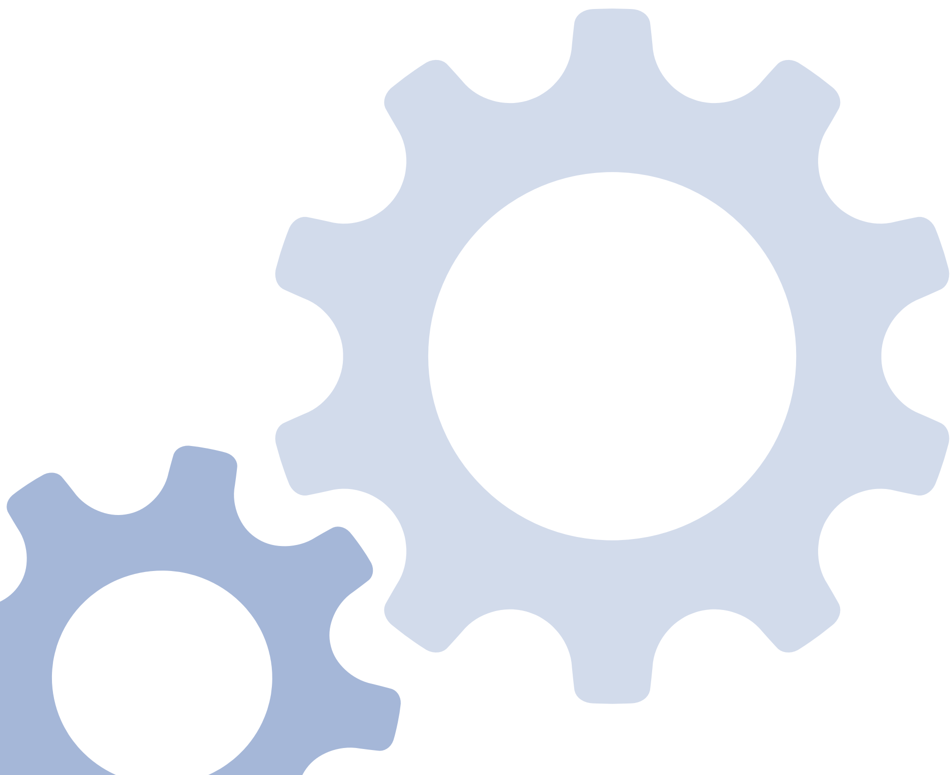
2019

ANNUAL REPORT
& FINANCIAL STATEMENTS

MALTA DEVELOPMENT BANK



About the MDB

The Malta Development Bank (MDB) 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. The MDB's strategic objective is to address market failures or financial gaps 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 and mutually supportive relationship, thereby ensuring additionality and diversifying Malta's financial base in a cost-effective manner.

MDB's primary goal is to contribute to public policy objectives and it is therefore 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, including feasibility.

Our Vision

To make a significant contribution towards sustainable economic development by promoting inclusive and environmentally sustainable economic growth and infrastructure development.

Our Mission

To bridge investment gaps in Malta by offering financing facilities that support productive and viable operations where the market is unable or unwilling to accommodate such activities and by linking entrepreneurship, digitisation, investment and economic growth to improved living conditions, a higher quality of life and better social inclusion.

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:

Chairperson

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.

(left to right)

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

Letter of Transmittal

MALTA DEVELOPMENT BANK

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27 April 2020

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

Dear Minister

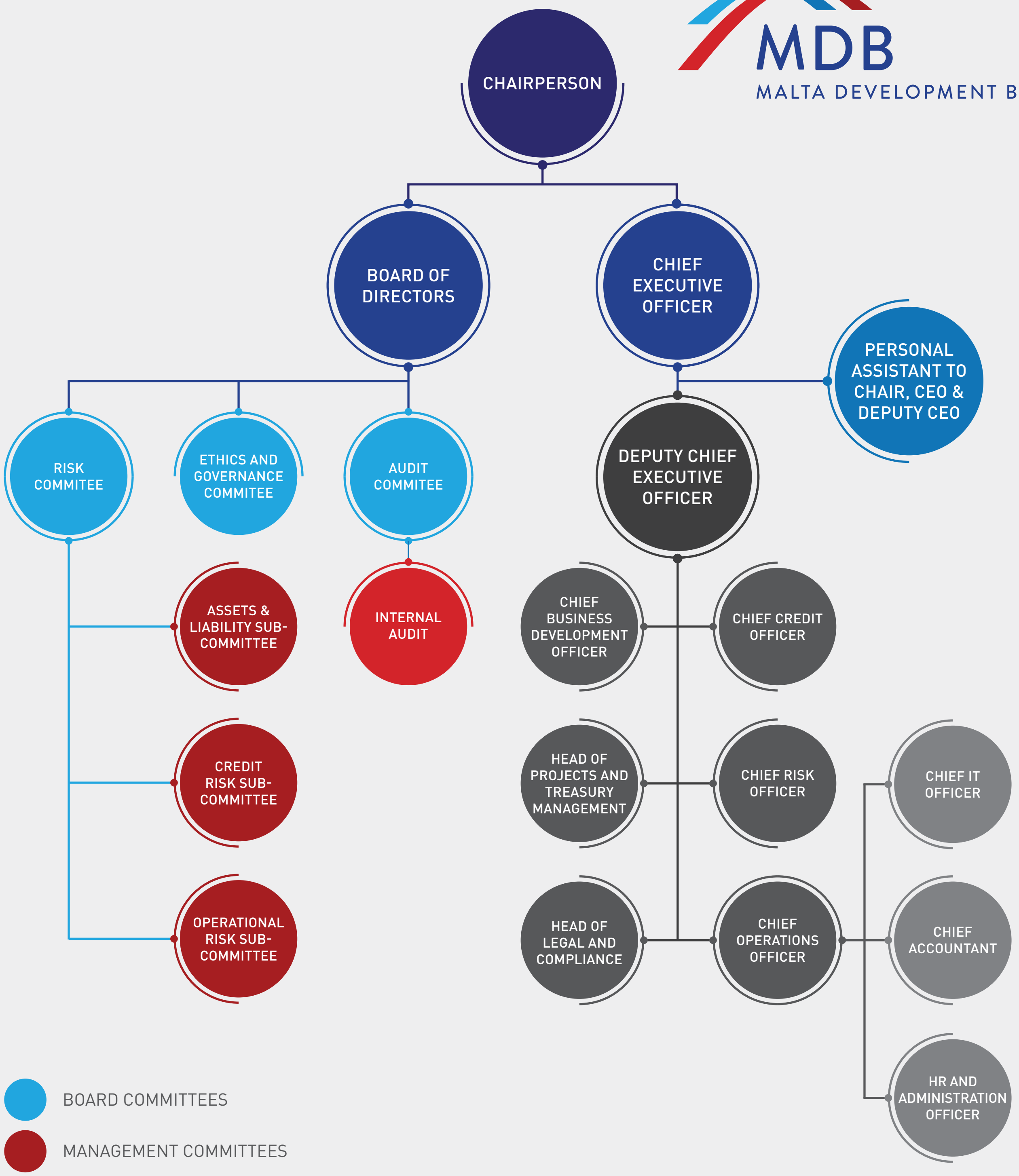
In terms of article 33 of the Malta Development Bank Act, 2016 (Cap 574), I have the honour to transmit to you a copy of the Annual Report of the Malta Development Bank for the year 2019.

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 2019.

Yours sincerely

JOSEF BONNICI
Chairperson

Malta Development Bank Organisational Chart



BOARD COMMITTEES

MANAGEMENT COMMITTEES

OUTSOURCED FUNCTION

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Chairperson's Statement

SUPPORTING SUSTAINABLE ECONOMIC GROWTH

In its second year of operation, the MDB launched its first financial products in the SME space and its first financial instrument funded from EU Structural Funds. Concurrently, the Bank proceeded at an accelerated pace with the strengthening of its organisational set-up and the capacity building exercise aimed at enabling the Bank to take on new responsibilities and a leadership role in addressing market failures and investment gaps.

Sustained SME growth is subject to moderately divergent forces. The rapid macroeconomic growth experienced over the past years has provided the comfort of rising demand to suppliers. At the same time, SMEs remain dependent on bank funding at a time of heightened regulatory pressures, so that the financing of SMEs remains constrained, particularly for start-ups and innovative ventures. Overt de-risking by commercial banks obliged to comply with legislation regulating the conduct of their business can have a disproportionately large and unintended effect on the financing of start-ups and smaller firms.

Improving SME's access to finance is therefore a priority for the MDB and is consistent with its objective to provide a remedy for sub-optimal investment situations and market failures. During 2019, the MDB continued to build on the initial exchanges with stakeholders and has identified various opportunities for collaborative arrangements. Negotiations have reached an advanced stage in the SME space with the roll-out of three schemes, each targeting a specific aspect of the SME market gap.

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 for family business transfers to the next generation within the family. This new Guarantee Scheme complements the fiscal incentives introduced by the Government in recent years to foster greater continuity, stability and further growth in the future of family businesses.

The Guarantee Facility for Loans to SMEs was the second scheme launched in 2019. It facilitates lending to smaller businesses that are viable but unable to raise the required loan capital due to inadequate or insufficient collateral, the novelty or nature of the business venture that may fall outside the risk appetite of commercial banks or to other factors such as the required repayment period. The facility enables smaller businesses to fulfil their investment plans and growth ambitions and is aimed at generating a positive contribution to the economy. Under this scheme, the MDB is providing a guarantee of 80% on loans to SMEs up to a maximum of €750,000.

Consistent with its objective to improve access to finance and to diversify the financing options to SMEs, the MDB seeks to magnify its outreach by collaborating with commercial banks to stimulate more active SME lending in Malta. It conducts this line of business by offering the opportunity to banks to act as the MDB's implementing partners for its Guarantee Facility for Loans to SMEs. Bank of Valletta was the first implementing partner and over the course of 2020, we look forward to the accreditation of more implementing partners. In this regard, negotiations have already reached an advanced stage.

The MDB Guarantee Facility for Loans to SMEs is being taken up very rapidly and results have exceeded expectations. By the end of the year, the value of sanctioned loans reached €14 million, implying that a quarter of the portfolio was taken up in the first 6 months of operation.

The value of SME investments has been increasing at a fast pace, in line with the rapidly growing economy. It has also become increasingly evident that the investment demands of individual SMEs can often exceed the upper limit of €750,000, such that the loan ceiling under guarantee schemes does not cater for the investment needs of larger SMEs. Hence, during 2019 the MDB conducted intensive negotiations with all the core domestic banks on a new

scheme that will involve an element of co-financing of loans to SMEs in conjunction with the banks. This is further combined with the provision by the MDB of a guarantee on part of the commercial bank's share of the loan. The MDB is allocating a fund of €50 million for this new facility which, together with the contribution of the partner banks, will generate a portfolio of new loans to SMEs of €100 million. The funds from the bilateral global loan agreement signed with KfW in June 2019 shall be mobilised for this facility which is targeting loans of up to €3 million each.

Concurrently, the Bank has introduced the Tailored Facility for SMEs, a similar set-up to the co-financing facility, but with parameters being negotiated on a case-by-case basis. The tailored facility shall serve as a pilot for the implementation of the larger scheme which is expected to be launched in the first half of 2020.

I am equally pleased to announce that during 2019 the MDB has also been actively supporting initiatives in the educational sector. Investment in human capital is a major social and economic priority, and the MDB made its contribution in this regard by way of its role as implementing body of a new financial instrument, the Further Studies Made Affordable (FSMA). This instrument is partly funded from the European Social Fund and is designed to support and enable eligible candidates to upgrade their skill endowments in order to aim for higher-skilled jobs.

The FSMA provides credit risk protection to the lending institution, enhances students' access to softer bank loans and addresses the difficulties that students face in accessing finance due to lack of security or insufficient required upfront contribution. Students also benefit from an interest rate subsidy during a moratorium period made possible by way of an innovative combination of part-loan, part-grant arrangement that further softens the overall terms of the instrument.

This kind of setup and collaboration with 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 dimension. In particular, such collaboration can result in the expansion of the reach and scope of such financial instruments, amplifying the impact on socio-economic progress.

The MDB is also collaborating with the Housing Authority and private investors on an innovative concept of affordable housing. Whereas social housing addresses the housing needs of the most vulnerable categories of society, affordable housing would address the housing needs of the next socio-economic group by supplying housing units at below-market rental rates, which would provide a basis for capital cost recovery. This initiative will also serve to support households in the respective socio-economic group in their transition from affordable housing to the standard residential market. Through this model it is possible to increase the supply of affordable housing in a financially viable way, without shifting the burden onto the taxpayer.

The MDB is also exploring opportunities to expedite its impact through equity-based products by leveraging on the experience and resources of the EIF. The MDB is a member of the EIF-National Promotional Institutions (NPI) Equity Platform which allows it to partner with national and regional promotional institutions active across the EU Member States to promote best practices in policy-driven equity investments and to enhance access to funding for SMEs and midcaps.

During the year the MDB also conducted consultations with the European Investment Fund to explore possible ways of collaboration. The MDB's role in leveraging EU resources can be significantly enhanced through such collaboration with the EIF, for instance through the provision of loan guarantee arrangements and counter guarantees for the SME sector under the COSME programme. The MDB has also procured an additional bilateral loan under the Multi-

“MDB aims to support the well-being of society by effectively addressing the country's main challenges”

Beneficiary Intermediated Lending Facility of the EIB with the funds to be mobilised for the benefit of SMEs and public sector entities.

With the support of the European Commission's Structural Reform Support Programme, the MDB during the year, made recourse to external expertise to strengthen its organisational capacity. This will enable the MDB to be in a position to consider applying for direct access to the EU guarantee and at the same time partnering with the European Investment Bank Group. Such capacity building will enhance the MDB's ability to comply with the Pillar assessment – a necessary requirement in order to be delegated the responsibility of acting as implementing partner of the EU Budget. 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 MDB is able to recycle and re-use funds over a longer period of time. 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.

We look forward to another year of achievements and further growth, reflected in the MDB's delivery of value-added solutions to Maltese businesses and the promotion of Malta's continued sustainable infrastructure development. The bank's strategic objectives remain underpinned by the country's strategic policy objectives and simultaneously securing sustainability in economic growth and public finances. In line with public policy objectives, the MDB aims to support the well-being of society by effectively addressing the country's main challenges, including investment in the infrastructure, technology and innovation and initiatives that promote social inclusion.

The Bank is still in its set-up phase and hence while it has to meet expenses to set up the institution, revenue from its services will increase gradually over a number of years as the balance sheet expands. The MDB appreciates the confidence shown by the Government following a further capital injection of €10million in 2019, which is consistent with the projected capital growth as indicated in the MDB business plan when it was set up at the end of 2017.

I am pleased to report that the MDB's development has exceeded expectations and this on account of the commitment and professionalism that the MDB staff have brought to the institution. While the road ahead is long and challenging, the MDB has made important strides towards achieving its objectives and fulfilling its mandate.

Thanks to its efforts to deliver professionally and continually establish good relationships with its stakeholders, the MDB has established itself as a reliable partner both domestically and internationally.

Corporate Governance Statement

GOVERNANCE

The Malta Development Bank Act was passed on 5 May 2017 (Act XXI of 2017 CAP 574) 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.

The Board of Directors is responsible for ensuring good governance and performs this task by setting strategic objectives and targets and taking strategic decisions on all key business issues. The regular day-to-day management, control and direction of the MDB are the responsibility of the Chief Executive Officer (CEO) and the senior management team. The CEO and the senior management team must follow the strategic direction set by the Board and in turn management provides the Board with the analysis needed for Board deliberations.

BOARD OF DIRECTORS STRUCTURE AND RESPONSIBILITIES

The MDB Act provides that there shall be 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 MDB 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.

The Board of Directors is composed of Prof. Josef Bonnici as Chairperson, Mr. Paul Abela, Dr. Rose Mary Azzopardi, Mr. Robert Borg, Mr. Paul Cardona, Mr. Godfrey Grima and Mr. Anthony Valvo.

Article 21 of the MDB Act provides that the Chairperson shall be appointed after consultation with the Opposition. Article 21(5) sets the term of the Chairperson at six years. The independent Directors nominated by the Malta Council for Economic and Social Development, Mr Paul Abela and Mr Robert Borg, were appointed for a term of six years, in line with article 21(6). The term of the other Directors is five years in accordance with article 21(4). The differing appointment terms provides continuity.

The responsibilities of the Board are prescribed in article 22 of the MDB Act, which formally lists the matters reserved for decision by the Board. These include:

- Annual Report and Financial Statements
- Risk management policy and framework
- Strategic Plan
- Budget and financing facilities
- Credit and risk-sharing policy
- Appointment and terms and conditions of the Chief Executive Officer

During the financial year under review, the Board met ten times.

BOARD COMMITTEES

Audit Committee

In November 2018, the Board approved the setting-up of the Audit Committee. This Committee's Terms of Reference were approved by the Board in 2019. The Audit Committee's role is to assist the Board in:

- Assuring accurate and timely reporting of the MDB's financial condition as required for its statutory reporting, to meet regulatory requirements and to provide management with appropriate reporting guidelines to assure proper management of the Bank.
- Fostering and ensuring adequate and systematic financial management practices to be consistent and compliant with MDB's values and ethics.
- Ensuring that the Bank's overall internal control framework is effective and aligned with the business strategy.
- Ensuring effectiveness, professional performance and objectivity of the internal and external auditors and other providers of assurance.

The Committee comprises three Directors appointed by the Board. The current members are Mr. Robert Borg (Chairperson), Dr. Rose Mary Azzopardi and Mr. Anthony Valvo.

The Committee met on four occasions in 2019.

Risk Committee

During the financial year under review, the Board of Directors approved the setting up of a Risk Committee and its Terms of Reference. In turn, three management committees report to the Risk Committee, namely the Asset-Liability Management Committee, the Credit Risk Committee, and the Operational Risk Committee.

The Risk Committee's role is to assist the Board in:

- Fostering sound risk governance across the Bank's operations by assuring that Bank management is taking a forward-looking perspective and anticipating changes in business conditions.
- Ensuring that processes are in place to assure the Board that management has appropriately identified, assessed, reported, controlled, and managed the risks relative to the Bank's strategy and operations.
- Promoting a culture of risk awareness within the Bank through communication and education.

The Risk Committee is chaired by Prof. Josef Bonnici, and includes Mr. Anthony Valvo and Mr Paul Abela, Directors, as well as the Chief Risk Officer and the Chief Credit Officer. It also includes the Chief Executive Officer, the Chief Accountant and Head of Projects and Treasury Management as observers.

The roles and composition of the management committees reporting to the Risk Committee

1. The Asset-Liability Management Committee provides oversight of asset and liability management, liquidity risk, interest rate risk and capital risk.

   It is chaired by Mr. Paul Abela, Director, and includes the Chief Executive Officer, the Chief Risk Officer, the Chief Accountant, the Chief Credit Officer and the Head of Projects and Treasury Management.

2. The Credit Risk Management Committee approves the credit risk assumed by the Bank and monitors the effectiveness and application of credit risk management policies and procedures.

   It is chaired by Mr. Robert Borg, Director, and includes the Chief Executive Officer, the Chief Risk Officer, the Chief Financial Officer, the Chief Credit Officer, the Head of Projects and Treasury Management and the Head of Legal and Compliance.

3. The Operational Risk Management Committee oversees the MDB's enterprise-wide risk framework that manages the operational risks to which the MDB is exposed in its conduct of business. The Operations Risk Committee is chaired by Mr. Paul Cardona, Director, and includes the Chief Executive Officer, the Chief Risk Officer, the Chief Operating Officer, the Chief IT Officer and the Head of Legal and Compliance.

The Risk Committee and its sub-committees met on two occasions in 2019.

Ethics and Governance Committee

In 2019, the Board of Directors also established the Ethics and Governance Committee to assist and advise the Board in fulfilling its oversight responsibilities. The role of the Ethics and Governance Committee is to:

- Ensure that the Bank's corporate governance principles, policies, standards and practices optimally support the Bank's internal control priorities.
- Foster values and establish an ethical policy framework of the Bank, ensuring compliance with professional and ethical standards.
- Provide recommendations in the best interest of MDB in relation to procurement practices and remuneration packages in order to achieve the strategic and cost control objectives adopted by the Board.

The Committee is composed of two Directors selected by the Board. The current members are Prof. Josef Bonnici (Chairperson) and Mr. Godfrey Grima.

The Committee met once in 2019.

Strategy

BUSINESS

In pursuance of its public policy mandate, the MDB is tasked with contributing towards sustainable economic development by promoting inclusive and environmentally sustainable economic growth and infrastructure development. The *raison d'être* of the MDB is that an institution with a public mandate is better placed than private operators to overcome the existing market gaps in Malta.

The MDB achieves its objectives through financing facilities that bridge financial gaps in productive and viable operations by complementing and supplementing commercial banks through a non-competitive and mutually supportive relationship, thereby contributing to additionality and a broader and more diversified financial base in a cost-effective manner. The MDB ensures that it achieves additionality by offering forms of intermediation that cannot be provided by the market alone.

Sustainable economic growth is achieved through a collective endeavour that involves a broad range of private and public sector participants and policy makers. Within such a context, the MDB seeks to collaborate with all stakeholders to support the national effort to promote socio-economic development in Malta. More broadly, the MDB seeks to offer the appropriate facilities to enhance access to financing of new investment contributing to the promotion of national competitiveness, social inclusiveness and sustainable development. Towards this end, the MDB is introducing services that complement the standard package that has traditionally been offered by commercial banks. It is also exploring innovative financial instruments that can act as a catalyst for the promotion of a broader range of financial services in the credit and investment markets.

In its initial years of establishment, the MDB is strategically building up the capacity to enhance market intelligence, identify financial market failures and design facilities to compensate for funding gaps by implementing new forms of financial intermediation.

Market gaps arise from the inability or unwillingness of financial intermediaries to accommodate various financial requests on their own, whether in whole or in part. In the SME segment, this market failure is typically caused by incomplete or intractable information especially when the borrower does not have a credit history or sufficient collateral, or where the proposed venture falls outside the bounds of the ordinary risk appetite of commercial banks.

On the other hand, 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' financial assets and liabilities are often mismatched, and not geared to provide very long-term financing. Moreover, such exposures may be too large for certain commercial banks to finance on their own and may reduce the required degree of diversification in an institutional setting where syndication is not readily available.

The MDB's funding sources are of a longer duration and therefore allow the provision of longer-term financing. In line with its funding profile, the Bank seeks to act as catalyst for the promotion of a loan syndication market in Malta by helping to pool-in diverse suppliers of credit so as to accommodate the financing needs of larger projects which are likely to be challenging to finance through one single financial intermediary due to their size, gestation period and overall risk. At a later stage, and if market conditions are considered to fit within the Bank's prevailing business plan, to supplement and diversify its sources of long-term borrowing, the MDB could also resort to bond issuance, mainly in the domestic market.

MDB's facilities for infrastructure investment can take the form of first-tier credit in the form of direct lending and co-financing. Such funding can be directed to national social and economic infrastructure by public and private sector entities with whom the MDB will act as co-financier along with the commercial banks, or possibly even directly.

The focus is always on projects with a strong social dimension – particularly 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 environmentally-friendly initiatives. Projects that enhance Malta's competitiveness also rank highly within the MDB's financing priorities.

As the MDB builds experience, networks, capacity, and a reputation in the sustainable infrastructure space, it will seek to co-finance with commercial banks and crowd-in resources from multilateral development institutions. This process would increase the appetite of commercial banks for infrastructure investment which go beyond the limits that banks are prepared to grant on their own.

In fulfilling its objective to complement commercial banks through a non-competitive, but rather collaborative relationship, the MDB seeks to delegate the operational aspects of its programmes to intermediaries, avoiding the duplication of operational intermediary services already provided efficiently by the banking sector. This *modus operandi* will decrease overall costs.

In pursuit of its objectives, the MDB is building up capacity to take a leadership role in addressing market failures and investment gaps 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 be difficult to envisage 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.

Utilizing this strategy, the MDB expects important outcomes. It aims to utilize its equity capital and government guarantees to raise the required long-term funding and to leverage its capacity to be in a position to direct the accruing benefits to the SME sector and social infrastructure. This financial engineering will enable MDB to support commercial banks in building up portfolios of loans on the basis of credit risk mitigation and providing capital relief. In addition, through the MDB's intervention as a financial intermediary, the SME segment and smaller-scale projects will be better able to benefit from the financial resources of multilateral development institutions. Such multilateral 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. One of the principles of the MDB is to raise wholesale funding from multilateral institutions for on-lending in the form of a portfolio of sub-loans to SMEs and smaller projects.

RISK

While the MDB's objective is to contribute to public policy objectives with a business model that is not driven entirely by commercial and profit maximisation considerations, the MDB supports only viable investments and assesses credit applications on the basis of sound banking principles. It meets its running costs through its operations while charging a reasonable premium for the credit risk assumed.

SPECIAL TOPIC I – MDB'S CREDIT RISK STRATEGY

Overview

The MDB supports entrepreneurship and socio-economic development in Malta by providing promotional investment and financing, amongst other services. The Bank identifies different risks in its operations, all of which are governed by an enterprise risk management framework. This framework comprises of risk policies and procedures formulated for the assessment, measurement, monitoring, controlling, and reporting of risks.

The Bank recognises that effective risk management is based on a sound risk culture, which is characterised, among others, by a high level of awareness concerning risk and risk management in the organisation.
Given the MDB's mission, credit risk is the main financial risk and arises from the Bank's lending operations and from exposures on guarantee instruments. Credit risk is defined as the risk of an economic loss resulting from (a) an obligor failing to meet its obligations in accordance with the agreed terms, or (b) a deterioration in the credit worthiness of the obligor, such that the risk of default increases. The potential loss from default includes lost principal and interest as well as collection costs, which may be partial if the lender is able to recover any amounts due.

As a general principle, all financing provided by the Bank must meet two conditions: (i) financing must be within the mission of the Bank, and (ii) the financing must represent acceptable credit risk.

Credit Risk Management Framework

The MDB is exempted from the Capital Requirements Directive (CRD) and the Capital Requirements Regulation (CRR) regulatory regime and other banking regulations in terms of article 2(5) of the Capital Requirements Directive (CRD). Nevertheless, in pursuance of the Bank's commitment to adopt sound and prudent banking principles, the Bank considers the European Union Directives and recommendations from the Basel Committee on Banking Supervision (BCBS) as an important reference within the context of its credit risk management framework.

During this financial year, inspired by the MDB's drive to implement a sound credit risk management that ensures effective decision-making within the context of promotional investment and financing, the Risk Management Department developed the following policies/procedures, which were also approved by the Board of Directors:

- ***Credit Risk Policy***
  This policy is designed to achieve satisfactory and sustainable long-term performance, combining a

growing credit exposure with an acceptable level of credit quality resulting in a low incidence of bad debts. The Credit Risk Policy aims to provide clear guidelines to the process of extending credit commensurate to the Bank's credit risk appetite and thereby provides a clear statement of the parameters within which most of the Bank's lending decisions will fall. Moreover, this Policy encourages all departments within the MDB to work in a structured and dynamic manner in offering promotional programmes and extending credit to achieve the Bank's mission.

- ***Risk Assessment Framework***
  This framework prescribes a structured risk assessment process that is practical, sustainable and easy to understand. This ensures that the risk levels of the borrowers are within the established tolerance thresholds and within the limits of prudence, bearing in mind the Bank's promotional role.

- ***Risk Assessment Criteria (RAC).***
  These criteria relate to the three main financial facilities on which the MDB is currently focusing its promotional role, namely: (i) Guarantees, (ii) SMEs/Mid-Caps, and (iii) Infrastructural Project Finance. The purpose of the RACs is to have an internal rating system that identifies the level of risk associated with the credit exposure in order to facilitate the management of each relationship. The RAC for the relative financing is based on the Bank's Risk Assessment Framework.

- ***Problem Credit Management***
  This explains the process through which non-performing loans are to be managed. This process encourages prompt and pre-emptive action aimed at minimising the negative impact on the Bank's profitability, capital and time. The Risk Management Department will lead the management of the problem credit and oversee all engagement with the borrower. The business originators will remain actively involved to facilitate communication and support the Risk Management Department.

Corporate Social Responsibility within the context of Credit Risk Management

The MDB places an emphasis on its corporate social responsibility. The MDB's mission statement emphasises that the role of the Bank is to:

"contribute towards sustainable economic development that benefits the Maltese people by promoting socially 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 and a higher quality of life."

In practical terms, the MDB shall fulfil its corporate and social commitments in its operations by weighing the social and environmental dimensions of its operations in addition to the economic dimension.

As part of the MDB's process of evaluating the proposed promotional investment and financing, the Bank takes into consideration not only the financial feasibility and economic dimension of the proposed project but also the social and the environmental dimension, as can be seen in the Figure below.

ECONOMIC MEASURES	ENVIRONMENTAL MEASURES	SOCIAL MEASURES
Variables that deal with the fundamental outcomes and the flow of money	*Measurements of natural resources and potential influences on sustainability*	*Social dimensions of a community or region*
Personal income	Selected priority pollutants	Unemployment rate
Job growth	Electricity/Fuel consumption	Female labour force participation rate
Employment distribution by sector	Solid waste management	Median household income
Percentage of firms in each sector	Hazardous waste management	Relative poverty
Revenue by sector contributing to gross state product	Change in land use/land cover	Health-adjusted life expectancy

More specifically, during the evaluation process, the MDB assesses the following key factors:

- *Sustainability of integrating economic, environmental and social aspects. The Bank seeks to ensure that the project fulfils these interrelated dimensions which may impact each other in various ways.*

- *Sustainability of integrating short-term and long-term aspects. The Bank seeks to ensure that there is a sustainable balance between the economic aspects of the projects, normally harvested in the short-term, and the environmental and social aspects, which may not occur before the medium to long-term. The Bank also considers the project's capability to continue delivering value over and beyond the financing period and the obligor's operational capacity to continue as a going concern.*

- *Sustainability in terms of income generation that safeguards the depletion of capital. The Bank considers projects that produce minimal impact on natural resources.*

- *Social responsibility. The Bank gives preference to projects that provide social benefits and mitigate social impacts through improved infrastructure services, enhanced environmental management, and employment opportunities amongst other benefits.*

- *The foregoing is encompassed within the Bank's strategic policy to give priority to projects that have a strong social dimension (such as education, health, affordable housing, elderly care) and projects that contribute to the green economy and to renewable energy and energy efficiency.*

CAPACITY BUILDING

The Bank is committed to invest in the skills and expertise of its human resources and in effective systems and processes to enable the achievement of its objectives. Following the first wave of recruitment in 2018 to fill the managerial posts of the various business areas, in 2019 the MDB continued to fill other senior posts and also embarked on a capacity building process to strengthen its organizational and technical capacity, also through the support of external expertise.

Business Review

During 2019, the MDB sustained its market-driven approach through constant dialogue with stakeholders in pursuing its objective of narrowing financing gaps. In the SME sector the MDB has focused on risk sharing instruments in the form of loan guarantee programmes, enabling it to maximise impact and optimise resource effectiveness. Through such instruments the MDB crowds-in commercial banks by mobilising the flow of liquidity into the provision of finance to SMEs financing, thereby generating a positive contribution to the Maltese economy in terms of new investment, employment opportunities, stronger competitiveness and higher economic activity.

The on-going consultation process has also revealed gaps in the provision of financing for infrastructure projects. The focus here is 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 climate action, green mobility and sustainable transport and water resources, as well as other environment-friendly initiatives. Projects that enhance Malta's competitiveness also rank high in the MDB's priorities.

The MDB has also developed a solid working relationship with the Managing Authority for EU Funds in connection with the Bank's role as a vehicle for leveraging EU resources. Consultations that commenced in 2018 led to the creation of a financial instrument that combines a grant element with a guarantee element, partly funded from EU structural funds. Such a financial instrument is enabling more students to further their tertiary education by benefitting from enhanced access to banking finance, enjoying longer moratorium periods, full 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.

FUNDING

During 2019, the MDB's operations have been funded from the paid-up capital provided by the Government in terms of Article 10 of the MDB Act. During 2019, the Bank's paid-up capital was increased by €10 million, to €40 million in accordance with the Bank's business plan. The Government Budget Estimates for 2020 provide for a further increase of €10 million in paid-up capital.

In 2020, the MDB will be supplementing the paid-up capital with bilateral borrowing from development institutions. The MDB held consultations with a number of international institutions to explore the possibility of acquiring long-term loans for on-lending to local operators, both in the SME segment and for infrastructural projects particularly those with a social dimension. To this effect, on 24 June 2019, the MDB signed a €45 million global loan agreement with the KfW Group. This loan facility will be mobilised for a financing scheme – the Guaranteed Co-lending Facility for SMEs – which the MDB intends to launch in 2020. This scheme will be intermediated through local commercial banks and will involve a combination of co-financing and a partial guarantee to promote SME finance in Malta.

On 19 December 2019, another loan agreement of €50 million was signed with the European Investment Bank under the Multiple Beneficiary Intermediated Loan (MBIL) programme. These funds will be utilised by the MDB to finance the facilities which it intends to offer to support SMEs, midcaps and infrastructure projects by private and public-sector entities.

GOVERNMENT GUARANTEE

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

Courtesy call of the KfW officials to the Minister for Finance during the course of KfW consultations with the MDB on bilateral collaboration.

guarantees issued by the Bank. According to the MDB's Business Plan, the Bank will rely on such Government guarantee for less than half of its overall operations.

In line with the indicative targets specified in the MOU signed between the MDB and the Ministry for Finance on 16 February 2018 as per Article 5(2) of the MDB Act, the Government Guarantee of €50 million which was issued on 16 February 2018 was replaced on 17 January 2019 by a new one of €100 million. On 17 January 2019, the Government guarantee was increased by a further €50 million to €150 million. The increase in the Government guarantee is intended to cover the two main international borrowing operations that have been negotiated with the EIB and KfW, as well as other prospective operations.

MDB FACILITIES FOR SMES

During 2019, the MDB addressed the SME financing gap by providing first-loss portfolio-capped guarantee schemes. Collaboration with commercial banks to operationalise its schemes enables the MDB to assume a leaner structure, more cost-effective operations, and a non-competing relationship with commercial banks, thereby fulfilling its public policy objectives more efficiently.

In addition, guarantee schemes contribute to credit enhancement, therefore helping the commercial banks to expand the size and range of loans to eligible SMEs. Banks also benefit from credit risk reduction and release of regulatory capital, and therefore the facilitation of higher leverage. Most importantly, SMEs benefit from reduced collateral requirements, lower interest rates, longer repayment terms and better conditions throughout.

During its second year of operations the MDB launched two schemes of this form, presented in the next two sections:

The Family Business Transfer Facility – Family Business Success

The Family Business Transfer Facility was the first scheme launched by the MDB. On the basis of a Risk Sharing Agreement between the MDB and Bank of Valletta, the MDB created a guarantee fund of €4 million which will enable BOV to generate a loan portfolio of €10 million for family concerns that are planning to transfer their business to other members of the family, often to the next generation. Under this scheme, the MDB provides a guarantee of 80% on BOV loans to family businesses of up to €750,000.

Banks in Malta have been very reluctant to finance such operations because these are perceived to add debt rather than value to the business. The facility therefore addresses a significant market gap and complements the fiscal incentives introduced by the Government in recent years to promote family business transfers on a sounder basis. Such transfers foster greater continuity, stability and further growth of such family businesses – which in Malta constitute a significant segment of the SME sector. This scheme was launched in April 2019, carrying the name *Family Business Success.*

THE FAMILY BUSINESS TRANSFER FACILITY – FAMILY BUSINESS SUCCESS

Who can apply?

To be eligible, a business must meet the following criteria:

- Applicants must be viable SMEs as defined by Commission Recommendation of 6 May 2003 (2003/361/EC). An SME is defined as an enterprise that:
    - has fewer than 250 employees.
    - has an annual turnover of up to €50 million or a balance sheet total of up to €43 million.
    - is independent and autonomous, i.e. not part of a wider group of enterprises.
- Applicants must be established and operating in Malta and must also be certified as family businesses with the Family Business Office under the Family Business Act.

How does the SME benefit?

- Lower than market interest rates.
- Reduced collateral obligations.
- Longer term of loan.
- Access to finance not otherwise available.

What methods of ownership transfer are eligible?

- The facility supports business ownership transfer through one or more of the following:
    - a takeover of the relevant family business through the transfer of the business from one family member to another.
    - a reduction in the Issued Share Capital.
    - the payment and distribution of a dividend.
    - the repayment of any shareholder loans due by the family business.

Key features of the scheme

- The maximum loan size is €750,000.
- A maximum repayment period of 10 years inclusive of any moratorium period.
- Possibility of up to 6 months moratorium on capital repayments at the discretion of the commercial bank.
- 80% of each individual loan amount is guaranteed by the MDB up to a cap of 50% at the level of the portfolio.
- Extendible security does not exceed 30% on a portfolio basis.

The MDB Guarantee facility for loans to SMEs – SME Invest

The MDB Guarantee Facility for Loans to SMEs is a scheme with very broad eligibility. It facilitates lending to smaller businesses that are viable but unable to obtain the required amount of finance from a commercial bank. This may be due to such factors as:

- collateral offered by the borrower fails to meet the bank's normal requirements,
- the novelty or nature of the business venture falls outside the bank's risk tolerance
- the required repayment period proposed by the borrower exceeds what the bank may be willing or able to accept.

The MDB seeks to magnify the reach of its incentives by collaborating with commercial banks to stimulate SME lending in Malta by offering the opportunity for banks to act as MDB's implementing partners.

Bank of Valletta was the first implementing partner of the MDB Guarantee facility for loans to SMEs through the launch of *SME Invest*. The MDB created a guarantee fund of €10 million, enabling BOV to generate a loan portfolio of €50 million. The MDB guarantees 80% of BOV loans to SMEs. Each loan can range from a minimum of €200,001 to a maximum of €750,000. This scheme was launched in April 2019.

THE MDB GUARANTEE FACILITY FOR LOANS TO SMES – SME INVEST

Who can apply?

- Applicants must be viable SMEs as defined by Commission Recommendation of 6 May 2003 (2003/361/EC). An SME is defined as an enterprise that:
    - has fewer than 250 employees.
    - has an annual turnover of up to €50 million or a balance sheet total of up to €43 million.
    - is independent and autonomous, i.e. not part of a wider group of enterprises.

- Applicants must be established and operating in Malta.

How does the SME benefit?

- Lower than market interest rates.
- Reduced collateral obligations.
- Longer term of loan.
- Access to finance not otherwise available.

What type of activities are eligible?

- The project must be supported by a viable business plan,
- The project is considered bankable by the credit institution, meaning that the business is reasonably expected to generate sufficient cash flow to enable timely repayments,
- The project is not physically completed or fully implemented on the approval date of the facility
- The activities of the SME are not in the list of excluded activities,
- The purpose of the financing includes a wide spectrum of possible activities including:
    - the establishment of new enterprises,
    - expansion capital,
    - capital for the strengthening or stabilisation of the general activities of an enterprise;
    - the realisation of new projects, penetration of new markets or new developments by existing enterprises.
    - investment-related working capital.

Key features of the scheme

- The size of eligible loans guaranteed under the facility ranges from a minimum of €200,001 up to a maximum of €750,000,
- The maximum term of loans is 10 years including the moratorium period if any,
- Possibility of a twelve-month moratorium on capital repayments at the discretion of the commercial bank,
- The minimum contribution by the SME is at the discretion of the commercial bank, normally 10% of the project costs,
- The commercial bank may require collateral in addition to MDB's guarantee to cover the exposure.

Tailored Facility for SMEs

Investment gaps in the financing of SME investments evolve over time in line with the growth of the economy and the changing landscape of Malta's banking sector. Despite the excess liquidity in the financial system, bank lending to SMEs remains constrained mainly due to the lower risk appetite by banks and the tighter regulatory conditions. As a result, viable businesses with bankable investment propositions continue to face barriers in accessing credit. In addition, the value of SME investments is constantly increasing, consistent with a rapidly growing economy. It has become increasingly evident that the investment demands of SMEs can often exceed the upper limit of €750,000 under guarantee schemes. This leaves a more pronounced financing gap for larger SMEs.

In accordance with its objective to support businesses at all stages of development, from start-up phase to scaleup, and of creating a more diverse and vibrant credit market and to stimulate more active SME lending in Malta, the MDB launched the Tailored Facility for SMEs. This facility offers a bespoke solution for SMEs with investment plans that exceed the €750,000 mark. The structure of the facility can take the form of co-financing with commercial banks and may also include an element of guarantee by the MDB. The facility can be calibrated in line with the characteristics of the proposed investment. The minimum loan size under the tailored facility is set at €3 million while the remaining gap between €750,000 and €3 million shall be catered for by the new guaranteed co-lending scheme that the MDB plans to launch during 2020 (see SME facilities in the pipeline on the next page).

TAILORED FACILITY FOR SMES

Who can apply?

To be eligible, a business must meet the following criteria:

- Applicants must be viable SMEs. An SME is defined by Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (2003/361/EC) as an enterprise that, among other aspects:
    - has fewer than 250 employees.
    - has an annual turnover of up to €50 million or a balance sheet total of up to €43 million.
    - is independent and autonomous, i.e. not part of a wider group of enterprises.
    - is established and operating in Malta.

How does the SME benefit?

- Lower than market interest rates
- Reduced collateral obligations
- Longer term of loan
- Access to finance not otherwise available

What type of projects are eligible?

- The project must be supported by a viable business plan. The project for which funds have been requested is considered bankable by the commercial bank, meaning that the business is reasonably expected to generate sufficient cash flow to enable timely repayments.
- The project is newly originated; and
- The activities of the SME should not be in the exclusion criteria
- The purpose of the financing covers a wide spectrum of possible activities including:
    - the establishment of new enterprises,
    - expansion capital,
    - capital for the strengthening and/or stabilisation of the general activities of an enterprise or,
    - the realisation of new projects, penetration of new markets or new developments by existing enterprises.

Key features of the scheme

- The size of the loan ranges from a minimum of €3 million to a maximum of €5 million,
- The required lending is co-financed by the commercial bank and the MDB in such proportions as may be agreed between the parties,
- The applicant will be required to front contribute part of the project funding requirements,
- On a case-by-case basis, the MDB may offer a partial credit risk protection by way of guarantee on the share of the loan provided by the partner commercial bank.

SME facilities in the pipeline

In line with the rationale of the Tailored Facility for SMEs to cater for loans that exceed the €750,000 mark, the MDB is working on a guaranteed co-lending facility with the commercial banks. During the year, the MDB conducted an intensive soft-market testing exercise with the commercial banks and initiated negotiations in connection with the new facility. The scheme would involve an element of co-financing of loans to SMEs by the MDB in conjunction with the commercial banks on a 50-50 basis, plus an element of guarantee where the MDB would be providing a guarantee on part of the commercial bank's share of the loan. The MDB would be allocating a fund of €50 million for this new facility which, together with the contribution of the partner banks, will generate a portfolio of new loans to SMEs of €100 million. This scheme is targeting loans of above €750,000 up to a maximum of €3 million each and is expected to be rolled out by the first half of 2020.

In 2020, the MDB plans to have in place a set of programmes that support a wide coverage of SME loans from a minimum size of €10,000 to a maximum of €5,000,000, as shown in the Table below.

MDB PROGRAMMES FOR SMES BY SIZE OF FACILITY

Size of facility	*Name of facility*	*Status*
€10,000 - €200,000	Guaranteed Facility for Loans to SMEs	To be launched in 2020
€200,001 - €750,000	BOV SME Invest	Available
€750,001 - €3,000,000	Guaranteed Co-Lending Scheme	To be launched in 2020
€3,000,001 - €5,000,000	Tailored Facility for SMEs	Available

SPECIAL TOPIC II – MDB COVERAGE OF THE SME FINANCING GAP

Estimating the SME financing gap

As part of the preparatory work for the establishment of the MDB, the Ministry for European Affairs in 2015 commissioned Ernst and Young (EY) after a public call for Expression of Interest to carry out a Market Study on the Potential Existence of Market Failures in Malta. The EY study concluded that the estimated market gap pertaining to SME and start-up financing ranged between a lower bound of €322.4 million and an upper bound of €583.6 million, or an average of €452.7 million spread over a period of five years.

The MDB carried out an internal exercise broadly based on the methodology used by the European Commission in SWD (2013) 517 final and later applied by Fi-Compass (2018) – which is very similar to the methodology adopted by EY for the 2015 market study - with a view of computing an updated estimate of this market gap.[1] The methodology used to calculate unmet demand for financial capital starts off with an estimate of the number of viable and therefore creditworthy enterprises which were unsuccessful in obtaining a loan; and then multiplying this number by the average enterprise loan amount. This estimate of viable enterprises that were unsuccessful in obtaining a loan comprises of three components:

i. Credit-worthy applications from viable applicants that were rejected by finance providers;
ii. Applications that were approved by lenders, but were then refused by the applicant, for instance due to the high interest rate demanded by the financial provider;
iii. Enterprises which were unwilling to apply for a bank loan because the conditions were perceived by the prospective applicant as prohibitive, too costly or difficult to satisfy.

In line with the Commission and EY studies, the identity to estimate the financing gap faced by enterprises in Malta has the following structure:

Loan financing gap = Number of enterprises X Ratio of financially viable enterprises X Ratio of unsuccessful enterprises X Average loan size for enterprises[2]

The Commission's methodology defines financially viable enterprises as those with positive turnover growth in the last financial period. Furthermore, to ensure a more accurate estimate of the loan financing gap, the Commission methodology applies a more stringent proxy for the proportion of financially viable enterprises represented by the share of high-growth SMEs by inserting two boundaries:

- A lower boundary comprising the share of enterprises with a turnover growth of 20% or higher in the previous three months;
- An upper boundary comprising the share of enterprises with positive turnover growth in the previous six months.

For the purposes of this exercise, the estimate of unsuccessful enterprises is given as a single figure, without upper and lower boundaries. The further insertion in upper and lower boundaries for all the sub-components of the 'unsuccessful enterprises' category would have been additionally beneficial, but the insertion of any boundary proved difficult to implement in the Maltese context.

Data sources and limitations

The data used in this note are in line with those used in the Commission paper mentioned above. The data sources are as follows:

- Number of enterprises: National Statistics Office, data for 2018 (latest available)
- Financially viable enterprises: Survey on the Access to Finance of SMEs in the Euro area (SAFE Survey), September-October 2019 (wave 21)
- Unsuccessful enterprises: SAFE Survey, September-October 2019 (wave 21)
- Average loan size for enterprises: Non-consolidated financial accounts of the Maltese economy dataset as at December 2017 divided by the number of enterprises.

Although such survey data have their limitations, they are still used extensively in studies on financing gaps when time and data constraints prevent a deeper assessment through analyses of the data. In the specific case of Malta, the relatively small sample size of 100 enterprises in the SAFE Survey may diminish the robustness of the results.

Additionally, the estimation of the financing gap in this note was compelled to use 'enterprises' as a proxy for SMEs, since not all sources provide data for the latter. Given that 99.8% of enterprises in Malta are SMEs, this procedure is considered plausible. Additionally, financial and insurance enterprises (numbering 16,296 - NACE sector K) are netted out from the total with a view to focus on the more relevant non-financial sector.

1 The methodology replicates that used by the European Commission in the paper "Ex-ante assessment of the EU SME Initiative" (SWD (2013) 517 final) and later applied by Fi-Compass in the paper titled "Financial gap in the EU agricultural sector" (2018).

2 The average loan size is based on the Financial Accounts dataset (Central Bank of Malta) and on NSO data on the number of enterprises (adjusted by netting out financial and insurance enterprises – NACE sector K)

The value of unmet demand for financial resources by SMEs in Malta as at December 2019 is estimated at €533.0 million. This estimate is reasonably consistent with the average figure of €452.7 million projected in the Market Study on the Potential Existence of Market Failures in Malta (2015), which had derived the 5-year level by summing up the annual amounts on the basis of the growth rate in SME funding gaps.

The increase of €80 million in the estimated financing gap between 2015 and 2019 is largely attributable to the increase in the number of enterprises during this period and the general tightening of credit conditions due to the general de-risking strategies adopted by most banks in the aftermath of the international financial crisis as well as the tightening in prudential regulatory conditions including higher capital charges for riskier operations.

Bridging the SME financing gap

Another purpose of this exercise is to benchmark the impact of the MDB in terms of its ability to bridge the market gaps in areas that fall within its mandate. This can be measured through the MDB's expected coverage of the estimated SME financing gaps by looking at both how much the MDB is envisaged to deploy directly into the market as well as the contribution from the private sector which is expected to be crowded in alongside that of the MDB.

The MDB expects to deliver €120.0 million in SME financing over a period of three years with the implementation of the MDB *Guarantee Facility for SMEs* in collaboration with financial intermediaries. An additional €10.0 million is expected to be delivered under the *Family Business Transfer Facility.*

Negotiations with all the core domestic banks are ongoing in connection with a new scheme that combines an element of co-financing of loans to SMEs by the MDB in conjunction with the banks on a 50-50 basis with an element of guarantee that the MDB will be providing on the bank's share of the loan. The MDB is allocating a fund of €50.0 million for this new facility which, together with the contribution of the partner banks, is expected to generate a portfolio of new loans to SMEs of €100.0 million over two years. This scheme is targeting loans of up to €3.0 million each and is expected to have a moderate ramp up in 2020 given that the product will be rolled out during the year.

Projected MDB impact on SME financing between 2020 and 2022

FACILITY	MAXIMUM PORTFOLIO AMOUNT
	(€ million)
Family Business Transfer Facility	10.0
Guarantee Facility for Loans to SMEs	
SME Invest - BOV	50.0
Second prospective accredited bank	50.0
Third prospective accredited bank	20.0
Guaranteed Co-lending Scheme (GCLS)	100.0
Total financing to SMEs	**230.0**

The Table above is a summary of the projected MDB financing to SMEs over the next three years taking into consideration the facilities that have been launched in 2019, as well as those in the pipeline for 2020. The MDB expects that a total of €230.0 million in additional SME financing for new investments will reach the market once such facilities are fully absorbed. Compared with the estimated size of the SME financial gap in Malta of €533.0 million, it is estimated that the value of SME financing supported by the MDB guarantee and co-financing programmes would address around 43% of this estimated gap.

MDB FINANCING OF INFRASTRUCTURE PROJECTS

During the year, the MDB continued to build experience, networks and a reputation in the financing of infrastructure projects by offering more diversified intermediation solutions such as syndicated facilities with commercial banks, longer term financing and low interest rates. This new form intermediation shall be instrumental in increasing the appetite of commercial banks for financing infrastructure investment when the risks involved cannot be handled by individual banks.

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 infrastructural projects. The MDB's preference is for such investments to be financed in conjunction with the commercial banks, and also to foster the promotion of a syndicated loan market in Malta – which so far has played a somewhat subdued role.

In 2019 the MDB intensified its negotiations with the Housing Authority and private investors on an innovative concept of affordable housing. This concept addresses the housing needs of the socio-economic group that falls in between the social housing segment and the housing market. The policy objective is to increase the supply of housing units at below-market rental rates, on a capital cost recovery basis. This initiative will also serve to support households in the respective socio-economic group in their transition from affordable housing to the standard residential market.

The MDB is also supporting an infrastructure project with a strong social dimension in the educational field. The project consists of a complex that will offer University students modern residential facilities in the proximity of the University of Malta campus, an extension of parking facilities within the campus; and a mix of administrative offices, educational facilities, commercial facilities and a community complex on campus. This project shall cater for the needs of the current and future campus population consisting of students, lecturers, staff and visitors. In addition, it will also cater for parking facilities for the general public visiting both the University and Mater Dei Hospital.

FURTHER STUDIES MADE AFFORDABLE – BOV STUDIES PLUS+

The Further Studies Made Affordable (FSMA) financial instrument (marketed as BOV Studies Plus+) is a new financing solution providing €5.5 million in soft loans, targeted for individuals seeking further studies. This facility is offered through the collaboration between the MDB, Bank of Valletta and the Managing Authority for EU Funds. The instrument is financed under the Operational Programme II – "Investing in human capital to create more opportunities and promote the wellbeing of society" which is co-funded by the European Social Fund Programme 2014-2020.

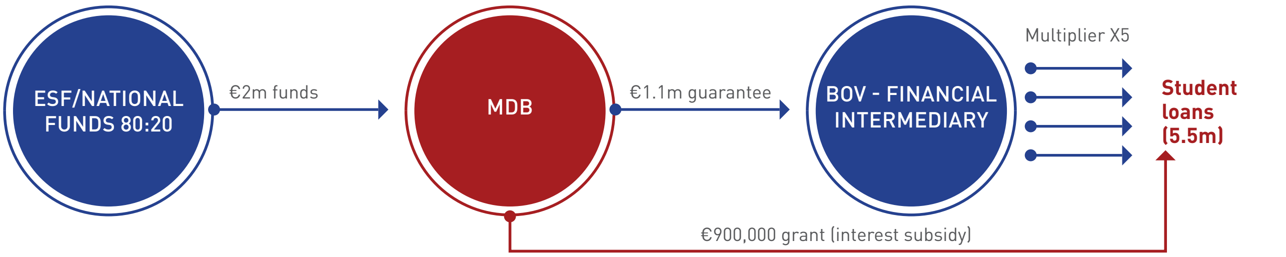
The initial fund allocated by the Managing Authority to this financial instrument has been set at an amount of up to €2 million with the possibility of increasing this amount to €3 million should there be a demand.

The objective of the financial instrument is to support the development of human capital and is aimed to meet the financing needs of students seeking to pursue a study programme for accredited courses in MQF levels 5, 6, 7 and 8 as well as other internationally recognised certificates. The eligible students are entitled to receive support for the activities related to tuition fees, accommodation costs, subsistence expenses and other expenses to further their studies in Malta and abroad.

Loans under this facility can be up to a maximum of €100,000 with a term of up to 15 years including a maximum moratorium period of 5 years. Students benefit from a grant on all the interest payments during the moratorium period which is being partly financed from ESF resources, and an attractive interest rate thereafter. Due to the guarantee of 80% provided by the MDB, no collateral or up-front contribution is requested from the student.

Out of the €2 million in the allocated resources, €1.1 million were used to create the guarantee fund upon which Bank of Valletta is leveraging a loan portfolio of €5.5 million, whereas the remaining €900,000 are allocated as grant to cover the interest payments during the moratorium period (See Figure on the next page). The combination of grants and financial instrument enabled softer terms and conditions for the students.

Structure of the Further Studies Made Affordable



FURTHER STUDIES MADE AFFORDABLE FINANCIAL INSTRUMENT – BOV STUDIES PLUS+

Who can apply?

Eligible students undertaking an accredited course in MQF levels 5,6,7 or 8 as well as internationally recognised certificates would need to be:

- Maltese citizens; or
- A national of an EU/EEA Member State or a family member of such EU/EEA national (as defined in SL460.17 and SL217.04 respectively for EU and EEA nationals), provided that such person has obtained permanent residence in Malta in accordance with SL460.17 and SL217.04 respectively for EU and EEA nationals; or
- A national of an EU/EEA Member State who is in Malta exercising his/her Treaty rights as an employee, self-employed person or person retaining such status in accordance with SL460.17; or
- third country national who has been granted long-term residence status under SL217.05

How does the student benefit?

- Lower than market interest rates
- No collateral obligations
- No down payment
- Longer term of loan
- A moratorium on capital and interest
- Access to finance not otherwise available

What type of study related costs are covered by the instrument?

- Tuition fees
- Living expenses
- Accommodation fees
- Transport costs
- Textbooks and other course related expenses

Key features of the scheme

- The maximum loan amount is €100,000. Should the student seek other forms of funding these can be used as contribution to study costs reducing the requested loan amount
- The scheme provides for a moratorium period equal to the period of study plus 12 months to a total maximum period of 5 years, allowing the student to seek employment. Students will make no capital and interest repayments during their studies, irrespective of whether in full time or part time study. The interest payments during this period are fully covered through the grant
- The maximum term of the loan is 10 years (plus a maximum of five-year moratorium period)
- The student is not required to provide any form of collateral requirements or life insurance cover
- During the capital and interest repayment period the product has a significant reduction in interest rate, and a longer-term repayment programme will be considered, ensuring that the loan is affordable for the student via a lower monthly repayment

KEY BUSINESS HIGHLIGHTS

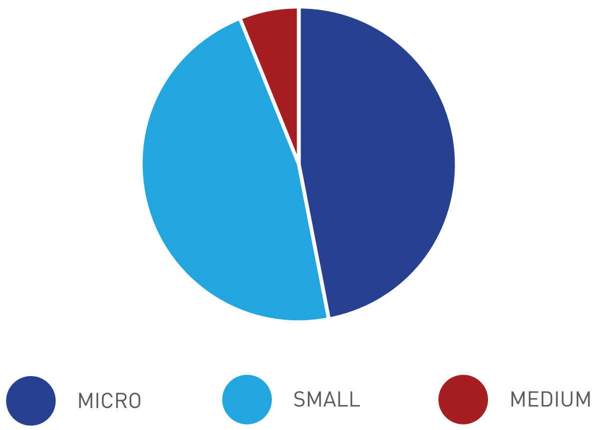
In 2019 the MDB started to deliver its first tangible impact on the Maltese economy with the launch of two guarantee programmes, the Family Business Transfer Facility (Family Business Success) and the Guarantee Facility for Loans to SMEs (SME Invest). The take-up under the SME Invest exceeded projections, with 30% of the total portfolio being sanctioned just six months since its launch. The following is a summary of the MDB's aggregate impact on SME financing.

AS AT END-DECEMBER 2019, TOTAL SANCTIONED LOANS TO SMES SUPPORTED BY THE MDB AMOUNTED TO €14.5 MILLION SPREAD ACROSS 33 BENEFICIARIES AND SUPPORTING NEARLY 600 JOBS

€14.5m	**33 SMEs**	**596 jobs**	**€308,500**
Total sanctioned SME loans supported by MDB	Number of SMEs supported by the MDB	Jobs supported by MDB	Average sanctioned loan size

94% of the SMEs were micro and small

SME Size



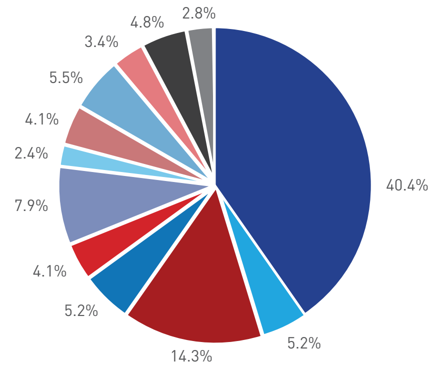
**SME size defined in accordance with the EU recommendation 2003/316*

**Micro-enterprises* are defined as enterprises that employ fewer than 10 persons and whose annual turnover or annual balance sheet total does not exceed € 2 million.

Small enterprises are defined as enterprises that employ fewer than 50 persons and whose annual turnover or annual balance sheet total does not exceed € 10 million.

Medium-sized enterprises are defined as enterprises that employ fewer than 250 persons and either have an annual turnover that does not exceed € 50 million, or an annual balance sheet total not exceeding € 43 million.

MDB funding is benefiting a wide range of economic sectors

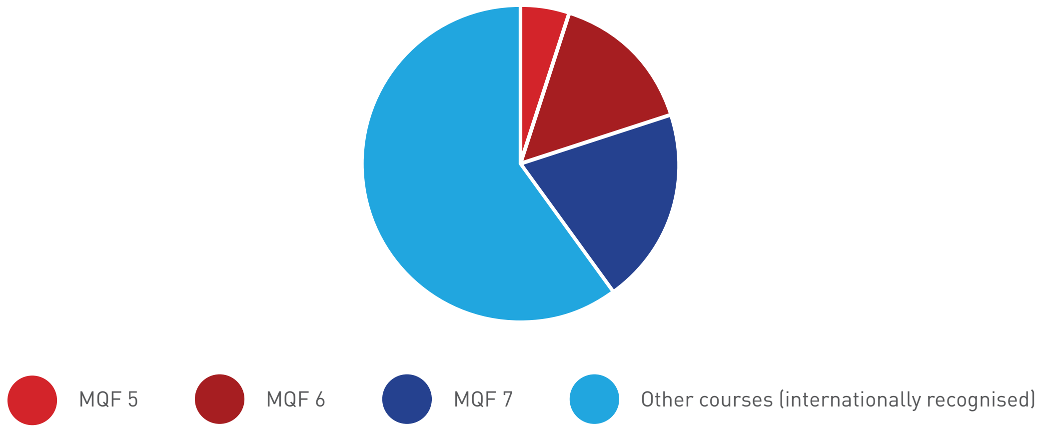


- MANUFACTURING
- WHOLESALE AND RETAIL TRADE; REPAIR OF MOTOR VEHICLES AND MOTORCYLES
- ACCOMMODATION AND FOOD SERVICE ACTIVITIES
- FINANCIAL AND INSURANCE ACTIVITIES
- EDUCATION
- ARTS, ENTERTAINMENT AND RECREATION
- WATER SUPPLY; SEWERAGE; WASTE MANAGEMENT AND REMEDIATION ACTIVITIES
- TRANSPORATION AND STORAGE
- INFORMATION AND COMMUNICATION
- ADMINISTRATIVE AND SUPPORT SERVICE ACTIVITIES
- HUMAN HEALTH AND SOCIAL WORK ACTIVITIES
- OTHER SERVICE ACTIVITIES

During the year, the MDB also delivered a significant impact in the area of social investment in education and skills through the Further Studies Made Affordable (BOV Studies Plus+). The take-up of this scheme exceeded projections and the full portfolio of €5.5 million is expected to be utilised by the second quarter of 2020, less than 9 months from its launch. FSMA is addressing a gap in the financing of tertiary education and costly international courses as the average loan size is considerably higher than the student loans that are normally available on the market.

€2.7m	**56 students**	**€48,695**
Total sanctioned student lending supported by MDB	Number of students supported by the MDB	Average sanctioned student loan size

MQF level of study



SIGNIFICANT EVENTS

As part of its programme to raise awareness and to enhance corporate visibility, the MDB was actively involved in several conferences, seminars and other events over the course of the year. These provided the MDB with the opportunity to explain its role and objectives to a wide range of stakeholders from various sectors. They also provide an opportunity to engage in productive collaboration with stakeholders that enables the MDB to take a market driven approach in its strategy.

Blue Invest in the Mediterranean

On 24 January 2019, the European Commission organised Blue Invest in the Mediterranean, a match-making event which brought together project promoters and the financial community to sustainably develop the Blue Economy. The event focussed on innovative projects originating in the Mediterranean. Promoters pitched their ideas in front of several panels of investors with a view to increase the visibility of their projects and explore investment and project development opportunities. MDB was represented by the Chief EU Financial Instruments Officer who was invited to sit on a panel themed "Green navigation". The five projects which were judged by the panel related to energy efficiency for maritime vessels, yacht berthing supervision, wind propulsion and underwater drones.

Paving the way towards a Sustainable Maltese Economy - Looking Ahead to 2050

The Conference was organised by the Ministry for the Environment, Sustainable Development and Climate Change with the objective to further encourage the engagement of key stakeholders in the development of Malta's Sustainable Development Strategy for 2050. The conference was held on 4 February 2019. Mr Rene Saliba, Chief Executive Officer at MDB, participated in the panel of one of the workshops on the topic of Financing instruments and tools for sustainable growth. Mr Saliba explained the promotional role of the MDB in collaborating with the commercial banks and other stakeholders to improve the supply of investment finance in areas affected by market failures. In this respect, the MDB places considerable emphasis on sectors that have a substantial social dimension – especially health, education and affordable housing – as well as environment-friendly initiatives that foster the green economy.

SME Invest Launch

On 13 May 2019, the MDB announced that it is making €50 million available to small businesses that are planning capital investment projects. Launched by Bank of Valletta and the MDB, the BOV SME Invest programme allows small and medium enterprises easier access to funding amounts ranging between €200,000 and €750,000. The €50 million financing package is based on the support of a €10 million guarantee provided by the MDB. The benefits are being passed on to the SMEs in the form of lower collateral obligations, reduced interest rates and a longer repayment period of up to 10 years.

Addressing the launch, Prime Minister Dr. Joseph Muscat and Finance Minister Prof. Edward Scicluna said they were pleased that financial tasks usually carried out by international banks or institutions were being implemented by Malta's own development bank.

Financing Gozitan Business to Prosper

On 5 July 2019, the MDB and Bank of Valletta, in collaboration with the Gozo Business Chamber, organised a seminar *Financing Gozitan business to prosper* at the Institute of Tourism Studies in Qala.

On behalf of the Minister for Gozo Justyne Caruana, Christian Vella Masini opened the seminar, highlighting recent developments vis-à-vis island connectivity and economic growth. He said easier access to finance was necessary for enhanced investment and job creation in Gozo.

Joseph Darmanin and Maria Xuereb, Chief Officers at the MDB, delivered a presentation on MDB guarantee facilities, also highlighting the Bank's role in the economy.

BOV Executive Alfred Buhagiar spoke about the BOV SME Invest and the Family Business Success Initiatives, providing practical detail on how such programmes eased SME access to finance for SMEs. He said the BOV SME Invest was aimed specifically at both start-ups venturing into new business sectors and traditional SMEs that wanted to revamp their current business model.

Gozo Business Chamber president Joseph Borg concluded the seminar stressing the difficulties faced by Gozitan SMEs, including state aid limitations on incentives for Gozitan-based SMEs.

Malta Chamber - MDB Guarantee Facilities

The Chamber of Commerce held an information session on 11 July 2019, in collaboration with Bank of Valletta and the MDB, to discuss the schemes that the MDB had launched in support of SMEs and family businesses. This session was one of a series of events co-organised with BOV in view of the recently extended partnership with the Chamber.

The programme gave a detailed insight on the latest financing opportunities available to SMEs. Special focus was dedicated to the BOV SME Invest and the BOV Family Business Success.

Joseph Darmanin and Maria Xuereb, Chief Officers at the MDB, gave an overview of the role and functions of the MDB with a focus on its remit in supporting SMEs.

Prof Josef Bonnici, Chairperson, Malta Development Bank, concluded the session by remarking with satisfaction that just after eight months of operations, the MDB is making an impact on the economy by rolling out its first two facilities. Malta now has a home-grown institution that provides a remedy for financial market gaps by designing financial instruments that are home-made and customised for the needs of the local economy. The MDB is also working on new programmes in areas that manifest a financial market gap and is looking forward to launching new facilities in the coming months.

Enterprise Consultative Council

During the Enterprise Consultative Council held on 30 September 2019, the Minister for the Economy, Investment and Small Businesses, Hon Chris Cardona launched the 2019 Malta SME Week. The MDB was invited to deliver a presentation on its programmes supporting SMEs. The event provided MDB with an opportunity to join in the dialogue between constituted bodies and government.

Launch of the BOV Studies Plus+

The launch of a financial instrument 'Further Studies Made Affordable', enabling the *Bank of Valletta Studies Plus+*, was marked by the signing of the risk sharing agreement between Bank of Valletta and the MDB on 3 October 2019. BOV's Chief Credit Business Development Officer Albert Frendo and the MDB Chairperson Prof. Josef Bonnici made introductory remarks. The audience was also addressed by Minister for Education Evarist Bartolo, Minister for Finance Prof. Edward Scicluna and the Parliamentary Secretary for European Funds and Social Dialogue Aaron Farrugia.

The instrument represents an important milestone for the MDB. It was the first to be funded from EU Structural Funds with the MDB acting as the implementing body. The facility is based on a grant element to cover the interest payments during the initial moratorium and a guarantee element, both provided by the MDB. The commercial bank can leverage up the guarantee by a multiple of 5.

GRTU SME Conference

On 31 October 2019, over 200 enterprise owners met for the 2019 edition of *GRTU Malta Chambers of SMEs - The SME Conference: Year in Review*. This year's conference focused on economic growth and the results of the GRTU study on the subject were published during the event. The MDB sponsored the event and also coordinated one of the workshops, *Acquiring Finance – Incentives, Investment and Guarantees*. The MDB delivered a presentation showcasing its products and facilities, as well as initiatives in the pipeline. This was followed by a panel discussion where the MDB replied to questions by participating SMEs.

INTERNATIONAL AFFILIATIONS AND COOPERATION

During 2019, the MDB collaborated with a number of international associations, multinational development institutions and foreign development banks. The MDB is a member of the European Association of Public Banks (EAPB), the European Long-Term Investors (ELTI) and the Network of European Financial Institutions for SMEs (NEFI). In 2019, the Bank also applied to become a member of the European Association of Guarantee Institutions (AECM). 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.

The MDB has important strategic alliances with other promotional institutions such as the KfW. On 24 June 2019, the MDB signed a €45 million global loan agreement with the KfW Group. The funds will be mobilised for the guaranteed co-lending facility which is expected to be rolled out by the first half of 2020. This loan agreement will contribute to deepen and extend the existing business relationship between KfW and MDB which started during the Bank´s incorporation process. The global loan with KfW is MDB´s first funding transaction.

The EIB Group, as the European Union's lending arm and the world's biggest multilateral financial institution, offers opportunities for synergies with the MDB in various policy areas. In 2019, the MDB signed an agreement with the EIB for a loan of €50 million under the EIB's Multiple Beneficiary Intermediated Loan (MBIL) programme which will be allocated towards SMEs, midcaps and public sector entities.

During the year, the MDB benefited from advisory services from the EIB in the setting up of the Further Studies Made Affordable financial instrument. Another form of collaboration with the European Investment Fund (EIF) is through the MDB's membership in the Network of EIF-EU NPBs on Securitisation (ENSI). During 2019, the MDB joined the EIF-National Promotional Institutions (NPI) Equity Platform, allowing the Bank to partner up with national and regional promotional institutions active in equity financing across the EU Member States to promote best practices in policy-driven equity investments and to enhance access to funding for SMEs and midcaps. MDB's participation in this platform shall provide a useful learning experience and a strong forum for cross fertilisation of ideas and opportunities with European peers which would help the MDB expedite its impact through equity investment in the area of Research and Innovation. In addition, MDB is also holding consultations with the European Investment Advisory Hub (EIAH) and the European Investment Bank (EIB) with a view to develop its expertise in areas such as state aid, financial instruments and product development.

ORGANISATIONAL CAPACITY

With the support of technical assistance from the European Commission's Structural Reform Support Programme (SRSP), the MDB during the year, made recourse to external expertise to strengthen its organisational capacity. This will enable the MDB to be in a position to consider applying for direct access to the EU guarantee and at the same time partnering with the European Investment Bank Group. Such capacity building will enhance the MDB's ability to comply with the Pillar assessment – a necessary requirement in order to be delegated the responsibility of implementing partner of the EU Budget. This capacity building project supported by SRSP commenced in September 2019 and is expected to achieve the following outcomes over a period of nine months:

- Outcome 1 – To significantly improve the MDB's internal control system, in order to ensure compliance with the requirements of the EU pillar assessment process and good National Promotional Banks' (NPB) practices, while delivering a wider spectrum of financial instruments and services.

- Outcome 2 – To significantly improve the MDB's accounting system in order to ensure compliance with the requirements of the EU pillar assessment process and good NPB practices;

- Outcome 3 – To significantly improve the MDB's publication of information, data protection and reporting in order to ensure compliance with the requirements of the EU pillar assessment process and good NPB practices.

In addition, the MDB has also signed an agreement with the European Investment Advisory Hub for the provision of technical assistance in the area of financial instruments, particularly in the context of Invest EU. This project is expected to be implemented over the course of 2020.

Risk and Capital Management

Pursuant to the Act No XXI of 2017 (the "Act") on the Malta Development Bank, the Bank takes risks consciously by applying the principles of banking operations to support the entrepreneurship and socio-economic development in Malta.

The MDB aims to manage risks in an informed and proactive manner, in accordance with its Risk Management Framework, such that the level of accepted risk is consistent with its underlying business activity, and that the MDB understands and is able to manage or absorb the impact of any risks that may materialise.

The MDB embarked on building an organisational structure based on 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. Great importance is given to the risk governance structure, which includes socio-economic value statements, codes of conduct and ethics, policies, procedures and risk assessments. Moreover, the Risk Management Department continuously strives to instil a cultural awareness that helps to establish a robust risk management framework and risk control processes across the Bank.

RISK GOVERNANCE

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

Supervisory Board

The 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 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.

Board of Directors

The Board of the MDB is responsible for setting the risk appetite and overseeing and guiding risk management activity across the MDB. The Board has mandated that risk management be integrated and embedded into the tone and culture of the MDB, with the management team of MDB responsible for regularly reviewing the risk register and individually confirming that the stated controls are in place. In order to effectively accomplish its tasks, the Board is assisted by three committees (viz. Risk Committee, Ethics and Governance Committee and Audit Committee) that are responsible for a wide range of activities as defined in the Corporate Governance Statement of this Annual Report.

Three lines of defence

The MDB Risk Management Framework is predicated on the three lines of defence model. Within this model, the business originators incur and own the risks.

The MDB's Risk Management Department and other control functions (the second line of defence) provide independent oversight and objective challenge to the first line of defence. They also provide risk monitoring and reporting. The Internal Audit function (which is outsourced to an audit firm that has direct experience in auditing of banks) acts as part of a third line of defence by providing independent, reasonable, risk-based assurance to key stakeholders on the robustness of the MDB risk management system, its governance and the design and operating effectiveness of the internal control environment.

PRINCIPAL RISKS

The MDB is exposed to a variety of risks which have the potential to affect its financial and operational performance. The Risk Management Framework establishes the processes to identify, assess, report and mitigate risk. The MDB has identified the following principal risks which may adversely affect the achievements of its objectives.

RISK	DESCRIPTION OF THE RISK	RISK MITIGATION MEASURE
Credit risk	The MDB is exposed to the risk that a borrowing counterparty defaults on its obligations and fails to repay its debt in full, resulting in losses to the MDB. The MDB is exposed to credit risk (i) due to its loans to the borrowers and (ii) in respect of its risk sharing schemes, due to loans made to final beneficiaries which have been guaranteed by the MDB.	The MDB controls credit risk through its credit risk policies, ordinances and prescribed procedures that determine the internal control system with an objective to act preventively. The credit risk management framework represents the most important part of the MDB's business policy and an important factor of its business strategy. Therefore, this area is regulated by separate documents, namely: (a) the Borrowing Evaluation Policy, which outlines the Bank's due diligence process, (b) the Credit Risk Policy that applies to all phases of the credit process (from the development of schemes and borrowing proposals, to risk assessments, monitoring of obligor and loan repayments) and (c) the Credit Risk Mitigation Policy, which sets the Bank's credit risk mitigation measures which are ancillary to, and complement, core credit risk considerations to ensure good and responsible lending. Other measures include the monitoring of key risk indicators and assessment of credit risk by the Credit Committee, a sub-committee of the Risk Committee, and the Board.
Liquidity risk and interest rate risk	Liquidity risk is the risk that the MDB cannot meet its short-term debt obligations. It is the risk of loss arising from a situation where there will not be enough cash to fund day-to-day operations and that the MDB will be unable to convert assets into cash in a timely manner. The MDB is exposed to interest rate risk on its cash, loans and funding positions. Adverse movements in the interest rates may negative impact the net interest income.	The MDB maintains the necessary level of liquidity reserves, continuously monitors current and planned liquidity and provides sufficient funds necessary for the timely settlement of obligations and disbursements under committed loans and planned commitments. The Banks monitors and strives to achieve compatibility of the existing and planned funding sources in terms of liquidity. The Bank is not a deposit taking institution and is therefore not exposed to wide daily fluctuations in liquidity. The MDB's lending facilities reflect the interest rate risk profile of the underlying funding agreements in order to minimize incidents of material interest rate mismatches. Liquidity and interest rate risk are managed by the ALCO Committee, a sub-committee of the Risk Committee, and the Board.

Operational risk	The MDB is exposed to a range of operational risks arising from the people, systems and processes involved in meeting the Bank's objectives. These could ultimately result in the MDB failing to meet its objectives and result in significant reputational damage.	In 2019, the MDB developed a Risk Register, which identifies the key risks faced by the MDB. The Risk Register shall be further developed such that the risks are graded, and controls are implemented to manage and mitigate these risks. Moreover, the MDB intends to develop an Operational Risk Policy, which established the basic principles for operational risk management. The Risk Register is reviewed by the Audit Committee.

CAPITAL MANAGEMENT

Capital management is 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. The MDB is not subject to externally imposed capital requirements. Nonetheless, the Bank is committed to ensuring it is adequately capitalised as there is a risk that inappropriate management of its capital could result in the inability to absorb any potential credit losses.

In order to ensure that the MDB is adequately capitalised to absorb any potential losses, the Bank applies the following structured approach:

- Complement the current and future business planning with adequate capital planning to meet the minimum level of capital as internally determined by the MDB, 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.

This structured approach ensures that the MDB adheres to its internal minimum level of capital such that it remains adequately capitalised to absorb any potential losses whilst fulfilling its public policy objectives as set by the Board of Directors.

Financial Statements for the period ended 31 December 2019

MDB

MALTA DEVELOPMENT BANK

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Directors' Report

The Directors present their annual report and the audited financial statements of the Malta Development Bank ("the Bank") for the year ended 31 December 2019.

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 MDB's primary objective is to contribute towards sustainable economic development by promoting inclusive and environmentally sustainable economic growth and infrastructure development. 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 in support of SMEs are mainly intermediated through the local credit institutions and are focused on the provision of guarantee or co-financing facilities. The MDB's facilities for infrastructure investment can take the form of first-tier operations in the form of direct lending and co-financing. Such funding can be 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.

REVIEW OF BUSINESS DEVELOPMENTS

During the accounting period under review, the Bank accelerated its capacity building process with the support of external expertise. Following the first wave of recruitment in 2018, the MDB continued to fill other senior posts in 2019. Concurrently, the Bank sustained its consultation process with stakeholders including local financial intermediaries, government entities, small and medium sized entities and international financial institutions. In its second year of operation, the MDB launched its first financial products supporting SMEs and its first financial instrument funded from EU Structural Funds supporting students. The Bank intensified its negotiations with private and public sector entities in connection with the financing of infrastructural projects with a strong social dimension in the sectors of education and affordable housing.

FINANCIAL PERFORMANCE

In August 2019, the Bank received a cash injection of €10,000,000 representing proceeds from the portion of the initial share capital subscribed by the Government. The Bank reported a loss of €834,822 (2018: €458,177) for the period under review, representing costs associated with the Bank's capacity building process. Total assets stood at €40,895,313 (2018: €29,569,993) as at the period end. Other results may be inferred from the Statement of Financial Position and Statement of Comprehensive Income on pages 48 and 49 respectively.

PRINCIPAL RISKS AND UNCERTAINTIES

The principal risks and uncertainties facing the MDB are:

- **Strategic Risk –** The MDB relies on demand from the local businesses to meet its key strategic objective of providing credit to enterprises in Malta to address failures in the Maltese credit market. Should the MDB fail to structure its products appropriately and deploy a suitable delivery strategy, there is a risk that businesses will not participate as envisaged and will not have an appetite for products offered by the MDB.
- **Credit Risk –** The MDB is exposed to the risk that a borrowing counterparty defaults on its obligations and fails to repay its debt in full resulting in losses to the MDB. The MDB is also exposed to credit risk in respect of its risk-sharing schemes due to loans made to final beneficiaries which have been guaranteed by the MDB.
- **Operational Risk –** The MDB is exposed to a range of operational risks arising from the people, systems and processes involved in meeting its objectives as well as legal risk. Legal risk includes, but is not limited to, exposure to fines, penalties, or punitive damages resulting from private settlements. Any fees or penalties imposed on the MDB due to non-compliance with the relative laws and regulations are not included with legal risk. Key operational risks include system failures, process errors, over-reliance on key individuals, failure to follow procedures, and reporting errors amongst others. These could ultimately result in the MDB failing to meet its objectives and may potentially result in significant reputational damage.
- **Compliance Risk –** The MDB's business activities are subject to Maltese laws and regulations, EU State aid and other EU regulations. There is a risk that the MDB fails to comply with these regulations, resulting in reputational or financial damage to the MDB. The MDB considers compliance risk as separate from operational risk.

- **Reputational Risk –** The MDB is exposed to reputational risk arising from any association, action or inaction which could be perceived to be inappropriate, unethical or inconsistent with the Bank's values and beliefs. These could negatively impact the Bank's earnings, capital and liquidity.

The MDB is also exposed to liquidity risk, interest rate risk and concentration risk in the normal course of its business. Further details on risks faced by the MDB are given in Section 2 of the financial statements.

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:

Prof. Josef Bonnici - Chairperson
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.

DIRECTORS' RESPONSIBILITIES

The directors are 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 each reporting period and of the profit or loss for that period.

In approving these financial statements, the Directors are responsible for:

- ensuring that the financial statements have been drawn up in accordance with International Financial Reporting Standards as adopted by the EU;
- selecting and applying appropriate accounting policies;
- making accounting estimates that are reasonable in the circumstances; and
- ensuring that the financial statements are prepared on the going concern basis unless it is inappropriate to presume that the Bank will continue in business as 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 credit 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 designing, implementing 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. In determining which controls to implement, to prevent and detect fraud, management considers the risks that the financial statements may be materially misstated as a result of fraud.

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

Subsequent to the financial reporting date, the outbreak of COVID-19 gave rise to events that will have a considerably negative impact on the global and the local economy. In respect of existing facilities, at publication date, the overall financial impact on the Bank cannot be accurately estimated but the directors do not consider that any adjustments are required to the financial information at this stage.

AUDITORS

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

Approved by the Board of Directors on 26 March 2020 and signed on its behalf by:

PROF. JOSEF BONNICI
Chairperson

MR. ROBERT BORG
Director

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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 2019, 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 48 to 83, comprise:

- the statement of financial position as at 31 December 2019;
- 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, including the Director's report, 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, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Bank's ability to continue as a going concern. In particular, it is difficult to evaluate all of the potential implications that COVID-19 will have on the Bank's assets and liabilities and the disruption to the respective operations and the overall economy.

- 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

26 March 2020

Statement of Financial Position

	NOTES	AS AT 31 DECEMBER 2019	AS AT 31 DECEMBER 2018
		€	€
ASSETS			
Loans and advances to banks	3	**39,557,971**	29,422,906
Investment property	4	**640,708**	-
Property and equipment	5	**63,896**	61,395
Right-of-use assets	6	**49,736**	-
Intangible assets	7	**13,862**	-
Other assets	8	**569,140**	85,692
Total assets		**40,895,313**	29,569,993
EQUITY AND LIABILITIES			
EQUITY			
Share capital	12	**40,000,000**	30,000,000
Accumulated losses		**(1,292,999)**	(458,177)
Total equity		**38,707,001**	29,541,823
LIABILITIES			
Amounts owed to other entities	9	**2,000,005**	-
Other liabilities	10	**188,307**	28,170
Total liabilities		**2,188,312**	28,170
Total liabilities and equity		**40,895,313**	29,569,993
MEMORANDUM ITEMS			
Commitments	11	**2,939,430**	-

The notes on pages 52 to 83 are an integral part of these financial statements.

The financial statements on pages 48 to 51 were approved by the Board of Directors on 26 March 2020 and signed on its behalf by:

PROF. JOSEF BONNICI
Chairperson

MR. ROBERT BORG
Director

Statement of comprehensive income

	NOTES	FOR THE YEAR ENDED 31 DECEMBER 2019	PERIOD FROM 11 DECEMBER 2017 TO 31 DECEMBER 2018
		€	€
Interest income	14	**292,423**	89,972
Interest expense	15	**(11,682)**	(38,431)
Net interest income		**280,741**	51,541
Other income			
Income from financial guarantees	16	**6,906**	-
Other income	17	**9,607**	-
		16,513	-
Other administrative expenses	19	**(302,968)**	(138,293)
Employee compensation and benefits	20	**(731,675)**	(366,058)
Depreciation of investment property, property plant and equipment and right-of-use asset	4, 5, 6	**(26,008)**	(5,367)
Amortisation of intangible assets	7	**(289)**	-
Change in expected credit losses and other impairment charges	18	**(71,136)**	-
Total operating expenses		**(1,132,076)**	(509,718)
Loss for the year/period		**(834,822)**	(458,177)

The notes on pages 52 to 83 are an integral part of these financial statements.

Statement of Changes in Equity

	NOTES	SHARE CAPITAL	ACCUMULATED LOSSES	TOTAL EQUITY
		€	€	€
Balance as at 1 January 2018		-	-	-
Transactions with owners			-	
Capital contributed by the Government of Malta - total transactions with owners	12	30,000,000	-	30,000,000
Comprehensive income				
Loss for the period - total comprehensive income		-	(458,177)	(458,177)
Balance at 31 December 2018		**30,000,000**	**(458,177)**	**29,541,823**
Balance as at 1 January 2019		30,000,000	(458,177)	29,541,823
Transactions with owners			-	
Capital contributed by the Government of Malta - total transactions with owners	12	10,000,000	-	10,000,000
Comprehensive income				
Loss for the period - total comprehensive income		-	(834,822)	(834,822)
Balance at 31 December 2019		**40,000,000**	**(1,292,999)**	**38,707,001**

The notes on pages 52 to 83 are an integral part of these financial statements.

Statement of Cash Flows

	NOTES	FOR THE YEAR ENDED 31 DECEMBER 2019	PERIOD FROM 11 DECEMBER 2017 TO 31 DECEMBER 2018
		€	€
Cash flows from operating activities			
Cash generated from/(used in) operations	21	**4,151,148**	(25,023,950)
Net cash generated from/(used in) operating activities		**4,151,148**	(25,023,950)
Cash flows from investing activities			
Payments to acquire investment property	4	**(642,851)**	-
Payments to acquire property and equipment	8	**(310,892)**	(66,762)
Payments to acquire intangible assets	7	**(14,151)**	-
Net cash used in investing activities		**(967,894)**	(66,762)
Cash flow from financing activities			
Capital contributed by the Government of Malta	12	**10,000,000**	30,000,000
Funding costs paid	8	**(120,000)**	-
Payments for the principal portion of lease liability		**(14,524)**	-
Net cash generated from financing activities		**9,865,476**	30,000,000
Net increase in cash and cash equivalents		**13,048,730**	4,909,288
Cash and cash equivalents at the beginning of year/period		**4,909,288**	-
Cash and cash equivalents at end year/period	**22**	**17,958,018**	4,909,288

The notes on pages 52 to 83 are an integral part of these financial statements.

Notes to the financial statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

1.1 Basis of preparation

The Bank's financial statements have been prepared in accordance with the requirements of International Financial Reporting Standards (IFRSs) as adopted by the EU and with the requirements of the Malta Development Bank Act, 2017. These financial statements are prepared under the historical cost convention, as modified by the fair valuation of financial assets and financial liabilities at fair value through profit or loss, including derivative financial instruments, and investments classified as available-for-sale.

The preparation of financial statements in conformity with IFRSs as adopted by the EU requires the use of certain accounting estimates. It also requires the directors to exercise their judgement in the process of applying the Bank's accounting policies.

Standards, interpretations and amendments to published standards effective in 2019

During the financial year ended 31 December 2019, the Bank adopted new standards, amendments and interpretations to existing standards that are mandatory for the Bank's accounting period beginning on 1 January 2019. The adoption of these revisions to the requirements of IFRSs as adopted by the EU did not result in substantial changes to the Bank's accounting policies.

IFRS 9 'FINANCIAL INSTRUMENTS'

During 2019, the Bank has adopted IFRS 9 as issued by the IASB in July 2014 with a date of transition of 1 January 2018, which resulted in changes in accounting policies and adjustments to the amounts previously recognised in the financial statements. The Bank did not early adopt any of IFRS 9 in previous periods.

As permitted by the transitional provisions of IFRS 9, the Bank has elected not to restate comparative figures. Any adjustments to the carrying amounts of financial assets and liabilities at the date of transition were recognised in the opening retained earnings of the current period.

The adoption of IFRS 9 has resulted in changes in accounting policies for recognition, classification and measurement of financial assets and financial liabilities and impairment of financial assets. Note 1.3 describes the changes in accounting polices driven by the Bank's adoption of IFRS 9. The impact arising upon the first-time adoption of this new accounting standard on the opening retained earnings has been considered to be insignificant.

IFRS 16 'LEASES'

On 1 January 2019, the Bank adopted the requirements of IFRS 16 retrospectively. The adoption of the standard increased assets by €69,710 and increased financial liabilities by the same amount with no effect on net assets or retained earnings – and represent the accounting for the lease arrangements in place on a motor vehicle used by the Bank.

Comparatives were not restated. On adoption of IFRS 16, the Bank recognised lease liabilities in relation to leases that had previously been classified as 'operating leases' in accordance with IAS 17 'Leases'. These liabilities were recognised in 'other liabilities' and measured at the present value of the remaining lease payments, discounted at the lessee's incremental borrowing rate at 1 January 2019. The associated right-of-use ('ROU') assets were recognised on the face of the Statement of financial position and measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments or provisions for onerous leases recognised on the balance sheet at 31 December 2018.

The differences between IAS 17 and IFRS 16 are summarised in the table below:

IAS 17

Leases were classified as either finance or operating leases. Payments made under operating leases were charged to profit or loss on a straight-line basis over the period of the lease.

IFRS 16

Leases are recognised as an ROU asset and a corresponding liability at the date at which the leased asset is made available for use. Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. The ROU asset is depreciated over the shorter of the ROU asset's useful economic life and the lease term on a straight-line basis. In determining the lease term, the Bank considers all facts and circumstances that create an economic incentive to exercise an extension option or not exercise a termination option over the planning horizon of five years. In general, it is not expected that the discount rate implicit in the lease is available so the Bank's incremental borrowing rate is used. This is the rate that the Bank would have to pay to borrow the funds necessary to obtain an asset of a similar value in a similar economic environment with similar terms and conditions. The rates are determined for each term by adjusting swap rates with funding spreads (own credit spread).

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

Certain new standards, amendments and interpretations to existing standards which are mandatory for accounting periods beginning after 1 January 2019 have been published by the date of authorisation for issue of this financial information. The Bank has not early adopted these requirements of IFRSs as adopted by the EU and the Bank's directors are of the opinion that, there are no requirements that will have a possible significant impact on the Bank's financial statements in the period of initial application.

1.2 Functional transactions and balances

a) Functional and presentation currency

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

b) Transactions and balances

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

1.3 Financial assets

Initial recognition and measurement

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

At initial recognition, the Bank measures a financial asset at its fair value plus or minus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset, such as fees and commissions. Transaction costs of financial assets carried at fair value through profit or loss are expensed in profit or loss. With effect from 1 January 2019, immediately alter initial recognition, an expected credit loss allowance (ECL) is recognised for financial assets measured at amortised cost and investments in debt instruments measured at FVOCI, which results in an accounting loss being recognised in profit or loss when an asset is newly originated.

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

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

Classification and subsequent measurement

From 1 January 2019, the Bank has applied IFRS 9 and classifies its financial assets in the following measurement categories:

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

The impact arising upon the first-time adoption of this new accounting standard on the opening retained earnings has been considered to be insignificant. As of 31 December 2019, all of the Bank's financial assets are classified under the amortised cost measurement category.

Debt instruments

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

Classification and subsequent measurement of debt instruments depend on:

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

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

- *Amortised cost:* Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ('SPPI'), and that are not designated at FVTPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any expected credit loss allowance recognised and measured as described in note 1.3. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method.

- *Fair value through other comprehensive income (FVOCI):* Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent solely payments of principal and interest, and that are not designated at FVTPL, are measured at fair value through other comprehensive income (FVOCI). Movements in the carrying amount of debt investments are taken through OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortised cost which are recognised in profit or loss. When the debt instrument is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in 'Net Investment income'. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

- *Fair value through profit or loss (FVTPL):* Assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of a hedging relationship is recognised in profit or loss and presented in the profit or loss statement within 'Net trading income' in the period in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately in 'Net investment income'. Interest income from these financial assets is included in 'Interest income' using the effective interest

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

Business Model Assessment

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

The information that will be considered in such assessment includes:

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

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

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

Cash flows that represent solely payments of principal and interest

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

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

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

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

Equity instruments

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

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

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

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

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.

1.4 Impairment of financial assets

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

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

Note 2.4.2.2 provides more detail of how the expected credit loss allowance is measured.

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

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

1.5 Intangible assets

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

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

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

At the end of each reporting period, intangible assets are reviewed for indications of impairment or changes in estimated future economic benefits. If such indications exist, the intangible assets are analysed to assess whether their carrying amount is fully recoverable (note 1.8).

1.6 Investment property

All investment property is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

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

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

	YEARS
Buildings	75

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (note 1.8).

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

1.7 Property, plant and equipment

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

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

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

	YEARS
Computer hardware	5
Other equipment	5-15

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (note 1.8).

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

1.8 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.

1.9 Current and deferred tax

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

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

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

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

1.10 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.

1.11 Financial liabilities

Initial recognition and measurement

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

Classification and subsequent measurement

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

- Financial liabilities at fair value through profit or loss: this classification is applied to derivatives, financial liabilities held for trading (e.g. short positions in the trading booking) and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at fair value through profit or loss are presented partially in other comprehensive income (the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability, which is determined as the amount that is not attributable to changes in market conditions that give rise to market risk) and partially profit or loss (the remaining amount of change in the fair value of the liability). This is unless such a presentation would create, or enlarge, an accounting mismatch, in which case the gains and losses attributable to changes in the credit risk of the liability are also presented in profit or loss;
- Financial liabilities arising from the transfer of financial assets which did not qualify for derecognition, whereby a financial liability is recognised for the consideration received for the transfer. In subsequent periods, the Bank recognises any expense incurred on the financial liability; and
- Financial guarantee contracts and loan commitments (note 1.13).

Financial liabilities measured at amortised cost comprise principally amounts owed to other entities together with other liabilities.

Derecognition

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

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

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

1.12 Trade and other payables

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

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

1.13 Financial guarantee contracts

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are issued by the Bank to credit institutions to facilitate the provision of credit facilities to customers, which are eligible under one of the Bank's credit schemes.

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

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

'Loan commitments' are the Bank's commitments to provide credit under pre-specified terms and conditions and are measured as the amount of the loss allowance (calculated as described in note 1.4).

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

1.14 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.

1.15 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.

1.16 Revenue recognition

Revenue is recognised to the extent that it is probable that future economic benefits will flow to the Bank and these can be measured reliably.

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.

Income on financial guarantees

The Bank provides financial guarantees on loan portfolios to credit institutions. Fees are charged on a periodical basis and are based on fixed contractual rates.
Revenue related to transactions is recognised at the point in time when the transaction takes place.

1.17 Leases

When a Bank is the lessee

a. Applicable as from 1 January 2019

The Bank recognises lease liabilities in relation to leases within 'other liabilities'. The lease liability is measured at the present value of the remaining lease payments, discounted at the Bank's incremental borrowing rate. The associated right-of-use (ROU) assets are recognised and included within 'property, plant and equipment' and are measured at the amount equal to the lease liability.

The Bank applies the following practical expedients:

- a single discount rate is applied to a portfolio of leases with reasonable similar characteristics;
- an assessment is performed on whether leases are onerous;
- hindsight are used in determining the lease term where the contract contains options to extend or terminate the lease.

Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease term.

The ROU asset is depreciated over the shorter of the ROU asset's useful economic life and the lease term on a straight-line basis.

The leases with a remaining lease term of less than 12 months are accounted as short-term operating leases.

Payments made under operating leases (net of any incentives received from the lessor) are charged to profit or loss on a straight-line basis over the period of the lease.

b. Applicable until 31 December 2018

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

1.18 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.

2. FINANCIAL RISK MANAGEMENT

2.1 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 and Risk Committees, which are responsible for the monitoring of risk in its specified areas. Non-executive directors sit on these Committees with the Chief Executive Officer also attending the Board meetings. The Audit and Risk Committees report to the Board of Directors on its activities.

The Credit Risk Policy, which includes the Risk Assessment Framework, the Risk Assessment Criteria and the Problem Credit Management, has been developed and implemented. The Credit Risk Mitigation Policy has been drafted and shall be formally implemented during 2020. The Bank is also in the process of enhancing the Risk Register and developing an Operational Risk Policy. The risk management policies and systems are reviewed by the Board on a regular basis to reflect changes in market conditions, products and services offered.

2.2 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.* The risk posed by adverse movements in interest rates that affect the bank's banking book positions.
- *Operational and other risks.* The risk of losses resulting from inadequate or failed processes, people and internal systems, or from external events.

2.3 Capital management

The MDB is not subject to externally imposed capital requirements. The MDB is committed to ensuring it is adequately capitalised as there is a risk that inappropriate management of its capital could result in the inability to absorb any potential credit losses. The MDB's paid-up share capital as at 31 December 2019 is €40 million (2018: €30 million), which was provided by the MDB's sole shareholder, the Minister for Finance.

The MDB's capital risk management process includes adherence to its internal minimum level of capital such that it remains adequately capitalised to absorb any potential losses whilst fulfilling its public policy objectives as set by the Board of Directors.

	2019	2018
	€	€
Capital		
Paid up share capital	**40,000,000**	30,000,000
Accumulated loss	**(1,292,999)**	(458,177)
Total capital	**38,707,001**	29,541,823

2.4 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 and financial guarantees issued. 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).

The credit risk policies and systems are reviewed periodically to reflect changes in market conditions, products and services offered.

During the year the Bank, in line with its principal activities and business model incepted the provision of issuing financial guarantees to credit institutions with the aim of facilitating the provision of credit facilities to customers of the same credit institutions who are eligible under one of the two Bank's credit schemes.

As of 31 December 2019, the Bank had issued an amount of financial guarantee contracts amounting to €2,939,000 – which are accounted as off-balance sheet instruments and on which the Bank carries credit risk (Note 11). The Bank needs to honour the guarantee in the event that borrower defaults on the obligation to the credit institution. The Bank has earmarked a pre-determined amount of own capital to fund these credit facilities, and has arrangements with the counter party credit institutions to issue guarantees which cover a defined percentage of the total exposure issued to customers, in the context of a capped portfolio limit.

The Bank's main financial assets at 31 December 2019 consist of amounts placed with banks registered in Malta, which are deemed to be high quality counterparties.

	2019	2018
	€	€
Loans and advances to banks	**39,557,971**	29,422,906
	39,557,971	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.

In view of the nature of the other assets held by the Bank (Note 8), which principally represent advance payments, no credit risk is deemed to arise on such assets.

2.4.1 Credit risk measurement

The measurement of credit exposure for risk management purposes considers that an exposure varies with changes in market conditions, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties. The Bank measures credit risk using Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD). This is similar to the approach used for the purposes of measuring Expected Credit Loss (ECL) under IFRS 9. Refer to note 2.4.2.2 for more details.

The Bank's financial assets primarily comprise of loans and advances to banks. The Bank uses external risk grades to reflect its assessment of the probability of default of individual counterparties. These published grades are continuously monitored and updated. The PDs associated with each grade are determined based on realised one-year default rates, as published by rating agencies.

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

2.4.2 Allowances for impairment

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

- A financial instrument that is not credit-impaired on initial recognition is classified in Stage 1 and has its credit risk monitored by the Bank;
- If a significant increase in credit risk ('SICR') since initial recognition is identified, the financial instrument is moved to Stage 2 but is not yet deemed to be credit-impaired;
- If the financial instrument is credit-impaired, the financial instrument is then moved to Stage 3.
- Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in Stages 2 and 3 have their ECL measured based on expected losses on a lifetime basis;
- The measurement of ECL considers forward-looking information.
- Purchased or originated credit-impaired financial assets are those financial assets that are credit-impaired on initial recognition. Their ECL is always measured on a lifetime basis ('Stage 3').

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

When determining whether the risk of default on a financial instrument has increased significantly, the Bank considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analyses, credit assessment and forward-looking information.

Credit risk grades are defined and calibrated such that the risk of default occurring increases as the credit risk deteriorates.

The following diagram summarises the impairment requirements under IFRS 9:

Change in credit quality since initial recognition

STAGE 1	STAGE 2	STAGE 3
(Initial recognition)	*(Significant increase in credit risk since initial recognition)*	*(Credit-impaired financial assets)*
12-month expected credit losses	Lifetime expected credit losses	Lifetime expected credit losses

Exposures are allocated to a credit risk grade at initial recognition based on available information about the borrower.

2.4.2.1 Definition of default and credit impaired

The Bank considers exposures to be in default when:

- The counterparty is past due more than 90 days on any material credit obligation to the Bank;
- The counterparty is unlikely to pay its credit obligations to the Bank in full, without recourse by the Bank to actions such as realising security (if any is held).

In assessing whether an exposure is in default, the Bank considers both qualitative and quantitative factors.

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

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

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

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

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

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

The conditional PD is adjusted to consider forward-looking information through macroeconomic modelling.

EAD is based on the amounts the Bank expects to be owed at the time of default, over the next 12 months (12M EAD) or over the remaining lifetime (Lifetime EAD). EAD represents the expected exposure in the event of a default (including any expected drawdowns of committed facilities).

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

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

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

The Loss Given Default (LGD) represents the Bank's expectation of the extent of loss on a defaulted exposure. Hence, the LGD represents expected credit losses on the EAD given the event of default, taking into account, among other attributes, the mitigating effect of collateral values (if any) at the time it is expected to be realised and the time value of money. The 12-month and lifetime LGD are determined based on the factors which impact the recoveries made post default.

Given that its portfolio of financial assets, consisting principally of loans and advances to banks, are generally unsecured, the LGD for the Bank's exposures is set at levels based on market available data for similar exposure classes.

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

Forward-looking economic information is also included in determining the 12-month and lifetime PD and LGD. Refer to note 2.4.2.3 for an explanation of forward-looking information and its inclusion in ECL calculations.
There have been no significant changes in estimation techniques or significant assumptions made during the reporting period.

2.4.2.3 Forward-looking information incorporated in the ECL model

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

In this respect, the Bank has identified key drivers of credit risk and credit losses for each portfolio of financial instruments and, using an analysis of historical data, has analysed relationships between macro-economic variables, credit risk and credit losses. The key drivers are predominantly EEA-average gross domestic product (GDP) at constant prices and EEA-average terms of trade of goods and services (ToD).

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

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

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

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

The 'base', 'upside' and 'downside' scenarios were used for all portfolios.
- The 'Base' Scenario captures business-as-usual macroeconomic expectations, whereby the current rhythm of economic activity is maintained;
- The 'Downside' Scenario is based on a subdued level of economic activity hypothesized to correspond to an economic recession;
- The 'Upside' Scenario is based on the assumption that it would be possible to marginally improve further over the already benign economic conditions.

The weightings assigned to each economic scenario were 50% for the 'Base' scenario, 25% for the 'Downside' scenario and 25% for the 'Upside' scenario. The number of scenarios used is based on the analysis of each major product type. The number of scenarios and their attributes are reassessed at each reporting date. The economic scenarios were simulated over a full economic cycle.

Such weightings take into account the current strong performance of the European economy over the foreseeable future and that at this relatively strong level of performance, further ameliorations would be affected by the law of diminishing returns. The Board considers that the probability weightings assigned to the respective scenarios reflect an unbiased evaluation of a range of possible outcomes.

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

2.4.3 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 and it has exhausted all practical recovery efforts and has concluded there is no reasonable expectation of recovery. 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.

2.4.4 Maximum exposure to credit risk

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

- Financial assets recognised on-balance sheet comprising principally loans and advances to banks. The maximum exposure to credit risk of these financial assets equals their gross carrying amounts.
- Financial guarantee contracts entered into on behalf of third parties. Such exposures are deemed to carry the same credit risk as loans and advances to customers. The maximum exposure to credit risk is the full amount that the Bank would have to pay if the guarantees are called upon.
- Loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities. The maximum exposure to credit risk is the full amount of the committed facilities. However, the likely amount of loss is less than the total unused commitments as most commitments to extend credit are contingent upon customers maintaining specific credit standards. These exposures are monitored in the same manner in respect of loans and advances.

The Bank's credit risk exposures relating to on-balance sheet assets and off-balance sheet instruments, reflecting the maximum exposure to credit risk before collateral held or other credit enhancements include the following:

	2019		2018	
	GROSS EXPOSURE	**ECL ALLOWANCE**	**GROSS EXPOSURE**	**ECL ALLOWANCE**
	€000	**€000**	€000	€000
Credit risk exposures relating to on-balance sheet assets:				
Subject to IFRS 9 impairment allowances			-	
Financial assets measured at amortised cost:				
Loans and advances to banks	**39,566**	**8**	-	-
Credit risk exposure	**39,566**	**8**	-	-
Credit risk exposures relating to off-balance sheet instruments:			-	
Financial guarantees	**2,939**	**63**	-	-
Credit risk exposure	**2,939**	**63**	-	-

2.4.5 Credit concentration risk

Within the Bank, concentration risk of losses results from inadequate diversification of the credit exposures. This risk is managed by actively measuring, reporting and monitoring on a regular and ongoing basis risk concentration levels against reasonable thresholds for counterparties and products.
In order to manage its principal risk exposures arising from its financial instruments, primarily financial guarantees on loans and advances to customers by the intermediary commercial bank, the Bank compiles and updates credit review reports in respect of these financial instruments. Where available, reference is also made to external reviews of primary counterparties.

2.4.6 Information on credit quality of financial assets

In the normal course of business, the Bank places funds and carries out transactions with listed international banks and local banks with a strong credit standing. The creditworthiness of these counterparties is monitored through the practical use of exposure limits. External ratings such as Moody's rating or their equivalents are used for monitoring these credit risk exposures.

At the end of the reporting period, none of the Bank's financial assets were past due or impaired.

The following tables set out information about the credit quality of the Bank's financial assets analysed by staging:

	2019				2018
	STAGE 1 12-MONTH ECL	STAGE 2 LIFETIME ECL	STAGE 3 LIFETIME ECL	TOTAL	TOTAL
	€000	€000	€000	€000	€000
Loans and advances to banks at amortised cost					
Gross carrying amount	39,566	-	-	39,566	-
Loss allowance	(8)	-	-	(8)	-
Carrying amount – net of loss allowance	39,558	-	-	39,558	-

As at 31 December 2019, there were no Purchased Credit-Impaired assets.

2.4.7 Loss allowances

Reconciliation of 12-month and lifetime ECL provision

The loss allowance recognised in the period is impacted by a variety of factors, as described below:

- Transfers between 'Stage 1' and 'Stages 2' or 3 due to financial instruments experiencing significant increases (or decreases) of credit risk or becoming credit-impaired in the period, and the consequent "step up" (or "step down") between 12-month and Lifetime ECL;
- Additional allowances for new financial instruments recognised during the period, as well as releases for financial instruments derecognised in the period;
- Impact on the measurement of ECL due to changes in PDs, EADs and LGDs in the period, arising from regular refreshing of inputs to models;
- Impacts on the measurement of ECL due to changes made to models and assumptions;
- Discount unwind within ECL due to the passage of time, as ECL is measured on a present value basis;
- Foreign exchange retranslations for assets denominated in foreign currencies and other movements; and
- Financial assets derecognised during the period and write-offs of allowances related to assets that were written off during the period.

The following tables explain the changes in the loss allowance between the beginning and the end of the annual period:

	2019			
	STAGE 1 12-MONTH ECL	**STAGE 2 LIFETIME ECL**	**STAGE 3 LIFETIME ECL**	**TOTAL**
	€000	**€000**	**€000**	**€000**
Loans and advances to banks at amortised cost				
Loss allowance as at 1 January 2019	-	-	-	-
New financial assets originated or purchased	8	-	-	8
Total net P&L charge during the year	8	-	-	8
Loss allowance as at 31 December 2019	8	-	-	8
Financial guarantee contracts				
Loss allowance as at 1 January 2019	-	-	-	-
New financial assets originated or purchased	63	-	-	63
Total net P&L charge during the year	63	-	-	63
Loss allowance as at 31 December 2019	71	-	-	71

Remeasurement of loss allowance arising from foreign-exchange and other movements were not considered significant.

Changes in the gross carrying amount that contributed to changes in loss allowance

The following table explains changes in the gross carrying amount of the financial assets to help explain their significance to the changes in the loss allowance for the same portfolios as discussed above:

	2019			
	STAGE 1 12-MONTH ECL	**STAGE 2 LIFETIME ECL**	**STAGE 3 LIFETIME ECL**	**TOTAL**
	€000	**€000**	**€000**	**€000**
Loans and advances to banks at amortised cost				
Gross carrying amount as at 1 January 2019	29,423	-	-	29,423
New financial assets originated or purchased	10,143	-	-	10,143
Gross carrying amount as at 31 December 2019	39,566	-	-	39,566
Financial guarantee contracts				
Gross carrying amount as at 1 January 2019	-	-	-	-
Movement during the year	2,939	-	-	2,939
Gross carrying amount as at 31 December 2019	2,939	-	-	2,939

Changes in gross carrying amount arising from foreign-exchange and other movements were not deemed significant.

2.5 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.

2.5.1 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 the re-pricing of financial instruments at reporting date together with the effective interest rates where applicable.

	EFFECTIVE INTEREST RATE	LESS THAN THREE MONTHS	BETWEEN THREE MONTHS AND ONE YEAR	BETWEEN ONE YEAR AND TWO YEARS	OTHER	CARRYING AMOUNT
		€	€	€	€	€
As at 31 December 2018						
Assets						
Loans and advances to banks	0.77%	5,910,024	23,512,882	-	-	29,422,906
Total assets		**5,910,024**	**23,512,882**	**-**	**147,087**	**29,569,993**
As at 31 December 2019						
Loans and advances to banks	0.89%	18,788,444	5,102,220	15,608,500	-	39,499,164
Total assets		**18,788,444**	**5,102,220**	**15,608,500**	**1,337,342**	**40,836,506**
Liabilities						
Amounts owed to other entities	0%	-	-	-	2,000,005	2,000,005
Total liabilities		**-**	-	-	2,000,005	2,000,005

2.5.1.1 *Interest rate profile*

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

	2019	2018
	€	€
Fixed rate instruments		
Loans and advances to banks	**34,720,952**	24,513,619
	34,720,952	24,513,619
Variable rate instruments		
Loans and advances to banks	**4,953,496**	4,909,287
	4,953,496	4,909,287

2.5.1.2 *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.

2.5.1.3 *Cash flow interest rate risk*

Cash flow interest rate risk is the risk that future cash flows of a financial instrument will fluctuate because of the changes in market interest rates. In the context of the financial instruments held at variable interest rates, the Bank does not consider the impact of cash flow interest rate risk to be material.

2.5.2 *Currency risk*

At the reporting date, the bank held €39,499,164 (2018: €29,422,906) in loans and advances to banks, all denominated in Euro. The Bank was hence not exposed to on balance sheet or off-balance sheet currency risk.

2.5.3 *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.

2.6 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, as much as practicable.

At 31 December 2019, the Bank's initial capital has been mainly deployed in loans and advances to banks. The Bank's financial liabilities mainly comprised payables and accruals for administrative expenses. Hence, liquidity risk during 2019 and at the reporting was not deemed to be significant.

Liquidity management policies are in the process of being established and will be subject to the review and approval by the Board of Directors.

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

	BETWEEN ONE AND THREE MONTHS	BETWEEN THREE MONTHS AND ONE YEAR	BETWEEN ONE YEAR AND TWO YEARS	TOTAL
	€	€	€	€
At 31 December 2018				
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**
At 31 December 2019				
Financial assets				
Loans and advances to banks	18,963,728	5,102,220	15,608,500	39,674,448
	18,963,728	**5,102,220**	**15,608,500**	**39,674,448**
Financial liabilities				
Amounts owed to other entities	-	-	-	2,000,005
	-	**-**	**-**	**2,000,005**
Maturity gap	-	-	-	-
	-	**-**	**-**	**-**

3. LOANS AND ADVANCES TO BANKS

	2019	2018
	€	€
Current		
Repayable on call and at short notice	**17,958,018**	4,909,288
Term loans and advances	**21,607,930**	24,513,618
Allowances for expected credit losses	**(7,977)**	-
	39,557,971	29,422,906

4. INVESTMENT PROPERTY

	2019
	€
Year ended 31 December 2019	
Additions	**642,851**
Depreciation charge	**2,143**
Closing net book amount	**640,708**
At 31 December 2019	
Cost	**642,851**
Accumulated depreciation	**(2,143)**
Net book amount	**640,708**

Investment property comprises an office building which is being leased out and which was acquired by the Bank during the year. The fair value as at 31 December 2019 is deemed to be in line with the carrying amount.

Disclosures required in terms of IFRS 13 in relation to fair value measurements attributable to investment property are presented below.

			SIGNIFICANT UNOBSERVABLE INPUTS
DESCRIPTION	FAIR VALUE AT 31 DECEMBER 2019	VALUATION TECHNIQUE	VALUE PER SQUARE RENTAL METRE
	€		€
Office building	640,000	Equivalent value per square metre	4,129

5. PROPERTY AND EQUIPMENT

	COMPUTER HARDWARE	OTHER EQUIPMENT	TOTAL
	€	€	€
Year ended 31 December 2018			
Additions	41,254	25,508	66,762
Depreciation charge	(4,182)	(1,185)	(5,367)
Closing net book amount	**37,072**	**24,323**	**61,395**
At 31 December 2018			
Cost	41,254	25,508	66,762
Accumulated depreciation	(4,182)	(1,185)	(5,367)
Net book amount	**37,072**	**24,323**	**61,395**

	COMPUTER HARDWARE	OTHER EQUIPMENT	TOTAL
	€	€	€
Year ended 31 December 2019			
Opening net book amount	37,072	24,323	61,395
Additions	12,123	1,269	13,392
Depreciation charge	(8,275)	(2,616)	(10,891)
Closing net book amount	**40,920**	**22,976**	**63,896**
At 31 December 2019			
Cost	53,377	26,777	80,154
Accumulated depreciation	(12,457)	(3,801)	(16,258)
Net book amount	**40,920**	**22,976**	**63,896**

As at 31 December 2019, capital expenditure authorised and contracted for amounted to €2,702,500 and is mainly related to the acquisition of immovable property.

6. RIGHT-OF-USE ASSETS

The Bank leases a motor vehicle for the use of its executives. The lease contract was made for a fixed period of five years but has an extension option. The extension option held is exercisable by both the Bank and the respective lessor, and hence the lease term excludes the impact of the extension option.

As from 1 January 2019, leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Bank.

Right-of-use assets

	2019
	€
On 1 January 2019	**62,710**
Depreciation	**(12,974)**
At 31 December	**49,736**

Lease liabilities

	2019
	€
Current	**12,498**
Non-current	**36,855**
	49,353

The total cash payments for leases in 2019 was €14,523.

The income statement reflects the following amounts related to the leases:

	2019
	€
Depreciation charge	**12,974**
Interest expense on lease liability	**1,167**
	14,141

7. INTANGIBLE ASSETS

	COMPUTER HARDWARE
	€
Year ended 31 December 2019	
Additions	14,151
Amortisation charge	(289)
Closing net book amount	**13,862**
At 31 December 2019	
Cost	14,151
Accumulated amortisation	(289)
Net book amount	**13,862**

8. OTHER ASSETS

	2019	2018
	€	€
Accrued interest and income	**112,586**	70,267
Prepayments and deferred costs	**438,970**	15,425
Other receivables	**17,584**	-
	569,140	85,692

Prepayments include an amount of €310,000 representing a payment effected by the Bank upon entering into a promise of sale agreement for the purchase of a property in Malta. Moreover, a funding fee of €120,000 which was paid by the Bank to secure the financing of a particular programme (Note 9) has been deferred and is being amortised over the expected term of the funding programme. The deferred element of this fee is recognised under 'Prepayments and deferred costs'.

9. AMOUNTS OWED TO OTHER ENTITIES

By virtue of the agreement entered into by the Bank and the Planning and Priorities Coordination Division (PPCD) within the Ministry for European Affairs and Equality (the "Managing Authority"), at 31 December 2019, an amount of €2,000,005 was held in favour and for the ultimate benefit of the Managing Authority as part of the implementation of the 'Further Studies Made Affordable' programme. The said amount will be used to provide financial guarantees and interest subsidies on loans sanctioned by a third-party commercial bank in favour of individuals seeking to further their studies at a tertiary education institution or equivalent.

10. OTHER LIABILITIES

	2019	2018
	€	€
Accounts payable	**19,276**	10,542
Accrued operating expenditure	**56,519**	17,628
Other payables	**49,353**	-
Expected loss provision on financial guarantees (Note 18)	**63,159**	-
	569,140	85,692

11. COMMITMENTS

Credit related commitments

	2019	2018
	€	€
Financial guarantee contracts issued	**2,939,430**	-

The Bank facilitates lending to smaller businesses that are viable but unable to obtain the required amount of finance from their commercial bank due to insufficient or inadequate collateral to meet the commercial's bank's normal security requirements or in view of the potential novelty or nature of the business venture that may fall outside the risk appetite and tolerance of commercial banks. Other factors include the required repayment period for which commercial banks may not be willing or able to provide the required financing in whole or part.

The Bank seeks collaboration with commercial banks to facilitate more active lending in by offering the opportunity for commercial banks to act as the Bank's implementing partners for its guarantee products.

Financial guarantee contracts issued, which represent irrevocable assurances that the Bank will make payments in favour of a third party commercial bank in the event that a borrower of the third party commercial bank customer fails to meet its obligations to the said commercial bank third parties, carry the same credit risk as loans. The Bank issues financial guarantee contracts in respect of loans originated by other third party commercial banks. At the end of each reporting period, these commitments are measured at the higher of (i) the amount of the loss allowance, and (ii) the premium received on initial recognition less income recognised in accordance with the principles of IFRS 15.

The expected credit losses charged in profit and loss on financial guarantee contracts during 2019 amounted to € 63,159 (Note 18).

Note 3.4 describes how the Bank measures accounts and manages credit risk emanating from such credit related commitments.

12. SHARE CAPITAL AND RESERVES

12.1 Share capital

	2019	2018
	€	€
Authorised		
2,000,000 shares of €100 each	**200,000,000**	200,000,000
Issued and fully paid up		
400,000 (2018: 300,000) shares of €100 each	**40,000,000**	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.

During the year the Bank issued 100,000 shares (2018: 300,000 shares) at par value of €100 each during the period. 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.

12.2 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 in favour of the Bank. The amount of the guarantee stood at €150 million as at 31 December 2019 (€50 million as at 31 December 2018).

13. CONTINGENT LIABILITIES

At 31 December 2019, the Bank was party to two risk-sharing agreements consisting of a maximum loan guarantee amounting to €4 million and €10 million respectively.

14. INTEREST INCOME

	FOR THE YEAR ENDED 31 DECEMBER 2019	PERIOD FROM 11 DECEMBER 2017 TO 31 DECEMBER 2018
	€	€
Interest income on demand deposits	**991**	6,087
Interest income on term deposits	**291,432**	83,885
	292,423	89,972

15. INTEREST EXPENSE AND SIMILAR CHARGES

	FOR THE YEAR ENDED 31 DECEMBER 2019	PERIOD FROM 11 DECEMBER 2017 TO 31 DECEMBER 2018
	€	€
Loans and advances to banks	**10,515**	38,431
Interest expense on lease liabilities	**1,167**	-
	11,682	

16. INCOME FROM FINANCIAL GUARANTEES

	FOR THE YEAR ENDED 31 DECEMBER 2019	PERIOD FROM 11 DECEMBER 2017 TO 31 DECEMBER 2018
	€	€
Income from financial guarantees	**6,906**	-

17. OTHER INCOME

	FOR THE YEAR ENDED 31 DECEMBER 2019	PERIOD FROM 11 DECEMBER 2017 TO 31 DECEMBER 2018
	€	€
Rental income	**9,607**	-

18. CHANGE IN EXPECTED CREDIT LOSSES AND OTHER CREDIT IMPAIRMENT CHARGES

Impairment losses on financial instruments comprise of loss allowances recognised on financial guarantees amounting to €71,136 as at 31 December 2019.

	FOR THE YEAR ENDED 31 DECEMBER 2019	PERIOD FROM 11 DECEMBER 2017 TO 31 DECEMBER 2018
	€	€
Change in expected credit losses recognised in profit and loss on:		
- Loans and advances to banks	**7,977**	-
- Financial guarantee contracts	**63,159**	-
	71,136	-

19. ADMINISTRATIVE EXPENSES

	FOR THE YEAR ENDED 31 DECEMBER 2019	PERIOD FROM 11 DECEMBER 2017 TO 31 DECEMBER 2018
	€	€
Employee compensation and benefits (note 20)	**731,675**	366,058
Rental fees	**61,700**	46,275
Professional fees	**96,960**	25,949
Supervision fees	**19,500**	19,582
Travel and accommodation	**20,349**	16,032
Memberships of international associations	**26,731**	10,791
Other	**77,728**	19,664
	1,034,643	504,351

Auditor's remuneration

Fees charged by the auditor for external audit services rendered are the following:

	FOR THE YEAR ENDED 31 DECEMBER 2019	PERIOD FROM 11 DECEMBER 2017 TO 31 DECEMBER 2018
	€	€
Auditor's remuneration	23,600	5,000

20. EMPLOYEE COMPENSATION AND BENEFITS

	FOR THE YEAR ENDED 31 DECEMBER 2019	PERIOD FROM 11 DECEMBER 2017 TO 31 DECEMBER 2018
	€	€
Staff costs		
- Wages, salaries and allowances	**609,536**	241,391
- Social security costs	**21,218**	7,156
- Costs of seconded personnel	**-**	14,811
- Other costs	**9,222**	11,845
Directors' fees	**91,699**	90,855
	731,675	366,058

The Bank employed a weekly average of 10 persons during the reporting period. At the reporting date the number of persons employed by the Bank was as follows:

	2019	2018
	NO.	NO.
Average number of employees		
Senior management	**11**	8
Middle management	**1**	-
Clerical	**-**	1
	12	9

21. NET CASH GENERATED FROM/(USED IN) OPERATING ACTIVITIES

	2019	2018
	€	€
Loss for the year	**(834,822)**	(458,177)
Adjustments for:		
Depreciation and amortisation (notes 4, 5, 6, 7)	**26,297**	5,367
Interest receivable (note 8)	**(108,500)**	(70,267)
Interest payable (note 10)	**-**	1,542
Change in expected credit losses and other impairment charges on financial guarantees	**71,136**	-
Interest expense on lease liabilities	**1,167**	-
Changes in operating assets and liabilities:		
(Increase)/decrease in term loans and advances (note 3)	**2,905,688**	(24,513,618)
Increase in amounts owed to other entities (note 9)	**2,000,005**	-
(Increase)/decrease in receivables, prepayments and deferred costs (note 8)	**42,552**	(15,425)
Increase in payables and accruals (note 10)	**47,625**	26,628
Cash generated from/(used in) operating activities	**4,151,148**	(25,023,950)

22. 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.

	2019	2018
	€	€
Loans and advances to banks repayable on call and at short notice (Note 3)	**17,958,018**	4,909,288

As at 31 December 2019, an amount of €2 million held was not available for use by the Bank. The amount was held for the ultimate benefit of the Managing Authority as part of the implementation of the 'Further Studies Made Affordable' programme, by virtue of the agreement entered into by the Bank and the Managing Authority. The said amount will be used to provide financial guarantees and interest subsidies on loans sanctioned by a third-party commercial bank in favour of individuals seeking to further their studies at a tertiary education institution or equivalent (Note 9).

23. RELATED PARTIES

23.1 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.

23.2 Related party transactions

Transactions entered into with related parties impacting the amounts presented within profit or loss comprise:

	2019	2018
	€	€
Rental fee	**61,700**	46,275
Supervision fees	**19,500**	19,582
Computer software & hardware maintenance	**8,178**	-
	89,378	65,857

23.3 Related party balances

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

	2019	2018
	€	€
Assets		
Loans and advances to banks	**17,666,000**	20,049,000

Malta Development Bank treats all banks at arm's length in a transparent, open and non-discriminatory manner. The Bank acts independently and in an autonomous manner and does not seek nor receives instructions from an authority, public or otherwise, or from any other institution.

	2019	2018
	€	€
Liabilities		
Accounts payable	**-**	9,000
Accruals	**10,500**	1,582
	10,500	10,582

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

23.4 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 and include the Chief Executive, Operations, Risk and Finance officers.

	2019	2018
	€	€
Compensation to key management personnel	**566,564**	225,852

24. EVENTS AFTER THE REPORTING PERIOD

Subsequent to the financial reporting date, the outbreak of COVID-19 gave rise to events that will have a considerably negative impact on the global and the local economy. In respect of existing facilities, at publication date, the overall financial impact on the Bank cannot be accurately estimated but the directors do not consider that any adjustments are required to the financial information at this stage. In order to address the impact on the local economy, the Bank is currently in talks with stakeholders to provide support to the local economy in terms of measures aimed at providing significant mitigation against the additional challenges posed by this unprecedented event. In conjunction with the authorities, a responsive programme is being designed to address the evolving situation. This will take the form of guarantees to banks on loans to be granted to industry for working capital purposes. These guarantees are not expected to have any material impact on the Bank's financial position as they will be fully backed by a corresponding guarantee from the Government to the Bank.

25. STATUTORY INFORMATION

Malta Development Bank is a bank established by virtue of the Malta Development Bank Act, 2017 (Act XXI of 2017 – Cap. 574) with a registered address at Pope Pius V Street, Valletta, Malta

The Bank's ultimate controlling party is the Government of Malta.

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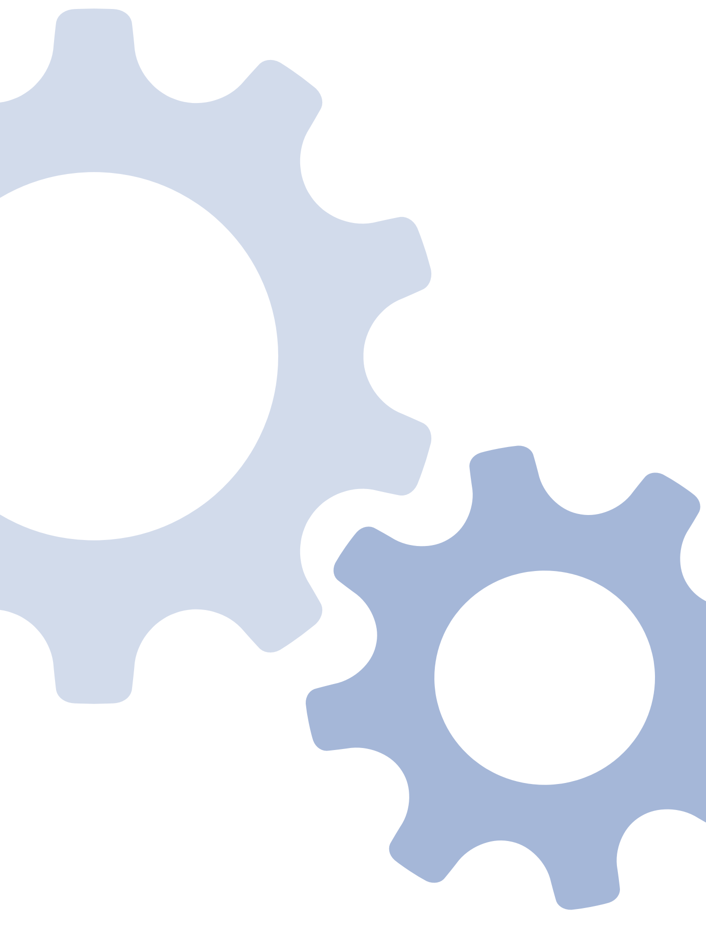

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