating costs, MDB, in accordance with Act No XXI of 2017, issues guarantees and on-lends its placements via commercial banks that assume the risk of collecting repayment from final borrowers. Wherever possible, MDB also requests collateral with the ratio between the placement value and the collateral determined by referring to the envisaged risks as well as the type of loan programme, including the underlying general terms and conditions. Moreover, Act No XXI of 2017 provides for a Government Guarantee of up 100% of MDB's assets and liabilities. As at 31.12.2018, the Government Guarantee of €50 million was not yet being utilised.
LIQUIDITY RISK AND INTEREST RATE RISK IN THE BANKING BOOK (IRRBB) Liquidity risk refers to the risk of incurring losses due to the inability of meeting obligations as they become due. Interest Rate Risk in the Banking Book (IRRBB) is the risk posed by adverse movements in interest rates that affect the bank's banking book positions.	During 2018, MDB did not assume any material liquidity risk and interest rate risk in the banking book (IRRBB). Nonetheless, as MDB's activity is expected to increase during 2019, the Bank will be ensuring quality management of liquidity and IRRBB through the setting up of a Risk Committee. This Committee will ensure the reduction of liquidity and interest rate risk to the lowest possible levels. The Bank also plans to step up its liquidity and IRRBB monitoring through scenario analyses and sensitivity analysis both under regular business conditions and under stress.
OPERATIONAL RISK The risk of losses resulting from inadequate or failed processes, people and internal systems, or from external events.	No material operational risks were identified during 2018. After the implementation of the Credit Policy and the Credit Risk Mitigation Policy, the Bank intends to develop an Operational Risk Management Policy. The Bank will also define the approach to the calculation of capital requirements for operation risk

CAPITAL MANAGEMENT AND PLANNING

Capital management and planning will be a fundamental process of the Bank's risk management function. The aim is to create a common framework of action that addresses and manages all types of risks with a view to ensure that adequate mitigating actions are taken to reduce the negative impacts of adverse movements on the operations of the Bank and on the financial statements.

MDB plans to actively manage capital in an integrated way by seeking to fulfil the Supervisory Board's requirements, guarantee solvency, and achieve long-term sustainability by holding reserves that sufficiently meet the risks inherent in the Bank's operations. To achieve this, MDB plans to apply the following structured approach:

- Complement the current and future business planning with adequate capital planning to meet the supervisory requirements and the associated risks, while maintaining the risk profile set by the Board of Directors within the Bank's public policy objectives.
- Ensure that sufficient capital is maintained to cover extreme volatilities inherent in the financial markets, the timing of the macroeconomic cycles of crisis and the consequent unpredictability of events.
- Ensure efficient use of capital and in return, to the extent possible, maximise the delivery of the Bank's public policy objectives.

Through this structured approach, it is ensured that the MDB is adequately capitalised to achieve its public policy objectives as set by the Board of Directors.

OWN FUNDS

MDB's capital base is composed of Common Equity Tier 1 (CET 1) capital, that is, common stock. As CET 1 capital is the highest form of quality capital, MDB intends to put much of its emphasis and monitoring on this capital element when it comes to capital planning and management. This shall provide the greatest level of protection against the assumed losses. As at 31 December 2018, the MDB's own funds amounted to €29.5 million, as can be seen from the Table below.

MDB OWN FUNDS	
	DEC-2018
Paid-in capital	€ 30,000,000
Accumulated losses	(€ 458,177)
CET 1 capital	**€ 29,541,823**

During the financial year 2019, the MDB's paid-in capital shall be increased by a further €10 million through a capital injection by the Government of Malta, in line with the MDB's business plan.

By considering the Standardised Approach for credit risk and the Basic Indicator Approach for operational risk, the total risk weighted assets as at the end of the financial year 2018 amounted to €14.9 million. This translates into a CET 1 ratio of 197.5%.

MALTA DEVELOPMENT BANK

FINANCIAL STATEMENTS FOR THE PERIOD ENDED 31 DECEMBER 2018

DIRECTORS' REPORT

The Directors present this report together with the audited financial statements of the Malta Development Bank ("the Bank") for the period 11 December 2017 to 31 December 2018 in accordance with Article 33 of the Malta Development Act (Act no XXI of 2017 Chapter 574, Laws of Malta) ("the Act").

BOARD OF DIRECTORS

In exercise of the powers conferred by Article 21 of the Act, the Minister for Finance appointed the following Directors on 11 December 2017:

CHAIRMAN
Prof. Josef Bonnici

DIRECTORS
Mr. Paul Abela
Dr. Rose Mary Azzopardi
Mr. Robert Borg
Mr. Paul Cardona
Mr. Godfrey Grima
Mr. Anthony Valvo

These appointments are valid for the periods stipulated in Article 21(4), (5) and (6) of the Act.

Mr. Rene Saliba was appointed Secretary of the Board on 11 December 2017.

PRINCIPAL ACTIVITIES

The Bank was set up by the Act which was passed on 5 May 2017 and came into effect on 24 November 2017 in terms of Legal Notice No. 340 of 2017. The Bank is fully owned by the Government of Malta.

The Bank performs a promotional role in line with public policy. It is principally engaged in addressing market failures by offering financing facilities to support productive and viable operations where the market is unable or unwilling to accommodate such activities on its own in whole or part. The MDB's operations are mainly intermediated through the local credit institutions and are focused on the provision of facilities to SMEs and infrastructure projects that contribute to socio-economic development.

REVIEW OF BUSINESS DEVELOPMENTS

During the accounting period under review, the Bank commenced its capacity building process with the setting up of the organisational structure and governance framework. The Bank completed the first wave of recruitment and filled various managerial posts. Concurrently, the Bank also performed a wide consultation process with stakeholders including local financial intermediaries, government entities, small and medium sized entities and international financial institutions. The Bank signed its first risk sharing agreement with a local bank in October 2018 in respect of a loan guarantee scheme for family business transfers.

FINANCIAL PERFORMANCE

In December 2017, the Bank received a cash injection of €30,000,000 representing proceeds from the portion of the initial subscribed share capital that has been paid up by the Government. The Bank reported a loss of €458,177 for the period under review, representing start-up costs. Total assets stood at €29,569,993 as at the period end. Other results may be referred to in the Statement of Financial Position and Statement of Comprehensive Income on pages 46 and 47 respectively.

PRINCIPAL RISKS AND UNCERTAINTIES

The main risk that the Bank has identified is credit risk arising from the Risk Sharing Agreement signed with a financial intermediary to meet the needs of family business transfers and, to a lesser extent, from funds deposited with financial intermediaries. Other risks which are closely monitored by management include liquidity risk, interest rate risk and operational risks.

The Bank is in the process of developing a risk management framework to correctly evaluate the risks and take a holistic approach to risk management.

DIRECTORS' RESPONSIBILITIES

The Board of Directors is responsible to ensure that the financial statements are drawn up in accordance with the requirements of the Act. The Act requires the Directors to approve financial statements which give a true and fair view of the financial position of the Bank as at the end of the financial year and of the profit or loss of the Bank for that period. In approving these financial statements, the Directors are responsible for:

- Selecting suitable accounting policies and applying them consistently from one accounting year to another.
- Making judgements and estimates that are reasonable and prudent.
- 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 going concern.

The Directors are responsible for the direction of the general operations of the Bank as well as the administration of the affairs and the business of the Bank. The Directors are also responsible for safeguarding the assets of the Bank, by overseeing the management of the Bank's loan portfolio to control risks and by taking reasonable measures for the prevention and detection of fraud and other irregularities.

The Directors, through their oversight of management, are responsible to ensure that the Bank establishes and maintains the appropriate internal controls to provide reasonable assurance with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

The Directors are responsible, through their oversight of management, to establish a control environment and maintain policies and procedures to assist in achieving the objective of ensuring, as far as possible, the orderly and efficient conduct of the Bank's business. This responsibility includes establishing and maintaining controls pertaining to the Bank's objective of preparing financial statements as required by the Act and managing risks that may give rise to material misstatements in those financial statements.

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

EVENTS OCCURRING AFTER REPORTING DATE

No significant events have taken place since the financial reporting date that would have otherwise required adjustment to and/or disclosure in this annual report.

AUDITORS

PricewaterhouseCoopers were approved as auditors of the Bank on 18 January 2019 following a public call for expressions of interest for the provision of independent external audit services.

Approved by the Board of Directors on 22 March 2019 and signed on its behalf by:

PROF. JOSEF BONNICI
Chairman

MR. ROBERT BORG
Director

Registered Address

Malta Development Bank
Pope Pius V street
Valletta, Malta
Tel: +356 22261700

CONTENTS

STATEMENT OF FINANCIAL POSITION

	NOTES	31 DECEMBER 2018
		€
ASSETS		
Loans and advances to banks	10	**29,422,906**
Property and equipment	11	**61,395**
Other assets	12	**85,692**
Total assets		**29,569,993**
LIABILITIES		
Payables and accruals	13	**28,170**
Total liabilities		**28,170**
EQUITY		
Called up share capital	14	**30,000,000**
Accumulated losses		**(458,177)**
Total equity		**29,541,823**
Total liabilities and equity		**29,569,993**

The accompanying notes are an integral part of these financial statements.

The financial statements on pages 46 to 63 were approved by the Board of Directors on 22 March 2019 and signed on its behalf by:

PROF. JOSEF BONNICI
Chairman

MR. ROBERT BORG
Director

STATEMENT OF COMPREHENSIVE INCOME

	NOTES	PERIOD FROM 11 DECEMBER 2017 TO 31 DECEMBER 2018
		€
Interest income	7	**89,972**
Interest expense and similar charges	8	**(38,431)**
Net interest income		**51,541**
Depreciation	11	**(5,367)**
Personnel expenses	9.2	**(366,058)**
Other operating expenses	9.4	**(138,293)**
Total operating expenses		**(509,718)**
Loss for the period		**(458,177)**

The accompanying notes are an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY

	SHARE CAPITAL	ACCUMULATED LOSSES	TOTAL EQUITY
	€	€	€
Capital contributed by Government of Malta	30,000,000	-	30,000,000
Loss for the period	-	(458,177)	(458,177)
Balance at 31 December 2018	**30,000,000**	**(458,177)**	**29,541,823**

The accompanying notes are an integral part of these financial statements.

STATEMENT OF CASH FLOWS

	NOTES	PERIOD FROM 11 DECEMBER 2017 TO 31 DECEMBER 2018
		€
Cash flows from operating activities		
Cash used in operations before changes in operating assets/liabilities	15	**(25,023,950)**
Net cash used in operating activities		**(25,023,950)**
Cash flows from investing activities		
Payments to acquire property and equipment	11	**(66,762)**
Net cash used in investing activities		**(66,762)**
Cash flow from financing activities		
Capital contributed by the Government of Malta	14	**30,000,000**
Net cash from financing activities		**30,000,000**
Net increase in cash and cash equivalents		**4,909,288**
Cash and cash equivalents at end of period	**16**	**4,909,288**

The accompanying notes are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

NOTES TO THE FINANCIAL STATEMENTS

1. REPORTING ENTITY

Malta Development Bank (the "Bank") was set up on 24 November 2017 by virtue of the Malta Development Bank Act 2017 (Chapter 574, Laws of Malta) ("the Act") and commenced operations on 11 December 2017 when the Board of Directors held its first meeting. The Bank's registered office is Malta Development Bank, Pope Pius V Street, Valletta VLT 1041, Malta.

2. BASIS OF PREPARATION

These financial statements cover the period from 11 December 2017 to 31 December 2018. The financial statements have been prepared on a historical cost basis; except for financial assets which have been measured at fair value.

The Bank presents its statement of financial position broadly in order of liquidity.

2.1 STATEMENT OF COMPLIANCE

These financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and comply with the Malta Development Bank Act, Cap. 574 of the Laws of Malta.

2.2 FUNCTIONAL AND PRESENTATION CURRENCY

These financial statements are presented in Euro, which is the Bank's functional currency. All amounts have been rounded to the nearest Euro, except when otherwise indicated.

2.3 SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

In the opinion of the directors, the accounting estimates and judgements made in the course of preparing these financial statements are not difficult, subjective or complex to a degree which would warrant their descriptions as significant and critical in terms of the requirements of IAS1: *Presentation of Financial Statements.*

3. CHANGES TO ACCOUNTING POLICIES AND DISCLOSURES

3.1 STANDARDS, INTERPRETATIONS AND AMENDMENTS TO PUBLISHED STANDARDS THAT ARE NOT YET ADOPTED

Certain new standards, amendments and interpretations to existing standards which are mandatory for accounting periods beginning on or after 1 January 2018 have been published by the date of authorisation for issue of this financial information. The Bank's directors are of the opinion that, with the exception of the below, there are no requirements that will have a possible significant impact on the Bank's financial statements in the period of initial application.

3.1.1 IFRS 9 'Financial Instruments'

In July 2014, the IASB issued IFRS 9 'Financial Instruments', which is the comprehensive standard to replace IAS 39 'Financial Instruments: Recognition and Measurement', and includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

Classification and measurement

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

Impairment

The impairment requirements apply to financial assets measured at amortised cost and FVOCI, and certain loan commitments and financial guarantee contracts. At initial recognition, an impairment allowance (or provision in the case of commitments and guarantees) is required for expected credit losses (ECL) resulting from default events that are possible within the next 12 months (12-month ECL). In the event of a significant increase in credit risk, an allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument (lifetime ECL). Financial assets where 12-month ECL is recognised are considered to be 'stage 1'; financial assets which are considered to have experienced a significant increase in credit risk are in 'stage 2'; and financial assets for which there is objective evidence of impairment, so are considered to be in default or otherwise credit impaired, are in 'stage 3'.

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

Transition

The requirements of IFRS 9 'Financial Instruments' will be adopted from 1 January 2019. The classification and measurement and impairment requirements are applied restrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate the comparative periods. The Bank is in the process of identifying any material impact on the Bank arising from the adoption of this standard.

3.1.2 IFRS 15 'Revenue from contracts with customers'

IFRS 15, 'Revenue from contracts with customers' deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognised when customer obtains control of good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' and related interpretations. The standard is effective for annual periods beginning on or after 1 January 2018 and earlier application is permitted. The Bank is in the process of identifying any material impact on the Bank arising from the adoption of this standard.

3.1.2 IFRS 16 'Leases'

Under IFRS 16, 'Leases', contract is, or contains, lease if the contract conveys the right to control the use of an identified asset for period of time in exchange for consideration. IFRS 16 requires lessees to recognise lease liability reflecting future lease payments and 'right-of-use asset' for virtually all lease contracts; an optional exemption is available for certain short-term leases and leases of low-value assets. The standard is effective for annual periods beginning on or after 1 January 2019 and earlier application is permitted. The Bank's non-cancellable commitments on its operating leases at reporting date are not significant and therefore the directors do not anticipate that the transition to IFRS 16 to result in material amounts recognised on-balance-sheet, and any differences in the timing and pattern of recognition of costs in respect of leases under IFRS 16, as compared to IAS 17, will not be material.

4. FOREIGN CURRENCY TRANSLATION

Transactions in foreign currencies are translated in the functional currency of the Bank at the foreign exchange rate prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into the functional currency at the foreign exchange rate ruling at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the year, adjusted for effective interest and payments during the year, and the amortised cost in foreign currency translated at the spot exchange rate at the end of the year.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated into the functional currency at foreign exchange rates ruling at the dates the fair values were determined.

Foreign currency differences arising on retranslation are recognised in profit or loss.

5. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently in the period presented in these financial statements.

5.1 FINANCIAL ASSETS AND LIABILITIES

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near term.

Loans and advances to banks and loans and advances to customers are classified as loans and receivables.

Loans and advances to customers are recorded when the Bank advances money to purchase or originate an unquoted non-derivative receivable from a customer due on fixed or determinable dates and has no intention of trading the receivable. Loans and advances to customers are carried at amortised cost, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the effective interest rate. The losses arising from impairment are recognised in the income statement.

5.2 IMPAIRMENT OF FINANCIAL ASSETS

The Bank assesses, at each reporting date, whether there is any objective evidence that a financial asset or a group of financial assets is impaired. An impairment exists if one or more events that has occurred since the initial recognition of the asset (an incurred 'loss event'), has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and observable data indicating that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Financial assets carried at amortised cost

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

The amount of any impairment loss identified is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate.

The carrying amount of the asset is reduced through the use of an allowance account and the loss is recognised in the income statement. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a write-off is later recovered, the recovery is credited to finance costs in the income statement.

5.3 DERECOGNITION OF FINANCIAL ASSETS

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is primarily derecognised (i.e. removed from the Bank's statement of financial position) when:

- The rights to receive cash flows from the asset have expired, or

- The Bank has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either (a) the Bank has transferred substantially all the risks and rewards of the asset, or (b) the Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Bank has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, it evaluates if, and to what extent, it has retained the risks and rewards of ownership. When it has neither transferred nor retained substantially all of the risks and rewards of the asset, nor transferred control of the asset, the Bank continues to recognise the transferred asset to the extent of its continuing involvement. In that case, the Bank also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Bank has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

5.4 CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise unrestricted balances and deposits with contractual maturities of less than three months from the acquisition date which are subject to an insignificant risk of changes in their fair value. Subsequent to initial recognition, cash and cash equivalents are carried at amortised cost in the statement of financial position.

5.5 PROPERTY AND EQUIPMENT

5.5.1 Recognition and measurement

Items of property and equipment are measured at cost or revalued amount less accumulated depreciation and any accumulated impairment losses.

5.5.2 Revaluation surplus or deficit

Increases in the carrying amount arising on revaluation of property are credited to the revaluation reserve in the statement of changes in equity. Decreases that offset previous increases of the same individual asset are charged against revaluation reserve directly in equity; all other decreases are expensed in the statement of profit or loss and other comprehensive income. Any subsequent increases are credited to the statement of profit or loss and other comprehensive income up to the amount previously debited, and then to the revaluation reserve. Upon disposal of premises, the relevant portion of the revaluation reserve realised is released and transferred from revaluation reserve to retained earnings.

Where parts of an item of property and equipment have different useful lives, they are accounted for as separate items of property and equipment.

5.5.3 Subsequent costs

The cost of replacing a component of an item of property and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits emanating from such component will flow to the Bank and its cost can be measured reliably. The carrying amount of the replaced part is derecognised. The costs of the day-to-day servicing of property and equipment are recognised in profit or loss as incurred.

5.5.4 Depreciation

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment from the date they are available for use.

Land is not depreciated. Upon revaluation of property, accumulated depreciation is eliminated against the gross carrying amount of the asset.

The estimated useful lives for the current and comparative years are as follows:

Computer hardware	5 years
Other equipment	5 - 15 years
Motor vehicles	5 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

5.6 INTANGIBLE ASSETS - SOFTWARE

Software acquired by the Bank is stated at cost less accumulated amortisation and any accumulated impairment losses.

Subsequent expenditure on software assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful life of the software, from the date that it is available for use since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset.

Amortisation methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate.

5.7 IMPAIRMENT OF NON-FINANCIAL ASSETS

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

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

For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets.

An impairment loss is recognised if the carrying amount of an asset or cash-generating unit (CGU) exceeds its estimated recoverable amount. Impairment losses are recognised in profit or loss.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

5.8 INTEREST INCOME AND EXPENSE

Interest income and expense are recognised in profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability.

The calculation of the effective interest rate includes all transaction costs, and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability.

5.9 OPERATING LEASE PAYMENTS

All leases which do not transfer to the lessee substantially all the risks and rewards incidental to the ownership of assets are classified as operating leases. As a lessee, leased assets are not recognised on the statement of financial position with the exception of long, non-cancellable leasehold interests.

Rentals payable under operating leases are spread on a straight-line basis over the lease periods and are recognised in 'Operating expenses'.

5.10 EMPLOYEE BENEFITS

The Bank contributes towards the State pension defined contribution plan in accordance with local legislation and to which it has no commitment beyond the payment of fixed contributions. Obligations for contributions to the defined contribution plan are recognised as an expense in profit or loss as they fall due.

5.11 CONTINGENT LIABILITIES

Contingent liabilities are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence of one or more uncertain future events not wholly within the control of the Bank.

5.12 SHARE CAPITAL

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares are recognised as a deduction from equity.

6. FINANCIAL RISK MANAGEMENT

6.1 ORGANISATION

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established the Audit Committee, which is responsible for the monitoring of risk in its specified areas. Further committees are envisaged to be set-up during 2019. Non-executive directors sit on these Committees with the Chief Executive Officer also attending the Board meetings. The Audit Committee reports to the Board of Directors on its activities.

Risk management policies are in the process of being established to identify and analyse the risks faced by the Bank, to set out appropriate risk limits and controls, and to monitor risks and adherence to limits. The risk management policies and systems will be reviewed regularly to reflect changes in market conditions, products and services offered.

6.2 RISK EXPOSURE

The Bank is exposed to the following risks:

- *Credit risk*. It is the risk of financial loss from the failure of a counterparty to fulfil its contractual obligations, or from the increased risk of default during the term of the transaction.
- *Liquidity risk*. The risk of incurring losses due to the inability of meeting obligations as they become due.
- *Interest rate risk in the banking book.* The risk posed by adverse movements in interest rates that affect the bank's banking book positions.
- *Operational risk.* The risk of losses resulting from inadequate or failed processes, people and internal systems, or from external events.

6.3 CAPITAL MANAGEMENT

The purpose of the Bank's capital management is to ensure an efficient use of capital in relation to risk appetite as well as business development.

The Bank's capital base is composed of Common Equity Tier 1 (CET 1) capital. As CET 1 is the highest form of quality capital, the Bank intends to put much of its emphasis and monitoring on this capital element when it comes to capital planning and management. By considering the Standardised Approach for credit risk and the Basic Indicator Approach for operational risk, the total risk weighted assets as at 31 December amounted to €14,962,178. The CET 1 ratio stood at 197.5% at 31 December 2018.

	2018
	€
Capital	
Paid up share capital	**30,000,000**
Accumulated losses	**(458,177)**
	29,541,823
Total capital	**29,541,823**

6.4 CREDIT RISK

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

Credit risk policies are in the process of being established to identify and analyse the risks faced by the Bank, to set out appropriate risk limits and controls, and to monitor risks and adherence to limits. The credit risk policies and systems will be reviewed regularly to reflect changes in market conditions, products and services offered.

The Bank's main financial assets at 31 December 2018 consist of amounts placed with banks registered in Malta, which are deemed to be high quality counterparties. The Bank's credit risk taking activities during 2018, considered its embryonic stage of development, consisted of deploying the initial share capital in placements with banks.

	2018
	€
Loans and advances to banks	29,422,906
	29,422,906

These financial assets are not past due or impaired; and the credit quality grading attributable to these assets is of a high grade.

6.4.1 Allowances for impairment

In view of adoption of IFRS 9 on 1 January 2019, the Bank is in the process of establishing an expected credit loss impairment methodology that represents its estimate of expected losses on future credit exposures.

6.4.2 Write-off policy

The Bank writes off a loan, security and/or a receivable balance (and any related allowance for impairment losses) when management determines that the loan, security and/or receivable is uncollectible. This determination is reached after considering information such as occurrence of significant changes in the borrower/issuer's financial position such that the borrower/issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

6.4.3 Concentration risk

The Bank will put in place mechanisms to monitor concentration of credit risk by sector and geography.

6.5 MARKET RISK

Market risk comprises the risk of losses in value caused by unexpected changes in market prices (interest rates, equity prices, foreign exchange rates and credit spreads) before the affected positions can be closed out or hedged. Market risk for the Bank consists entirely of interest rate risk, which is the risk of losses because of changes in interest rates.

6.5.1 Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature or re-price at different times or at different amounts. This risk will be managed through the matching of the interest resetting dates on assets and liabilities as much as practicable. The Bank seeks to maximise the spread over the cost of capital by investing excess liquidity in a portfolio of term deposits with local banks. The following table summarises re-pricing at reporting date together with the effective interest rates where applicable.

	CARRYING AMOUNT	EFFECTIVE INTEREST RATE	LESS THAN THREE MONTHS	BETWEEN THREE MONTHS AND ONE YEAR	OTHERS
Assets					
Loans and advances to banks	29,422,906	0.77%	5,910,024	23,512,882	-
Other assets	147,087	-	-	-	147,087
Total assets	29,569,993		5,910,024	23,512,882	147,087
Liabilities					
Other liabilities	28,170	-	-	-	28,170
	28,170				28,170

6.5.1.1 Interest rate profile

At the reporting date, the interest rate profile of the Bank's interest bearing financial instruments was:

	2018
	€
Fixed rate instruments	
Loans and advances to banks	**24,513,619**
	24,513,619
Variable rate instruments	
Loans and advances to banks	**4,909,287**
	4,909,287
Total capital	**29,541,823**

6.5.1.2 Fair value sensitivity analysis for fixed rate instruments

The Bank does not account for any fixed rate financial assets and liabilities at fair value through profit or loss. Therefore, a change in interest rates at the reporting date would not affect profit or loss.

6.5.2 Currency risk

At the reporting date, the bank held €29,422,906 in loans and advances to banks denominated in Euro. The Bank was not exposed to on balance sheet or off balance sheet currency risk.

6.5.4 Fair values of financial instruments

Financial instruments not measured at fair value

Loans and advances to banks

This category of assets is reported net of impairment allowances to reflect the estimated recoverable amounts. Loans and advances to banks are repriceable within 12 months. The carrying amounts of these financial assets therefore approximate their fair values.

6.6 LIQUIDITY RISK

Liquidity risk is the risk that the Bank's obligations to repay liabilities or fund new loans exceeds the Bank's ability to raise funds from either the liquidation of assets or the acceptance of new funding. Liquidity risk arises because a bank does not exactly match the maturity of assets with the maturity of liabilities but must always be able to meet its liabilities as they fall due. Liquidity risk may also be affected by the depth of the market in which the Bank has its assets and liabilities.

The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

The Bank's liquidity risk management focuses on structuring both the asset and liability portfolio so as to maintain diversity of funding sources and a spread of asset and liability maturities.

At 31 December 2018, the Bank's initial capital has been mainly deployed in loans and advances to banks and the Bank's financial liabilities mainly comprised payables and accruals for administrative expenses. Hence, liquidity risk during 2018 and at the reporting date is insignificant.

All liquidity policies are subject to the review and approval by the Board of Directors.

The following table provides an analysis of the financial assets of the Bank into relevant remaining maturity groupings based on the expected remaining periods to recovery or repayment:

AT 31 DECEMBER 2018	BETWEEN ONE AND THREE MONTHS	BETWEEN THREE MONTHS AND ONE YEAR	TOTAL
	€	€	€
Financial assets			
Loans and advances to banks	5,910,024	23,512,882	29,422,906
	5,910,024	**23,512,882**	**29,422,906**

7. INTEREST INCOME

	2018
	€
Interest income on demand deposits	6,087
Interest income on term deposits	83,885
	89,972

8. INTEREST EXPENSE AND SIMILAR CHARGES

	2018
	€
High balance fees considered negative interest in nature	38,431
	38,431

9. LOSS FOR THE YEAR

9.1 The loss is stated after charging fees payable, exclusive of VAT, to the Bank's auditors for external audit services:

	2018
	€
Auditors' remuneration	5,000
	5,000

9.2 Personnel expenses incurred by the Bank during the year are analysed as follows:

	2018
	€
Directors' fees	90,855
Staff costs:	
- wages, salaries and allowances	241,391
- defined contribution social security costs	7,156
- costs of seconded personnel	14,811
Other costs	11,845
	366,058

9.3 The Bank employed a weekly average of four persons during the reporting period. At the reporting date the number of persons employed by the Bank was as follows:

	2018 NO.
Managerial	8
Clerical	1
	9

9.4 Other expenses incurred by the Bank during the year are analysed as follows:

	2018
	€
Rental and Occupancy fees	46,275
Professional fees	25,949
Supervision fees	19,582
Travel and accommodation	16,032
Memberships of International Associations	10,791
Other	19,664
	138,293

10. LOANS AND ADVANCES TO BANKS

	2018
	€
Repayable on call and at short notice	4,909,288
Term loans and advances	24,513,618
	29,422,906

11. PROPERTY AND EQUIPMENT

AT 31 DECEMBER 2018	TOTAL	COMPUTER HARDWARE	OTHER EQUIPMENT
	€	€	€
Cost			
At 11 December 2017	-	-	-
Acquisitions	66,762	41,254	25,508
At 31 December 2018	66,762	41,254	25,508
Depreciation			
At 11 December 2017	-	-	-
Charge for year	5,367	4,182	1,185
At 31 December 2018	5,367	4,182	1,185
Carrying amount			
At 11 December 2017	-	-	-
At 31 December 2018	61,395	37,072	24,323

As at 31 December 2018, capital expenditure authorised but not contracted for amounted to €650,000 and is mainly related to the acquisition of property.

12. OTHER ASSETS

	2018
	€
Accrued income	**70,267**
Prepayments	**15,425**
	85,692

13. PAYABLES AND ACCRUALS

	2018
	€
Accrued interest payable	**1,542**
Accounts payable	**9,000**
Accrued expenses	**17,628**
	28,170

Accounts payable and accruals include amounts due to related parties (see note 19.3) amounting to €9,000 and €1,582, respectively.

14. SHARE CAPITAL AND RESERVES

14.1 SHARE CAPITAL

	2018
	€
On issue at 28 December 2017:	
Issued for cash	**30,000,000**
On issue at 31 December 2018 – fully paid	**30,000,000**

The Bank is fully owned by the Government of Malta. In accordance with article 10(1) of the Malta Development Bank Act, Chapter 574 of the Laws of Malta, the initial authorised share capital of the Bank is €200 million divided into 2 million shares having a par value of €100 each. The Bank issued 300,000 shares at par value of €100 each. The authorised and issued share capital shall be determined by the shareholders from time to time.

The Government may subscribe up to thirty per cent of the authorised and paid-up capital in the form of moveable and, or immoveable property that is free and clear of all encumbrances, hypothecs or other attachments.

The Bank's objectives when managing capital are to safeguard the Bank's ability to continue as a going concern in order to perform the functions assigned to it under the Malta Development Bank Act, Chapter 574 of the Laws of Malta, and to maintain an optimal capital structure.

14.2 GOVERNMENT GUARANTEE

In terms of Article 5 of the Malta Development Bank Act, the Government of Malta guarantees up to 100% of all obligations of the Bank and up to 100% of the loans, facilities or guarantees issued by the Bank.

A Government guarantee was issued on 16 February 2018 with the amount of the guarantee being initially set at €50 million for 2018 and is reviewable annually in line with the business growth of the Bank.

15. NET CASH USED IN OPERATING ACTIVITIES

	2018
	€
Loss for the year	**(458,177)**
Adjustments for:	
Depreciation (Note 11)	**5,367**
Interest receivable (Note 12)	**(70,267)**
Interest payable (Note 13)	**1,542**
Changes in operating assets and liabilities:	
Changes in term loans and advances (Note 10)	**(24,513,618)**
Changes in receivables and prepayments (Note 12)	**(15,425)**
Changes in payables and accruals (Note 13)	**26,628**
	(25,023,950)

16. CASH AND CASH EQUIVALENTS

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

	2018
	€
Loans nad advances to banks repayable on call and at short notice (Note 10)	**4,909,288**
	4,909,288

17. OPERATING LEASES

At 31 December 2018, the Bank was party to an operating lease agreement for property in respect of which the future minimum lease payments extend over two years. The minimum lease payment per annum amounts to €61,700.

18. CONTINGENT LIABILITIES

At 31 December 2018, the Bank was party to a risk-sharing agreement consisting of a maximum loan guarantee amounting to €4 million.

19. RELATED PARTIES

19.1 IDENTITY OF RELATED PARTIES AND ULTIMATE CONTROLLING PARTY

The Bank's ultimate controlling party is the Government of Malta. All functions and bodies forming part of government (including ministries), together with all entities that are ultimately controlled by the government or whose share capital is entirely owned by the government, are considered to be related parties.

19.2 RELATED PARTY TRANSACTIONS

Transactions entered into with related parties impact the amounts presented in the statement of comprehensive income comprise:

	2018
	€
Rental and Occupancy fees	**46,275**
Supervision fees	**19,582**

19.3 RELATED PARTY BALANCES

The statement of financial position includes outstanding balances w related parties as follows:

	2018
	€
Liabilities	
Accounts payable	**9,000**
Accruals	**1,582**

Accounts payable and accruals consist of supervision fees payable to the Ministry for Finance.

19.4 TRANSACTIONS WITH KEY MANAGEMENT PERSONNEL

Key Management Personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the Bank, being the Directors and the Bank's executives.

	2018
	€
Compensation to key management personnel	**225,852**

INDEPENDENT AUDITOR'S REPORT

To the Shareholder of Malta Development Bank

Report on the audit of the financial statements

Our opinion

In our opinion:

The financial statements of Malta Development Bank give a true and fair view of the Bank's financial position as at 31 December 31 2018, and of the Bank's financial performance and cash flows for the period then ended in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU and comply with the Malta Development Bank Act (Cap. 574).

What we have audited

The financial statements of Malta Development Bank, set out on pages 46 to 63, comprise:

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

Basis for opinion

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

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

Independence

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

Other information

The directors are responsible for the other information. The other information comprises the Directors' Report (but does not include the financial statements and our auditor's report thereon) which we obtained prior to the date of this auditor's report, and Malta Development Bank's complete Annual Report, which is expected to be made available to us after that date.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information 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.

When we read Malta Development Bank's complete Annual Report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance in accordance with International Standards on Auditing.

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

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with IFRSs as adopted by the EU and comply with the Malta Development Bank Act (Cap. 574), 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.

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.

PricewaterhouseCoopers
78, Mill Street
Qormi
Malta

FABIO AXISA
Partner

22 March 2019

MDB
MALTA DEVELOPMENT BANK