BANK MALTI GĦALL-IŻVILUPP
MALTA DEVELOPMENT BANK

ANNUAL REPORT 2020
& FINANCIAL STATEMENTS

ISSN: 2663-5364 (print), ISSN: 2663-5372 (online), ISSN: 2663-5380 (digital)

Contents

About the Malta Development Bank

The Malta Development Bank (MDB) was established by virtue of the Malta Development Bank Act which was passed by Parliament in May 2017 and came into force in November 2017. On 11 December 2017, the Minister for Finance, the Hon Prof Edward Scicluna, appointed the members of the Board of Directors and the Supervisory Board of the MDB. On the same day, the Board of Directors held their first meeting and the Bank officially commenced operations.

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.

Furthermore, learning from the difficulties during the sovereign debt crisis, it became clear that Malta lacked an important institution that acts counter-cyclically to mitigate the adverse impacts of the prevailing economic cycle. Hence, the launch of the MDB marks an important event in the development of financial intermediation in Malta.

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[1]
Dr. Rose Marie Azzopardi
Mr. Robert Borg
Mr. Paul Cardona
the late Mr. Godfrey Grima[2]
Mr. Anthony Valvo

These appointments are valid for the periods stipulated in Article 21(4), (5) and (6) of the Act. Mr Rene Saliba, the Chief Executive Officer of the MDB, was appointed Secretary of the Board on 11 December 2017.[3]

1 *On 11 February 2021 Ms Jackie Camilleri was appointed in lieu of Mr Paul Abela.*
2 *On 14 April 2021 Dr Michele Cardinali was appointed director in lieu of the late Mr Godfrey Grima.*
3 *With effect from 27 January 2021 Dr Bernadette Muscat replaced Mr Rene Saliba as Secretary of the Board.*

(left to right)

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

Letter of Transmittal

Pope Pius V Street
Valletta, VLT 1041, Malta
T: + 356 2226 1710
info@mdb.org.mt
https://mdb.org.mt/

26 April 2021

The Hon Clyde Caruana BCom (Hons), MA (Econ), MP
Minister for Finance and Employment
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 2020.

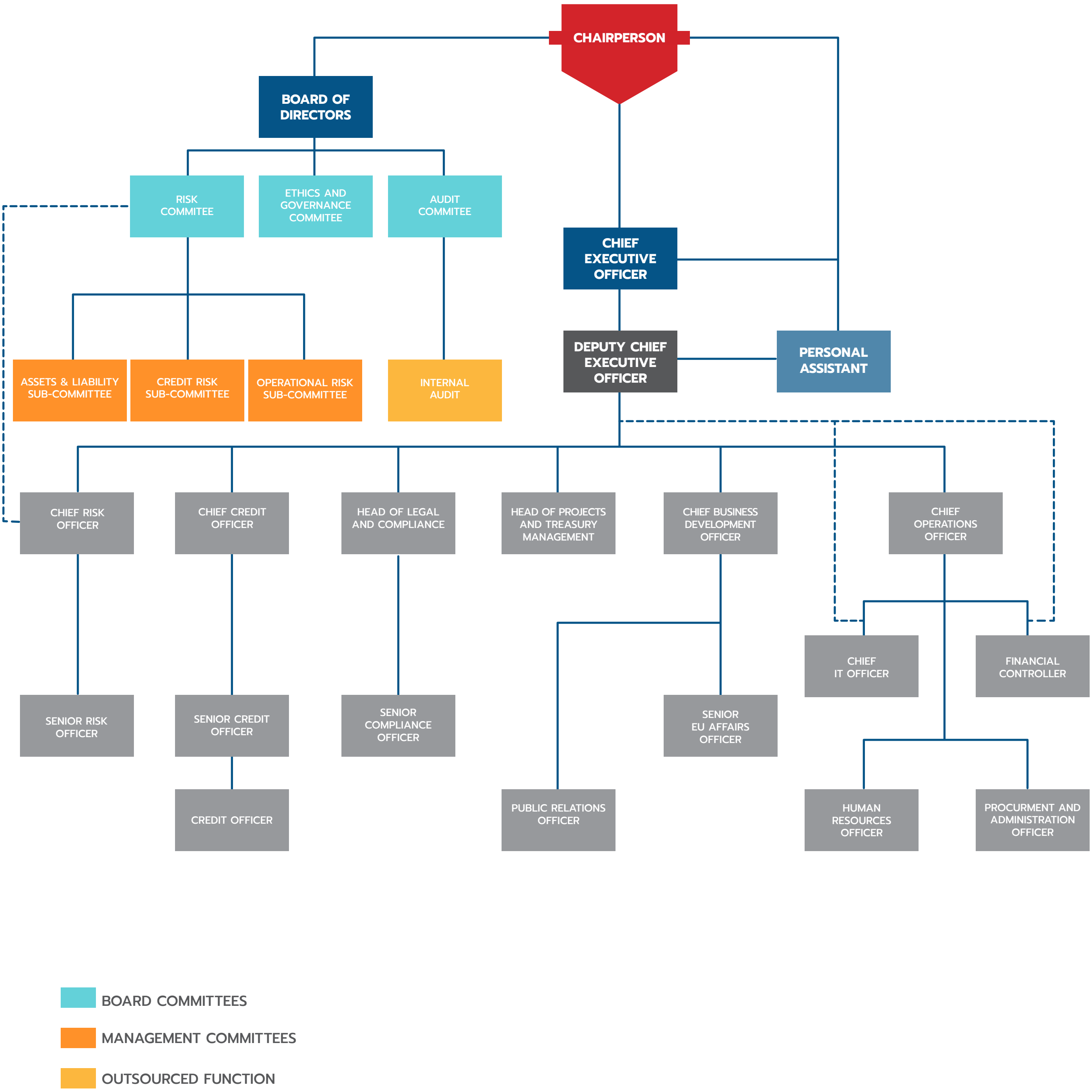
In terms of article 33 of the Malta Development Bank Act, I am also transmitting a copy of the audited accounts of the Bank for the financial year ended 31 December 2020.

Yours sincerely

JOSEF BONNICI
Chairperson

Malta Development Bank

ORGANISATIONAL CHART



Chairperson's Statement

AGILE IN RESPONSE, IMPACTFUL IN DELIVERY

The economic shock to the Maltese economy caused by the Covid-19 pandemic quickly saw the Malta Development Bank transform into a key channel for the delivery of the government's anti-crisis measures. We expanded our remit to support companies of all sizes in all economic sectors and to provide a broader range of financing that fits the needs of businesses during such unprecedented circumstances. Our team was swift to respond, and the Board is truly grateful for their dedication and diligent work in developing the mechanism for delivering millions of euro in cashflow to Maltese businesses in a timely manner.

The Bank is now in its fourth year of operation, having been founded at the end of 2017 to fill any financial gaps in the financial system and to support sustainable economic growth by promoting social inclusion, climate protection and sustainable infrastructure development. By the end of December 2020, we were facilitating over €400 million in working capital loans under the COVID-19 Guarantee Scheme through nine commercial banks, supporting more than 500 businesses accounting for around 30,000 employees. The SME Invest scheme had reached almost €30 million and close to 200 students were supported through loans under the Further Studies Made Affordable scheme. Our schemes have led to expanding the volume and diversifying the range of finance being made available, in part through our intermediary partners.

Other important milestones were also reached in 2020. We accelerated the pace of strengthening the Bank's organisational set-up and invested in our human resources and capacity building, which was crucial in enabling the MDB to take on more responsibilities, and a leading role in the pandemic. By November 2020 the MDB successfully concluded the technical assistance programme supported by the Structural Reform Support Programme; a project which contributed to significantly improve the Bank's internal control system, its accounting system, its publications of information format, as well as data protection and reporting. This upskilling and process re-engineering aims to ensure closer alignment to good practices applied by other National Promotional Banks (NPBs) as well as compliance with the requirements of the EU Pillar Assessment process. In this regard, I am pleased to report that in 2020, MDB's application for the Pillar Assessment was approved by the European Commission following a successful eligibility check, and we look forward to carrying out the assessment to become direct implementing partners of the InvestEU. Direct access to this Fund would place the MDB in a better position to roll out and implement EU market-based financial instruments tailored to specific local circumstances, enabling it to play a fuller role.

Throughout most of 2020, reflecting the spread of the global pandemic, our focus has been on identifying those actions needed to implement counter-cyclical

We expanded our remit to support companies of all sizes in all economic sectors

economic initiatives more effectively. Large important sectors of the Maltese economy were effectively brought to a standstill by the health and travel restrictions, and our role was to intensify support to mitigate the adverse impacts of the prevailing economic cycle.

An important lesson from this crisis is that the foresight shown during the upswing period served to build in greater safety margins to be able to react to adverse shocks. In a crisis period, cycles become more synchronised, while asset prices become more volatile. The confluence of the turn in asset prices, capital market tension and slump in trade typically challenges the ability of counter-cyclical policies to cope with a severe downturn. However, our experience now reveals that since Malta's fiscal position was sound, we were better positioned to buffer shocks.

Complementing the fiscal manoeuvring space, it is also important to have the institutional capacity to deliver this support effectively while protecting the interest of public finances. In this regard, the establishment of the MDB was indeed propitious. Having set up the necessary foundations and gained experience in implementing financial instruments, the MDB was able to respond to the COVID-19 economic crisis with agility and impact. Acting as a go-between the public sector, commercial banks and the business community, the MDB created a tri-party risk sharing mechanism that mobilised millions of euro to businesses, unlocking commercial banks' liquidity in the process. This is an excellent example of how the MDB effectively enables the Government to obtain the benefits of financial leverage. In doing so the MDB limits pressures on budgetary resources by leveraging private funds. This also demonstrates the importance of crowding-in commercial banks as their role is critical, both in terms of the large amount of liquidity they can mobilise, as well as their operational capacity and expertise in reaching out to the ultimate beneficiaries. MDB's involvement in the anti-crisis response exemplifies the benefits of the country having an institution being able to attain such optimal outcomes.

More specifically, MDB's reaction to the economic crisis was to develop an umbrella of new instruments to cater for the needs of economic operators in the peculiar circumstances of 2020. Our analysis of the situation rapidly indicated that early in the year the highest priority was the survival of businesses and the protection of jobs.

Our solutions were structured around the COVID-19 Guarantee Scheme (CGS). By April, we had analysed market requirements and developed targeted instruments, partnering with commercial banks to bring them to market. Our communications team, working in tandem with our credit team, rose to the challenge of informing and publicising the availability of these instruments, and we were delighted to see that response to our schemes from the private sector, both from larger enterprises and from SMEs, has been particularly strong.

The MDB anti-crisis measures were targeted at enhancing firms' access to bank credit and increasing the affordability of credit. As the implementing body of the COVID-19 Guarantee Scheme, the MDB achieved leverage on a Government guarantee of €350 million by mobilising commercial banks liquidity into the flow of credit to the real economy. Through this scheme, the MDB is guaranteeing the loans extended by nine accredited banks to meet the working capital requirements of businesses whose liquidity had been acutely impacted by the COVID-19 outbreak. Commercial banks are thus being provided with very substantial credit risk reduction and capital relief enabling the creation of a portfolio of up to €777.8 million in new working capital loans. This made credit for working capital much more easily accessible for firms during such difficult times.

The second incentive introduced by the MDB is the COVID-19 Interest Rate Subsidy Scheme. This provides a Government funded grant of up to 2.5 percentage points on the interest payable on the same CGS loan for the initial two years of the scheme. This instrument, combined with the CGS, effectively reduces significantly the cost of borrowing, hence making credit much more accessible than otherwise would have been the case. Later on during the year the MDB introduced a third incentive – the COVID-19 Small Loans Guarantee Scheme where the MDB reduced, and sometimes eliminated, the need for soft collateral to ensure that those smaller businesses who are not in a position to offer personal guarantees to banks will still be able to benefit from cheap credit made available under the first two complementary instruments. This scheme provides an important additional impetus to SMEs, which are the backbone of the Maltese economy. In just over 8 months we helped deliver more than €400 million of

MDB anti-crisis measures were targeted at enhancing firms' access to bank credit and increasing the affordability of credit

critical support, with over 530 facilities provided to businesses at their time of greatest need.

While this year the Bank's response to the Covid-19 pandemic has somewhat overshadowed the work we would have undertaken in normal circumstances, it is important to recognise the progress that continued to be made on other fronts.

As the attention shifts from stabilisation to recovery, the MDB remains focused on the needs of businesses to ensure that they can navigate through the new challenges they face. Growth will be key to a thriving post-Covid-19 Maltese economy, and the MDB will have an integral role in supporting that. Launched in May 2019, the SME Invest remains the Bank's main financial instrument supporting growth through new investments by SMEs and will continue to play an important role in supporting the recovery. The scheme enables enhanced access to investment financing since these loans are both affordable and accessible, even for those SMEs that may have limited assets that can be collateralised. As at end of 2020, SME Invest has injected almost €30 million in new investments in the local economy, supporting 96 projects undertaken by local SMEs. The sanctioned projects include investments related to childcare centres, refurbishment of retail outlets, including hotels and upgrading of the tourist product, digitalisation, renovation of factories and investment in health-related projects. It is indeed encouraging to see that Maltese firms are not only surviving this period, but they are also investing in their future growth potential, and we can be proud to be facilitating such investment.

I am pleased that in addition to our market interventions in support of businesses, during the course of 2020, we also continued to assist the education sector through the Further Studies Made Affordable scheme. This financial instrument supports the development of human capital and is aimed to meet the financing needs of students seeking to pursue further studies by facilitating soft loans to cover activities related to tuition fees, accommodation costs, and other expenses to further their studies in Malta and abroad. Following the successful take-up of the initial allocation, we extended the total portfolio to a maximum of €8,250,000, after securing additional European funds with the support of the Managing Authority.

Apart from the various financing instruments and support schemes, we also continued to be active in the infrastructure financing space by offering forms of intermediation that cannot be provided by the market alone. We engaged the market by acting as catalyst for loan syndications by helping to pool-in diverse suppliers of credit so as to accommodate the financing needs of larger projects which are likely to be difficult to finance through one single financial intermediary. During the year we played an important enabling role in designing a financing solution for the development of the Campus Hub at Malta's University at Tal-Qroqq. The project involves the development of a university residence, ancillary commercial space, student community amenities, well-being facilities, language school, medical facilities, lecture space, office building and an underground car park.

Consultations also continued on other projects including a recycling project that is expected to make significant inroads towards Malta's recycling targets and help reduce reliance on landfills. Another project that is also maturing relates to affordable housing in collaboration with the Housing Authority. In this case, the objective is to develop a new affordable housing scheme for lower middle -income earners, where affordable rent payments would go towards the loans to fund the project on a cost-recovery basis. This project is an example how social objectives can be attained in a financially sustainable manner without shifting the burden on the taxpayer. It is also a business model of how affordable housing policy can complement social housing policy to achieve a broader reach while also aligning closer to the principle of matching the supply of social utilities and needs to affordability. This pilot project in conjunction with the public sector could also act as a catalyst for similar affordable housing projects driven by the private sector. The MDB was also approached by a number of other entities, both private and public, with interesting projects that fall within its social-dimension remit, as well as projects that enhance Malta's competitiveness.

As the year progressed, we continued to identify the need for easily accessible and more affordable financing to sustain investment for the forthcoming recovery phase. We continued 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. This is an integral element of the MDB's evidence-based and market-compatible approach in the design and operationalization of its programmes.

" ***acting as catalyst for loan syndications by helping to pool-in diverse suppliers of credit so as to accommodate the financing needs of larger projects***

Continuous monitoring of commercial developments based on close collaboration and engagement with market players is a critical ingredient in the Bank's modus operandi.

During 2020, in recognition of the crucial role that family-owned businesses play in the Maltese economy, and their priority status for the MDB, the Bank embarked on an extensive product review process of the Family Business Transfer Facility – a facility developed to assist and facilitate family businesses to transfer their business from one generation to the next.

Our business strategy team also continued to work on a programme of technical assistance in the area of financial instruments in the context of the Invest EU supported by the European Investment Advisory Hub. This project is currently being implemented and is expected to be finalised by 2021. The outcome of this project will be a set of financial instruments that will provide an effective response to the identified market needs, in line with the requirements of the InvestEU investment guidelines and MDB's priorities.

Going forward we aim to continue building on what we achieved so far. I am pleased to report that following the first capacity building project supported by the Structural Reform Support Programme in 2019, the Bank will be benefitting from a second technical assistance programme under the European Commission's Technical Support Instrument. This project is designed to create financial instruments to support equity participation particularly in initiatives involving research, innovation, digitalisation and start-ups. The MDB also held initial consultations with other stakeholders to explore how to play a complementary role and to facilitate collaboration within the equity support ecosystem as well as to contribute to an integration of various fragmented initiatives in this field which is characterised by very significant market gaps.

In conclusion, I am confident that the Bank will continue to provide the necessary support that we have provided in this difficult and challenging 2020. It was a year in which the global economy was buffeted by an extraordinary shock, and it was exactly the scenario in which a counter-cyclical institution such as the MDB steps up to the challenge. I am glad to report the number of enterprises that we have helped in dire circumstances, the sheer value of the financing we have leveraged, and the thousands of jobs we have saved, which numbers continue to increase during the current year.

One important lesson learned during the past year has been the value of institutional preparedness for an adverse shock. Our experience has shown that the existence of the Bank ensured that there was institutional capacity to manoeuvre going into a downturn. Based on this experience, we believe that in order to deal with similar shocks in the future, macroeconomic and financial sector policies should consider precautionary policy settings and macroprudential regulation to address systemic threats to stability.

Malta's business community has shown remarkable resilience to endure this phase, and we can be proud of the role we have played. There is more to do, and we will definitely not rest on our laurels. We are now looking forward to ensuring that we can continue supporting the economy in a post-COVID-19 recovery period.

Corporate Governance

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 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), the Deputy Chief Executive Officer (DCEO), and the senior management team. The CEO, DCEO and the senior management team follow the strategic direction set by the Board and in turn management provides the Board with the analysis needed for Board deliberations.

BOARD 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 for a Board of Directors that 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 Chairman, Mr. Paul Abela, Dr. Rose Marie Azzopardi, Mr. Robert Borg, Mr. Paul Cardona, *the late* 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[4] 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 Board of Directors are accountable to carry out their responsibilities in a professional manner establishing the professional standards and corporate values that promote integrity in accordance with the Code of Ethics for the Board of Directors. 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 Bank's staff.

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

The Board delegates specific responsibilities to three committees, namely the Audit Committee, the Ethics and Governance Committees and the Risk Committee. Each Committee operates in line with respective terms of reference approved by the Board.

4 *On 11 February 2021, the Minister appointed Ms Jackie Camilleri, in lieu of Mr Paul Abela pursuant to an agreement within MCESD that the term of the Board member nominated by the employers shall be shared equally between the Chamber for SMEs and the Chamber of Commerce.*

Board Committees

AUDIT COMMITTEE

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

- Assuring accurate and timely reporting of the MDB's financial position as required for its statutory reporting, to meet regulatory requirements and to provide it with appropriate reporting guidelines to assure sound 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, 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 Marie Azzopardi and Mr Anthony Valvo.

During 2020 the Committee received regular reports from the internal auditor and reviewed the key findings from the outcome of individual internal audit reviews carried out under the approved risk-based internal audit plan for 2020. The Committee also reviewed the draft Annual Report and Financial Statements and recommended them for approval to the Board. The review focused on the accounting methods, the MDB Act and the clarity and completeness of disclosures in line with international financial reporting standards as adopted by the EU.

The Committee met on four occasions in 2020.

ETHICS AND GOVERNANCE COMMITTEE

The Ethics and Governance Committee is appointed by the Board to oversee that a high standard of, and best practice in, corporate governance is maintained by fostering a culture of ethics, transparency and accountability. In fulfilling its oversight responsibilities, the 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 establishing the 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 to achieve the strategic plan adopted by the Board.

During the year 2020, the minimum number of Board members sitting on the Ethics and Governance Committee was increased from two to three in order to further strengthen the Bank's internal governance framework. Moreover, to further support the Bank's performance and control environment and legal requirements, the Committee recommended to the Board's approval a set of policies.

The Committee is composed of three Directors appointed by the Board. The current members are Prof. Josef Bonnici (Chairperson), *the late* Mr. Godfrey Grima and Mr Anthony Valvo.

The Committee met on four occasions in 2020.

RISK COMMITTEE

During the financial year under review, the Bank reconsidered the composition of the Risk Committee and the designation of its sub-committees to further improve its corporate government structures.

Prior to this change, the Risk Committee comprised of two Board members and five members of senior management. The Committee now comprises of at least three Board members, all of whom shall be appointed by the Board of the MDB, and two

members of senior management. At the same time, the sub-committees of the Risk Committee were redesignated as management committees rather than Board committees. The existing composition of the sub-committees was maintained.

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, reported, assessed, managed and controlled 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 Dr Rose Marie Azzopardi, Director, Mr. Anthony Valvo, Director, as well as the Chief Risk Officer and the Chief Credit Officer.

Three management committees report to the Risk Committee, namely the Asset-Liability Management Committee, the Credit Risk Committee, and the Operational Risk Committee. The roles and composition of the three management sub-committees reporting to the Risk Committee are as follows:

1. The *Asset-Liability Management Sub-Committee*, which 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 Deputy Chief Executive Officer, the Chief Risk Officer, the Financial Controller, the Chief Credit Officer and the Head of Projects and Treasury Management.

2. The *Credit Risk Sub-Committee*, which 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 Deputy Chief Executive Officer, the Chief Risk Officer, the Financial Controller, the Chief Credit Officer, the Head of Projects and Treasury Management and the Head of Legal and Compliance.

3. The *Operational Risk Sub-Committee*, which oversees the MDB's enterprise-wide risk framework that manages the operational risks to which the MDB is exposed in its conduct of business.

It is chaired by Mr. Paul Cardona, Director, and includes the Chief Executive Officer, the Deputy Chief Executive Officer, the Chief Risk Officer, the Chief Operating Officer, the Head of IT and the Head of Legal and Compliance.

The composition of these management sub-committees reflects the entity-wide scope and inclusive nature of the Bank's risk management strategy. These management sub-committees are envisaged to be fully functional once the Bank achieves a certain level of maturity and growth. For the time being, the meetings of the Risk Committee and its management sub-committees are held jointly.

During 2020, the Risk Committee received regular reports on the MDB's risks and the controls in place to mitigate risks as well as credit proposals from management. It has also reviewed a number of policies and recommended them for approval by the Board. The Committee has also reviewed its terms of reference and recommended amendments to the Board.

The Risk Committee met on four occasions in 2020.

Compliance and Legal Activities

During the year under review, the MDB's Compliance Unit continued to direct its efforts toward promoting and delivering robust frameworks both with regard to anti-money laundering (AML) and data protection activities which help ensure that good standards of practice are being adopted and adhered to. In order to continue to strengthen its efforts in this regard, in May 2020, MDB recruited a Senior Compliance Officer, appointed to take over the functions of Data Protection Officer (DPO) and Money Laundering Reporting Officer (MLRO) and to execute compliance functions, which had been carried out by the Head of Legal and Compliance.

AML/CFT ACTIVITIES

During 2020, the MDB's Compliance Unit continued drafting and implementing measures, policies, controls and procedures in order to further strengthen MDB's Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework. In order to achieve this, and in light of the fact that risk is not static, MDB's AML/CFT Policy has been reviewed to ensure its ongoing relevance, taking into account new legislation, good practices relating to implementation guidelines, as well as changes in MDB's activities and services.

Customer Due Diligence (CDD) measures consisting of checklists detailing the respective identification and verification information and documentation to be collated and analysed for natural persons, as well as a Know Your Client (KYC) Questionnaire have been drawn up to assist MDB in obtaining sufficient information from its prospective customers, such as who the applicant for business / customer or any beneficial owner is, to verify that such persons are who they state they are, to determine whether they are acting on behalf of another person, and to establish the purpose and intended nature of the business relationship.

In the light of finance agreements entered into by MDB with EU development banks or institutions, MDB also ensures that local partner banks with which it conducts business have sound AML/CFT policies and procedures in place. In fulfilling its obligations, MDB has started to conduct AML/CFT assessment and monitoring exercises to gain comfort that partner financial intermediaries are implementing their AML/CFT obligations. MDB interviews financial intermediaries' MLRO and reviews intermediaries' AML/CFT processes, procedures and policies, and ongoing and recurring AML/ CFT issues faced by the intermediary.

In 2020, MDB's AML framework and practices were also assessed by an external audit firm as part of the Pillar Assessment to be conducted this year for the purposes of participating in the InvestEU Programme. The audit presented their findings to MDB in November 2020, making a number of recommendations which MDB's Compliance Unit has taken stock of and discussions are currently underway with Senior Management in order to implement any required ameliorations.

The Compliance Unit continued providing awareness and training for members of staff. Such formal in-house training sessions were provided to ensure staff remain up to date on current legal obligations, money laundering and terrorist financing methods and trends, as well as on MDB's policies and procedures, among other things.

DATA PROTECTION ACTIVITIES

During 2020, focus was also placed on updating existing data protection policies, such as MDB's Data Protection Policy, to reflect developments in the law which necessitated changes to applicable MDB policies as well as any changes in operational procedures or MDB's administrative set up. MDB's data processing register, which records all MDB's processing activities, the scope of such processing, the legal basis for the processing, retention periods, any processing agreements that have been entered into, and any transfer of data to third parties, have also been duly updated. A Data Protection Impact Assessment (DPIA) and a DPIA Screening Questionnaire have also been implemented in order to mitigate risks to the rights and freedoms of individuals through MDB's processing of personal data.

MDB's data protection framework was also assessed as part of the Pillar Assessment. In 2020, the findings on such assessment were presented to MDB management and work is currently ongoing to implement such recommendations.

Finally, awareness and training were provided by the DPO to all members of staff on the general data protection legal framework, including recent developments in the law, amendments to MDB's data protection policy, among other things.

Strategy

BUSINESS

In line with its mandate, the MDB is tasked to fill any market gaps in the financial system and to contribute towards the sustainable economic development of Malta by promoting inclusive and environmentally sustainable growth. Since its inception in 2017, the strategy of the MDB has been to crowd-in private and public investment by complementing, rather than competing, with commercial banks.

MDB's business model is largely based on the recommendations emanating from a market failure study commissioned by the Government of Malta in 2015, which had identified two main sectors of market gaps: namely the financing of the SME and infrastructural sectors. The MDB achieves its objectives through financing facilities that bridge financial gaps in productive and viable operations, 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.

LAUNCHING THE COVID-19 GUARANTEE FACILITIES

In its first two years of establishment, the MDB has strategically built 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. Towards this end, the MDB has introduced financial instruments that complement the standard packages that have traditionally been offered by commercial banks, and thus acting as a catalyst for the promotion of a broader range of financial services in the credit and investment markets.

Market gaps arise from the inability, or unwillingness, of financial intermediaries to accommodate businesses' financial requirements on their own. 2020 was a year where MDB's intervention was crucial in ensuring

> ***By supporting access to credit, the MDB provided a lifeline to businesses and at the same time helping the country's economic stabilisation effort in anticipation of the expected economic recovery in the post-pandemic phase.***

that the Maltese business community survives the severe liquidity constraints that they were facing due to restrictions brought forward by the pandemic spread. Indeed, following the pandemic outbreak, liquidity has become the biggest challenge for local entrepreneurs at a time when the credit worthiness of many businesses is adversely impacted due to a sudden collapse in business activity. By supporting access to credit, the MDB provided a lifeline to businesses and at the same time helping the country's economic stabilisation effort in anticipation of the expected economic recovery in the post-pandemic phase.

The MDB responded to the pandemic repercussions by supporting businesses impacted by Covid-19 with a portfolio of three mutually supportive facilities as part of the wider package of Government's Covid-19 Response Support Programme launched in March 2020.

The Covid-19 Guarantee Scheme (CGS) is the first scheme where the MDB provides guarantees to commercial banks in order to enhance access to bank financing for the working capital requirements of businesses in Malta facing a sudden acute liquidity shortage as a result of the Covid-19 outbreak. The CGS is backed by a Government Guarantee Fund of €350 million. Under this Scheme, the MDB provides a First Loss Guarantee covering 90% of the individual loans, with a cap rate of 50% at the portfolio level, generating a multiplier of 2.22. Thus, by partnering with nine accredited commercial banks, the MDB enabled the generation of a covered portfolio with a potential to provide up to €777.8 million in new working capital loans for all types of businesses. The financial intermediaries are to pass on the benefit of the guarantee to the final beneficiary by way of a reduction in the interest rate, lower levels of collateral requirements and a moratorium of 6 months that can be extended to 12 months by the banks on a case-by-case basis. The scheme was approved by the European Commission on 2 April 2020 under the Temporary Framework for State aid measures to support the economy in the current Covid-19 outbreak.

One month later, the CGS was complemented by the Covid-19 Interest Rate Subsidy Scheme which was approved by the Commission on 14 May. This second scheme provides a grant of up to 2.5 percentage points on the interest payable on the same CGS loan for the initial two years of the scheme. Thanks to this sub-scheme, the borrowers can pay an interest rate as low as 0.1%, net of the guarantee fee. This instrument, combined with the CGS, effectively reduces the cost of borrowing to a negligible level, hence making credit both accessible and cheap.

The third instrument is the Small Loans Guarantee Scheme, which was approved by the Commission on 29 July 2020. By reducing and sometimes eliminating the need for soft collateral (personal guarantees) on loans of up to €250,000, this scheme enables smaller businesses who are not in a position to offer guarantees to banks to benefit from cheap credit made available under the first two complementary instruments. This scheme provides an important additional impetus to SMEs which are the backbone of the Maltese economy.

BECOMING AN INVESTEU IMPLEMENTING PARTNER

Albeit the focus of the MDB during 2020 was diverted towards the successful rollout of the Covid-19 guarantee measures, the Bank continued on its ambitious route to become an implementing partner of the InvestEU. As Malta's only promotional bank, the MDB aims to become the country's entry point for such guarantees, but before doing so, it needed to undergo a screening process to assess its eligibility for managing EU guarantees. In October 2020, the MDB submitted its formal application for the Pillar Assessment, and in the beginning of 2021 the European Commission informed the Bank that they have positively considered the application of the MDB to launch a Pillar Assessment. 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 will be able to recycle and re-use financial resources over a longer period of time. Detailed information on the MDB's process to become an implementing partner of the InvestEU is presented in a separate special topic on page 20 of this report.

SUSTAINING INFRASTRUCTURAL INVESTMENT

During the year under review, the MDB held various consultation sessions with private and public sector entities on how to engage in first-tier operations in the form of direct or co-financed lending of infrastructural projects. In this regard, the MDB has been approached by a number of entities to enquire on the possible role of the Bank in facilitating the financing of new investment in connection with infrastructural projects. The MDB's preference is that such investments would be financed in conjunction with the commercial banks, thereby highlighting the collaborative arrangement that the MDB would like to develop with the banks and also to foster the promotion of a syndicated loan market in Malta – which so far has played a somewhat subdued role. The emphasis has mostly been on infrastructural projects related to education, health, renewable energy, the environment, affordable housing, and other initiatives with a social dimension, as well as projects that enhance Malta's competitiveness.

PRODUCT REVIEW AND NEW FACILITIES IN THE PIPELINE

MDB is committed to excellence, and as part of its ongoing operations, it periodically scans the market to ensure that changing circumstances are being monitored and analysed. In the same manner, the Bank intermittently carries out a detailed evaluation of its own instruments, to ensure the appropriateness of its response. The Family Business Transfer Facility was the first instrument launched by the MDB, in October 2018; however, the uptake of this product was not as successful as anticipated. During 2020 the Bank conducted a series of consultations with stakeholders to explore how the effectiveness of this instrument can be enhanced. It also carried out market research to gain a better understanding of prevailing concerns and perceptions on business transfer facilities in Malta. The evaluation of this facility will continue in the first part of 2021, and subsequently, it is likely that the MDB will redefine the eligibility rules, and reconsider the terms and conditions of this product to make it more appealing to a wider cohort of SMEs. More details on this product review are provided in a separate special topic on page 45 of this report.

Moreover, besides working on expanding the scope and eligibility of the Family Business Transfer facility, the MDB is also exploring the possibility of introducing new financial instruments focusing on the green and digital transition. In order to augment the Bank's reach and impact, it is the Bank's intention to open these schemes to the widest audience possible, potentially even including households.

While recognising the importance of having schemes with established uniform parameters in place to facilitate the build-up of large portfolios, the MDB also wants to ensure that no project slips through the net due to their specific characteristics. To cater for this, in 2019 the MDB launched the Tailored Facility for SMEs, which provides 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 a partial guarantee by the MDB. The facility can be calibrated in line with the characteristics of the proposed investment with the parameters being negotiated on a case-by-case basis. The tailored facility served as an important financial solution for some projects that failed to fit within the established schemes. It also served as a pilot for the implementation of a larger scheme which is expected to be launched in 2021. The Bank has seen an increasing demand for SME investments exceeding the upper limit of €750,000, leaving a more pronounced financing gap for larger SMEs. Hence, through co-financing with commercial banks, the MDB can support viable operations where the financial market is unable or unwilling to provide the needed funding on its own.

Given MDB's capital resources and the limit to the risks that MDB can prudently assume at this stage, the outreach of the current facilities can be significantly magnified through counter-guarantees under the Competitiveness of Small and Medium-Sized Enterprises (COSME) and the pan-European Guarantee Fund (EGF). During 2020 the MDB intensified its discussions with the European Investment Fund (EIF) and on 9 December 2020 the MDB signed the COSME agreement. Concurrently, the MDB is also evaluating the potential opportunities of participating in these EIF facilities, which in turn can be used for potentially new financial instruments. The MDB is currently also evaluating the range of EGF products offered by the EIF to address market needs, including new hybrid instruments.

Applying 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. This will be more important in a post-crisis recovery phase.

INVESTEU AND THE PILLAR ASSESSMENT PROCESS

SPECIAL TOPIC I

After strengthening its organisational capacity, during 2020 the MDB embarked on an ambitious trajectory: that of becoming a direct implementing partner under the InvestEU Programme which covers the period 2021 – 2027.

InvestEU brings together, under one roof, many different EU support instruments to boost investment, innovation and create more jobs. The programme will be the EU's main investment support instrument and will succeed the Investment Plan for Europe which came to an end in 2020.

The InvestEU Programme will consist of the InvestEU Fund and the InvestEU Advisory Hub. Using a guarantee from the EU budget, the InvestEU Fund will mobilise public and private investment managed by implementing partners. The InvestEU Advisory Hub will offer advisory services provided by advisory partners to develop a robust project pipeline for investments across the EU.

The InvestEU Fund, which builds on the experience of the European Fund for Strategic Investments (EFSI) set up under the Investment Plan for Europe, will provide support to final recipients by integrating and simplifying the financing offered under a single budgetary guarantee scheme, thereby improving the impact of EU support while reducing the cost to the Union payable from the budget. The InvestEU Programme will provide the EU with crucial long-term funding, crowding in private investments in support of a sustainable recovery and helping build a greener, more digital and more resilient European economy.

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 will be able to recycle and re-use funds over a longer period of time. By accessing the InvestEU Fund, the MDB will also be able to leverage additional public or private co-investments to address market failures, while encouraging a move away from grant-dependency.

INVESTEU FINANCIAL COVERAGE

In December 2020, a political agreement was reached between the European Commission (EC), European Parliament and EU Member States in the Council on the InvestEU Regulation. It was agreed that the total budget of InvestEU will be of €11.2 billion, with €6.1 billion sourced from the Next Generation EU fund while the remainder funded from the Multi Financial Framework budget and reflows.

The Invest EU is provisioned at 40% (compared with 35% under EFSI), which means that there is a reserve of cash in the EU budget - a provisioning fund - equivalent to a percentage of the guarantee which is expected to be sufficient to cover potential losses. This provisioning may be adjusted downwards or upwards to take account of the risks attached to the financial product to be used. Under the InvestEU Programme €10.5 billion will be allocated to the provisioning fund, which can leverage €26.2 billion in InvestEU guarantees. Assuming an overall multiplier potential of 15, the InvestEU is expected to enable the mobilisation of €400 billion to be invested across the European Union from 2021 to 2027. At the same time, the Advisory Hub will be allocated a budget of €400 million.

Guarantees under the InvestEU will target four policy windows: the Sustainable Infrastructure Window with a budgetary guarantee of €9.9 billion; the Research Innovation and Digitisation Window with €6.6 billion; the SME Window with a fund of €6.9 billion; and the Social Infrastructure and Skills Window with a dedicated budget of €2.8 billion. Strategic investments will be possible under all four windows, to cover areas of European strategic importance. Similarly, capital support for SMEs that were negatively affected by the Covid-19 crisis will be possible under all four windows.

INVESTEU CLIMATE TRACKING AND SUSTAINABILITY PROOFING

In line with the European Commission's target to cut carbon emissions to 55% of 1990 levels within a decade and to become carbon neutral by 2050, at least 30% of operations under the InvestEU will need to address climate targets. Under the Sustainable Infrastructure window, the carbon reduction target is set at 60%.To this

end, the InvestEU Regulation introduces the principles of climate tracking and sustainability proofing in order to ensure that the InvestEU Fund will contribute to building a sustainable finance environment.

Climate tracking, or screening, of financing and investment operations shall be conducted to determine if and to what extent the underlying investment has an environmental, climate or social impact. Screening involves assessment of ex-ante information of a financing or investment operation. It is conducted by the implementing partners, based on information provided by promoters or final beneficiaries / financial intermediaries requesting financing and in line with criteria laid down in the sustainability guidance.

If the screening determines that a financing or investment operation has a significant environmental, climate or social impact, for projects above a certain size, it shall be subject to climate, environmental and social sustainability proofing. The aim of sustainability proofing is to improve a financing or investment operation, with a view to minimise detrimental impacts and maximise benefits on the climate, environment and social dimension.

Moreover, as the design and implementation of EU's activities and policies must integrate environmental protection requirements conductive to sustainable development, the guidance on sustainability proofing highlights that the principle of "do no significant harm" will be embedded in all activities funded by the InvestEU. This will help in the development of an internal market that protects and improves the quality of the environment and works for a sustainable development based on a balanced economic growth, price stability and a competitive social market economy in Europe.

ACCESSING THE INVESTEU AS AN IMPLEMENTING PARTNER

The main partner of the InvestEU Fund will be the EIB Group with an allotment of 75% of the funds allocated for the EU guarantee. For the first time, National Promotional Banks (NPBs) and international financial institutions that qualify as implementing partners are directly allocated 25% of the total budget guarantee that will enable them to independently design financial instruments that can be tailored for their specific needs.
As Malta's only NPB, the MDB aims to become the country's entry point for such guarantees, but before doing so it must undergo a screening process to assess its eligibility for managing EU funds. The assessment takes place in three main steps: (i) submit an application form to notify the European Commission (EC) about the organisation's intent to become an implementing partner, (ii) the EC checks the eligibility of applicants and (iii) eligible applicants must complete a screening process, the "Pillar Assessment", to ensure that the entity has the appropriate capacities to manage EU funds and protect the interests of the Union.
The Pillar Assessment is conducted by an independent external auditor, guided by very specific terms, and carried out to ensure compliance with the rules and procedures for managing EU funds. The Commission will conclude its assessment based on the findings of the auditor's report.
Once this assessment is concluded, entities that are certified to have satisfied all the conditions to become

InvestEU implementing partners are to respond to a call for expression of interest to be issued by the EC. The Commission then enters into negotiations with the implementing partners to define the type of financial product they intend to implement, and the conditions attached to it. The negotiations are concluded by signing a guarantee agreement granting the status of InvestEU implementing partner.

PILLAR ASSESSMENT

As already indicated, the Pillar Assessment is a review of the systems and procedures of entities wishing to become implementing partners under the InvestEU Programme. In this assessment the entities aiming to become implementing partners must meet the requirements and benchmark criteria in various areas. More specifically, the terms of reference of this assessment cover nine different areas (or pillars): internal control, accounting, external audit, grants, procurement, financial instruments, controls to exclude ineligible projects from access to funding, publication of information on recipients, and personal data protection.

Some pillars are compulsory for all entities (namely internal control, accounting, external audit) while the applicability of others depends on the nature of the activities which the implementing partner is planning to undertake (namely, grants, procurement and financial instruments and within those, exclusion from access to funding, publication of information on recipients and protection of personal data).

This demanding assessment aligns the internal and external operations of potential implementing partners with the rules set out under the article of General Budget of the European Union which sets out the methods of implementation of the budget including 'indirect management'. Under indirect management, the Commission can entrust budget implementation tasks to countries, organisations and bodies.

The objective of the Pillar Assessment is to ensure a level of protection of the financial interests of the Union equivalent to the one that is provided for when the Commission manages EU funds directly.

MDB'S APPLICATION

On 12 October 2020, the MDB submitted its formal application for the Pillar Assessment, and the European Commission started its formal eligibility check. Early in 2021 the Commission informed the Bank that they have positively considered the application of the MDB to launch a Pillar Assessment with a view to its potential participation in the InvestEU Programme as an implementing partner. Following this encouraging news, the Bank issued a request for quotations for the provision of services to select the external auditor to conduct the Pillar Assessment.

The Pillar Assessment can take from 6 to 18 months, depending on the entity, the complexity of its structure, the internal departments involved, the availability of resources when the auditors carry out the assessment and the number of pillars to check.

MARKET GAP ANALYSIS

SPECIAL TOPIC II

Market gaps occur when markets fail to efficiently provide or distribute goods and services. As a result of such market gaps, new investment in viable projects might not be able to procure access to the required funding sources and might end up failing to materialise. The overriding objective of the MDB is to address such market gaps. More specifically, the MDB's remit is to complement commercial banks in order to bridge financial gaps in bankable investments, particularly in respect of investments by SMEs and infrastructural projects.

Two major analytical exercises were carried out in 2020 in order to shed light on the current market gaps in Malta. First, the bi-annual Survey on the Access to Finance of Enterprises (SAFE), published by the European Commission and the European Central Bank (ECB)[5]; and second, a gap analysis of Malta's financial product offering conducted by a local accounting firm with the support of the European Investment Bank (EIB), through its European Investment Advisory Hub (EIAH). Both exercises are critical to the formulation of the MDB's strategy and programme of intervention, particularly considering the Bank's preparation for implementing financial instruments under the InvestEU Programme in Malta.

SAFE is a benchmarking exercise, mapping out whether and how SMEs enjoy access to financing across the EU. Clearly, 2020 has been a very particular year in view of the impact of the COVID-19 outbreak: the importance of typical SMEs' problems has changed drastically and included various COVID-19 related issues. SAFE found a significant deterioration in economic outlook, balanced by more intensive public financial support, a comparatively higher willingness of bank financing, matched by a lower willingness of other partners and private investors.

SAFE FINDINGS

In the 2019 SAFE report, SME's in Malta were primarily concerned about sourcing staff, while finding customers, competition and financing were the next important concerns. During the pandemic, changes to economic realities reordered the list of concerns to prioritise firstly finding customers, then staff, followed by cost control, competition, and then financing. Access to financing was prioritised as the most important consideration in 2020 by around 9% of SMEs, down from around 14% in 2019. Interestingly, the relatively lower level of priority given to access to financing by Maltese SMEs in 2020 compares very favourably on an EU-wide basis.

An important finding of this report is that in Malta, bank loans were found to be relevant for 58% of SMEs and used by 12% of them. This relatively low usage rate of bank loans is due to the fact that most businesses tend to rely more intensely on credit lines, both in the form of bank overdrafts and trade credits from suppliers. In fact, credit lines were relevant for 71% of SMEs and used by 41%. Leasing was relevant for 30% and equity for 22% of SMEs. As opposed to previous years, grants and other loans became more important sources of finance.

Even the utilisation of financing reflects the specific circumstances of 2020. SMEs used less financing for fixed investment, inventory, and hiring and training of employees, developing and launching of new products or services, refinancing, or paying off obligations, and other purposes. On the other hand, SMEs used financing more often for working capital purposes as the devastating effects of COVID-19 forced most businesses to shift the focus from new investment and growth, to survival and consolidation.

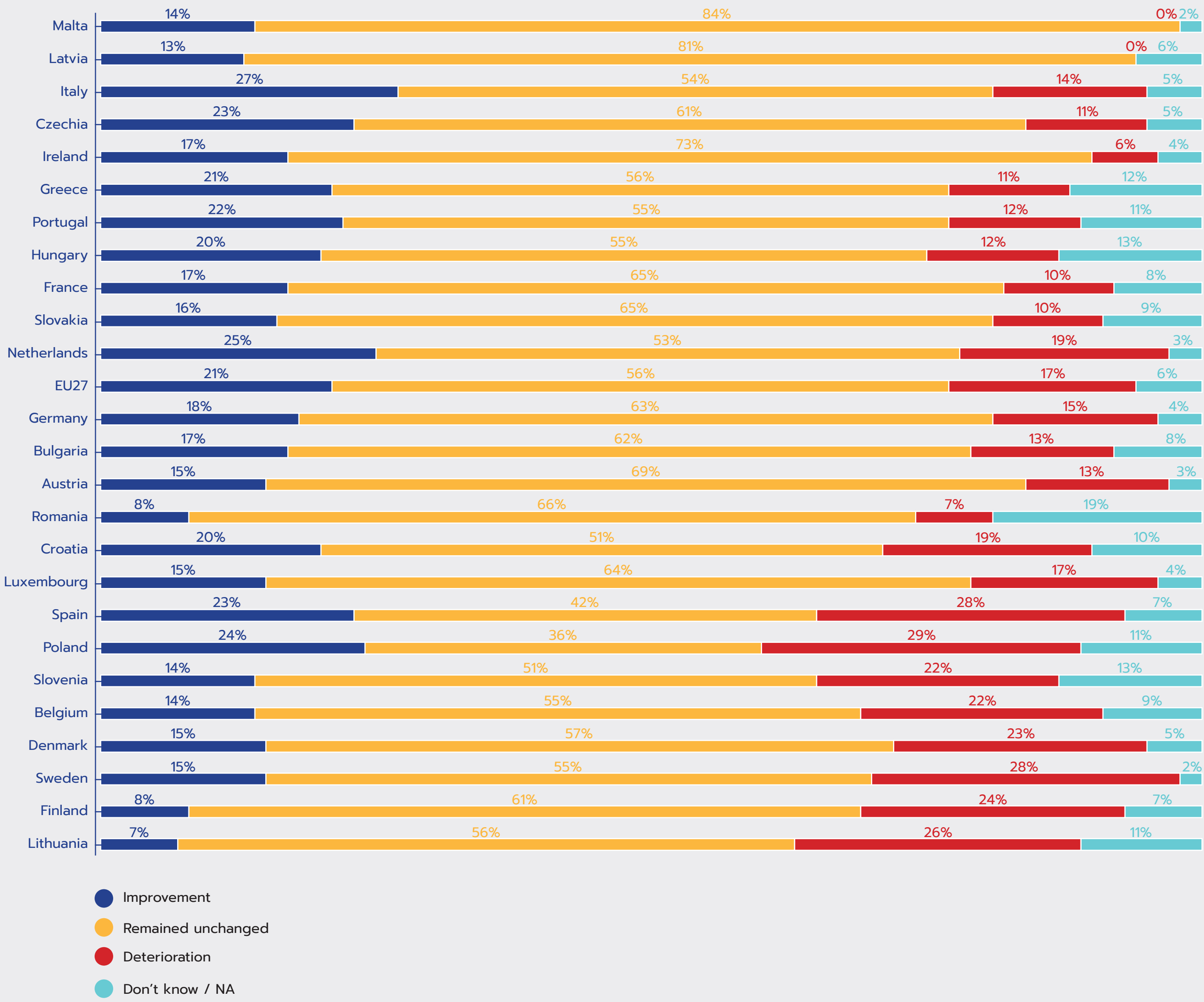
The use of external financing to support inventory or other working capital requirements during April to September 2020 increased to around 41% of SMEs across the EU27, up from the 35% level recorded in the corresponding survey of 2019. SMEs in Malta were among the highest national group to make use of financing to support working capital, with 52% of SMEs resorting to this method of financing. This is to a significant extent attributable to the very strong take-up of the COVID-19 Guarantee Scheme implemented by the MDB (see pages 51-54). A strong element of commonality appears to prevail among a number of Mediterranean

5 *The SAFE exercise is conducted twice a year: once by the ECB covering euro area countries and once in cooperation with the European Commission covering all EU countries plus some neighbouring countries. More detailed information on the 2020 report can be accessed from: https://ec.europa.eu/docsroom/documents/43872 and https://www.ecb.europa.eu/stats/ecb_surveys/safe/html/index.en.html*

EU member states, with relatively higher levels of SMEs using external financing to support working capital in Portugal (56%), Spain (at the same level as Malta at 52%), Greece (49%) and Cyprus (46%). The evident commonality among these states is that each of these economies is characterised by a strong tourism sector, in which economic operators were significantly impacted during the pandemic as a result of the travel restrictions put in place by most European health authorities.

Three specific indicators are highly relevant to the impact of COVID-19 on SMEs in Malta. Firstly, SAFE assessed the extent of the change in the level of interest rates charged to SMEs during the period between April and September 2020. Across the EU27, 56% of SMEs saw no difference in the level of interest rates, while a further 17% reported that they had experienced higher interest rates during the period (see Chart 1). By contrast, no Maltese SMEs reported a worsening situation, most SMEs saw no change in the level of interest rates, while 14% of SMEs experienced lower interest rates. This probably reflects the interest rate benefit pass-through facilitated by MDB's schemes as well as the interest rate subsidy embedded in the COVID-19 Guarantee Scheme.

CHART 1: CHANGES IN THE LEVEL OF INTEREST RATES DURING APRIL TO SEPTEMBER 2020 FOR SMES IN THE EU27 BY COUNTRY

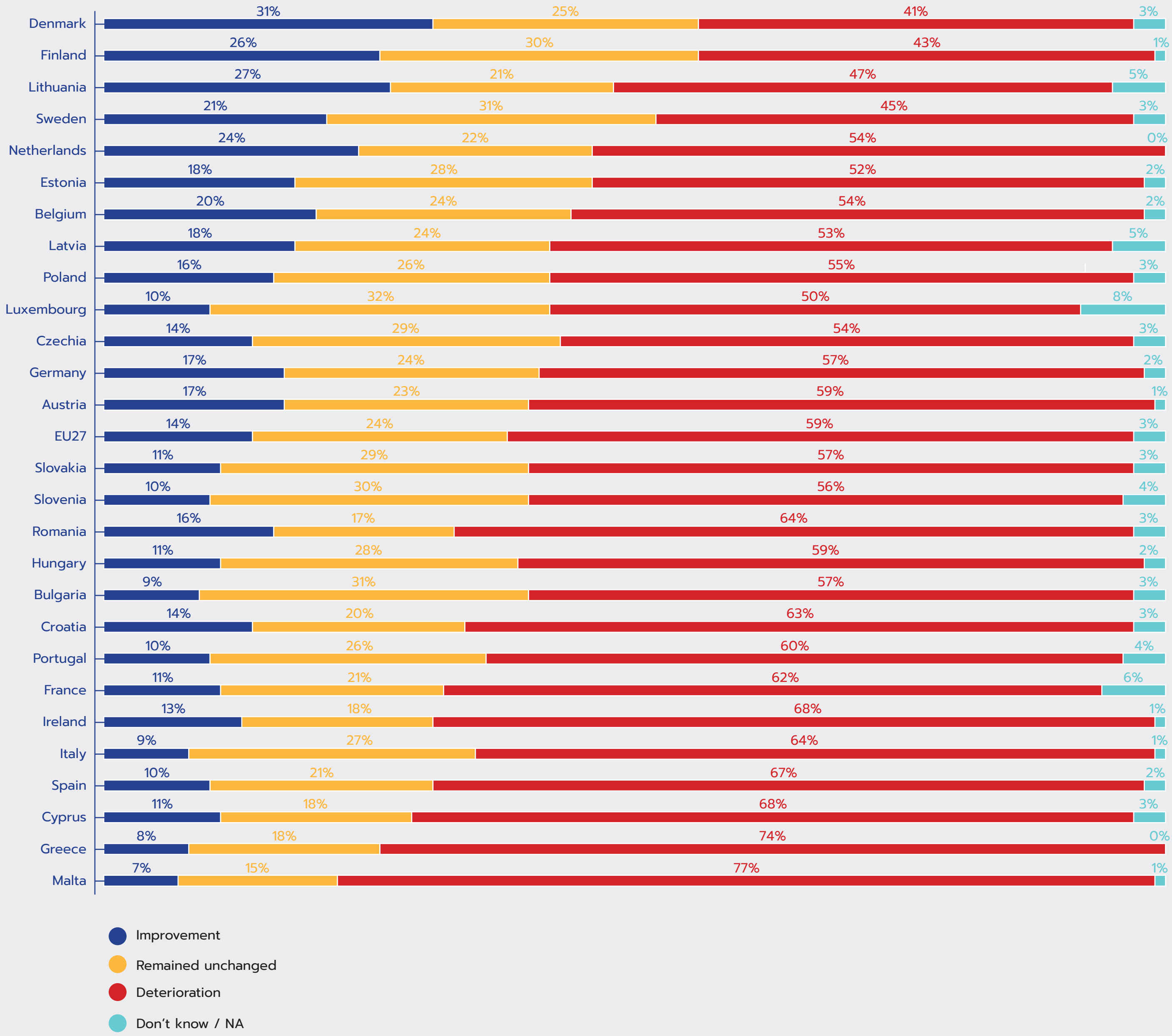


Source: SAFE (2020), European Commision, November 2020

**Results for Cyprius and Estonia are not reliable because of too low a number of observations*

Clearly, COVID-19 had a significant impact on profitability; a large cohort, equivalent to 59% of SMEs surveyed across the EU-27 reported that their profitability had deteriorated during the period (see Chart 2). The SAFE data indicates that SMEs in Malta were among the hardest hit across the European Union, with 77% of respondents indicating a deterioration in their profitability, even higher than the impact on profits of SMEs in other Mediterranean tourist destinations like Greece, Cyprus, Spain and Italy.

CHART 2: CHANGES IN PROFIT DURING APRIL TO SEPTEMBER 2020 FOR SMES IN THE EU27 BY COUNTRY



Source: SAFE (2020), European Commision, November 2020

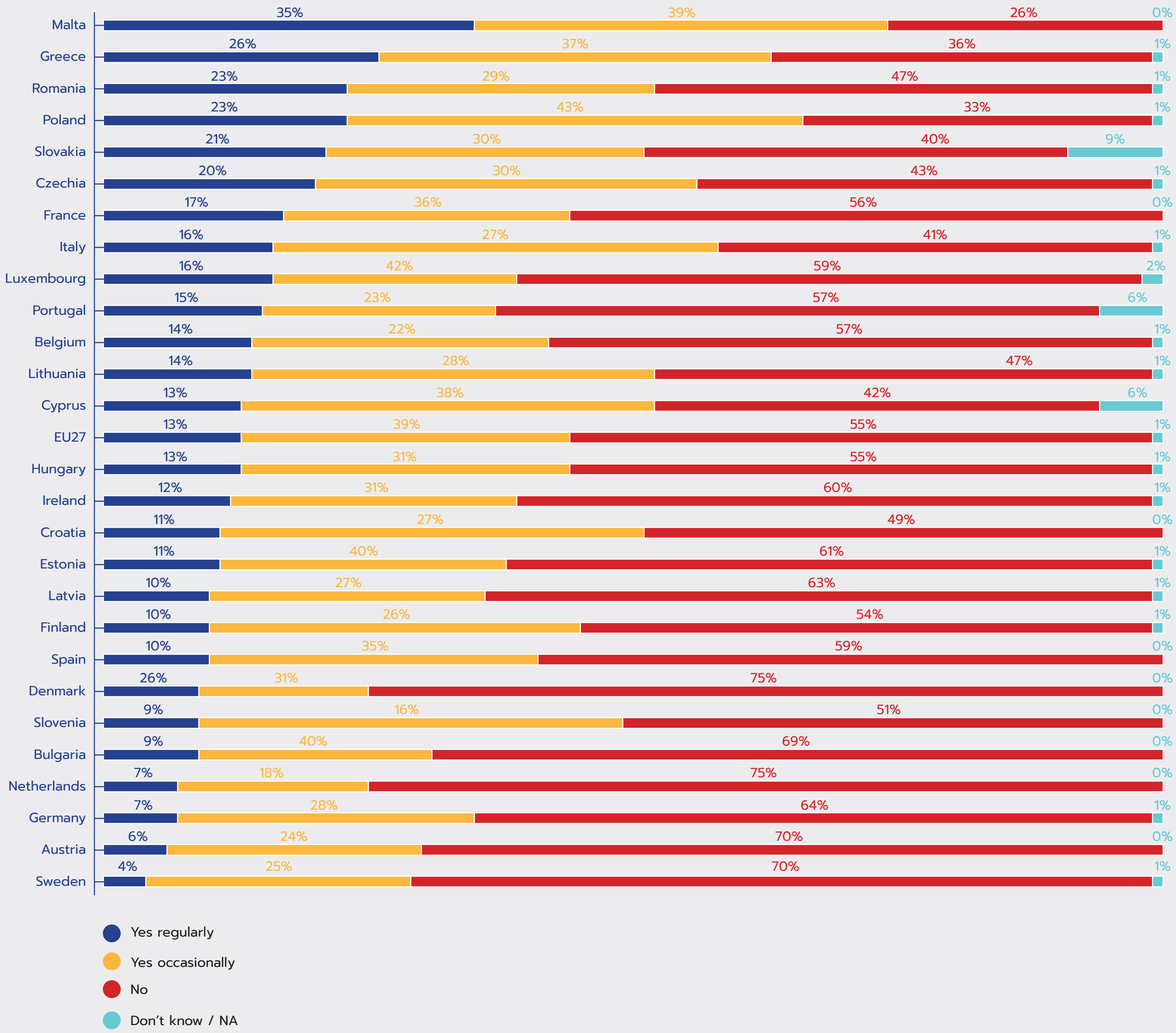
The indications in the SAFE report are that the very high impact on Malta's SMEs arises because the hardest hit sectors are not only limited to the tourism industry, but also comprise wholesale and retail activities. Clearly, SMEs in the latter sector have been subject to competitive pressures from online shopping even before the COVID period, but the impact of additional health precautions and increased consumer concerns have exerted increased pressure on this sector during the pandemic.

In addition, during 2020, SMEs reported a small increase in the incidence of late payments over previous years, with this factor in turn affecting payments to suppliers and delaying investment and new recruitment. Across the EU-27 region, 13% of SMEs reported a regular deterioration in the promptness of payments, while a further 31% of SMEs reported an occasional deterioration. Cumulatively, 44% of small and medium sized firms across the entire region have experienced cash flow deterioration, which in turn creates an ongoing chain of delayed payments.

The timeliness of cash flows in the commercial sector has long been a problematic issue in Malta. Research shows that as a result of defaults or delays in commercial payments, heavy administrative and financial burdens are placed on businesses, particularly those that are small and medium in size. SMEs, being more vulnerable due to their size and power in their respective markets, will feel the pinch more than large organisations. The transposition into Maltese law of the European Directive to combat Late Payment in Commercial Transactions in 2012 has alleviated this problem, but late payment has been reported as a significant problem in the SAFE report.

Indeed, 35% of Maltese SMEs reported late payments to be a regular problem during the COVID-19 pandemic, while a further 39% classified late payment as an occasional problem (see Chart 3). Only one out of every four SMEs claimed that the timeliness of payment was not a problem for their operations during this period.

CHART 3: PROPORTION OF SMES IN THE EU27 THAT EXPERIENCED PROBLEMS DUE TO LATE PAYMENTS FROM ANY PRIVATE OR PUBLIC ENTITIES IN THE PAST SIX MONTHS AND THE RESULTING CONSEQUENCES, BY COUNTRY



Source: SAFE (2020), European Commision, November 2020

Interestingly, the discouraged applicant effect, where SMEs do not approach banks to seek financing for fear of rejection, was lower than in previous years. This could possibly be the result, in part, of MDB initiative to improve access to financing even for those SMEs who would typically have been ineligible for bank credit in previous years. Indeed, one of the successful features of the COVID-19 Guarantee Scheme (CGS) has been its open access to finance to all economic sectors. This was achieved by combining higher affordability (through the interest rate subsidy) with improved accessibility (reduction in collateral requirements as a result of the guarantee instrument).[6]

6 *More detailed information on the features and impact of the Covid-19 Guarantee Scheme (CGS) is provided in the Business Review Section of this report.*

EIAH STUDY

The second important report conducted during 2020 on market gaps is the study commissioned by the MDB and funded by the EIB to help the Bank in its preparation for implementing the InvestEU Programme in Malta. The objective of this study, "Gap Assessment of the Financial Products offered by MDB", is to identify those areas of the economy that hold the most potential for MDB's intervention through financial instruments under InvestEU and to propose a set of instruments that could potentially be deployed to mitigate these identified market failures. Thus, this analysis provides a major source of information in the formulation of MDB's strategic decisions and programme of intervention. Other outputs from this exercise include the identification of the priority areas for investment within the Maltese economy. It continues with a more elaborated analysis of the priority subsectors.

In profiling the financial instruments implemented in Malta so far, the EIAH, in conjunction with an international audit firm, has identified that the local market for such financial products is characterised by a limited number of instruments, dominated by guarantee products, and one risk-sharing loan instrument, and with lack of equity financing instruments to date. SMEs are the predominant focus of the existing instruments, with the most popular being two SME guarantee schemes, which have demonstrated high absorption rates but are also characterised by some overlaps in their product offering. Some specialised instruments targeting sectors such as skills and education, and energy efficiency and renewable energy have recently been established, but due to their recent introduction, there is limited history on which to draw conclusions concerning their absorption and impact. Currently, all guarantee products are portfolio guarantees, through the intermediation of a number of commercial banks, with a grant component being combined with the financial instrument in a limited number of cases.

As also reflected in the SAFE results, the guarantee schemes seem to be the preferred and most prominent financial instruments in the overall financing market in Malta. This raises major strategic questions for MDB: the Bank needs to think about further refinement in the portfolio of instruments to ensure that market gaps are addressed, and to consider whether the market requires the broadening of the range of instruments to also include equity or other financial products.

The Report highlights that on the demand side, MDB has been reasonably successful in reaching out to SMEs and provide enhanced access to bank financing at attractive interest rates in the current portfolio of financial instruments. As also evidenced by the SAFE results, the Bank has been successful in moderating the discouraged applicant effect. Through such an analysis, the Bank is now able to investigate the incidence of its current reach. In particular, the Bank is focusing its strategic orientation to enhance its relevance in a number of priority focus areas.

This gap assessment report has analysed the Maltese economy and MDB intervention through an exhaustive review of the financial instruments currently implemented in Malta. This was done through an analysis of major policy documents and literature available, and by consulting with a wide range of relevant stakeholders. As stated, the aim of the report was also to identify the market sectors holding the most potential for MDB intervention and develop an investment strategy with the most appropriate financial instruments that, by leveraging on the InvestEU Guarantee, can provide a significant contribution to addressing the market gaps.

The EIAH report notes that financial instruments are the appropriate mechanism to address financial barriers, such as lack of collateral, high interest rates, and lack of equity financing. However, other barriers that have emerged from the analysis, namely policy related constraints and shortage of skilled workforce, cannot be effectively addressed using the existing instruments.

Moreover, the Report identifies several gaps in subsectors which can be narrowed or filled utilizing InvestEU policy windows via new financial instruments tailored to the Maltese market. The subsectors that appear to provide most scope for further analysis are presented in Table 1.

TABLE 1: AREA OF POTENTIAL CONSIDERATION	
Policy Windows	*Subsectors*
Sustainable Infrastructure	Public Transport & Sustainable Mobility Waste Renewable Energy Production
Small and Medium sized Enterprises (SMEs)*	General SMEs Start-ups Internationalistion Research, Development and Innovation
Social Investment & Skills	Social Enterpreneurship Skills & Education Social Infrastructure
Horizontal sectors**	Energy Efficiency Circular Economy Blue Economy

** Given that most of the funding and financing of research, development and innovation (RDI) is provided to SMEs, the RDI segment has been included as a subsector within the analysis of SMEs. This encompasses SMEs or projects related to technology, research and innovation, digitisation and artificial intelligence.*

*** As some subsectors have an impact across sereral Policy Windows, a "Horizontal Sector" window was created for the purpose of this analysis.*

It is important to mention that all the subsectors are relevant for the Maltese economy and it should also be stressed that, in principle, financial instruments can be implemented in all policy areas and their promotion should be sought. However, the purpose of this analysis was to identify those subsectors that under the current circumstances (and targeting the short-term implementation of financial instruments) would provide the most potential for implementation under InvestEU. The subsectors highlighted in Table 2 were identified in the Report as top priority targets for financial instruments.

TABLE 2: SUBSECTORS IDENTIFIED AS TOP PRIORITY AREAS

Sustainable Infrastructure	This subsector was assessed to be a top priority for MDB predominantly due to strong investment needs and maturity in combination with very high ploicy and applicability of financial instruments. The social housing sector has been characterised by significant increases in demand refleting the strong economic and population growth.
SMEs and start-ups	SMEs have a majority presence in the Maltese market, and their support remains the top priority for MDB. The investment needs, policy priority, suitability for the application of instruments were all ranked very high across the different subsectors of the SMEs windows. For this reason, the SME Policy Windows has been selected as a whole from further analysis.
Waste Management and Circular economy	To ensure complementarity and efficiency, waste management and circular economy were combined and are jointly considered as top priority for MDB due to high investment needs. The analysis highlighted the need for improving waste management practices. The circular economy sector in Malta is still in its infancy, with limited uptake or investment in circular economy practices in the private sector, weak infranstructural capacity to support the sector at national-level and insufficient RDI outputs to support its development.
Renewable Energy Production and Energy Efficiency	Renewable energy was assessed to be a top priority for MDB, predominantly due to very strong investment needs and the high policy priority. Malta's levels of renewable energy production are currently below targets, despite improvements in recent years. Several schemes have been put in place over the last years in order to support the sector, however additional investments will be required over the next programming period, including investments in RDI to support new and innovative renewable energy production practices and solutions.
Blue Economy	The Blue Economy plays an important role in Malta, especially the subsectors of coastal tourism, parts and shipping. Other sectors remain more underdeveloped, but the investment needs are expected to increase in the coming years. These include, inter alia: marine biotechnology and aquaculture and other sustainable fishing practices, natural enhancement and protection of the marina and ocean energy

The MDB takes a market-driven approach through constant dialogue with stakeholders in pursuing its objective of narrowing financing gaps. This process includes on-going monitoring through the close links that the Bank seeks to maintain with the business community, as well as analysing the supply of and demand for financing in its different forms, in order to ensure that the Bank's schemes address the needs of the intended beneficiaries.

The Bank will remain driven by its mission to enhance the financing of local economic actors, including its role as a major counter-cyclical operator when required, within the constraints imposed by its mandate, capacity and resources.

OPERATIONS

MDB's lean and efficient approach is in line with the vision articulated by the Bank's mission. Thanks to the strong commitment, clear guidance and effective oversight of its Directors, the leadership of its Management Team and the steadfast dedication of its staff, the Bank has successfully consolidated itself as a dynamic institution providing a long-lasting contribution. In this context, the high technical capacity of the Bank's staff and a sound technology backbone are essential bricks in a solid foundation for MDB's further growth and development.

Now in its third year of operations, the Bank is a fully functional institution which has the strategic agility and strong execution capability to shift gears and refocus as required by the emerging challenges and opportunities as well as the evolving environment caused by the ongoing COVID-19 pandemic.

CAPACITY BUILDING

Besides expanding its operational capacity to deliver the COVID-19 anti-crisis programme, the MDB also continued to strengthen its organizational capacity. With the support of technical assistance from the European Commission's Structural Reform Support Programme (SRSS), the MDB made recourse to external expertise to strengthen its organisational capacity with a view to preparing for the European Commission's Pillar Assessment for eligibility to become an implementing partner under InvestEU. This technical assistance programme, initiated in September 2019, was concluded in November 2020, and contributed to significantly improve the Bank's internal control system, its accounting system, its publication of information, data protection and reporting. This upskilling and process re-engineering aims to ensure compliance with the requirements of the EU Pillar Assessment process, and a closer alignment to good practices applied by other NPBs.

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 the design and implementation of financial instruments, particularly in the context of Invest EU. This project is currently being implemented and is expected to be finalised during 2021. The objective of this assignment is to assess the performance of MDB's financial instruments implemented in the current programming period; to conduct a high-level market analysis in order to identify and assess the priority sub-sectors under the InvestEU windows that hold the most potential for MDB intervention; and to understand the size and nature of market gaps and bottlenecks hindering the development of the sector. The final part of the assignment relates to the identification of the best practice tools to be implemented by the MDB in order to mitigate these gaps. The outcome of this project will be a set of financial instruments that will provide an effective response to the identified market needs, in line with the requirements of the InvestEU investment guidelines and MBD's priorities. More details on this market gap analysis are provided in a separate special topic on page 23 of this report.

In 2020, the MDB also applied for further technical assistance under the European Commission's Technical Support Instrument (formerly SRSS). MDB's request for support, which has been approved by the Commission, involves the provision of external expert services for the development of two financial instruments to support equity participation and start-ups. The MDB is keen to embark on this project over the course of 2021 which will contribute significantly to the Bank's efforts to broaden the range of facilities to address these two very important investment gaps in Malta.

The MDB also seeks to deepen its technical expertise through its international affiliations. Through its membership in various NPB networks, the MDB participates in regular cross border meetings which serve as a platform for engaging with its peers and exchange views on issues of common interest.

ENHANCING HUMAN RESOURCES

Throughout 2020, MDB continued to build a team of professionals with extensive experience, knowledge, and skills. MDB's human resources strategy seeks to ensure that the Bank attracts, and nurtures, motivated and well talented people who are committed to the Bank's mandate and strategic goals, and who will add value to the Bank's day-to day work.

ATTRACTING TALENT

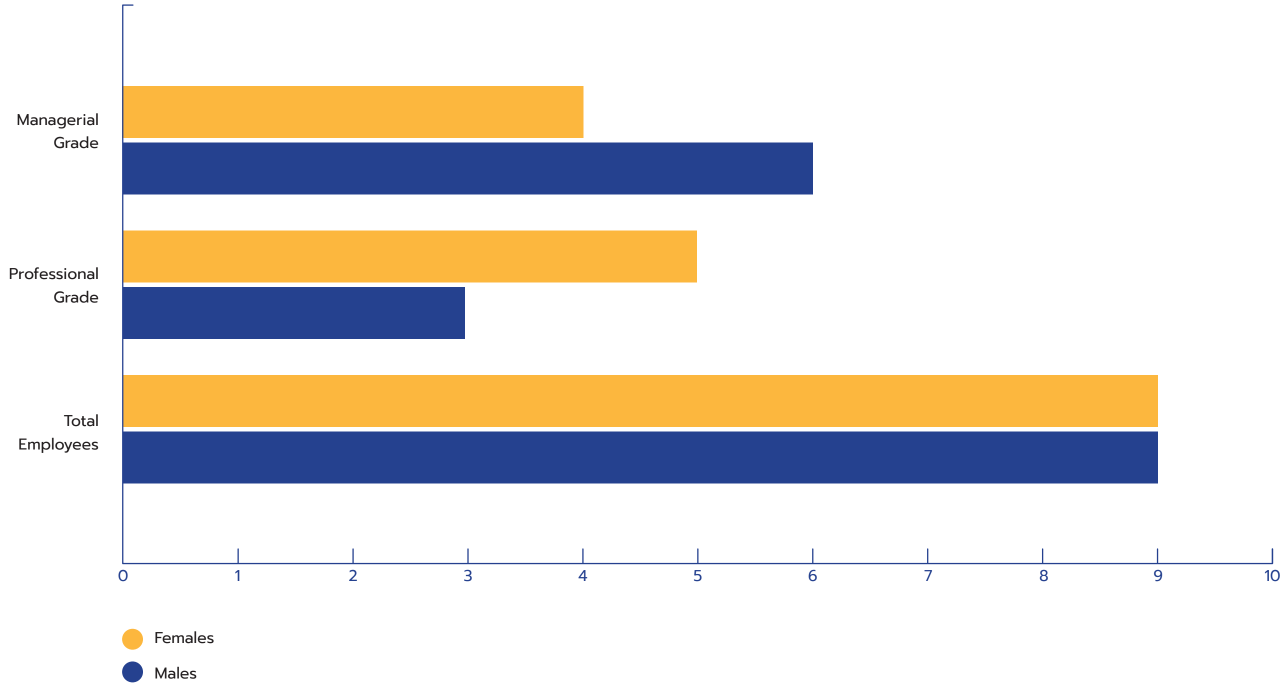
MDB's total headcount increased by a net of 7 employees during 2020. This positive dynamic is mainly attributable to the continuous efforts towards staff recruitment and capacity building.

During the year, the Bank recruited more staff to cover important roles and continue strengthening the Governance of the Bank, these included the Deputy

Chief Executive Officer, and other officers in the areas of compliance, procurement, human resources, credit, EU Affairs and risk. As at the end of 2020, the Bank had a full-time complement of 18 staff members.

MDB continues to give prominence to gender balance, recruiting and retaining female employees at all levels. As at the end of 2020 women accounted for 50% of the Bank's total headcount.

CHART 1: EMPLOYEES BY GENDER AND GRADE AS AT 31 DECEMBER 2020



MANAGEMENT TEAM

The Management team as at the end of 2020 was made up of the following:
Mr Rene Saliba, Chief Executive Officer
Mr Paul V Azzopardi, Deputy Chief Executive Officer
Mr Tyrone Mizzi Navarro, Chief Risk Officer
Ms Maria Xuereb, Chief Credit Officer
Dr Bernadette Muscat, Head of Legal and Compliance
Mr Kevin Vassallo, Head of Projects and Treasury Management
Mr Joseph Darmanin, Chief Business Development Officer
Dr Angele Ellul Fenech, Chief Operations Officer
Ms Joanne Dimech, Financial Controller
Mr Robert Gauci, Chief IT Officer

DEVELOPING TALENT

MDB strives to support the professional development of staff through off-the-job and role-specific technical training. MDB's employees participated in various training sessions to improve their professional competencies and deeper awareness in relevant fields. Regular in-house sessions were held to update staff on changes to the Bank's guidelines and practices as well as the mandatory awareness sessions including Health and Safety, Data Protection and Governance. Staff members also regularly attend seminars and information sessions organized by international associations to which it is affiliated.

The year under review was mostly dominated by the Covid-19 pandemic thus giving rise to the need for the introduction of new measures at the workplace to keep employees and visitors safe and help prevent the spread of the COVID-19 whilst still keeping the operations of the Bank going. Since the start of the pandemic in March, almost all employees have been working from home. All meetings, both internal and external, were

conducted online and working physically at the office was limited as much as reasonably possible. Safety procedures were also implemented whilst health awareness sessions were regularly conducted to all staff members.

The Bank will continue to scale up human resources in line with its growth plans and business volume to better serve the Maltese community and its economy. In 2021, a steady and controlled headcount growth is expected in areas of strategic priority. Talent acquisition will target highly specialised skills and technical competences to complement the skill mix of the current workforce and better assist emerging business needs.

MDB's organisation structure will remain adaptive and lean to enable the Bank to fulfil its objective in the most efficient manner. The Bank will continue to review its key human resources policies and work towards the formulation of a human resource strategy to remain an attractive employer which believes in equality, professionalism, empowerment, social focus and continuous development. The Bank will also lay out a more focused approach to learning and development of its staff members.

LEVERAGING INFORMATION TECHNOLOGY

Leveraging information technology is a cornerstone of MDB's strategy. The Bank developed various strategies within the IT infrastructure to manage internal risks and increase operational efficiency. Investment in IT, including selection and implementation of appropriate solutions, is driven by MDB's operational plans and verified on an ongoing basis.

Following the COVID-19 pandemic the Bank continued its operations seamlessly via remote working, by continuing to invest in its IT system, striving to integrate digitalisation equipment. MDB pays particular attention to information security as a new digital imperative as one of the risks that needs to be actively managed. During the year 2020, the Bank performed security tests conducted by independent professionals to actively manage new risks emerging from digitalization.

The Bank is committed to continue strengthening its internal controls by embarking on new technology and financial solutions for activities of strategic prominence, to ensure a strong governance, including standards and policies. MBD will also continue increasing resilience through information and cyber security capabilities through the development of policies and regular testing performance.

PREMISES

Since its inception, the Bank has been operating from leased premises in Valletta which however can no longer accommodate the Bank's growing staff complement. During the year 2020, the Bank accordingly acquired a restored old building in Floriana that will serve as its head office in due course. Establishing its offices was a strategic priority in order to strengthen the Bank's operations and to align with the development priorities of the Bank's mission.

The Bank further focused on sustainability and green environment strategies by entering into additional restoration works of a 520m^3 well underneath the building so that it can be used for its rainwater harvesting system. This is complemented by

wastewater collected from the Bank's Reverse Osmosis system which are then both used as second-class water thus providing a water management solution to enable efficient water resource management. The Bank continued to provide adequate sorting resources to contribute on the waste separation policy to ensure that such used material is collected and separated at source in the best manner possible.

Going forward, MDB is committed to continue working towards the implementation of green and efficient strategy, incorporating environmentally friendly technologies within the new building. Within a broad spectrum, the Bank will continue with the further consolidation and leveraging of its expertise in mobilising resources for infrastructure and sustainable development projects. The Bank will also continue to place a special focus on security and health and safety within all key areas of the new building.

FINANCE

The Finance function within MDB has implemented a number of initiatives to strengthen its accounting and reporting processing. The Bank has also implemented an accounting system which automates back-end processes, minimising operational risks. During the year 2020, a number of policies were formulated to support the governance across the Bank.

The Finance Unit shall focus on the design and implementation of a Budget policy supported by a robust performance monitoring and reporting system, to further support the Board of Directors in executing MDB's strategic objectives. As MDB ventures into its credit lending activities in 2021, monitoring and assessment of the credit loss provisioning will be performed on a regular basis to ensure expected credit losses are in line with MDB accounting policies and its Credit Risk Framework. In addition, Finance will continue to support the planned balance sheet growth through direct liaison with Treasury operations, funding and cashflow management operations. As a result of MDB's planned organizational growth, Finance will ensure operational risks are sufficiently mitigated through its continuous oversight of daily operational controls and procurement processes. Furthermore, the Finance function is adequately positioned to embrace further accounting and reporting challenges as MDB aspires to become an implementing partner of the Invest EU scheme.

RISK

The mission of the Malta Development Bank is to contribute towards sustainable economic development that benefits the Maltese people by promoting inclusive and environmentally sustainable economic growth and infrastructure development. The mission reflects the statutory purpose provided for in Article 4 of the Malta Development Bank Act.

The MDB fulfils its mission inter alia, by providing promotional investment and financing by applying the principles of sound banking operations. Through this activity the MDB extends credit and/or guarantees third party loans extended by the MDB's implementing partner banks. This activity exposes the MDB to financial and non-financial risks. Accordingly, the MDB recognises that effective risk management is imperative to sustaining a sound risk culture, which is characterised, among others, by a high level of awareness concerning risk and risk management in the organisation.

The MDB manages its financial and non-financial risks effectively by employing the three lines of defence model, in line with industry best practice. This model allocates responsibility for risk management across all units and all levels of staff within the organisation, while ownership and accountability are retained by top management. The second line of defence is supported by a fully functional Risk Management Unit that analyses, assesses, measures risks, develops risk-management related policies, procedures and methodologies, supervises and monitors their implementation, recommends exposure limits and monitors the adherence to the adopted exposure limits, gives recommendations and suggestions for adequate risk-management as well as reports risk to the Board and relevant committees.

CREDIT RISK

The MDB controls credit risk through the Credit Risk Framework, which covers all phases of the credit processes from the development of new products, to requests for new loans, monitoring of borrowers and final loan repayments. The Credit Risk Framework comprises of the following comprehensive documents:

- The *Credit Risk Policy* that 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 provides 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.

- A *Risk Assessment Framework* that 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 defined tolerance thresholds without being overcontrolled or forgoing desirable opportunities.

- The *Risk Assessment Criteria (RAC)* for guarantee schemes, SMEs and 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 *Credit Risk Mitigation Policy* supports effective and intelligent risk decisions such that the Bank's credit risk management objectives are achieved. Accordingly, this policy sets the Bank's credit risk mitigation measures which are ancillary to, and complement, core credit risk considerations to ensure good and responsible lending.

OPERATIONAL RISK

During 2020 work was carried out to extend the coverage of risks captured in the enterprise risk management framework to better cover the risks of the Bank, in particular on the management of the MDB's operational risks. The basic principles for operational risk management are determined in the Operational Risk Framework which defines the methodology used to identify, assess, respond, and report operational risk. The Policy is aimed at integrating operational risk management into the decision-making process of the MDB. It also enables the identification of deviations from accepted risk levels, hence the timely execution of response action.

LIQUIDITY RISK

The principles for the management of the MDB's liquidity are articulated in the Treasury Management Policy with decisions sanctioned by the Board of Directors or the Risk Committee as appropriate and in line with the provisions of the said policy. For the purpose of managing liquidity risk, the MDB currently retains callable balances with reputable financial institutions as well as a maturity ladder of short-term deposits.

The MDB monitors planned and forecast financial commitments closely and ensures that funds are available for the timely settlement of these obligations as well as capital and operational expenditure. The Bank is statutorily precluded from taking retail deposits and is therefore not exposed to wide daily fluctuations in liquidity.

Business Review

During 2020 the MDB swiftly redirected its support to address the challenges of the COVID-19 pandemic and its economic consequences; however, this was not done at the expense of the other schemes launched earlier. Indeed, the Bank's monitoring and proactive approach was sustained to ensure that the portfolio of schemes and instruments mirror the needs of the market they are meant to address.

The pandemic outbreak has brought various key economic sectors to a virtual standstill, exerting severe liquidity strains on many businesses. In order to mitigate the economic impact of the pandemic and help businesses to be more resilient, and better prepared for the challenges and possible opportunities ahead, the Bank launched three complementary anti-crisis measures to ensure that local businesses will have the necessary working capital at their disposal. Moreover, despite working remotely for most of the year, the MDB continued to sustain its market-driven approach through constant dialogue with stakeholders in pursuing its objective of bridging investment gaps in Malta.

The on-going consultation process has also revealed further gaps in the provision of financing for infrastructure projects. The focus here remains on projects with a strong social dimension, particularly those related to education, health, elderly care, affordable housing, as well as those that contribute to the climate and digital transition.

The MDB continued to work closely with the Managing Authority for EU Funds in connection with the Bank's role as a vehicle for leveraging EU resources. This has led to the creation of a financial instrument in 2019, and that was further strengthened during the year under review. By combining a grant with a guarantee element, during 2020 the Bank has assisted more students to further their tertiary education.

This section of the report will offer an overview of the Bank's funding sources and provide an outline of all current financial instruments facilitated by the MDB. This section also includes a summary of the review process of one of the instruments and attempts to assess the economic implications of three of the Bank's products in the prevailing macroeconomic scenario. Special attention is devoted to the impacts of the Covid-19 Guarantee Facilities, the guarantee facility for loans to SMEs, and the Further Studies Made Affordable scheme. Through its instruments, the MDB crowds-in commercial banks by mobilising liquidity into business and educational financing, thereby generating a positive contribution to the Maltese economy in terms of new investment, employment opportunities, stronger competitiveness, and higher economic output.

FUNDING SOURCES AND GOVERNMENT GUARANTEE

FUNDING

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.[7] After being launched in 2017 with an initial paid -up equity of €30 million, the Bank's paid-up capital was increased by €10 million in 2019 to €40 million, and in 2020 it was increased by a further €10 million to reach €50 million, in line with the Bank's business plan.

The MDB supplemented the paid-up capital with bilateral borrowing from international development institutions. A number of consultation meetings with international institutions were held 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, in 2019 the MDB signed a €45 million global loan agreement with the KfW Group. In addition, toward the end of 2019, another loan agreement of €50 million was signed with the European Investment Bank under the Multiple Beneficiary Intermediated Loan (MBIL) programme. On 11 December 2020, this EIB loan was topped up to €60 million. These funds will be utilised by the MDB to finance the facilities to support SMEs, mid-caps and infrastructure projects by private and public-sector entities.

7 *The MDB has an authorised share capital of €200 million. This stems from Article 10(1) of the MDB Act. In terms of the First Schedule to the Act, €60 million were subscribed by Government as initial capital. The Board of Directors is empowered by Article 10(3)(b) of the MDB Act to determine the paid-up capital of the Bank. The issued and subscribed share capital of €100 million by 2025 is a projection based on the Bank's business plan and accordingly is a function of its forecast economic activity.*

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 guarantees issued by the Bank. According to the MDB's Business Plan, the Bank will rely on the Government guarantee for less than half of its overall 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 in favour of the Bank has been increased gradually in line with the Bank's business growth. At the end of 2020, it stood at €150 million. Part of these guarantees are intended to cover the two main international borrowing operations with the EIB and KfW, as well as other prospective operations.

In addition to the above guarantees, in April 2020 the Government issued another guarantee of €350 million specifically for the Covid-19 facilities.

MDB FACILITIES FOR SMES AND STUDENTS

The products outline below summarises the key features of the schemes being offered by the MDB. In 2020, apart from the existing schemes supporting SMEs and students, the MDB launched three complementary Covid-19 guarantee schemes which were instrumental in considerably enhancing businesses access to affordable bank financing during a period of high uncertainty and risk aversion.

PRODUCT NAMES	GUARANTEE FACILITY FOR LOANS TO SMES
PRODUCT OUTLINE	This facility was launched in May 2019 with an applicability period of three years or until the portfolio is fully utilised. This scheme is aimed at assisting SMEs in enhancing their access to finance. The facility enables commercial banks to be more responsive to the borrowing requirements of smaller businesses, which, in turn allows these businesses to fulfil their growth ambitions.
OBJECTIVE	To provide better access and more affordable finance to smaller businesses that are viable but unable to obtain the required amount of finance for their investment needs from a commercial bank. This may be due to factors such 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 commercial bank's risk tolerance and the required repayment period proposed by the borrower exceeds what the bank may be willing or able to accept.
STRUCTURE	The MDB provides a First Loss Guarantee covering 80% of the individual loans under the scheme, with a cap rate of 25% at the portfolio level, generating a multiplier of 5. Thereby, a guarantee of €10 million by the MDB enables an implementing partner to generate a portfolio of up to €50 million new loans to SMEs.
BANKING FACILITY	The size of eligible loans guaranteed under the facility ranges from a minimum of €10,000 up to a maximum of €750,000. The minimum loan size may vary from one implementing partner to another. A twelve-month moratorium on capital repayments is possible at the discretion of the commercial bank. The maximum term of loans is 10 years including the moratorium period, if any. The minimum contribution by the SME is normally 10% of the project costs, at the discretion of the commercial bank. The commercial bank may require collateral in addition to MDB's guarantee to cover the exposure.

Eligibility criteria	
Loan eligibility	The project must be supported by a viable business plan and 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 not physically completed or fully implemented on the approval date of the facility. The purpose of the financing covers a wide spectrum of possible activities including: (a) the establishment of new enterprises, (b) expansion capital, (c) capital for the strengthening and/or stabilisation of the general activities of an enterprise; (d) the realisation of new projects, penetration of new markets or new developments by existing enterprises, (e) investment-related working capital.
Eligible applicants	Applicants must be viable SMEs, established and operating in Malta. The activities of the SME should not be in the exclusion criteria of the EU. Moreover, an SME cannot apply for the facility if it is in financial difficulty; has suspended its business activities; is bankrupt/insolvent or being wound up; in the last 5 years has entered into an arrangement with its creditors; and in case of a sole trader or of the individuals managing a corporate entity, has been convicted of an offence concerning professional misconduct by judgment, fraud, corruption, involvement in a criminal organisation, money laundering or any other illegal activity.
State Aid	The scheme is subject to de minimis regulation of the EU, which allows aid up to €200,000 over three consecutive fiscal years, to a single undertaking for a wide range of purposes.
Benefits	Eligible SMEs benefit from: enhanced access to credit availability; better terms and conditions, including a longer repayment period; and lower interest rates as a result of the credit risk protection from the MDB's guarantee.
Application process	The scheme is available through commercial banks. SMEs are to apply for the facility through the commercial banks by providing their borrowing proposal and any other necessary documentation. Bank of Valletta was the first implementing partner of the MDB Guarantee facility for loans to SMEs through the launch of SME Invest. More information on the SME Invest scheme can be obtained from BOV Branches or Business Centre, or by sending an email to smefinance@bov.com. MDB is in discussions with additional possible implementing partners to start offering this facility.

PRODUCT NAME	**FAMILY BUSINESS TRANSFER FACILITY – FAMILY BUSINESS SUCCESS**

Product Outline	The scheme enhances access to bank credit to family businesses wishing to transfer their businesses to the next generation within the family. This financial instrument was launched in October 2018, with an applicability period of three years or until the portfolio is fully utilised.
Objective	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 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.

Structure	The MDB provides a First Loss Guarantee covering 80% of the individual loans under a scheme which is capped at 50% of the commercial bank's portfolio earmarked for this scheme, generating a multiplier of 2.5. Thus, 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 up to €10 million.
Banking Facility	The maximum loan size is of €750,000, spread over a repayment period of 10 years. The scheme allows for the possibility of up to 6 months moratorium on capital repayments at the discretion of the commercial bank.
Eligibility criteria	
Loan eligibility	The facility supports business ownership transfer related to: (i) a takeover of the relevant family business through the transfer of the business from one family member to another; (ii) a reduction in the Issued Share Capital; (iii) the payment and distribution of a dividend and (iv) the repayment of any shareholder loans due by the family business.
Eligible applicants	To be eligible, a business must meet the following criteria: (i) applicants must be viable SMEs as defined by the European Commission, established and operating in Malta, and (ii) applicants must also be certified as family businesses with the Family Business Office under the Family Business Act.
State Aid	The scheme is subject to de minimis regulation of the EU, which allows aid of up to €200,000 over three consecutive fiscal years, to a single undertaking for a wide range of purposes.
Benefits	The main benefits are in the form of lower interest rates, reduced collateral obligations, longer term of loan
Application process	The scheme is available through MDB's implementing partner – Bank of Valletta. Information on loan applications this scheme can be obtained from BOV Branches or Business Centre, or by sending an email to smefinance@bov.com. Information about registering under the Family Business Act and other initiatives for family businesses can be found at www.familybusiness.org.mt.

PRODUCT NAME	**FURTHER STUDIES MADE AFFORDABLE (FSMA) SCHEME - BOV'S STUDIES PLUS+**

Product Outline	This financial instrument is targeted towards students aiming at furthering their educational attainment. This scheme was launched in October 2019 for a period of three years or until the portfolio is fully utilised. This instrument is financed under the Operational Programme II, co-funded by the European Social Fund (ESF) Programme 2014-2020.
Objective	The FSMA scheme seeks to support students in pursuing higher level of studies at internationally recognised institutions. FSMA is available to students through MDB's intermediating partner Bank of Valletta, under the BOV's Studies Plus+ scheme.
Structure	The MDB provides a First Loss Guarantee covering 80% of the individual loans under the scheme which is capped at 25% of the commercial bank's portfolio earmarked for such loans, generating a multiplier of 5. Thus, a fund of €1.65 million financed from the ESF stimulates up to €8.25 million of new eligible loans. The financial instrument is divided into two elements: (i) Guarantee element: portfolio capped financial guarantee providing credit risk coverage on a loan by loan basis; and (ii) Interest rate subsidy element to cover all the interest incurred during the moratorium period of each student loan.

Banking Facility	The maximum size of eligible loans guaranteed under the facility is €100,000, with a loan term of up to 15 years, including the moratorium period. The maximum term of capital moratorium covers the term of the course plus an additional twelve months, subject to a maximum moratorium period of five years.
Eligibility criteria	
Loan eligibility	Students pursuing a study programme which is an accredited course in MQF levels 5, 6, 7 and 8, as well as internationally recognised certificates. The loans are available for full time and part time studies. The loan can finance tuition fees, living expenses, accommodation fees, transport expenses, textbooks and related expenses.
Eligible applicants	The applicant has to be a Maltese citizen; or national of an EU/EEA Member State provided that such person has obtained permanent residence in Malta or is in Malta exercising his/her EU Treaty rights as an employee, self-employed person or person retaining such status. The applicant can also be a third country national that has been granted long-term residence status in Malta.
State Aid	No state aid rules apply for this scheme.
Benefits	No payment obligations to the beneficiary during the period of study plus one year. A maximum term of capital moratorium that covers the term of the course plus an additional twelve months, subject to a maximum moratorium period of five years. Attractive interest rate. No interest burden on the borrower during the moratorium period. The interest due during the moratorium period is fully covered by an interest rate subsidy funded by the ESF. No collateral or upfront contribution shall be requested from the borrower by the partnering commercial bank.
Application process	The scheme is available through MDB's implementing partner – Bank of Valletta under the name of BOV Studies Plus+ (https://www.bov.com/news/bov-studies-plus).

PRODUCT NAME	**COVID-19 GUARANTEE FACILITIES**
Product Outline	Since the onset of the pandemic, the Bank has been supporting businesses impacted by COVID-19 with a portfolio of three complementary instruments. The COVID-19 Guarantee Scheme (CGS) was launched in April 2020 with the purpose of guaranteeing loans granted by commercial banks in Malta to meet new working capital requirements of businesses facing cashflow disruptions due to the effects of the COVID-19. The second complementary facility is the COVID-19 Interest Rate Subsidy scheme (CIRSS) which further softens the terms of working capital loans extended by banks under the CGS. The third component is the COVID-19 Small Loans Guarantee Scheme (SLGS) intended to support smaller businesses by reducing the soft collateral in the form of personal guarantees for loans up to €250,000.
Objective	The purpose of the COVID-19 facilities is to support businesses, regardless of size or sector, impacted by COVID-19. The schemes provide guarantees to commercial banks in order to enhance access to bank financing for the working capital requirements of businesses in Malta facing a sudden acute liquidity shortage as a result of the COVID-19 outbreak.

Structure	The MDB provides a First Loss Guarantee covering 90% of the individual loans under the CGS, with a cap rate of 50% at the portfolio level, generating a multiplier of 2.22. Thus, the MDB mobilised the government guarantee of €350 million to enable implementing partners to generate a portfolio of up to €777.8 million in new working capital loans. An additional amount of up to €40 million was made available to all beneficiaries under the CGS in the form of a grant of up to 2.5 percentage points on the interest rate paid on the loan for the initial two years of the term.
Banking Facility	Loan amount: The maximum individual loan amounts for SMEs is of €10 million, and up to €25 million for large enterprises. Amounts higher than €2 million for SMEs and €5 million for large enterprises require the prior ad-hoc approval of MDB. These limits are subject to the condition that amounts must not exceed double the annual wage bill of the beneficiary or 25% of total turnover of the beneficiary in 2019. The eligible amount will be based on the projected working capital requirements of 18 months for SMEs and 12 months for large enterprises. Loan Term: Minimum 18 months to maximum of 48 months. The term can increase to 72 months, subject to additional terms and conditions. Loan terms longer than 72 months will not be covered by the CGS. Moratorium: Minimum period of 6 months with the possibility to extend to one year on a case-by-case basis. The moratorium applies to both interest and capital repayments.
Eligibility criteria	
Loan eligibility	The CGS covers new working capital loans. Eligible costs under these loans mainly include, but are not limited to: salaries of employees, lease and rental costs, utility bills, unpaid invoices due to a decrease in business revenues, acquisition of material and stock for continuation of business, expenses directly related to contracts which were cancelled or postponed because of the COVID-19 outbreak, maintenance costs and bond coupons on listed securities.
Eligible applicants	With the exception of undertakings that were already in financial difficulties by end of December 2019 (based on the GBER definition of undertaking in difficulties), and entities which are within the restricted sectors, all businesses established and operating in Malta are eligible under this scheme.
State Aid	The CGS, CIRSS and the SLGS were approved by the European Commission under the Temporary Framework for State aid measures to support the economy in the prevailing COVID-19 outbreak.
Benefits	In view of the credit enhancement and substantially reduced credit risk exposure provided by Government guarantee, the benefits to commercial banks are passed on to the largest extent possible to the final beneficiaries, mainly in the form of: higher volume of finance, moratorium period, low interest rate and reduced collateral requirement.

Application process	The following are the accredited commercial banks offering facilities under the CGS: o APS Bank (https://www.apsbank.com.mt/aps-jet-pack) o Bank of Valletta (https://www.bov.com/content/bov-mdb-covid19-assist) o BNF Bank (https://www.bnf.bank/mdbcovid-19guaranteescheme) o FCM Bank (https://fcmbank.com.mt/news/fcm-mdb-covid-19-working-capital-support) o FIMBank plc (https://www.fimbank.com/en/covid19-rapid-response-loans) o HSBC Bank Malta (https://www.business.hsbc.com.mt/en-gb/important-announcement) o Izola Bank (https://www.izolabank.com/mt-en/izola-boost#izola-boost-about) o Lombard Bank (https://www.lombardmalta.com/covid19-assistance-to-borrowing-customers) o MeDirect (https://www.medirect.com.mt/business/meassist)

PRODUCT NAME	**TAILORED FACILITY FOR SMES**

Product Outline	The Tailored Facility was launched in August 2019 and is aimed at assisting SMEs, including start-ups, in enhancing their access to finance. This facility offers a bespoke solution for SMEs with investment plans that require credit larger than what currently is offered under other standard schemes of the MDB.
Objective	The facility is designed to address the following major barriers to lending: insufficient value or type of collateral; innovative business ventures, economic sectors or technologies which fall outside the risk appetite and tolerance of commercial banks; and other factors for which commercial banks may not be willing or able to provide the required financing in whole or part.
Structure	The required loan is co-financed by the commercial bank and the MDB in such portions as may be agreed between the parties. On a case-by-case basis, the MDB may offer a partial guarantee on the commercial bank's share of the loan.
Banking Facility	The size of the loan ranges from a minimum of €750,000 to a maximum of €5 million. The minimum term of the loan is 24 months. The maximum term depends on the lifetime of the asset being financed, to be agreed on a case by case basis.
Eligibility criteria	
Loan eligibility	The project must be supported by a viable business plan and considered bankable by the commercial bank and the MDB, meaning that the business is reasonably expected to generate sufficient cash flow to enable timely repayments. 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. New investment contributing to the promotion of national competitiveness, social inclusiveness and green and sustainable development are given priority.
Eligible applicants	Applicants must be viable SMEs, established and operating in Malta. The activities of the SME should not be in the exclusion criteria of the EU.
State Aid	The provision of funding for the tailored purpose facility is made in accordance with the state aid rules and obligations of the de minimis and the General Block Exemption Regulation of the EU.

Benefits	Eligible SMEs benefit from enhanced access to credit as insufficient collateral and lack of credit history should not remain an obstacle when seeking finance from the banking sector. SMEs also benefit from better terms and conditions and lower interest rates as a result of the risk sharing co-financing arrangement with the commercial bank and the protection of the MDB's guarantee, if applicable. The commercial bank shall pass on the benefit from MDB's guarantee, if applicable, to the SME.
Application process	SMEs are to apply with their commercial bank by providing their borrowing proposal and any other necessary documentation. The approval of the facility is at the discretion of the commercial bank acting in conjunction with the MDB.

INVIGORATING THE FAMILY BUSINESS TRANSFER FACILITY

SPECIAL TOPIC III

MARKET GAP AND NEED

The rationale for national promotional banks is predicated, in part, upon the imperfection of the market. While accepting that a competitive market, such as the banking sector in Malta, will generally identify and satisfy market needs, there will always be instances of market failures, or of market gaps where the operators have not covered all instances of market requirements.

One such gap, first identified in 2018, concerned the transfer of family-owned businesses from one generation to the next. The transfer of ownership across generations is a critical part of the renewal of the life cycle of a family business. Arguably, however, the financing of such a transaction may be perceived to increase the business's indebtedness without creating incremental value to the business itself, resulting in a higher gearing ratio. For this reason, commercial banks were historically reluctant to finance such transactions, in this way creating a market gap. Moreover, it is estimated that only 30% of family businesses actually survive into the second generation, 12% remain viable into the third generation and only 3% operate into the fourth generation or beyond. The ease of inter-generational transfer is critically important to the long-term sustainability of this sector. The MDB in conjunction with other stakeholders accordingly decided to address this important market gap by introducing a facility to ensure continuity, stability and further growth in the future of such family businesses – which in Malta constitute a significant segment of the SME sector and a large proportion of total employment.

The Family Business Transfer Facility was the outcome of the first risk-sharing agreement that the MDB signed with a commercial bank, following consultations with the Family Business Office. The scheme was launched in October 2018 in the context of a renewed emphasis by Government to foster and encourage family-owned businesses, including through a number of fiscal incentives in terms of the Family Business Act 2016. The facility, intermediated by BOV as Family Business Success, was designed to enhance access to bank credit in respect of family business transfers to the next generation within the family. Through this guarantee instrument, the MDB is contributing partial credit risk protection on the lending portfolio of BOV. More specifically, the MDB provides a guarantee fund capped at €4 million which enables the commercial bank to generate a loan portfolio of up to €10 million for such family business transfers. The MDB guarantees 80% of each eligible transaction, subject to the capping of 50% at the level of the portfolio.

EVALUATING THE INSTRUMENT'S REACH AND EFFECTIVENESS

MDB is committed to ensuring maximum impact of its facilities, and as part of its ongoing operations, the Bank periodically scans the market to ensure that changing circumstances are being monitored and analysed. The marketplace is constantly in flux, and as the economic axis shifts, the economic tempo slackens or hastens, or as the market reacts to the external ecosystem, new failures or gaps may emerge that were not identifiable earlier.

In the same manner, the Bank intermittently carries out a detailed evaluation of its own instruments. Just as the market changes, so can the appropriateness of the Bank's response. The Bank has therefore evolved an intensive process for the evaluation of its instruments. It tests the market, initially through market research, and later through networking and detailed research of stakeholder opinions. The Bank researches options and alternatives; it considers good practices in other countries and it evaluates to what extent local demand creates a need for a specific instrument. These mechanisms are demand driven, the Bank believes that its financial instruments should be a reaction to a need, and therefore most of its evaluation process focuses on identifying the nature and extent of the need. As a subsequent step, the Bank looks at the supply side and engages with commercial banks to test the appetite and ability to bring to market new or modified versions of an existing instrument.

This process is important as it seeks to ensure that the Bank's finite resources are yielding optimal benefits for clients and stakeholders. Identifying what components of an initiative work or do not work, and why, is essential to be able to design a more effective instrument.

Unfortunately, the initial iteration of the Family Business Transfer Facility was not as successful as anticipated. As a result, during the course of 2020 the MDB initiated a series of consultations with the Family Business Office, the intermediary commercial bank and other stakeholders to seek to explore how the effectiveness of the facility could be enhanced. In October 2020 the MDB embarked on a more rigorous review process of the scheme to better understand prevailing concerns and perceptions on business transfer facilities in Malta. The first step of this review process was the launch of a field research, in the form of a questionnaire, which was carried out during November and December 2020. Mainly thanks to MDB's close relationship with key local stakeholders, a brief online survey was distributed to business entities. Through this collaboration the MDB managed to gather 171 complete responses to the survey which is considered to be a satisfactory response rate for surveys of this nature. The second part of the review process analysed comparable practices in ten other European countries. Insights from other institutions were collated to help the MDB to formulate better and more comprehensive financial instruments.

One critical condition in the original scheme was that eligible beneficiaries needed to first be recognised as family businesses by the Family Business Office, in accordance with the definitions of the Family Business Act. On the basis of this field research, it appears that such a condition might have perhaps been excessively onerous and could have been one of the main reasons why the scheme has not taken off as well as projected.

Indeed, the Bank's research shows that mergers and acquisitions do happen among family owned businesses, but the transfer of business is not limited to intra-family transactions. From the 171 surveyed firms, 52 businesses, or 30.4%, disclosed that in the past they have acquired at least another business entity (see Chart 1). Interestingly, only 15 of these respondents (8.8% of the total companies questioned) have acquired a business from a family member, whereas 42 (24.6% of the total) have acquired a business from unrelated members (see Chart 2).[8]

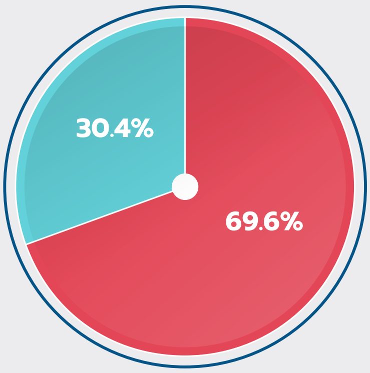


CHART 1

As a business owner have you ever acquired another business?

171 responses

- Yes
- No

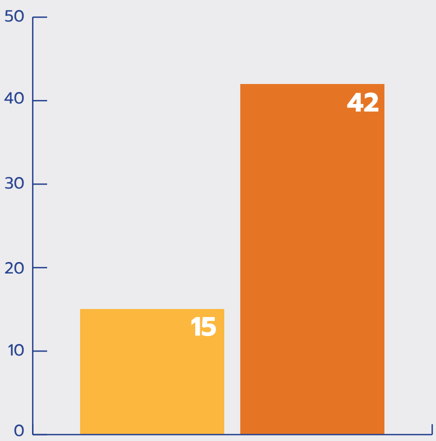


CHART 2

Did you acquire the business from a family member or from unrelated parties?

52 responses

8 *A small number of respondents have acquired businesses from both family and unrelated member.*

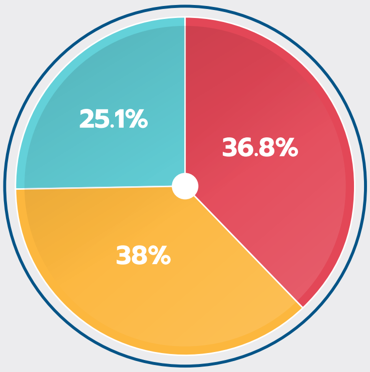


CHART 3
Over the next 5 years would you consider
171 responses

- Selling or transferring your business
- Acquiring, merging or taking over another business
- Non of the above

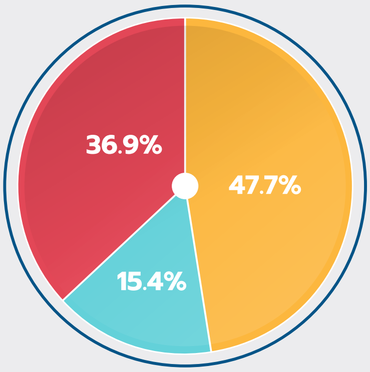


CHART 4
Should an attractive financial instrument (such as a soft loan facility) facilitating a possible business transfer, is made available, would you consider selling, acquiring, merging or taking over another business?
65 responses

- Yes
- No
- Maybe

A key finding from the Survey is that mergers and acquisitions are an important component of the market. A quarter of the survey population envisage selling a business over the next five years. Concurrently, almost 37% of the respondents anticipate an acquisition, merger or a take-over of another business over the same time frame (see Chart 3). Of utmost interest to the MDB, the survey shows that most of the companies who were reluctant to engage in future business transfers opined that if an attractive business transfer financial instrument is readily available, they will be more inclined to consider selling or acquiring a business entity (see Chart 4)

The Bank's networking exercise with other European NPBs has shown that 10 other promotional banks are currently offering business transfer facilities to a range of businesses in their respective countries. Whilst these facilities are generally a sub-component of wider scoped financial instruments, it is evident that business transfer facilities are an important feature in the portfolio of schemes offered by European peers. It is also pertinent to note that due to the pandemic spread of Covid-19, and the rolling out of crisis measures and support programmes, some NPBs have momentarily suspended the schemes related to business transfers.

THE WAY AHEAD

The Bank's evaluation of the Family Business Transfer facility will continue in the first part of 2021. The emphasis now shifts from the demand to the supply side, and the Bank will start to structure the findings of diverse research processes to design a targeted instrument based on its market research. To this end, the Bank is likely to redefine the eligibility rules, reconsider the terms and conditions, possibly varying the guarantee parameters, and may even decide to dedicate increased funding to support the instrument. From the supply side, the Bank will evaluate the commercial banks' appetite for the new instrument, take heed of feedback about its implementation modalities, and look at alternative ways in which it can bring the new instrument to the market and maximise its impact.

MDB's facilities in Malta's economic context

MACROECONOMIC BACKDROP

After an extended period of economic expansion, it was expected that 2020 would be less buoyant, owing mainly to the foreseen Brexit ramifications on key economic sectors in Malta. However, it will go down in history as the coronavirus-induced slump year. The output collapse in the second quarter of 2020 far exceeded that of previous crises, bringing economic activity in a number of key sectors to a near stand-still. The mild recovery that followed in the third quarter of the year lost momentum as COVID-19 cases surged in the latter half of the year.

The European Commission's Economic Sentiment Indicators (ESI) for Malta show that overall sentiment fell by more than 25 points in 2020, when compared to 2019, around 10 points more than the average decline in the EU and the euro area.[9] This significant deterioration reflected developments across all main five survey sectors: industry; services; construction; retail and consumers. Nonetheless, given the importance of service-oriented sectors in the local economy, the largest swing in sentiment was recorded in this sub-component, mainly reflecting the impact of the tourism downturn on the Maltese economy. Indeed, the number of inbound tourists visiting Malta in 2020 were at par with the 1980s crisis levels. Moreover, other activity indicators, such as volume of retail trade, industrial production and construction development permits, all point towards a severe contraction in activity.

Against the backdrop of weak economic activity, employment levels and the unemployment rate did not deteriorate to the same extent, mainly thanks to the support measures introduced by the Government. As expected, during a period of sluggish activity, cost and price pressures generally remained contained during 2020. Concomitantly, the decline in goods exports was much more muted than the sharp drop in imports, leading to a narrowing in the merchandise trade gap. On the contrary, the drop in services receipts, largely propelled by a sharp decline in tourist expenditure, was more acute, leading to a notable dip in the net positive balance of the services' account. This led to a deficit in the overall current account balance.

Unfavourable macroeconomic conditions severely impacted the fiscal deficit and debt balances, which in recent years had improved substantially. COVID-19 has had a considerable impact on general government finances through a decline in revenues, mirroring slower economic activity, and notable increases in expenditure, on the back of fiscal stimulus packages. However, during 2020, the Maltese government debt-to-GDP ratio remained well below the corresponding ratios of the EU and for the euro area as a whole, indicating that Malta still retains fiscal space for manoeuvre.

Looking ahead, GDP growth in Malta is expected to rebound in 2021, but not enough to offset the contraction experienced in 2020. A recovery, however, will likely be subdued and dependent on many external factors. Therefore, the near-term outlook remains highly uncertain.

ECONOMIC IMPACT OF MDB'S INTERVENTION DURING THE PANDEMIC

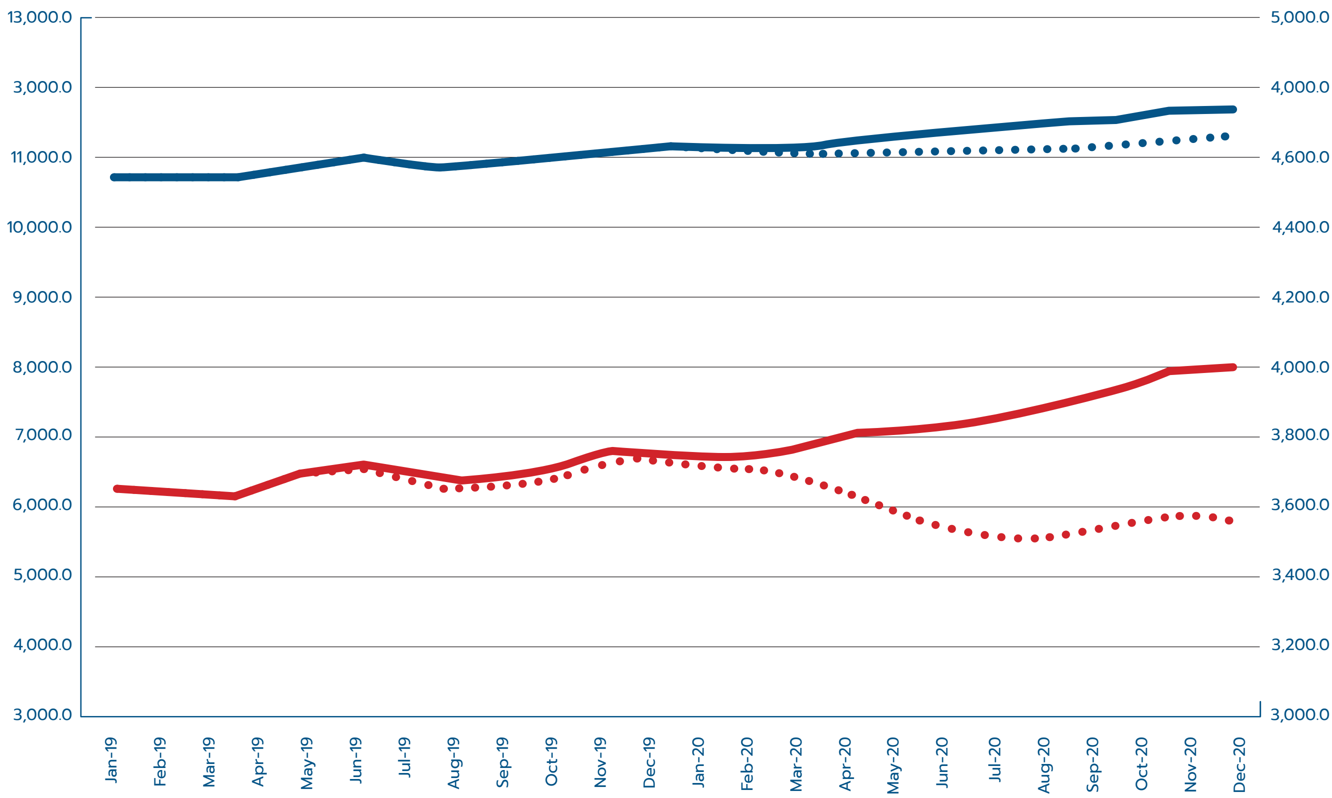
With the global pandemic, promotional banks took on a different dimension, and started implementing countercyclical instruments. In this scenario, the MDB likewise rapidly shifted its focus on support measures to address the COVID-19 pandemic and its economic repercussions. At the same time, the Bank sustained its intervention through the other schemes launched during 2019. Indeed, during the year under review, the Bank continued to provide SMEs with affordable and accessible finance for capital investments, and supported students to finance their academic courses, hence investing in the human capital development of the country.

As at end 2020, the Bank's total financing volumes, including all guarantees and loans, stood at €453.2 million, predominantly spurred by the €408.1 million related to Covid-19 Guarantee Scheme (CGS), and to a lesser extent, by the almost €30 million related to the SME Invest facility. As can be seen in Charts 1 and 2, the impact of the latter two schemes is also notable on a national level. Data published by the Central Bank of Malta show that outstanding loans to

9 *The ESI summarises developments in confidence in five surveyed sectors: industry; services; construction; retail and consumers. Data can be retrieved from: https://ec.europa.eu/info/business-economy-euro/indicators-statistics/economic-databases/business-and-consumer-surveys/download-business-and-consumer-survey-data/time-series_en*

non-financial corporations (NFCs) residing in Malta reached €4 billion by the end of 2020, with loans covered by MDB guarantee schemes accounting for more than 10% of this sum. Moreover, when looking at the bigger picture, over the same period, MDB's support to local businesses has reached close to 4% of total lending in Malta.[10] Unsurprisingly, the impact of MDB's intervention became more pronounced with the introduction of the CGS in April 2020. Indeed, as can be seen in Chart 2, lending to NFCs (including loans supported by MDB) expanded by an annual rate of 9.0% during 2020. Without MDB's intervention, such lending to NFCs would have contracted by 2.5%. This marked role is also noticeable when looking at the headline total lending in the country, with MDB-guaranteed loans contributing 3.8 percentage points or 55% of the overall credit growth of 6.9% recorded during the year.

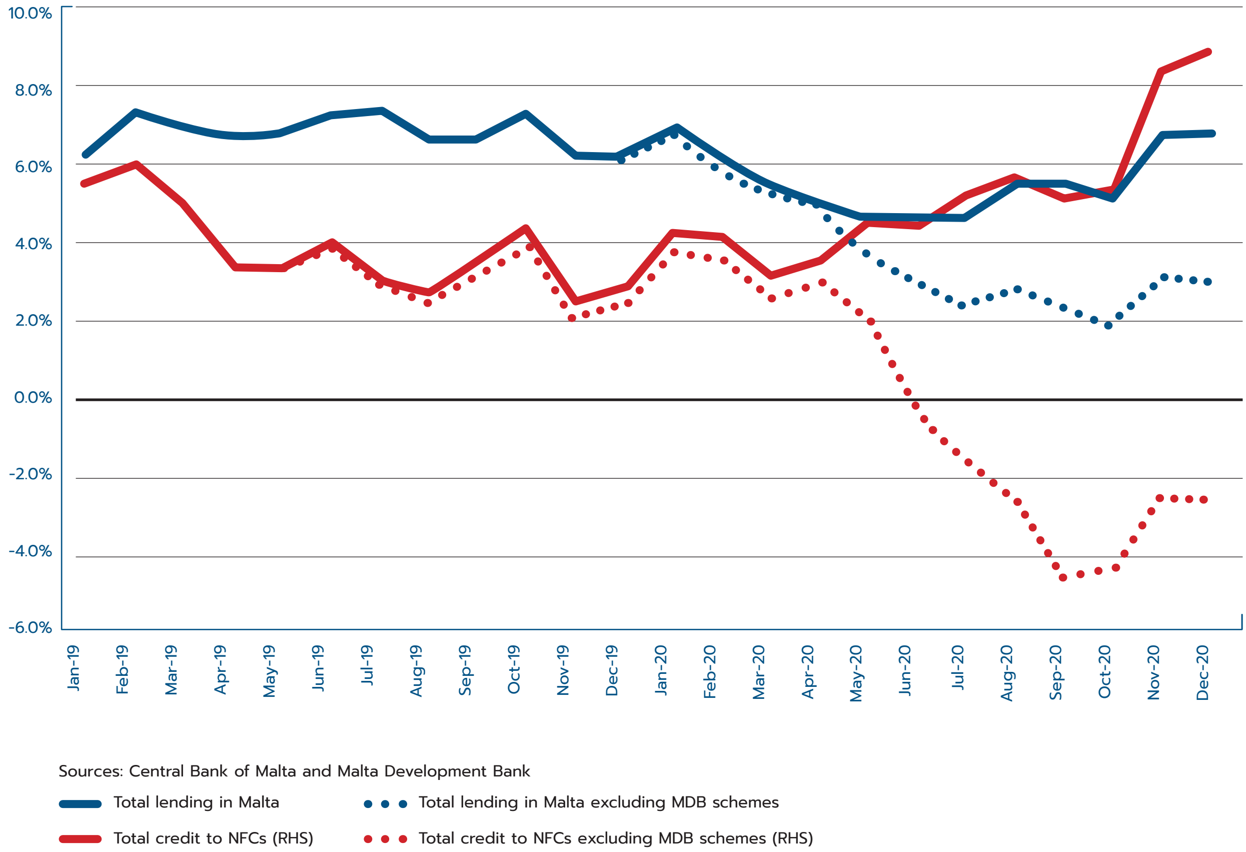
CHART 1: OUTSTANDING LOANS TO RESIDENTS OF MALTA (€ MILLIONS)



Sources: Central Bank of Malta and Malta Development Bank

10 *Total lending comprises credit to the general government, financial and non-financial corporations, insurance & pension funds, and households & non-profit institutions.*

CHART 2: ANNUAL GROWTH RATES IN OUTSTANDING LOANS TO RESIDENTS OF MALTA (PER CENT)



Sources: Central Bank of Malta and Malta Development Bank

Whilst it is difficult to estimate the economic impacts of financial products, this section will try to shed some light on the outreach of the schemes, including key performance indicators, and provide a qualitative macroeconomic assessment of the schemes offered by the MDB.

GUARANTEE FACILITY FOR LOANS TO SMES

SMEs constitute more than 99% of all firms in Malta, with the vast majority, over 97%, being micro firms employing less than 10 persons. Small firms, employing between 10 and 49 workers, account for around 2% of all enterprises, while less than 1% of all firms are medium-sized. The MDB plays a key role in reducing lending costs and collateral requirements for SMEs through risk sharing instruments in conjunction with commercial banks. These products are instrumental in supporting the banks to engage more with smaller and innovative firms.

The SME Invest, launched in 2019, remains MDB's main guarantee scheme for new SME investments. This scheme is open to SMEs operating in all economic sectors and targets those SMEs planning new capital investment projects, providing easier access to finance through reduced collateral requirements and finance costs. Enterprises may seek bank financing up to a maximum of €750,000, at attractive interest rates and better credit terms. Throughout 2020, despite the pandemic, the SME Invest has supported 62 projects undertaken by local SMEs, up from 43 in 2019. As can be seen in Table 1 the majority of enterprises supported were micro firms.

The monetary injection into the local economy from this scheme reached €17.6 million during 2020, €3.1 million more than a year earlier. Reflecting the higher uptake by micro enterprises during the period under review, the average sanctioned loan size under this financial product stood at around €284,000, notably less than the €337,000 recorded in 2019.

TABLE 1: FACILITIES UNDER THE SME INVEST				
Year	*Number of facilities by type of enterprise*			
	MICRO	SMALL	MEDIUM	TOTAL
2019	22	18	3	43
2020	38	20	4	62
Totals	60	38	7	105
Totals net*	55	34	7	96

TABLE 2: FACILITIES UNDER THE SME INVEST			
	Sanctioned loans (Euro millions)	Average loan size (Euro)	Number of employees
2019	14.5	337,209	570
2020	17.6	283,871	842
Totals	32.1	305,714	1412
Totals net of withdrawn applications*	29.3	305,282	1347

** A small number of facilities that were sanctioned in 2019 and 2020 were withdrawn by applicants*

As at end of 2020, the SME Invest scheme has injected a cumulative €29.3 million in new investments in the local economy, supporting 96 projects undertaken by local SMEs. The average term of loan duration under this scheme stood at close to 10 years, and in total, these beneficiaries employ 1,337 persons. The sanctioned projects supported by this scheme include a wide array of capital investments, these included amongst others, projects related to childcare centres, refurbishment of retail outlets, including hotels and the upgrading of the tourism product, digitalisation, renovation of factories and investment in health-related ventures.

Economic theory, particularly as postulated by Keynes, suggests that an initial increment in investment increases the final aggregated output of the country by a multiple effect, this is known as the investment multiplier. In other words, it is observed that when investment is increased by a certain amount, then the change in national income is not restricted to the extent of the initial investment, but it changes several times the change in investment. To this end economic literature suggests that private investment plays a major role in sustaining economic growth. Given the government-backed nature of most guarantees provided by the MDB, the Bank is enhancing the effective utilisation of public funds. In particular, the MDB is leveraging public funds in terms of rendering private investment more productive and in stimulating more private investment in productive assets.

COVID-19 GUARANTEE FACILITIES

Throughout 2020 the Maltese government announced a series of stimulus measures to mitigate the pandemic's blow and help companies to stay afloat during this difficult period. As already discussed in the previous sections of this report, in the first set of measures announced by the government in March 2020 the MDB was entrusted with a guarantee fund of €350 million that enabled partnering with commercial banks to leverage up a total portfolio volume that has a potential to generate up to €777.8 million in new loans to meet new working capital requirements of businesses facing cashflow disruptions due to the effects of the COVID-19. This scheme is open to all types of businesses, regardless of size or sector, in Malta.

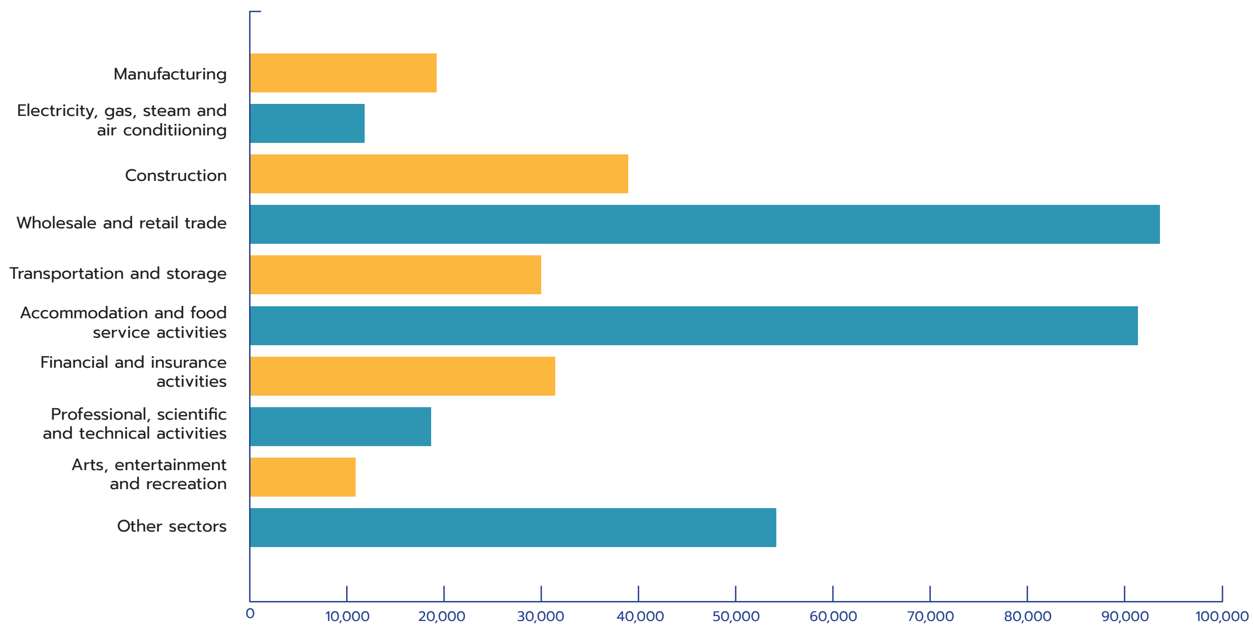
In view of the substantially reduced credit risk exposure for the intermediating commercial banks, the benefits from the MDB guarantee are passed on to the final beneficiaries. These include higher volume of finance, lower collateral requirement, and lower interest rates. Another important benefit for the beneficiaries relate to the wide array of eligible working capital costs covered under the CGS, these comprise salaries, rental costs, energy and water bills and fuel, unpaid invoices due to a decrease in revenues, acquisition of material and stock for continuation of business, expenses directly related to contracts which were cancelled or postponed because of the present situation and maintenance costs. Moreover, the scheme also covers payments towards capital expenditure contracted prior to COVID-19 and payments for interest on bonds.

In addition, the CGS is providing the much-needed breathing space for businesses by providing a six-month moratorium on both the interest payments, as well as on capital repayments. The moratorium period can be extended by the commercial banks to one year on a case-by-case basis. Originally, applicability of the CGS was in respect of eligible facilities that are approved up to 31 December 2020, in line with the provisions of the European Commission's Temporary Framework of State aid measures. Following the Commission's decision in October 2020 to extend the applicability period to 30 June 2021, the MDB obtained the Commission's clearance to likewise prolong the CGS to applications approved by end-June 2021.

Following the launch of the CGS in April, the MDB in May introduced a complementary COVID-19 Interest Rate Subsidy Scheme as an additional measure to further soften the terms of working capital loans extended by banks under the CGS. Through CIRSS, businesses benefit from a subsidy of up to 2.5 percentage points on the interest rate charged by banks during the first two years of working capital loans guaranteed by the CGS. A few months later during 2020, to further cushion the smaller-sized enterprises, a third COVID-19 instrument was launched - the Small Loans Guarantee Scheme. This scheme helps smaller businesses in taking out loans under the CGS without the need to provide high levels of soft collateral in the form of personal guarantees. By eliminating the need for soft collateral, the MDB makes it possible for those investors who are not in a position to offer personal guarantees to the commercial banks to still be able to benefit from the ease of access of cheap credit made available under the first two complementary instruments.

By the end of 2020, less than 8 months from its launch, the nine partnering commercial banks that are rolling-out the CGS, have sanctioned a total of €408.1 million in working capital loans. These CGS loans have supported 522 businesses, that collectively employ around 30,000 persons. The supported businesses range from hotels, to large retail outlets but also to smaller firms from all economic sectors (see Charts 3 and 4). As can be noted from the charts, firms in the tourism-related sectors (accommodation & food services activities, and wholesale & retail activities), which were the most adversely impacted by the pandemic, have collectively been granted close to €190 million, or 46.1%, of total loans sanctioned under the CGS.

CHART 3: COVID-19 GUARANTEE SCHEME - SANCTIONED LOANS BY ECONOMIC SECTOR (€000)



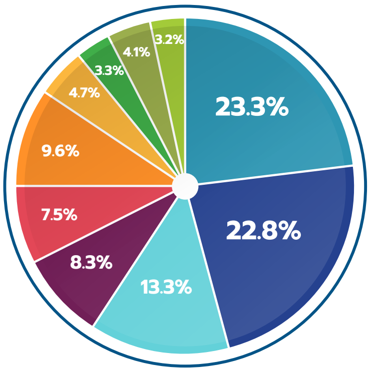
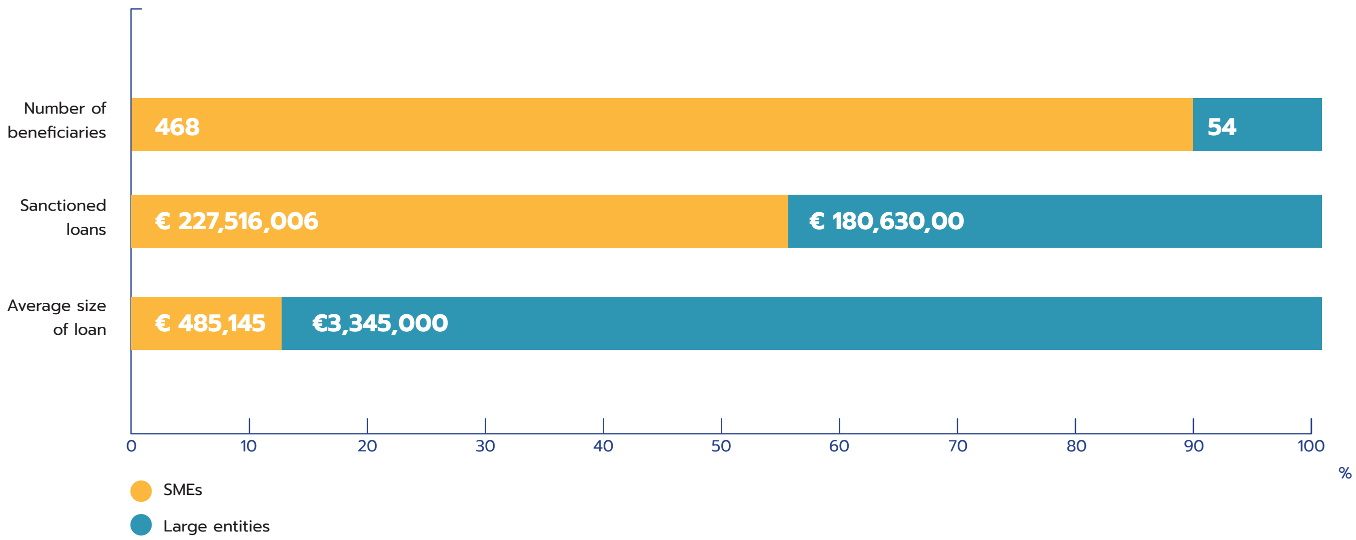


CHART 4: COVID-19 GUARANTEE SCHEME - PERCENTAGE DISTRIBUTION ACROSS ECONOMIC SECTORS (%)

- Wholesale and retail trade **23.3%**
- Accommodation and food service activities **22.8%**
- Others Sectors **13.3%**
- Financial and inssurance activities **8.3%**
- Transportation and storage **7.5%**
- Constraction **9.6%**
- Manufacturing **4.7%**
- Electricity, gas, steam and air conditioning supply **3.3%**
- Professional, scientific and technical activities **4.1%**
- Arts, entertainment and recreation **3.2%**

Under the CGS scheme, businesses of any size can apply for a loan, with amounts that can reach up to €5 million for SMEs, and €25 million for larger entities, depending on the firm's wage bill, turnover and projected working capital requirements. Applications exceeding €2million for SMEs and €5 million for large enterprises require the prior clearance of the MDB that they meet the eligibility criteria. During the period under review, the average loan per facility of the 522 beneficiaries stood at around €780,000. Out of these beneficiaries, 468 firms, almost 90% of the total, are classified as SMEs, whereas 54 are large entities (see Chart 5). As larger firms require a higher level of working capital, the requested loans of these enterprises were as expected markedly higher than those requested by smaller firms. Indeed, the average loan size of SMEs amounted to €486,000, as opposed to an average of €3.3 million granted to larger entities.

CHART 5: DISTRIBUTION ACROSS BENEFICIARIES BY SIZE



As already indicated, the MDB's role in supporting businesses impacted by COVID-19 through a portfolio of three complementary instruments was vital in reassuring local firms that their liquidity constraints are being alleviated, and that they can keep their focus on their longer-term objectives. The impact of these instruments cannot be assessed in isolation, but as part of broader government economic regeneration measures targeted towards local businesses, which amongst others include wage supplements and subsidies on utility bills.

Estimating the macroeconomic impact of the reach of MDB's facilities during the peak of the crisis is difficult; however, economic literature suggests that working capital problems may severely affect the supply side of the economy. In this regard, the importance of working capital in representing operating liquidity available to firms and having the right amount of working capital at the right time, is crucial for the efficient operation of businesses.

As decisions about working capital are mainly driven by liquidity considerations, lessons from the past financial crisis highlight the importance of liquidity not only on the financial sector but more importantly on the corporate sector. Given that the incidence of late payments in Malta prior the crisis was already an endemic part of the local business framework, a further credit crunch would have worsened the stresses on the payments cycle. It was important to ensure that appropriate instruments were in place to ensure that credit keeps flowing in the economy.

Uncertainty about receiving payments for goods and services, together with difficulties in obtaining trade credit insurance, may have led some firms to delay production and possibly affecting employment levels. Moreover, working capital difficulties may result in firm insolvencies and, thus, overall capital depletion. According to these supply-side arguments, weak working capital positions are likely to result in lower employment and output.

Once macroeconomic data is published, more research is required to fully understand and appreciate the impact of working capital assistance and liquidity requirements on macroeconomic outcomes. However, there is no doubt that MDB's intervention has helped in mitigating the mentioned risks and avoided more acute problems in sectors that were significantly liquidity constrained.

FURTHER STUDIES MADE AFFORDABLE

Human capital has always been a critical resource in Malta. As a small open economy, the island saw its economy develop on the strength of the value-added created by the development of its human resources. The MDB is mandated to contribute to inclusive and sustainable economic growth and considers education as a major pillar in reaching this overarching objective.

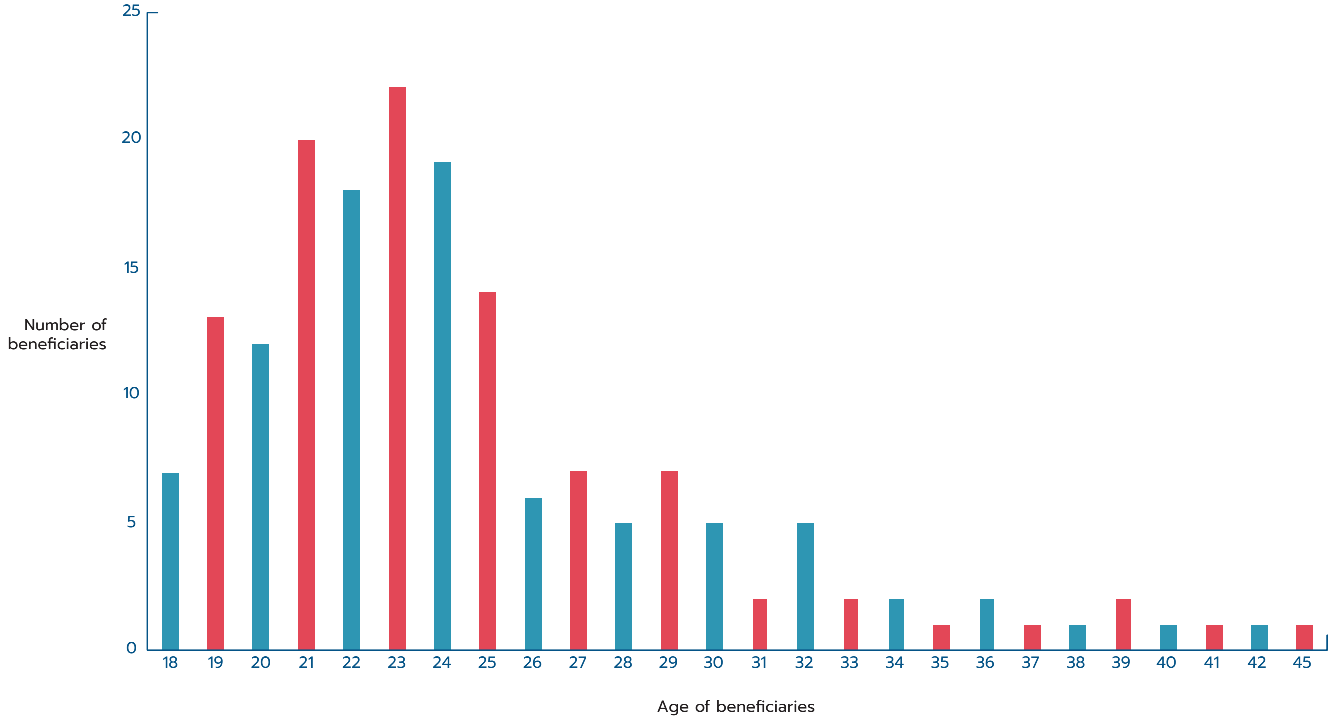
In collaboration with the Managing Authority of EU funds, the MDB had launched the Further Studies Made Affordable (FSMA) financial instrument in October 2019. When first introduced, the initial allotment from the European Social Fund was split between a guarantee component to reduce the commercial bank's collateral requirements and a subsidy element to reduce interest payable. It was felt that the transition from grants to financial instruments could be made smoother by combining the two components: the grant element that makes the instrument more appealing for aspiring students, and the guarantee enhances student access to bank financing by absorbing a substantial part of the risks. A total portfolio of €5.5 million was made available through the intermediation of Bank of Valletta (through BOV's Studies Plus+) which was the bank selected by the MDB after a public call in 2019. Towards the end of 2020, owing to higher than anticipated demand, this pot was augmented to a maximum of €8.25 million. Once again this was possible through MDB's collaboration with the Managing Authority, which made available additional EU funds to extend the portfolio.

The purpose of the FSMA is to facilitate the financing of cost of students' studies in Malta and overseas, including tuition, accommodation, subsistence, and related expenses. The scheme covers full time, part time or distance learning study courses, at MQF levels 5 – 8, and internationally recognised academic certificates. The maximum loan value can reach up to €100,000 for a term of up to 15 years.

By the end of 2020, 177 students have been supported with loans totalling €6.3 million, or an average loan size of €35,800, which is much higher than what commercial banks are willing to offer in absence of such a guarantee scheme. Indeed, access to student loans was thus greatly enhanced, especially for larger amounts, and made more affordable. The beneficiaries are aged between 18 and 45 years. However, close to 60% of all students are in the 20-25 age cohort, with a median age of 23 years old (see Chart 6).

As can be seen in the Chart 7, the most popular courses undertaken by the beneficiaries of the FSMA scheme were for MQF 7 level of education, which is equivalent to a master's degree, with 77 students, or 43.5% of the total, followed by 73 beneficiaries opting for internationally recognised certificates, including courses for aircraft pilots. Reflecting the substantial costs related to the latter professional courses, the total amount sanctioned for international recognised certificates accounted for close to 65% of the total funds (see Chart 8). At the same time, MQF 6 level courses were taken by 20 beneficiaries, whilst loans to students pursuing MQF levels 5 (diploma) and 8 (PhD) were taken by 4 and 3 beneficiaries, respectively.

CHART 6: FSMA BENEFICIARIES BY AGE



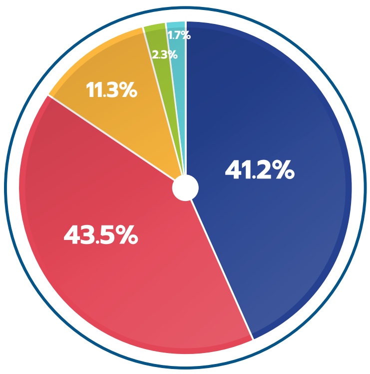


CHART 7: BENEFICIARIES SUPPORTED ACROSS QUALIFICATION LEVELS

- Internationally Recognised Certificates **41.2% of students**
- MFQ 8 level **1.7% of students**
- MFQ 7 level **43.5% of students**
- MFQ 6 level **11.3% of students**
- MFQ 5 level **2.3% of students**

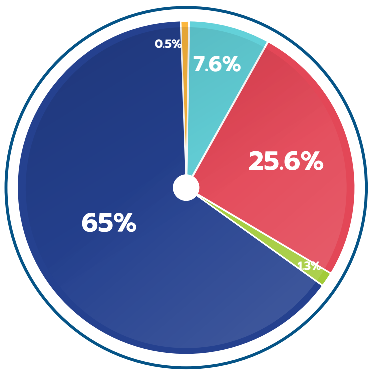


CHART 8: DISTRIBUTION OF SANCTIONED LOANS BY VALUE

- Internationally Recognised Certificates **1.3%**
- MFQ 8 level **0.5%**
- MFQ 7 level **25.6%**
- MFQ 6 level **7.6%**
- MFQ 5 **65%**

Besides offering a significantly reduced interest rate, the FSMA facility offers a moratorium on both capital repayments and interest for the period of study plus 12 months. The interest accumulated during this period is fully covered by the interest rate subsidy, which means that the student is not required to make any payments during the period of study and will also have an additional year to seek employment. No additional fees and processing fees are charged and no collateral, life insurance and up-front contribution are requested. It is a scheme designed to fit the requirements of students at a stage in life where they lack financial resources and require peace of mind during their studies, without the anxiety of having to cope with loan repayments.

Educational systems play an important role in supporting societies. They also have major macroeconomic implications, although this aspect is not always properly acknowledged. By injecting capital into education, the benefits flow beyond an improvement in living standards for the individuals concerned. An effective investment strategy in education can contribute to increased economic growth and greater participation in civil society.

Various studies shed light on the importance of stimulus in the educational system in terms of the multiplier effect it creates, which in many cases can be more than double the initial investment. Investment in a knowledge-based society will result in better and more efficient systems, which in turn can help policymakers to direct budgets to other important attainment areas.

MDB firmly believes that investment in human capital is crucial to expand Malta's growth potential and ensure long-term macroeconomic competitiveness. The take-up of the FSMA was significantly higher than expectations and the initial allotted portfolio of €5.5million was fully absorbed, clearly affirming the need and the impact of this scheme. Indeed, the FSMA scheme was a real game changer and transformed the student loan market. The size of student loans increased and there was no longer any need for collateral or upfront contributions from borrowers or any reliance on parents' income and wealth.

FINANCING OF INFRASTRUCTURE PROJECTS

In pursuit of its objectives, the MDB takes 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 not have occurred in the absence of support from the MDB. As a result, the Bank acts as catalyst to create economic value to investors while promoting activities in pursuance of national social and economic priorities.

As a provider of diversified intermediation solutions, including syndicated facilities with commercial banks, offering longer term financing and lower interest rates, MDB is emerging as an important stakeholder in infrastructure financing. Typically, MDB's intermediation functions as an enabler, increases the appetite of commercial banks for financing infrastructure investment when the risks involved cannot be handled by individual banks alone.

The MDB engages in dialogue with a range of both public and private entities on a diverse selection of projects. The role normally adopted by the MDB in facilitating the financing of such investment in infrastructural projects, is for such investments to be co-financed by MDB in conjunction with the commercial banks. This is a priority for MDB also because it believes that its purpose also includes the promotion of a syndicated loan market in Malta enabling the mobilisation of commercial banking liquidity.

Increasingly, the MDB is seeking the convergence of such projects with its own values. As part of its ethos, the MDB is prioritising Environmental, Social, and Corporate Governance (ESG) criteria, as three central factors in measuring the sustainability and societal impact of an infrastructure investment. At the intermediation stage, the MDB gives priority to projects that have a strong social dimension and projects that contribute to the transition towards a greener economy.

Aside from the benefits of creating a more ethical portfolio, there is evidence that ESG investments deliver similar, or in certain instances, better returns than traditional investments, and potentially carry less risk. In evaluating financing opportunities, 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, as well as the obligor's operational capacity.

One example of infrastructure investment in which the MDB has played an important enabling role is the Campus Hub at Malta's University at Tal-Qroqq. The project involves the development of a university residence, ancillary commercial space, student community amenities, well-being facilities, language school, medical facilities, lecture space, office building and an underground car park. These are much needed facilities that will help students to improve their overall educational experience. Moreover, the project makes use of the patented system 'BubbleDeck', which is a voided structural slab design that uses recycled plastic spheres between layers of reinforcing steel. The Hub will also have thermal break double glazing in apertures, the use of low-energy lighting and more efficient heating, ventilation, and air conditioning. The structures are complemented by extensive cyclist facilities and a green transport plan. The MDB played a pivotal role in the realization of such project by providing a financial solution that was tailored to the needs of the project given its size, long gestation period, and complexity.

Consultations also continued on other projects, mainly related to education, health, renewable energy, the environment, affordable housing and other initiatives with a social dimension, as well as projects that enhance Malta's competitiveness. More specifically, the MDB is supporting a recycling project that is expected to make significant inroads towards Malta's recycling targets and help reduce reliance on landfills. Another project that is also maturing relates to affordable housing in collaboration with the Housing Authority. In this case, the objective is to develop a new affordable housing scheme for lower middle-income earners where affordable rent payments would go towards the loans to fund the project on a cost-recovery basis.

The MDB also engaged in discussions with INDIS Malta (Industrial Innovative Solutions) on the implementation of the multi-year industrial infrastructure programme announced in November 2020. The first project in this programme relates to the €100 million extension of the Malta Life Sciences Park, which will add five new blocks to the three existing ones, increasing space by 30,000 square metres. This will provide an international class facility for life sciences and information technology development.

During the year, the MDB has been approached by a number of other entities, both public and private, to enquire on the possible enabling role of the MDB in facilitating the financing of new investment in infrastructural projects. MDB's support in infrastructure financing is an example of how it can act as a catalyst, by boosting private financing and narrow investment gaps.

FACILITIES IN THE PIPELINE

In line with the rationale of the Tailored Facility for SMEs to cater for SME loans that exceed the €750,000 mark, the MDB worked on a guaranteed co-lending facility with the commercial banks. During 2019, the MDB conducted an intensive soft-market testing with the commercial banks and initiated negotiations in connection with the proposed new guaranteed co-lending facility. The MDB intended to launch this scheme during 2020 but, given the unfolding events led by the spread of the pandemic, this launch was postponed to 2021 to prioritise the working capital loans offered under the Covid-19 guarantee facilities. As the name suggests, the new scheme will involve an element of co-financing of loans to SMEs by the MDB in conjunction with the banks on a 50-50 basis,

plus an element of guarantee where the MDB will be providing a partial guarantee on the commercial bank's share of the loan. The MDB will 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 more than €750,000, up to a maximum of €3 million.

Furthermore, besides working on expanding the scope and eligibility of the Family Business Transfer facility, the MDB is also exploring the possibility of introducing new financial instruments focusing on the green and digital transition. In order to augment the Bank's reach and impact, it is the Bank's intention to open these schemes to the widest audience possible.

ON THE ROAD TO RECOVERY

MDB's assistance and fiscal support played a significant role in cushioning the economic shock from the pandemic. As the crisis abates, policy makers need to balance the risks from large and growing debt loads with those from slowing the economy through premature fiscal tightening. As much of the fiscal support provided in 2020 is expected to be withdrawn, possibly weighing on growth, the MDB is ready to continue playing an important role in the recovery phase and assist local businesses in revitalising the economy. In the process, the MDB will continue supporting the financial sector through a reversal of the commercial banks deleveraging process.

A slow recovery can be avoided through productivity-enhancing structural reforms, in terms of higher level of educational attainment, effective investment, sectoral reallocation, and improved governance. The MDB strongly believes that it can be a main player in offsetting the pandemic's effects and lay the fundamentals for higher long-run growth. Investment in green infrastructure projects, innovation and digitalisation can provide further support to sustainable growth while also contributing to climate change mitigation and targets.

Significant events

LAUNCH OF THE COVID-19 GUARANTEE FACILITIES

Undoubtedly, the launch of the Covid-19 Guarantee Scheme (CGS) on 3 April was MDB's most significant event of the year. The CGS is a key component of the wider package of Government's COVID-19 Response Support Programme.

On 14 May, the MDB launched a complementary Interest Rate Subsidy scheme as an additional measure to further soften the terms of working capital loans extended by banks under the CGS to businesses experiencing acute liquidity shortages due to the COVID-19 outbreak.

In August, the MDB launched the third and final Covid-19 related facility, the MDB COVID-19 Small Loans Guarantee Scheme through which it started providing additional protection to the banks in return for a reduction of their soft collateral requirements to small firms.

COVID-19 GUARANTEE SCHEME OUTREACH CAMPAIGN

Following the launch of the Covid-19 facilities, during the months of April and May, the MDB embarked on an educational outreach campaign to explain the terms and conditions of the CGS, including the benefits and eligibility criteria of these favourable schemes. Despite the pandemic, and difficulties in organising virtual conferences in a short time, the MDB tried its utmost to ensure that all involved stakeholders are informed about this assistance. Webinars, or information sessions, were held with commercial banks, the Malta Chamber of Commerce, the Chamber of SMEs, the Malta Institute of Accountants, the Malta Bankers Association, the Malta Financial Services Authority, the Gozo Business Chamber and the Malta Employers Association amongst others.

FURTHER STUDIES MADE AFFORDABLE SCHEME TOP-UP

In December 2020, following the successful take-up of the initial allocation of the Further Studies Made Affordable Scheme, Bank of Valletta agreed to extend its BOV Studies Plus+ fund to €8,250,000, after the MDB secured additional European funds with the support of the Managing Authority. The will giving more students the opportunity to benefit from this financial instrument.

CHALLENGES AND OPPORTUNITIES OF THE EUROPEAN GREEN DEAL

On 30th April, the MDB participated as a main panel discussant during the webinar organised by the Malta Business Bureau which also featured MEPs Dr. Miriam Dalli and Dr. Roberta Metsola. The keynote speech of the webinar was delivered by Dr. Joanna Drake, Deputy Director-General in charge of Coordination of Resource Efficiency, Policies and Instruments in the European Commission's DG Environment. During the pursuant discussion Mr Joseph Darmanin, the Bank's Chief Business Development Officer, explained the role and objectives of the MDB and gave an overview of the potential role of the Bank in unlocking new private investment through the Green Deal which can be partly mobilised through InvestEU.

INTERNATIONAL AFFILIATIONS AND COOPERATION

During 2020, the MDB continued to build a value-laden relationship, and collaborated with a number of

international associations, multinational development institutions and foreign development banks. After becoming 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), the MDB in 2020 also became 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. To this end, 2020 proved that membership in these associations was fundamental to help MDB

EUROPEAN ASSOCIATION ELTI LONG-TERM INVESTORS

EAPB EUROPEAN ASSOCIATION OF PUBLIC BANKS

aecm EUROPEAN ASSOCIATION OF GUARANTEE INSTITUTIONS

NEFI Network of European Financial Institutions for Small and Medium Sized Enterprises to keep abreast with the latest EU discussions and initiatives proposed to combat the effects of the pandemic and in technical dialogues regarding the Pillar Assessment process amongst others.

During 2020, the MDB participated in the European Investment Fund (EIF)-National Promotional Institutions (NPI) Equity Platform, allowing the Bank to partner up and learn more on national and regional promotional institutions active in equity financing across the EU Member States. The Equity Platform promotes best practices in policy-driven equity investments and to enhance access to funding for SMEs and midcaps. MDB's participation in this platform provides a strong forum for cross fertilisation of ideas and opportunities with European peers which would help the MDB expedite its impact through equity investment.

EUROPEAN INVESTMENT ADVISORY HUB SUPPORTING MDB IN IMPLEMENTATION OF FINANCIAL INSTRUMENTS

In the year under review, the European Investment Advisory Hub (EIAH), the advisory arm of the European Investment Bank's (EIB), provided support and advise on the preparation and implementation of financial instruments under the InvestEU Programme in Malta for the next Multiannual Financial Framework (MFF).

The EIAH supported the MDB in identifying those areas of the economy that hold the most potential for the Bank's intervention through financial instruments under InvestEU, and to propose a set of products that could potentially be deployed to mitigate these identified market failures. This exercise was completed in March 2021.

These advisory services were funded by the European Investment Bank (EIB) and were structured around three major components:

Component 1: The objective of this component was to identify the financial instruments implemented in the 2014-2020 programming period and, where possible, provide an indication of their performance. This Component aimed to ascertain the degree of success of the implementation of the financial instruments implemented in the current programming period, as well as map the instruments under implementation across the different areas of the economy to avoid duplication and displacement in the market.

Component 2: The objective of this component was to conduct a broad market analysis of the Maltese economy, with the aim of identifying the specific areas of the economy that hold the most potential for MDB's intervention through financial instruments in the next programming period. The findings of the market analysis were incorporated into an analytical framework, that assesses and ranks each subsector against a predefined set of criteria.

Component 3: The objectives of this component were (i) to analyse the selected subsectors further with the aim to gain a stronger view on the current bottlenecks and the type of intervention needed to mitigate the existing market failures, and (ii) to propose a set of financial instruments that could be implemented by MDB to contribute to mitigating the identified gaps within each of the selected priority subsectors.

TECHNICAL SUPPORT INSTRUMENT (TSI)

During the year, the MDB continued to collaborate with the European Commission in terms of the Technical Support Instrument (TSI) which is the Commission's instrument to provide technical support to reforms in EU Member States. The TSI builds on the success of its predecessor, the Structural Reform Support Programme (SRSP). Following the first engagement on capacity building in preparation for the Pillar Assessment supported by the SRSP between September 2019 and November 2020, such collaboration has now been extended in the context of the Technical Support Instrument on another project planned for 2021, this time focusing on equity-based financial instruments.

Risk and Capital Management

Pursuant to the MDB Act, the Bank takes risks consciously by applying the principles of sound 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 built 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 socioeconomic 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 is exempt from the EU Capital Requirements Directive (CRD), the EU Capital Requirements Regulation (CRR) and other banking regulations, in terms of article 2(5) of the CRD as amended by Directive (EU) 2019/878 of the European Parliament and of the Council. The MDB is instead subject to supervision under ad hoc local regulation which should enable the MDB to fulfil its promotional role and public policy mission more effectively, while ensuring proper and sound banking conduct.

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, Dr Christopher Buttigieg, Chief Executive Officer ad interim and Chief Officer Supervision, 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 it deems necessary. It supervises the MDB's corporate governance, as well as the MDB's 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. Audit Committee, Ethics and Governance Committee and Risk 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 during the year under review was 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	
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 without incurring material losses arising from the pricing of wide liquidity premia. 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 without incurring material losses. 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 and the economic value of the equity of the MDB.	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 Bank monitors and strives to achieve compatibility of the existing and planned funding sources in terms of liquidity. The Act precludes the Bank from raising deposits and therefore the MDB is not exposed to wide daily fluctuations in liquidity. The MDB's seeks, to the extent possible, to reflect in its lending facilities the interest rate risk profile of the underlying funding agreements to minimize material interest rate mismatches. Liquidity and interest rate risks are managed by the ALCO Committee, a sub-committee of the Risk Committee, and the Board.
Operational risk	The MDB is exposed to the risk of a loss resulting from inadequate or failed internal processes, people, and systems or from external events. When material, such risk could impact the reputation of the MDB, its financials or, at the extreme, its ability to meet its statutory purpose and strategic objectives.	In 2019, the MDB developed a Risk Register, which identifies the key risks faced by the MDB. The MDB has subsequently developed an Operational Risk Policy, which established the basic principles for operational risk management. It provides for the grading of risks within processes. The grading of risks is a function of the impact and likelihood of the respective risk. The Risk Committee and Board approves responses that mitigate the residual risks of the MDB's main processes. There is a two-way communication channel between the Board Risk Committee and the Audit Committee on operational risk related matters.

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 to accommodate for eventual balance sheet growth and to provide a buffer for potential credit and other losses, both in the current as well as in more severe but plausible economic scenarios.

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 but plausible shocks due to volatilities inherent in the financial markets and cyclical macroeconomic downturns.
- 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.

OWN FUNDS

Even though the MDB falls outside of the scope of the CRR and CRD, the MDB is committed to ensuring it is adequately capitalised. The MDB is committed to holding a capital buffer that accommodates eventual balance sheet growth and provides an adequate buffer for potential losses in the current and in more severe but plausible scenarios. The paid-up share capital of the MDB as at 31 December 2020 stood at €50 million, up from €40 million in 2019. The share capital was provided by the MDB's sole shareholder, the Government of Malta.

Financial Statements

31 DECEMBER 2020

MDB BANK MALTI GĦALL-IŻVILUPP
MALTA DEVELOPMENT BANK

Contents

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 2020.

PRINCIPAL ACTIVITIES

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

The Bank'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 Bank'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 Bank'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 Bank 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's capacity building process continued unabated with a view to gearing itself better in fulfilling its public policy objective. The Bank sustained its consultation process with the various stakeholders including local financial intermediaries, government entities, small and medium sized entities and international financial institutions with the aim of providing solutions to identified and eligible financing needs. The third year of operation was dominated by the pandemic and the Bank's response to it in the form of the COVID-19 Guarantee Scheme ("CGS"). Concurrently, the Bank intensified its negotiations with private and public sector entities in connection with the financing of infrastructural projects that exhibit a strong social dimension.

FINANCIAL PERFORMANCE

During 2020, the Bank registered a growth in its balance sheet by €35.9 million, a result of a capital injection of €10 million in November 2020, representing proceeds from the portion of the initial share capital subscribed by the Government, and additional funding of €25 million from a fixed term loan with KfW (see Note 10). Such funding will be deployed through various planned projects and initiatives including direct lending to SME's and large cap infrastructure during 2021.

In response to the COVID-19 pandemic, the Bank has been entrusted to develop, administer and implement the CGS, on behalf of the Government of Malta, to assist entities in financing working capital at a subsidised interest rate with the aim to alleviate the negative effects of the COVID-19 pandemic on the economy. The scheme was launched on 2 April 2020. As of 31 December 2020, it reached a portfolio of €408 million in sanctioned facilities through the intermediation of nine commercial banks. In its administrative capacity, the Bank generated guarantee fee income from the CGS of €229,000 during 2020.

The Bank continued to attract financing of new investment through its SME Loan Guarantee Scheme which is intermediated through a commercial bank. Sanctioned facilities covered by this scheme doubled during the year from €14.5 million in 2019 to €29.4million by the end of 2020. During 2020, guarantee fee income from the SME Invest amounted to €54,000 (2019: €7,000).

The Bank generated additional income of €146,000 (2019: €10,000) from ad-hoc projects and rental income. Ad-hoc projects consisted mainly of administration fees relating to the implementation of the Financial Instrument 'Further Studies Made Available.

The Bank generated a net interest income of €137,000 (2019: €281,000) as part of its deployment of excess liquidity through money market placements with local banks in line with the credit risk appetite of the bank.

The Bank reported a loss of €1,282,000 (2019: €835,000) for the period under review, representing costs associated with the Bank's capacity building process and an increase in expected credit loss (ECL) allowances by €391,000 (2019: €71,000) to allow for elevated credit risks as a result of the subdued economic performance driven by the COVID-19 pandemic and the higher volume of outstanding guarantees.

In this respect, the increase in expected credit losses during the financial year ended 31 December 2020 is primarily driven by a number of downward migrations of exposures from Stage 1 to Stage 2 as well as significant increases in forward-looking risk parameters (Probability of Defaults) reflecting more pessimistic macroeconomic scenarios being forecasted in the modelling of credit loss allowances. This is described in more detail in Note 2.4.2.3 – Forward-looking information incorporated in the ECL model.

Total assets stood at €77m (2019: €41m) as at the period end. Other results may be referred to in the Statement of financial position and Statement of comprehensive income on pages 74 and 75 respectively.

PRINCIPAL RISKS AND UNCERTAINTIES

The principal risks and uncertainties facing the Bank are:

- ***Strategic Risk*** – The Bank 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 Bank 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 Bank.
- ***Credit Risk*** – The Bank 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 Bank. The Bank is exposed to credit risk in respect of its risk-sharing schemes, due to loans made to final beneficiaries which have been guaranteed by the Bank, and which credit losses are not directly guaranteed by the Government of Malta.
- ***Operational Risk*** – The Bank is exposed to a range of operational risks arising from the people, systems and processes involved in meeting its objectives. 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 Bank failing to meet its objectives and may potentially result in significant reputational damage.
- ***Compliance Risk*** – The Bank's activities are subject to EU State aid and other regulations. There is a risk that the Bank fails to comply with these regulations, resulting in reputational or financial damage to the Bank. The Bank considers compliance risk as separate from operational risk.

The Bank 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 Bank are explained in Note 2 to 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 who held office during the period:

Prof. Josef Bonnici - Chairperson
Mr. Paul Abela
Dr. Rose Marie Azzopardi
Mr. Robert Borg
Mr. Paul Cardona
the late Mr. Godfrey Grima
Mr. Anthony Valvo

These appointments are valid for the periods stipulated in Article 21(4), (5) and (6) of the Act.
In exercise of the powers conferred by Article 21(2)(c) of the Act, Cap. 574, the Minister for Finance and Employment has appointed Ms Jacqueline Camilleri, as director in lieu of Mr Paul Abela on 11 February 2021. This appointment is valid up to 10 December 2023.

Mr Rene Saliba served as Secretary of the Board during the period ending 31 December 2020. With effect from 27 January 2021 Mr Rene Saliba was replaced by Dr Bernadette Muscat, Head of Legal and Compliance.

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 regarding the 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.

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

AUDITORS

PricewaterhouseCoopers 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 2021 and signed on its behalf by:

PROF. JOSEF BONNICI
Chairperson

MR. ROBERT BORG
Director

Registered Address

Malta Development Bank
Pope Pius V street
Valletta, Malta

Independent auditor's report

To the Shareholders of Malta Development Bank

Report on the audit of the financial statements

Our opinion

In our opinion:

- The financial statements give a true and fair view of the financial position of Malta Development Bank (the Bank) as at 31 December 2020, and of the Bank's financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU; and
- The financial statements have been prepared in accordance with the requirements of the Malta Development Bank Act (Cap. 574).

What we have audited

Malta Development Bank's financial statements, set out on pages 8 to 45, comprise:

- the statement of financial position as at 31 December 2020;
- the statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include significant accounting policies and other explanatory information.

Basis for opinion

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

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

Independence

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

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 the Malta Development Bank's complete Annual Report, which is expected to be made available to us after that date.

Independent auditor's report - continued

To the Shareholders of Malta Development Bank

Our opinion on the financial statements does not cover the other information and we do not and will 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 on the other information that we obtained prior to the date of this auditor's report, 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 the 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 Standard 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 which 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.

Independent auditor’s report - *continued*

To the Shareholders of Malta Development Bank

- 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 trade, customers and suppliers, and the disruption to its business 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.

Other matter – use of this report

Our report, including the opinion, has been prepared only for the Bank’s shareholders as a body in accordance with the Malta Development Act (Cap. 574) and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior written consent.

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

Fabio Axisa
Partner

26 March 2021

Statement of financial position

	NOTES	AS AT 31 DECEMBER	
		2020	2019
		€	€
ASSETS			
Balances with Central Bank of Malta	3	**13,966,827**	-
Loans and advances to banks	3	**56,607,707**	39,557,971
Investment property	4	**632,089**	640,708
Property and equipment	5	**3,251,738**	63,896
Right-of-use assets	6	**36,695**	49,736
Intangible assets	7	**18,403**	13,862
Other assets	8	**2,260,693**	569,140
Total assets		**76,774,152**	40,895,313
EQUITY AND LIABILITIES			
EQUITY			
Share capital	9	**50,000,000**	40,000,000
Accumulated losses		**(2,575,270)**	(1,292,999)
Total equity		**47,424,730**	38,707,001
LIABILITIES			
Amounts owed to banks	10	**25,000,000**	-
Amounts owed to other entities	11	**3,671,863**	2,000,005
Other liabilities	12	**677,559**	188,307
Total liabilities		**29,349,422**	2,188,312
Total liabilities and equity		**76,774,152**	40,895,313
MEMORANDUM ITEMS			
Commitments	13	**5,753,045**	2,939,430

The notes on pages 78 to 109 are an integral part of these financial statements.

The financial statements on pages 74 to 109 were approved by the Board of Directors on 26 March 2021 and signed on its behalf by:

PROF. JOSEF BONNICI
Chairperson

MR. ROBERT BORG
Director

Statement of comprehensive income

	NOTES	YEAR ENDED 31 DECEMBER	
		2020	**2019**
		€	**€**
Interest receivable and similar income	14	**298,569**	292,423
Interest payable and similar expense	15	**(161,724)**	(11,682)
Net interest income		**136,845**	280,741
Income from financial guarantees	16	**283,599**	6,906
Other income	17	**146,199**	9,607
Net operating income		**566,643**	297,254
Changes in expected credit losses	18	**(391,488)**	(71,136)
Administrative expenses	19	**(367,612)**	(302,968)
Employee compensation and benefits	20	**(1,049,602)**	(731,675)
Depreciation of investment property, property plant and equipment and right-of-use asset	4, 5, 6	**(36,287)**	(26,008)
Amortisation of intangible assets	7	**(3,925)**	(289)
Loss for the year - total comprehensive income		**(1,282,271)**	(834,822)

The notes on pages 78 to 109 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 2019		30,000,000	(458,177)	29,541,823
Transactions with owners				
Capital contributed by the Government of Malta - total transactions with owners	9	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**
Balance as at 1 January 2020		40,000,000	(1,292,999)	38,707,001
Transactions with owners				
Capital contributed by the Government of Malta - total transactions with owners	9	10,000,000	-	10,000,000
Comprehensive income				
Loss for the period - total comprehensive income		-	(1,282,271)	(1,282,271)
Balance at 31 December 2020		**50,000,000**	**(2,575,270)**	**47,424,730**

The notes on pages 78 to 109 are an integral part of these financial statements.

Statement of cash flows

	NOTES	YEAR ENDED 31 DECEMBER	
		2020	**2019**
		€	**€**
Cash flows from operating activities			
Net cash (used in)/generated from operating activities	21	**(4,753,768)**	4,151,148
Cash flows from investing activities			
Purchase of investment property	4	**-**	(642,851)
Purchase of property and equipment	5	**(3,202,469)**	(310,893)
Purchase of intangible assets	7	**(8,467)**	(14,150)
Net cash used in investing activities		**(3,210,936)**	(967,894)
Cash flow from financing activities			
Proceeds from issue of share capital	9	**10,000,000**	10,000,000
Proceeds from long term borrowing		**25,000,000**	-
Funding costs paid	8	**-**	(120,000)
Payments for the principal portion of lease liability		**(13,701)**	(14,524)
Net cash generated from financing activities		**34,986,299**	9,865,476
Net increase in cash and cash equivalents		**27,021,595**	13,048,730
Cash and cash equivalents at beginning of year		**17,958,018**	4,909,288
Cash and cash equivalents at end year	22	**44,979,613**	17,958,018

The notes on pages 78 to 109 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 certain financial assets and financial liabilities.

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 professional judgment in the process of applying the Bank's accounting policies.

Standards, interpretations and amendments to published standards effective in 2020

In 2020, the Bank adopted amendments and interpretations to existing standards that are mandatory for the Bank's accounting period beginning on 1 January 2020. The adoption of these revisions to the requirements of IFRSs as adopted by the EU did not result in changes to the Bank's accounting policies impacting the Bank's financial performance or position.

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 on or after 1 January 2021 have been published by the date of authorisation for issue of these financial statements. 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 Bank 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 recognised at fair value through profit or loss (FVTPL), 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 FVTPL are expensed in profit or loss.

Immediately after initial recognition, an expected credit loss (ECL) allowance is recognised for financial assets measured at amortised cost and investments in debt instruments measured at fair value through other comprehensive income (FVTOCI), 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

The Bank classifies its financial assets in the following measurement categories:
- FVTPL;
- FVTOCI; or
- Amortised cost

As of 31 December 2020, all 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 the 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 ECL allowance recognised and measured as described in Note 2.4.2. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

- ***FVTOCI:*** Financial assets that are held for the 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 FVTOCI. Movements in the carrying amount of debt instruments are taken through other comprehensive income (OCI), except for the recognition of impairment losses or impairment loss reversals, interest revenue and foreign exchange gains and losses on the instrument's amortised cost which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in 'Net investment income'. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

- ***FVTPL:*** Assets that do not meet the criteria for amortised cost or FVTOCI are measured at FVTPL. 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 rate method.

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

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 i.e. whether the Bank's objective is solely to collect the contractual cash flows from the assets or 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 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 i.e. 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 FVTOCI 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 ECLs associated with its debt instruments carried at amortised cost and FVTOCI 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;
ii. The time value of money; and
iii. Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

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

ECL 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 instruments 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 FVTOCI: 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 six 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 AND EQUIPMENT

All property 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 costs 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
Property	75
Improvements to property	5 - 15
Computer equipment	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

By virtue of the Malta Development Act (Cap. 574), the Bank is exempt from all taxation under the Income Tax Act and duty on documents and transfers that may apply to its assets, property, income and its operations and transactions.

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 and 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 FVTPL 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 FVTPL: 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 FVTPL 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 (Note 1.13).

Financial liabilities measured at amortised cost comprise principally of 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 guarantor to make specified payments to reimburse the holder of the guarantee for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt obligation. 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.

The loss allowance on financial guarantee contracts is 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

Under IFRS 16, leases are recognised as a Right of Use (ROU) asset and a corresponding liability at the date at which the leased asset is made available for use.

The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any direct costs incurred and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or the site on which it is located, less any lease incentives received.

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

The ROU asset is depreciated using the straight-line method from the commencement date to the end of the lease term, unless the lease transfers ownership of the underlying asset to the Bank by the end of the lease term or the cost of the ROU asset reflects that the Bank will exercise a purchase option. In that case the ROU asset will be depreciated over the useful life of the underlying asset, which is determined on the same basis as those of property and equipment. In addition, the ROU asset is periodically reduced by impairment losses, if any, adjusted for certain remeasurements of the lease liability.

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.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Bank's incremental borrowing rate. 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).

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

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 the 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 specified areas and are chaired by a Non-executive director. Non-executive directors sit on these Committees with the Chief Executive Officer and Deputy Chief Executive Officer also attending the Board meetings. The Audit and Risk Committees report to the Board of Directors on its activities.

The Bank controls credit risk through the Credit Risk Framework, which covers all phases of the credit processes from the development of new products, to requests for new loans, monitoring of borrowers and final loan repayments. During 2020 work was carried out to extend the coverage of risks captured in the enterprise risk management framework to better cover the risks of the Bank, in particular on the management of the Bank's operational risks. 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***: This 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***: This is the risk of incurring losses due to the inability of meeting obligations as and when they become due.
- ***Interest rate risk***: This is the risk posed by adverse movements in interest rates that affect the bank's banking book positions.
- ***Operational and other risks***: This is the risk of losses resulting from inadequate or failed processes, people and internal systems, or from external events.

2.3 CAPITAL MANAGEMENT

The Bank is not subject to externally imposed capital requirements. 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. As at 31 December 2020, the Bank's paid-up share capital stood at €50 million (2019: €40 million), which has been provided by the Bank's sole shareholder, the Government of Malta (see Note 9).

The Bank'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 in accordance with the MDB Act.

	2020	**2019**
	€	€
Capital		
Paid up share capital	**50,000,000**	40,000,000
Accumulated loss	**(2,575,270)**	(1,292,999)
Total capital	**47,424,730**	38,707,001

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 in a timely manner and arises principally from the Bank's loans and advances to banks and financial guarantee contracts 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.

In line with its principal activities and business model, the Bank issues financial guarantee contracts to credit institutions, with the aim of facilitating the provision of credit facilities to customers of the same credit institutions that are eligible under one of the Bank's four credit schemes:

- ***Family Business Transfer Facility:*** to provide financial guarantees to commercial banks to assist and facilitate family businesses to transfer their business from one generation to the next.
- ***SME Invest:*** to provide financial guarantees for loans to SMEs facilitating lending to smaller businesses that are viable but unable to obtain the required amount of finance from a commercial bank.

- ***Further Studies Made Affordable (FSMA):*** to provide financial guarantees and interest subsidies on loans sanctioned by third party commercial banks in favour of individuals seeking to further their studies at a tertiary education institution or equivalent.
- ***COVID-19 Guarantee Scheme (CGS):*** to provide financial guarantees to commercial banks in order to enhance access to bank financing for the working capital requirements of businesses in Malta facing a sudden acute liquidity shortage as a result of the COVID-19 outbreak.

The FSMA and CGS schemes are backed-up by a government guarantee that provides cover against all credit risks emanating from credit losses. The Government of Malta provides indemnification to the Bank in respect of all expected credit losses, arising from these schemes, under the IFRS 9 framework of accounting. The impacts of these financial guarantees are therefore incorporated within the loss given default component of the ECL calculation, resulting in a nil loss given default (LGD) and therefore a nil ECL.

As of 31 December 2020, the Bank had issued an amount of financial guarantee contracts amounting to €29.4million (2019: €14.5million) with respect to the Family Business Transfer Facility and the BOV SME Invest schemes, which are considered as off-balance sheet instruments and on which the Bank carries credit risk. The Bank needs to honour the guarantee in the event that that the borrower defaults on the obligation to the credit institution. The Bank has earmarked a pre-determined amount of own capital to fund this credit facility and has arrangements with the counterparty credit institutions to issue guarantees which cover a defined percentage of the total exposure issued to customers. The risk sharing agreement entered into with the counterparty commercial bank, guarantees 80% of each eligible loan granted, subject to a capping of 25% under the SME Invest and 50% under the Family Business Transfer Facility which effectively contains the credit risk exposure of the Bank to €5,753,045 (2019: €2,939,430) (see Note 13).

As at 31 December 2020, the Bank's main financial assets consist of balances held with the Central Bank of Malta and amounts placed with local banks, which are considered to be high quality counterparties.

	2020	**2019**
	€	€
Balances with Central Bank of Malta	**13,966,827**	-
Loans and advances to banks	**56,607,707**	39,557,971

These financial assets are neither past due nor impaired; and the credit quality grading attributable to these assets is of a high grade. The process in which the Bank measures credit risk is described in Note 2.4.1.

Other assets held by the Bank (Note 8) principally represent amounts receivable from the Government of Malta. In view of the nature of the counterparty, expected credit losses arising on such balances are considered to be insignificant for the years ended 31 December 2020 and 2019.

From a risk perspective, the pandemic has given rise to changes in the behaviour of economic agents. This has impacted the performance of the Bank's ECL models, requiring enhanced monitoring of model outputs and use of alternative mechanisms or controls. As detailed in Note 2.4.7, the ECL charge for the financial year ended 31 December 2020 was significantly higher compared to the prior financial year charge, driven by charges relating to the impact of the outbreak of the COVID-19 pandemic on economic conditions and the higher volume of outstanding guarantees. The notable increase in credit loss allowances estimated in respect of exposures underlying the Bank's schemes classified in Stage 1 and Stage 2 reflects the general deterioration of economic conditions, as well as a significant deterioration in the forward economic outlook as a result of the pandemic.

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

2.4.2 EXPECTED CREDIT LOSS MEASUREMENT

IFRS 9 outlines a 'three stage' model for impairment measurement 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 ECLs that result from default events possible within the next 12 months. Instruments in Stages 2 and 3 have their ECL measured based on ECL 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 ECL requirements apply to financial assets measured at amortised cost and FVTOCI, 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 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. ECLs are the discounted product of the PD, EAD, and LGD. These three components are multiplied together effectively calculating the forward-looking ECL, which is then discounted back to the reporting date. The discount rate used in the ECL calculation is the 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 using 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, or over the remaining lifetime 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. Market data is utilised to align PDs attributable to external credit grades to those linked to internal credit gradings taking cognisance of the relationship between external and internal credit risk grades. 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 or over the remaining lifetime. 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 that is based on the contractual repayments owed by the borrower over a 12month or lifetime basis.

The LGD represents the Bank's expectation of the extent of loss on a defaulted exposure. Hence, the LGD represents ECLs 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 the portfolio of financial assets, consisting principally of balance held with the Central Bank of Malta and loans and advances to banks, is generally unsecured, the LGD for such 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.

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 ECLs 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 European Economic Area (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 that 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 assumes that it would be possible to marginally improve further over the already benign economic conditions.

The weightings assigned to each economic scenario were 50% (2019: 50%) for the 'Base' scenario, 35% (2019: 25%) for the 'Downside' scenario and 15% (2019: 25%) for the 'Upside' scenario.

Such weightings consider the subdued performance of the European economy over the foreseeable future, as a result of the COVID-19 pandemic. The Board considers that the probability weightings assigned to the respective scenarios reflect an unbiased evaluation of a range of possible outcomes.

The number of scenarios and their attributes are reassessed at each reporting date. The economic scenarios were simulated over a full economic cycle.

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. In relation to the financial guarantee portfolio, a management overlay was developed in order to estimate the impact of the delayed emergence of defaults due to government support schemes and regulatory relief measures on the calculation of credit loss allowances as at 31 December 2020. The possibility of future defaults linked to extended moratoria measures were also considered. The management overlay considers potential higher PDs and a number of possible future credit deteriorations and credit rating downgrades.

2.4.3 WRITE-OFF POLICY

The Bank writes off a loan, 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 repay 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 of balances held with the Central Bank of Malta and loans and advances to banks. The maximum exposure to credit risk on 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, unless the exposure is backed-up by a government guarantee as detailed in Note 2.4. The maximum exposure to credit risk is the full amount that the Bank would have to pay if the guarantees are called upon.

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:

	2020		**2019**	
	GROSS EXPOSURE	**ECL ALLOWANCE**	**GROSS EXPOSURE**	**ECL ALLOWANCE**
	€000	**€000**	€000	€000
Credit risk exposures relating to on-balance sheet assets:				
Financial assets measured at amortised cost Balances with Central Bank of Malta			-	
and other banks	**70,583**	**8**	39,566	8
Credit risk exposure	**70,583**	**8**	39,566	8
Credit risk exposures relating to off-balance sheet instruments				
Financial guarantees	**5,753**	**454**	2,930	63
Credit risk exposure	**5,753**	**454**	2,930	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.

To manage its principal risk exposures arising from its financial instruments, primarily financial guarantees on loans and advances to customers of 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.

As of 31 December 2020, all loans and advances to banks were placed with local credit institutions.

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 table sets out information about the credit quality of the Bank's financial assets analysed by staging:

	2019			
	STAGE 1 12-MONTH ECL	**STAGE 2 LIFETIME ECL**	**STAGE 3 LIFETIME ECL**	**TOTAL**
	€000	€000	€000	€000
Balances with Central Bank of Malta and other banks at amortised cost				
Gross carrying amount	39,566	-	-	39,566
Loss allowance	(8)	-	-	(8)
Carrying amount	39,558	-	-	39,558

	2020			
	STAGE 1 12-MONTH ECL	**STAGE 2 LIFETIME ECL**	**STAGE 3 LIFETIME ECL**	**TOTAL**
	€000	**€000**	**€000**	**€000**
Balances with Central Bank of Malta and other banks at amortised cost				
Gross carrying amount	**70,583**	**-**	**-**	**70,583**
Loss allowance	**(8)**	**-**	**-**	**(8)**
Carrying amount	**70,575**	**-**	**-**	**70,575**

The credit rating of Malta was classified as investment grade by external rating agencies as at 31 December 2020 and 2019.

There were no purchased credit-impaired assets as at 31 December 2020 and 2019.

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
- 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		TOTAL	
	GROSS CARRYING AMOUNT €000	EXPECTED CREDIT LOSSES €000	GROSS CARRYING AMOUNT €000	EXPECTED CREDIT LOSSES €000
Balances with Central Bank of Malta and other banks at amortised cost				
At 1 January 2019	29,423	-	29,423	-
New financial assets originated or purchased	10,143	8	10,143	8
At 31 December 2019	39,566	8	39,566	8
Total net income statement credit for the year			-	8

	2020			
	STAGE 1		TOTAL	
	GROSS CARRYING AMOUNT €000	EXPECTED CREDIT LOSSES €000	GROSS CARRYING AMOUNT €000	EXPECTED CREDIT LOSSES €000
Balances with Central Bank of Malta and other banks at amortised cost				
At 1 January 2020	39,566	8	39,566	8
New financial assets originated or purchased	31,016	-	31,016	-
At 31 December 2020	**70,582**	**8**	**70,582**	**8**
Total net income statement credit for the year				**-**

	2019							
	STAGE 1		STAGE 2		STAGE 3		TOTAL	
	GROSS AMOUNT €000	EXPECTED CREDIT LOSSES €000	GROSS AMOUNT €000	EXPECTED CREDIT LOSSES €000	GROSS AMOUNT €000	EXPECTED CREDIT LOSSES €000	GROSS AMOUNT €000	GROSS CARRYING AMOUNT €000
Financial guarantee contracts								
At 1 January 2019	-	-	-	-	-	-	-	-
New financial guarantees originated	2,939	63	-	-	-	-	2,939	63
At 31 December 2019	2,939	63	-	-	-	-	5,753	63
Total net income statement charge for the year								63
At 1 January 2020	**2,939**	**63**	**-**	**-**	**-**	**-**	**2,939**	**63**
New financial guarantees originated	3,552	31	-	-	-	-	3,552	31
Repayments	(737)	(19)	(2)	-	-	-	(738)	(19)
Transfers of financial instruments Stage 1 to Stage 2	(351)	(1)	351	1	-	-	-	-
Net remeasurement of ECL arising from stage transfers and changes in risk parameters	-	218	-	161	-	-	-	379
At 31 December 2020	**5,404**	**292**	**349**	**162**	**-**	**-**	**5,753**	**454**
Total net income statement charge for the year								**391**

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. The risk is managed by monitoring on a continuous basis the level of mismatch of interest rate repricing, taking cognisance of the terms of the Bank's principal financial liabilities, amounts owed to banks, that are not repriceable. The Bank also invests in highly liquid quality assets, namely term deposits with local banks, for the purpose of mitigating exposures to fluctuations in interest rates.

The following table summarises the re-pricing of financial instruments at reporting date together with the effective interest rates where applicable.

		STAGE 1		TOTAL	
	CARRYING AMOUNT €000	EFFECTIVE INTEREST RATE	LESS THAN 3 MONTHS €000	BETWEEN 3 MONTHS AND 1 YEAR €000	BETWEEN 1 YEAR AND 5 YEARS €000
As at 31 December 2019					
Financial assets Loans and advances to banks	39,558	0.89%	18,964	5,102	15,492
Total financial assets	39,558		18,964	5,102	15,492
At 31 December 2020					
Balances with Central Bank of Malta	13,967	-0.50%	13,967	-	-
Loans and advances to banks	56,608	0.33%	32,934	23,674	-
Total financial assets	**70,575**		**46,901**	**23,674**	**-**
Financial liabilities					
Amounts owed to banks	25,000	0.60%	-	-	25,000
Total financial liabilities	**25,000**		**-**	**-**	**25,000**
Interest repricing gap			**46,901**	**23,674**	**(25,000)**
Cumulative gap			**46,901**	**70,575**	**45,575**

2.5.1.1 INTEREST RATE PROFILE

The table below analyses interest-earning assets and interest-bearing liabilities between those that have a fixed rate and a variable rate:

	2020		2019	
	FIXED	VARIABLE	FIXED	VARIABLE
	€000	**€000**	€000	€000
Interest-earning assets				
Balances with Central Bank of Malta	-	13,967	-	-
Loans and advances to banks	39,610	16,998	34,605	4,953
	39,610	**30,965**	34,605	4,953
Interest-bearing liabilities				
Amounts owed to banks	25,000	**-**	-	-
	25,000	**-**	-	-

2.5.1.2 FAIR VALUE SENSITIVITY ANALYSIS FOR FIXED RATE INSTRUMENTS

The Bank does not account for any fixed rate financial assets or liabilities at fair value through profit or loss and are therefore not subject to fair value interest rate risk.

2.5.2 CURRENCY RISK

At the reporting date, the Bank's financial assets were all denominated in Euro, and therefore not being 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

Balances with Central Bank of Malta, loans and advances to banks and amounts owed to banks are carried at amortised cost in the Statement of Financial Position and reported net of impairment allowances to reflect the estimated recoverable amounts. The directors consider the carrying amounts of these balances to be a reasonable estimate of their fair value principally in view of the relatively short periods to repricing or maturity from the end of the reporting period.

2.5.3 CASH FLOW SENSITIVITY FOR VARIABLE RATE INSTRUMENTS

The Bank is exposed to cash flow interest rate risk principally in respect of financial assets which are subject to floating interest rates. A sensitivity analysis in respect of interest rate changes is not required since the Bank is not exposed to variable interest rate risk on financial liabilities.

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 2020, the Bank's initial capital has been mainly deployed in loans and advances to banks with a residual maturity of less than one year. As at the end of the reporting period, the Bank's financial liabilities mainly comprised of a €25 million loan (2019: nil) to a financial institution payable over five years, and payables and accruals for administrative expenses. Hence, liquidity risk during 2020 and at the reporting date is considered to be insignificant in view of the margin of liquidity available to manage repayment on refinancing of liabilities.

A Treasury Management policy covering liquidity management was approved by the Board after the balance sheet date and will be subject to the periodical review by the Board of Directors.

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

	CARRYING AMOUNT €000	WITHIN 3 MONTHS €000	BETWEEN 3 MONTHS AND 1 YEAR €000	BETWEEN 1 YEAR AND 5 YEARS €000	OVER 5 YEARS €000	NO MATURITY DATE €000
As at 31 December 2019						
Financial assets						
Loans and advances to banks	39,558	14,010	5,103	15,492	-	4,953
Other assets	569	449	9	80	31	-
Total financial assets	40,127	14,459	5,112	15,572	31	4,953
Financial liabilities						
Amounts owed to other entities	2,000	-	-	-	-	2,000
Other liabilities	188	70	10	37	-	71
Total financial liabilities	2,188	70	10	37	-	2,071
Maturity gap		14,389	5,102	15,535	31	2,882
Cumulative gap		14,389	19,491	35,026	35,057	37,939
As at 31 December 2020						
Financial assets						
Balances with Central Bank of Malta	13,967	-	-	-	-	13,967
Loans and advances to banks	56,608	14,017	25,593	-	-	16,998
Other assets	2,261	2,145	29	69	18	-
Total financial assets	**72,836**	**16,162**	**25,622**	**69**	**18**	**30,965**
Financial liabilities						
Amounts owed to banks	25,000	2,647	2,647	19,706	-	-
Amounts owed to other entities	3,672	680	-	-	-	2,992
Other liabilities	459	181	10	23	-	245
Total financial liabilities	**29,131**	**3,508**	**2657**	**19,729**	**-**	**3,237**
Maturity gap		12,654	22,965	(19,660)	18	27,728
Cumulative gap		12,654	35,619	15,959	15,977	43,705

3. BALANCES WITH CENTRAL BANK OF MALTA AND OTHER BANKS

	2020	2019
	€	€
Current		-
Repayable on call and at short notice	**44,979,614**	17,958,018
Term loans and advances	**25,603,124**	21,607,930
Gross carrying amount	**70,582,738**	39,565,948
Less allowances for expected credit losses	**(8,205)**	(7,977)
Net carrying amount	**70,574,533**	39,557,971

By virtue of an agreement entered into between the Ministry for European Affairs and Equality (the "Managing Authority)" and the Bank, as the entity entrusted with the implementation of the FSMA programme, an amount of €2 million (2019: €2 million) was held in favour and for the ultimate benefit of the Managing Authority as part of the implementation of the FSMA 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.

4. INVESTMENT PROPERTY

	2020	2019
	€	€
Year ended 31 December		-
Opening net book amount	**640,708**	-
Additions	**-**	642,851
Depreciation charge	**(8,619)**	(2,143)
Closing net book amount	**632,089**	640,708
At 31 December		
Cost	**642,851**	642,851
Accumulated depreciation	**(10,762)**	(2,143)
Net book amount	**632,089**	640,708

Investment property located outside Malta comprises an office building which is being leased out and which was acquired by the Bank in 2019. The fair value as at 31 December 2020 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 2020 €**	**VALUATION TECHNIQUE**	**VALUE PER SQUARE RENTAL METRE €**
Office building	640,000	Equivalent value per square metre	4,100

5. PROPERTY AND EQUIPMENT

	PROPERTY €	FURNITURE €	COMPUTER EQUIPMENT €	OTHER EQUIPMENT €	TOTAL €
Year ended 31 December 2019					
Opening net book amount	-	24,323	37,072	-	61,395
Additions	-	225	12,123	1,044	13,392
Depreciation charge	-	(2,511)	(8,275)	(105)	(10,891)
Closing net book amount	-	22,037	40,920	939	63,896
At 31 December 2019					
Cost	-	25,734	53,377	1,044	80,155
Accumulated depreciation	-	(3,697)	(12,457)	(105)	(16,259)
Net book amount	-	22,037	40,920	939	63,896
Year ended 31 December 2020					
Opening net book amount	-	22,037	40,920	939	63,896
Additions	3,183,590	5,483	13,309	87	3,202,469
Depreciation charge	-	(2,545)	(11,925)	(157)	(14,627)
Closing net book amount	**3,183,590**	**24,975**	**42,304**	**869**	**3,251,738**
At 31 December 2020					
Cost	3,183,590	31,217	66,686	1,130	3,282,623
Accumulated depreciation	-	(6,242)	(24,382)	(261)	(30,885)
Net book amount	**3,183,590**	**24,975**	**42,304**	**869**	**3,251,738**

The Bank acquired two immovable properties by virtue of deeds of purchase on the 17 March 2020 and 14 December 2020. The properties are intended to be used as the headquarters of the Bank and were consolidated into one office block. During the year the Bank incurred improvement works on these properties amounting to €74,000 which are included in the cost of property and equipment.

As at 31 December 2020, capital expenditure authorised and contracted for amounted to €117,000 (2019: €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 but may be extended. 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.

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

	2020	2019
	€	€
Opening net book amount	**49,736**	-
Additions	**-**	62,710
Depreciation	**(13,041)**	(12,974)
At 31 December	**36,695**	49,736

LEASE LIABILITIES

	2020	2019
	€	€
Lease liabilities		
Current	**14,114**	12,498
Non-current	**22,464**	36,855
At 31 December	**36,578**	49,353

The total cash payments for leases in 2020 was €13,701 (2019: €14,524).

The income statement reflects the following amounts relating to leases:

	2020	2019
	€	€
Depreciation charge of right-of-use asset	**13,041**	12,974
Interest expense on lease liabilities	**926**	1,167
	13,967	14,141

7. INTANGIBLE ASSETS

	2020	2019
	€	€
Computer Software		
Year ended 31 December		
Opening net book amount	**13,861**	-
Additions	**8,467**	14,150
Amortisation charge	**(3,925)**	(289)
Closing net book amount	**18,403**	13,861
At 31 December		
Cost	**22,617**	14,150
Accumulated amortisation	**(4,214)**	(289)
Net book amount	**18,403**	13,861

8. OTHER ASSETS

	2020	2019
	€	€
Accrued interest	**95,067**	108,500
Prepayments and deferred costs	**143,323**	438,970
Income from financial guarantees (Note 16)	**265,900**	4,086
Amounts receivable from the Government of Malta	**1,754,103**	-
Other receivables	**2,300**	17,584
	2,260,693	569,140

Prepayments and deferred costs include a funding fee of €120,000 which was paid by the Bank to secure the financing of a particular programme (Note 10) and which has been deferred and is being amortised over the 10-year term of the funding programme. As at 31 December 2020, the deferred element of this fee recognised under 'Prepayments and deferred costs' is €110,538 (2019: €120,000).

As at 31 December 2019, prepayments and deferred costs included 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. The property was subsequently purchased in 2020.

Amounts receivable from the Government of Malta represent:

- €1 million (2019: nil) in virtue of the Addendum no.1 to the Agreement between the Managing Authority and the Bank (Notes 3 and 11) whereby the FSMA fund was increased by €1 million to reach the maximum of €3 million in accordance with Article 2.2 of the Funding Agreement. The €1 million represents €550,000 allocated to the portfolio guarantee and €450,000 allocated to the interest subsidy element of the FSMA financial instrument;
- €70,860 (2019: nil) administrative fees representing the Bank's services provided in connection with the preparation and implementation of the FSMA scheme (Note 17);
- €679,844 (2019: nil) in relation to the Bank's mandate by the Government of Malta issued on 16 April 2020 to set up and manage the COVID-19 Interest Rate Subsidy Scheme providing an interest rate subsidy of up to 2.5% on the interest payable by all eligible business in respect of working capital loans extended to such business which are covered under the CGS. By virtue of the Government Letter of Comfort in favour of the Bank dated 4 February 2021, the Government of Malta was due to pay the Bank the interest rate subsidy of €679,844 in relation to loans sanctioned by accredited banks under the CGS for the period to 31 December 2020 (Note 11); and
- €3,399 (2019: nil) administrative fees representing the Bank's services provided in connection with the preparation and implementation of the Interest Rate Subsidy Scheme (Note 17).

9. SHARE CAPITAL

9.1 SHARE CAPITAL

	2020	2019
	€	€
Authorised		
2,000,000 shares of €100 each	**200,000,000**	200,000,000
Issued and fully paid up		
500,000 (2019: 400,000) shares of €100 eacha	**50,000,000**	40,000,000

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 authorised share capital of the Bank is €200 million divided into 2 million shares having a par value of €100 each.

During 2020, the Bank issued 100,000 shares at par value of €100 each which were fully subscribed by the Government of Malta. In 2019, the Bank also issued another 100,000 shares at par value of €100 each, which were also fully subscribed by the Government of Malta.

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.

9.2 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 2020 (2019: €150 million).

10. AMOUNTS OWED TO BANKS

	2020	2019
	€	€
Current	5,294,118	-
Non-current	19,705,882	-
	25,000,000	-

On 24 June 2019, the Bank entered into a loan agreement with KfW, for the amount of €45 million. This amount is made up of four separate loan disbursements each attracting a different interest rate which is fixed under the agreement four days before disbursement on the basis of the swap offer rate in the Euro capital market at the time of disbursement for maturities matching as closely as possible the term of the loan to be disbursed plus an interest margin. As at the end of the financial year two loan disbursements of €10 million and €15 million have been executed. Accordingly, at year-end a balance of €20 million from the total loan facility of €45 million remained undrawn and subject to pricing risk at time of disbursement. The loan is for a period of 10 years with repayments of capital commencing in 2021 and periodical separate payments of interest.

The Bank is also party to a loan agreement with the EIB for an amount of €60 million. This loan amount is made up of fixed and floating rate tranches. As at the reporting date, no amounts under this agreement have been disbursed.

11. AMOUNTS OWED TO OTHER ENTITIES

By virtue of an agreement entered into between the Ministry for European Affairs and Equality (the "Managing Authority)" and the Bank, as the entity entrusted with the implementation of the FSMA programme, an amount of €3 million (2019: €2 million) was held in favour and for the ultimate benefit of the Managing Authority as part of the implementation of the FSMA 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.

Similarly, €679,844 (2019: nil) represent interest rate subsidies payable to participating banks in the Bank's capacity as the implementing partner of the COVID-19 Interest Rate Subsidy Scheme (Note 8).

12. OTHER LIABILITIES

	2020	2019
	€	€
Accounts payable	**116,435**	19,276
Lease liabilities (Note 6)	**36,578**	49,353
Accrued interest (Note 10)	**43,895**	-
Accruals and deferred income	**26,232**	56,519
Expected credit losses on financial guarantees (Note 13)	**454,419**	63,159
	677,559	188,307

13. COMMITMENTS

Credit related commitments

	2020			2019		
	DRAWN COMMITMENTS € €000	UNDRAWN COMMITMENTS €	TOTAL €	DRAWN COMMITMENTS €	UNDRAWN COMMITMENTS €	TOTAL €
Total sanctioned loans (net of repayments)	**13,190,916**	**15,480,862**	**28,671,778**	3,609,499	10,943,112	14,552,611
Maximum exposure guaranteed by the Bank	**2,656,872**	**3,096,173**	**5,753,045**	741,066	2,198,364	2,939,430
guaranteed by the Bank	**2,656,872**	**3,096,173**	**5,753,045**	741,066	2,198,364	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 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 by offering the opportunity for commercial banks to act as the Bank's implementing partners for its guarantee products. In this respect, the Bank issues financial guarantee contracts in respect of loans originated by other third party commercial banks.

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 fails to meet its obligations to the said commercial bank, carry the same credit risk as loans. 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.

Note 2.4 describes the process of how the Bank measures, accounts and manages credit risk emanating from such credit related commitments.

The maximum exposure guaranteed by the Bank is calculated by reference to a portfolio capping on the maximum credit losses, as stipulated in the risk-sharing agreements entered into between the Bank and the commercial banks.

In the event of default by a borrower of the third party commercial bank, the guarantee on the undrawn balance is revocable as stipulated in the loan agreements between the third party commercial bank and its borrowers.

As at 31 December 2020, the expected credit losses arising on financial guarantee contracts amounted to €454,419 (2019: €63,159) (Note 12).

14. INTEREST RECEIVABLE AND SIMILAR INCOME

	2020	2019
	€	€
Interest income on term deposits	280,079	291,432
Other interest income	18,490	991
	298,569	292,423

15. INTEREST PAYABLE AND SIMILAR EXPENSE

	2020	2019
	€	€
On balances with Central Bank of Malta and other banks	57,584	10,515
On amounts owed to banks (Note 10)	103,214	-
On lease liabilities	926	1,167
	161,724	11,682

16. INCOME FROM FINANCIAL GUARANTEES

	2020	2019
	€	€
SME Invest Scheme	53,569	6,757
Family Business Success Scheme	878	149
COVID-19 Guarantee Scheme	229,152	-
	283,599	6,906

In line with its principal activities and business model, the Bank issues 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 Bank's four credit schemes. The Bank receives a portion of the interest charged by the credit institutions in the form of a guarantee fee as consideration for providing the guarantee on such exposures.

17. OTHER INCOME

	2020	2019
	€	€
Rental income	31,940	9,607
Administration fees (Note 8)	74,259	-
Other income	40,000	-
	146,199	9,607

18. CHANGES IN EXPECTED CREDIT LOSSES

	2020	2019
	€	€
On balances with Central Bank of Malta and other banks	**228**	7,977
On financial guarantee contracts	**391,260**	63,159
	391,488	71,136

19. ADMINISTRATIVE EXPENSES

	2020	2019
	€	€
Rent	**61,700**	61,700
Legal and professional fees	**140,150**	96,960
Supervisory fees	**19,500**	19,500
Travelling and accommodation	**1,130**	20,349
Memberships of international associations	**20,893**	26,731
Insurance costs	**24,329**	20,611
Advertising and public awareness	**28,077**	18,926
Repairs and maintenance	**32,808**	14,571
Other	**39,025**	23,620
	367,612	302,968

AUDITOR'S REMUNERATION

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

	2020	2019
	€	€
Annual statutory audit	**23,600**	23,600

20. EMPLOYEE COMPENSATION AND BENEFITS

	2020	2019
	€	€
Staff costs		
- Wages, salaries and allowances	**898,706**	609,536
- Social security costs	**32,070**	21,218
- Other costs	**18,937**	9,222
Directors' fees	**99,889**	91,699
	1,049,602	731,675

Total fees payable to non-executive directors amounted to €99,889 during 2020 (2019: €91,699).

The average number of persons employed by the Bank was as follows:

	2020	2019
	€	€
Senior management	**10**	9
Middle management	**4**	1
	14	10

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

	2020	2019
	€	€
Loss for the year	**(1,282,271)**	(834,822)
Depreciation and amortisation (Notes 4, 5, 6, 7)	**40,212**	26,297
Interest receivable (Note 8)	**(95,067)**	(108,500)
Interest payable (Note 12)	**43,895**	-
Change in expected credit losses (Note 18)	**391,488**	71,136
Interest expense on lease liabilities (Note 6)	**926**	1,167
Changes in operating assets and liabilities:		
(Increase)/decrease in term loans and advances (Note 3)	**(3,995,194)**	2,905,688
Increase in amounts owed to other entities (Note 11)	**1,671,858**	2,000,005
(Increase)/decrease in receivables, prepayments, and deferred costs (Note 8)	**(1,596,487)**	42,552
Increase in accounts payable and accruals and deferred income (Note 12)	**66,872**	47,625
Net cash (used in)/generated from operating activities	**(4,753,768)**	4,151,148

22. CASH AND CASH EQUIVALENTS

The table below shows an analysis of the Bank's balances of cash and cash equivalents as shown in the Statement of Cash Flows. Cash and cash equivalents comprise of demand deposits and balances with a contractual maturity of not more than three months.

	2020	2019
	€	€
Balances with Central Bank of Malta and other banks		
Repayable on call and at short notice (Note 3)	**44,979,613**	17,958,018

23. RELATED PARTIES

23.1 IDENTIFICATION OF RELATED PARTIES AND THE ULTIMATE CONTROLLING PARTY

The Bank's ultimate controlling party is the Government of Malta. All functions and bodies forming part of the 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. Key management personnel of the Bank are also considered to be related parties.

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

23.2 TRANSACTIONS WITH RELATED PARTIES

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

	2020	2019
	€	€
Income from related parties		
Interest receivable and similar income	**207,389**	158,358
Income from financial guarantees	**264,555**	6,906
Other income	**106,199**	9,607
Expenses charged by related parties		
Interest payable and similar expense	**57,584**	10,515
Administrative expenses	**94,884**	89,378

The Bank treats all related party transactions 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 receive instructions from an authority, public or otherwise, or from any other institution.

23.3 BALANCES WITH RELATED PARTIES

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

	2020	2019
	€	€
Amounts owed by related parties		
Balances with Central Bank of Malta	**13,966,827**	-
Loans and advances to banks	**32,182,312**	17,666,000
Other assets	**2,113,752**	123,408
Amounts owed to related parties		
Amounts owed to other entities	**3,671,862**	-
Other liabilities	**30,649**	10,500
23.4 Transactions with key management personnel		
Key management personnel are defined in Note 23.1		

	2020	2019
	€	€
Compensation to key management personnel	**786,481**	660,611

24. ACCOUNTING ESTIMATES AND JUDGEMENTS

24.1 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING THE BANK'S ACCOUNTING POLICIES

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

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

24.2 MEASUREMENT OF THE EXPECTED CREDIT LOSSES

The measurement of the ECL allowance for financial guarantees is an area that requires the use of complex models and significant assumptions about future economic conditions and credit behaviour. Explanation of the inputs, assumptions and estimation techniques used in measuring ECL is further detailed in note 2.4.2.

A number of significant judgements are required in measurement of expected credit loss, such as:
- Determining criteria for significant increase in credit risk;
- Choosing appropriate models and assumptions for the measurement of ECL; and
- Establishing the number and relative weightings of forward-looking scenarios and associated ECL.

In view of potential higher uncertainties, management have recognised an overlay to reflect potentially higher PDs and / or credit rating downgrades in the context of current and potential future economic realities (see note 2.4.2.3).

Detailed information about the judgements and estimates made by the Bank in the above areas is set out in note 2.4.2.

24.3 ASSESSMENT OF ESTIMATES AND JUDGEMENTS

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

However, the directors would like to draw attention to these accounting judgements that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In this respect, these primarily comprise assumptions and estimates relating to the calculation of impairment allowances in respect of financial guarantee contracts (see note 2.4.2).

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.

NOTES

BANK MALTI GĦALL-IŻVILUPP
MALTA DEVELOPMENT BANK

MDB.ORG.MT