HSBC Bank Malta p.l.c.

Annual Report and Accounts 2016

The HSBC Group

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2016 delivered many surprises especially on the international political scene, and on both sides of the Atlantic resulting in significant uncertainties about the future direction of some of the world's major economies. Besides these political uncertainties, 2016 continued to be a challenging year for the banking sector, in particular within the eurozone. The prevailing context of low interest rates, continuing increases in costs and regulatory demands, have continued to affect the performance of most European banks.

Despite this rather gloomy backdrop, the performance of the Maltese economy remained resilient throughout 2016, and forecasts for 2017 are positive. The performance of the local economy augurs well in terms of the opportunities this can present for our bank.

Results

Profit before tax for the year under review was €62.2m, an increase of 33% when compared to the 2015 results. Adjusted profit before tax, which excludes the effect of non-recurring items was €59.4m, 3% down on 2015 but in line with management expectations.

The bank's capital position remained solid and during 2016, the bank continued to build a strong capital base. Common equity tier 1 capital increased to 13.2% from 12.3% at the end of 2015. At December 2016, the bank was compliant with its end-point regulatory capital requirements. This enabled the bank to maintain its dividend payout ratio at 65% of the profit after tax, one of the highest in the industry. During the year, the bank adhered to the revised Banking Rule 09 which imposes higher allocations for past due exposures. Taking into consideration the reduction in non-performing exposures, the bank was not required to set aside an additional General Banking risk provision.

L-2016 kienet sena li ġabet ħafna sorpriżi, speċjalment fix-xena politika internazzjonali u fuq iż-żewġ naħat tal-Atlantiku, bir-riżultat li nħolqu bosta inċertezzi serji dwar fejn sejrin uħud mill-ekonomiji l-kbar tad-dinja. Minbarra dawn l-inċertezzi politiċi, l-2016 kompliet iġġib sfidi għas-settur bankarju, speċjalment għal dawk fiż-żona tal-ewro. Il-kuntest prevalenti ta' rati baxxi tal-imgħax, żidiet kontinwi fl-ispejjeż u l-pressjoni tar-rekwiżiti regolatorji komplew ikollhom effett fuq l-andament ta' ħafna banek Ewropej.

Minkejja dan l-isfond kemmxejn mudlam, l-ekonomija Maltija baqgħet iżżomm sod matul l-2016, u t-tbassir għall-2017 huwa pożittiv. Il-prestazzjoni tal-ekonomija Maltija tawgura tajjeb għal dawk li huma opportunitajiet li tippreżenta għall-bank tagħna.

Riżultati

Il-profitt qabel it-taxxa għall-2016 kien ta' €62.2m, żieda ta' 33% meta mqabbel mar-riżultati tal-2015. Il-profitt aġġustat qabel it-taxxa, li jeskludi l-effett ta' entrati li ma jirrepetux ruħhom kien ta' €59.4m, 3% anqas milli fl-2015 imma konformi mal-aspettativi tal-*management*.

Il-pożizzjoni tal-kapital tal-bank baqgħet soda u matul l-2016 il-bank kompla jsaħħaħ il-bażi kapitali. Il-*common equity tier 1 capital* żdied għal 13.2% minn 12.3% fl-aħħar tal-2015. F'Diċembru 2016 il-bank kien konformi mar-rekwiżiti ta' kapital regolatorju kollu li kellu jilħaq. B'hekk il-bank seta' jżomm il-ħlas tad-dividend fil-livell ta' 65% tal-profitt wara t-taxxa, wieħed mill-ogħla fl-industrija. Matul is-sena l-bank segwa r-Regola Bankarja Nru 9, kif riveduta, li timponi allokazzjonijiet ogħla għal self li ma jitħallasx lura f'waqtu. Minħabba li naqqas is-self li ma kienx jirrendi, il-bank ma kienx meħtieġ iwarrab ammont addizzjonali bħala provvediment ġenerali għar-riskju bankarju.

Profit attributable to shareholders amounted to €40.2m resulting in earnings per share of 11.2 cent compared with 8.5 cent in 2015. The Board recommends a final gross dividend of 4.1 cent per share (2.7 cent per share net of tax). Together with the interim dividend paid in September 2016, the total gross dividend for the year will be 11.2 cent per share (7.3 cent per share net of tax), which represents a 45% increase compared to the 2015 dividend. The final dividend will be paid on 20 April 2017 to shareholders who are on the bank's register of shareholders at 14 March 2017.

Our regulatory environment

The pace and complexity of regulatory change during the year under review continued to be very demanding and costly. New regulations were issued requiring the bank to intensify its efforts to ensure a smooth implementation.

The regulatory change programme revolved around the adoption of new international standards, such as those brought about by the Common Reporting Standard (CRS), where a number of countries around the world agreed within the context of the Organisation for Economic Co-operation and Development (OECD) to start sharing information to tackle tax evasion.

During 2016, the bank implemented the Central Credit Register (CCR), which was introduced by Directive 14 of the Central Bank of Malta (CBM) requiring banks to provide information to the CBM on natural and legal persons having exposures in excess of €5,000.

The Market Abuse Regulation (MAR) and the Market Abuse Directive II (MAD II) became effective in July 2016, requiring banks to take actions aimed at enhancing and harmonising the EU regime on market abuse.

Financial inclusion was enhanced through the Payment Account Directive (PAD), requiring banks to: improve the transparency and comparability of fees on payment accounts; facilitate payment account switching; and give access to every EU resident to a basic banking account.

These developments were implemented by the bank in parallel with preparations for the imminent introduction of further regulations, namely Markets in Financial Instruments Directive (MiFID) II; Payment Services Directive II; and the Fourth Anti Money Laundering Directive.

Il-profitt attribwibbli lill-azzjonisti ammonta għal €40.2m li jirriżulta fi qligħ sehem b'sehem ta' 11.2 ċenteżmi, imqabbel ma' 8.5 ċenteżmi fl-2015. Il-Bord jirrakkomanda dividend gross finali ta' 4.1 ċenteżmi kull sehem (2.7 ċenteżmi kull sehem wara t-taxxa). Meta tgħodd dan mad-dividend interim imħallas f'Settembru 2016, id-dividend gross totali jilħaq 11.2 ċenteżmi kull sehem (7.3 ċenteżmi kull sehem wara t-taxxa), li jfisser żieda ta' 45% meta mqabbel mad-dividend tal-2015. Id-dividend finali ser jitħallas fl-20 ta' April 2017 lill-azzjonisti li kienu fuq ir-reġistru tal-azzjonisti tal-bank fl-14 ta' Marzu 2017.

L-ambjent regolatorju

Il-pass u l-komplessità tal-bidliet regolatorji li seħħew matul is-sena li qed nirrapportaw dwarha reġgħu swew ħafna riżorsi u spejjeż. Ħarġu regolamenti ġodda li kienu jeħtieġu li l-bank jintensifika l-isforzi biex l-implimentazzjoni tagħhom tkun bla skossi.

Il-programm ta' bidla regolatorja kien dar madwar l-adozzjoni ta' standards ġodda internazzjonali, pereżempju dawk li daħlu bl-Istandard ta' Rappurtar Komuni (il-*Common Reporting Standard* jew CRS), li bih għadd ta' pajjiżi madwar id-dinja qablu, fil-kuntest tal-Organizzazzjoni għall-Kooperazzjoni Ekonomika u Żvilupp (OECD), li jgħaddu l-informazzjoni lil xulxin biex jikkumbattu l-evażjoni tat-taxxa.

Matul l-2016, il-bank beda jħaddem ir-Reġistru Ċentrali tal-Kreditu (CCR). Dan ir-Reġistru ddaħħal bid-Direttiva Nru 14 tal-Bank Ċentrali ta' Malta (CBM) li titlob lill-banek jagħtu informazzjoni lill-Bank Ċentrali dwar persuni naturali u legali li jkollhom bilanċi ta' self li jeċċedu l-€5,000.

Ir-Regolament dwar l-Abbuż fis-Suq (MAR) u t-tieni Direttiva dwar l-Abbuż fis-Suq (MAD II) bdew japplikaw minn Lulju 2016. Dawn jeħtieġu li l-banek jieħdu passi biex ir-reġim tal-Unjoni Ewropea (UE) dwar l-abbuż fis-suq ikun imtejjeb u armonizzat.

Permezz tad-Direttiva dwar Kontijiet ta' Pagament (PAD) iddaħħlet aktar inklużjoni finanzjarja. B'din id-direttiva l-banek iridu jżidu t-trasparenza u l-komparabilità fit-tariffi fuq kontijiet ta' pagament, jagħmluha aktar faċli biex wieħed jaqleb minn kont ta' pagament għal ieħor, u jippermettu lil kull persuna residenti fl-UE li tuża kont bankarju bażiku.

Dawn l-iżviluppi ġew implementati mill-bank fl-istess ħin li qed isiru preparamenti għad-dħul imminenti ta' regolamenti ġodda, li huma Markets in Financial Instruments Directive (MiFID) II; it-tieni Direttiva dwar Servizzi ta' Pagament, u r-raba' Direttiva kontra l-Ħasil tal-Flus.

The HSBC Water Programme – Catch the Drop Campaign, supported by a €540,000 grant from the HSBC Group, has reached out to every student in Malta and Gozo.

At the same time, the Board and our management team continued to proactively manage relationships with our regulators to ensure open and transparent communications during assessments and thematic reviews, while preparing for business model changes in response to key regulatory and external environment changes.

The relationship with our lead regulator: the Joint Supervisory Team – composed of representatives from the European Central Bank as well as from the Malta Financial Services Authority – continued to develop in a constructive manner. As the regulatory development oversight capabilities continued to be enhanced, the bank on a parallel track has been embedding a number of initiatives forming part of its structured conduct programme. The impact of the programme outcomes are being measured through a Conduct Maturity Assessment to ensure we deliver fair outcomes for our customers and uphold high market standards in line with regulatory obligations.

Our responsibility towards the community

We continue to play an active role in the community we serve. Through our HSBC Malta Foundation, we have assisted various sectors of the community throughout 2016 via a number of key projects and initiatives. Sustainability and our role as a good corporate citizen remains a core focus of HSBC.

Fl-istess waqt, il-Bord u l-*management* komplew jiġġestixxu proattivament ir-relazzjonijiet tagħna mar-regolaturi biex jassiguraw li jkun hemm komunikazzjoni aperta u trasparenti meta jsir assessjar jew meta ssir xi analiżi tematika, u bdew ukoll iħejju għall-bidliet fil-mudell kummerċjali li jridu jsiru biex jilqgħu għat-tibdil importanti li qed iseħħ fir-regolamentazzjoni u fl-ambjent estern.

Ir-relazzjoni mar-regolatur ewlieni: – it-Tim Konġunt ta' Sorveljanza – magħmul minn rappreżentanti tal-Bank Ċentrali Ewropew u tal-Awtorità għas-Servizzi Finanzjarji ta' Malta – kompliet tiżviluppa b'mod kostruttiv. Fuq linja parallela mat-tisħiħ tal-kapaċitajiet ta' sorveljanza regolatorja, il-bank kien qed jinkorpora għadd ta' inizjattivi li jifformaw parti mill-programm strutturat tiegħu dwar kif għandu jopera. L-impatt tal-eżiti ta' dan il-programm qed jitkejjel permezz ta' Evalwazzjoni tal-Maturità tal-Kondotta, biex inkunu ċerti li l-klijenti tagħna nagħtuhom riżultati xierqa u li nżommu fil-għoli l-istandards tas-suq kif jitolbu l-obbligi regolatorji.

Ir-responsabbiltà tagħna lejn il-komunità

Bqajna nieħdu parti attiva fil-komunità li qed inservu. Permezz tal-HSBC Malta Foundation, għenna diversi setturi tal-komunità matul l-2016 b'għadd ta' proġetti u inizjattivi importanti. Is-sostenibilità u r-rwol tagħna bħala ċittadin korporattiv eżemplari għadhom fiċ-ċentru tal-ħidma tagħna.

The three pillars of the HSBC Malta Foundation are to improve the quality of life and education for children, especially those disadvantaged; to promote and work towards a more sustainable environment; and to preserve Malta's rich and unique historical heritage.

Voluntary work is highly encouraged and pride is taken in our colleagues who contribute to the charities and causes that they feel passionate about. Our employees are encouraged to take an active role in initiatives supported by the HSBC Malta Foundation with an extra day's leave granted for voluntary work. During 2016, HSBC colleagues volunteered for more than 257 days on a range of projects around the country.

The HSBC Malta Water Programme – Catch the Drop Campaign continued to reach out to every student in Malta and Gozo, as well as various local councils, with the main emphasis being on water shortage, water consumption reduction and water harvesting. This national environmental and educational water conservation campaign raises awareness about the water scarcity issue, and provides information and tips as to how people can tackle it.

It-tliet pilastri tal-HSBC Malta Foundation huma t-titjib tal-kwalità tal-ħajja u l-edukazzjoni tat-tfal, speċjalment dawk żvantaġġjati; il-promozzjoni u l-ħidma għal ambjent aktar sostenibbli; u l-konservazzjoni tal-patrimonju storiku rikk u uniku ta' Malta.

Aħna ninkoraġġixxu bis-sħiħ ix-xogħol volontarju, u aħna kburin bil-kollegi tagħna li jagħtu kontribut lill-karitajiet u 'l-kawżi li għandhom għal qalbhom. L-impjegati huma mħeġġa jieħdu sehem attiv fl-inizjattivi li għandhom l-appoġġ tal-Fondazzjoni, u nagħtuhom jum frank żejjed għal xogħol volontarju. Fl-2016, il-kollegi tal-HSBC offrew ruħhom għal aktar minn 257 jum ta' volontarjat fuq proġetti diversi madwar il-pajjiż.

L-HSBC Malta Water Programme – Catch the Drop Campaign kompliet twassal il-messaġġ tagħha lil kull student f'Malta u Għawdex, kif ukoll lil diversi kunsilli lokali, bl-enfasi ewlenija tkun fuq l-iskarsezza tal-ilma, l-ekonomija fil-konsum tal-ilma u l-ġbir u l-ħażna tal-ilma. Din il-kampanja nazzjonali, ambjentali u edukattiva, għall-konservazzjoni tal-ilma żżid il-kuxjenza dwar in-nuqqas tal-ilma u tipprovdi tagħrif u tagħlim fuq x'għandhom jagħmlu n-nies biex itaffu l-problema.

In 2016, HSBC team members volunteered for a collective 2,056 hours, or 257 days, of community work.

This campaign was supported by a €540,000 grant from the HSBC Group. Our employees are at the heart of this campaign with over 500 members of staff volunteering to deliver the information sessions in all 172 schools around Malta and Gozo.

The HSBC Malta Foundation became the first organisation outside of the UK to introduce one of The Prince's Trust's long-standing educational programmes in secondary schools. One of its most successful programmes, namely the xl programme, is now available to young people in Malta, helping them to develop the skills and confidence they need to reach a positive future, through informal and engaging learning. The xl programme was initially introduced in seven schools during the 2015/16 scholastic year across all of Malta and Gozo, with the full support of the Education Ministry. With effect from the 2016/17 scholastic year, the number of schools increased to 20.

Our community commitment extends also to the field of environmental awareness. HSBC Malta has installed 614 photovoltaic panels and commissioned seven electric vehicles including six charging points at the bank's Operations Centre in Qormi. The PV panels, which were placed on top of 10 of the bank's offices across Malta and Gozo, power 37 of our offsite ATMs. As a result of this initiative referred to as 'Simply Electric' the bank's emissions have been reduced by an estimated 186 tonnes of CO_2 per annum.

Din il-kampanja kellha l-appoġġ tal-Grupp HSBC, li għamel għotja għaliha ta' €540,000. Il-ħaddiema tagħna huma fil-qalba tal-kampanja, tant illi kien hemm 'il fuq minn 500 impjegat li vvolontarja biex jindirizza l-istudenti f'laqat ta' informazzjoni fil-172 skola li hawn madwar Malta u Għawdex.

L-HSBC Malta Foundation saret l-ewwel organizzazzjoni barra r-Renju Unit li introduċiet wieħed mill-programmi edukattivi stabbiliti tal-Prince's Trust fl-iskejjel sekondarji. Iż-żgħażagħ Maltin issa għandhom l-opportunità li jidħlu għal wieħed mill-programmi l-aktar ta' suċċess tat-Trust, il-programm xl, li juża tagħlim informali u impenjattiv biex jgħinhom jiżviluppaw il-ħiliet u l-kunfidenza meħtieġa biex ikollhom futur pożittiv. Il-programm xl għall-ewwel kien introdott f'seba' skejjel f'Malta u Għawdex fis-sena skolastika 2015/16, bil-kooperazzjoni sħiħa tal-Ministeru tal-Edukazzjoni. B'effett mis-sena skolastika 2016/17, in-numru ta' skejjel tela' għal 20.

L-impenn tagħna lejn il-komunità jinfirex ukoll fil-qasam tal-kuxjenza ambjentali. L-HSBC Malta installa 483 pannelli fotovoltajiċi u kkommissjona seba' vetturi bl-elettriku, inklużi sitt posti għall-karigu tal-batteriji fiċ-Ċentru tal-Operazzjonijiet tal-bank f'Ħal Qormi. Il-pannelli PV, li tqiegħdu fuq il-bjut ta' 10 mill-uffiċċji tal-bank f'Malta u Għawdex, jipprovdu l-elettriku għal 37 mill-*offsite* ATMs tagħna. B'din l-inizjattiva li nsejħulha 'Simply Electric' huwa stmat li l-emissjonijiet tal-bank tnaqqsu b'186 tunnellata ta' CO_2 fis-sena.

HSBC Malta became the first corporate entity in the country to support Women Directors Malta and its charter which advocates for gender diversity at board levels.

The bank continued to build a strong capital base during 2016.

I take this opportunity to thank, on your behalf, the many among our people who support these initiatives by spending their time, capabilities and energies to ensure the success of these projects.

Nieħu l-opportunità biex nirringrazzja, f'isimkom, lil dawk il-ħafna fost in-nies tagħna li jsostnu dawn l-inizjattivi billi jagħtu l-ħin, l-ħiliet u l-energiji tagħhom għas-suċċess ta' dawn il-proġetti.

Our Board of Directors

Il-Bord tad-Diretturi

In 2016, there were three changes in the membership of the Board of Directors of the bank.

After assuming the position of Chief Executive Officer of the bank in November 2015, Mr Andrew Beane joined the Board of Directors in March 2016.

Ms Caroline Zammit Testaferrata Moroni Viani resigned in April 2016.

In May 2016, Ms Tanuj Kapilashrami and Dr Maryanne sive Sue Vella were appointed members of the Board. Ms Kapilashrami resigned in December 2016, following her departure from the HSBC Group.

I thank Ms Zammit Testaferrata Moroni Viani and Ms Kapilashrami for their service and dedication to the bank.

I feel honoured and privileged to be the Chairman of a Board whose members possess a wealth of knowledge and experience, at both the local and international levels. They contribute to the guidance and oversight of the bank, consistently deploying their vast experience and expertise in many different fields. I am also very proud of our management team, who constantly work diligently, and with courage and integrity, in order to ensure that the bank performs well during these unusually challenging times.

Fl-2016 saru tliet bidliet fil-kompożizzjoni tal-Bord tad-Diretturi tal-bank.

Wara li assuma l-pożizzjoni ta' Kap Eżekuttiv tal-bank f'Novembru 2015, Mr Andrew Beane ingħaqad mal-Bord tad-Diretturi f'Marzu 2016.

Ms Caroline Zammit Testaferrata Moroni Viani rriżenjat f'April 2016.

F'Mejju 2016, Ms Tanuj Kapilashrami u Dr Maryanne sive Sue Vella inħatru membri tal-Bord. Ms Kapilashrami irriżenjat f'Diċembru 2016, wara li telqet mill-Grupp HSBC.

Nirringrazzja lil Ms Zammit Tertaferrata Moroni Viani u lil Ms Kapilashrami għas-servizz u d-dedikazzjoni tagħhom lill-bank.

Huwa unur u privileġġ għalija li nkun iċ-*Chairman* ta' Bord li l-membri tiegħu huma mogħnija b'tant għarfien u esperjenza, sew fuq il-livell lokali kemm dak internazzjonali. Huma jikkontribwixxu billi jiddiriġu u jissorveljaw il-bank, billi jirrikorru konsistentement għall-esperjenza vasta u l-għerf espert tagħhom f'oqsma differenti. Jien kburi wkoll bit-tim tal-*management*, li dejjem imxew bil-għaqal f'xogħolhom, u b'kuraġġ u integrità, biex jaraw li l-bank iġib riżultati tajbin anke f'dawn iż-żminijiet ta' sfida mhux tas-soltu.

I am also proud of the fact that in 2016, our bank became the first private organisation in Malta to sign the Women Directors Malta charter.

Looking ahead

It is clear that we are not out of the woods. The global economic uncertainties, especially in the eurozone, coupled with the political changes that took place in 2016 – most notably the UK's Brexit referendum decision, the outcome of the US Presidential election, and significant political changes in countries within the European bloc – will most likely usher new realities which will have significant impact on the way our business is transacted. As we continue to face significant headwinds, I see more challenges and the need for more transformation for our bank. We have a clear strategy which has been agreed by the Board in February 2016 on how to become the bank of choice, and 2017 will see us implement a number of our strategic priorities. I am encouraged by the knowledge that this bank possesses a highly skilled, competent, experienced and dedicated group of people, who have time and again proved that they can meet any challenge which they face.

My gratitude also goes to you our shareholders, for the continued support and commitment to this bank. We will continue to strive to deliver to you the best results possible, and the highest return on your investment.

I conclude my statement by thanking our clients, who are the reason why this bank exists. We will continue to focus on providing them with the highest quality of products and services.

Sonny Portelli, *Chairman*
21 February 2017

Jagħmilni kburi wkoll il-fatt li fl-2016 il-bank tagħna sar l-ewwel organizzazzjoni privata f'Malta li ffirma l-karta tal-Women Directors ta' Malta.

Ħarsa 'l quddiem

Huwa ċar li l-maltemp għadu m'għaddiex. L-inċertezzi ekonomiċi globali, speċjalment dawk fiż-żona tal-ewro, kif ukoll il-bidliet politiċi li seħħew fl-2016 partikolarment id-deċiżjoni favur il-Brexit fir-referendum tar-Renju Unit u r-riżultat tal-elezzjoni presidenzjali Amerikana. Dawn, flimkien ma' bidliet politiċi importanti f'xi pajjiżi tal-blokk Ewropew, x'aktarx se jġibu realtajiet ġodda li jħallu impatt sinjifikanti fuq il-mod kif nagħmlu n-negozju. Bl-irjieħ għadhom jonfħu kontrina, jiena nara aktar sfidi u aktar ħtieġa ta' trasformazzjoni għall-bank. Għandna strateġija ċara li ġiet miftiehema mill-Bord fi Frar 2016 dwar kif ser insiru l-bank tal-għażla, u l-2017 ser tarana nimplimentaw għadd ta' prijoritajiet strateġiċi. Ninsab qalbi qawwija għax naf li f'dan il-bank għandna grupp ta' nies dedikati, b'livell għoli ta' ħila, kompetenza u esperjanza, li mhux darba u tnejn urew li kapaċi jilqgħu kull sfida li jiffaċċaw.

Irrid inrodd ħajr ukoll lill-azzjonisti tagħna, għas-sostenn kontinwu u l-impenn lejn il-bank. Aħna nibqgħu nistinkaw biex inġibulkom l-aħjar riżultati u l-ogħla rendita mill-investiment tagħkom.

Nagħlaq billi nirringrazzja lill-klijenti, li huma r-raġuni li dan il-bank jeżisti. Aħna nibqgħu niffokaw l-isforzi tagħna biex nagħtuhom prodotti u servizzi tal-ogħla kwalità.

Chief Executive Officer's Review

During 2016, the bank made significant progress through the implementation of our strategic plan, achieving a level of profitability on an adjusted basis that was in line with our expectations. In particular, strong progress was demonstrated on cost management which we signalled as a priority to our shareholders in our 2015 results announcement and has enabled us to offset some of the challenges posed by the unprecedented level of interest rates and increased regulatory costs.

Our 2016 results were affected negatively by a provision relating to a legacy charge in our now closed brokerage business. As I will be explaining later on, this is a disappointing development and the issue dates back to an operational failure that took place some 10 years ago. However, I believe that HSBC's approach to self-identify, self-report and remediate this issue demonstrates to our customers that our bank is committed to the highest standards of conduct by doing what is right for our customers at all times.

The local economy continues to perform well and the outlook is favourable. However, the growth prospects in the eurozone remain challenging, and negative interest rates are expected to persist, depressing the profits of banks.

In 2016, the bank's capital position remained solid and we continued building a strong capital base. Common equity tier 1 capital increased to 13.2% from 12.3% at the end of 2015. At December 2016, the bank was compliant with its end-point regulatory capital requirements – which enabled us to maintain our dividend payout ratio at 65% of the profit after tax, one of the highest in the industry.

We continued to accelerate the compliance agenda which is key in terms of medium term profitability. Our bank remains well capitalised and liquid. Our bank is strong, safe and secure, and well-positioned to navigate the current environment.

Matul l-2016 il-bank għamel progress sew fl-implimentazzjoni tal-pjan strateġiku, billi kiseb livell ta' profittabilità fuq bażi aġġustata li jaqbel mal-aspettitivi tagħna. B'mod partikolari sar progress tajjeb fil-ġestjoni tal-ispejjeż, punt li konna mmarkajnieh bħala prijorità lill-azzjonisti tagħna meta konna ħabbarna r-riżultati tal-2015, u li għenna npattu xi ftit għall-isfidi li ffaċċajna minn rati tal-imgħax f'livell baxx bħal qatt qabel u minn spejjeż regolatorji dejjem jiżdiedu.

Ir-riżultati tal-2016 kienu milquta ħażin minn provvediment marbut ma' transazzjonijiet antiki fin-negozju ta' brokerage li kellna, u li minn dak iż-żmien għalaqnieh. Kif se nispjega 'l quddiem, dan l-iżvilupp huwa ta' diżappunt u jirreferi għal falliment operazzjonali li seħħ xi għaxar snin ilu. Madankollu, naħseb li l-mod kif mexa l-HSBC biex jidentifika, jirrapporta lilu nnifsu f'din il-kwestjoni u jirrimedjaha, jagħtu xhieda lill-klijenti tagħna li l-bank huwa impenjat li jsegwi l-ogħla standards ta' kondotta billi jagħmel il-ħin kollu dak li hu sew għall-klijenti.

L-ekonomija lokali baqgħet sejra tajjeb u l-prospetti għadhom favorevoli. B'kuntrast, il-prospetti ta' tkabbir fiż-żona tal-ewro għadhom ta' sfida, u r-rati tal-imgħax mistennija li jibqgħu negattivi u li jżommu l-profitti tal-banek 'l isfel.

Fl-2016 il-pożizzjoni tal-kapital tal-bank baqgħet soda u komplejna nsaħħu l-bażi kapitali. Il-common equity tier 1 capital żdied għal 13.2% minn 12.3% fl-aħħar tal-2015. F'Diċembru 2016 il-bank kien konformi mar-rekwiżiti ta' kapital regolatorju kollu li kellu jilħaq. B'hekk il-bank seta' jżomm il-ħlas tad-dividend fil-livell ta' 65% tal-profitt wara t-taxxa, wieħed mill-ogħla fl-industrija.

Komplejna naċċeleraw l-aġenda tal-konformità mar-regolamenti, li hi kruċjali għall-profittabilità f'terminu medju. Il-bank tagħna għandu biżżejjed kapital u likwidità. Huwa bank b'saħħtu u sigur, u qiegħed f'pożizzjoni tajba biex ibaħħar fl-ambjent li ninsabu fih illum.

Performance

HSBC Bank Malta p.l.c. reported a profit before tax of €62.2m for the year ended 31 December 2016. This represents an increase of €15.4m or 33% on the previous year.

The reported profit before tax incorporates two 'non-recurring' items which are excluded from the adjusted results as it is considered internally as a better reflection of management's performance.

The first item relates to the gain on disposal of the bank's membership interest in Visa Europe. During the first half of 2016 Visa Inc. completed the acquisition of Visa Europe. As a result of this transaction, the bank received an upfront cash consideration and preferred stock. The total amount of income recognised in the reported results in relation to this transaction is €10.8m.

The second item represents a provision of €8m set aside in relation to a legacy operational and regulatory failure in the bank's now-closed brokerage business. This sum reflects the estimated cost of ensuring that customers affected by this specific issue are not disadvantaged in line with HSBC's commitment to the highest standards of conduct and fairness.

The bank has self-identified and self-reported the issue to the regulator, Malta Financial Services Authority. This issue relates to 'execution only' trades dealt in by customers purchasing complex instruments without the bank undertaking an appropriateness test required by MiFID. The bank will contact affected customers directly once final details of the resolution approach are agreed with the Malta Financial Services Authority at which point the final costs will be confirmed.

	2016	2015
	€000	€000
Reported profit before tax	**62,221**	46,772
Adjusting items:		
Exclude the gain on VISA transaction	**(10,787)**	–
Add the provision for brokerage remediation costs	**8,000**	–
Add the provision for early voluntary retirement	**–**	14,668
Adjusted profit before tax	**59,434**	61,440

Net interest income was down by 0.5% to €126.4m compared with 2015. The trend of low interest rates persisted in 2016 and continued to have an adverse impact on lending margins in retail and commercial loan portfolios. Yields on the investment book continued to decline as reinvestment rates were considerably lower and attractive reinvestment options remained limited.

Riżultati

L-HSBC Bank Malta p.l.c. irrapporta profitt qabel it-taxxa ta' €62.2m għas-sena li għalqet fil-31 ta' Diċembru 2016. Dan jirrappreżenta żieda ta' €15.4m jew 33% fuq is-sena ta' qabel.

Il-profitt qabel it-taxxa kif irrapportat jinkorpora fih żewġ 'entrati li ma jirrepetux ruħhom' li huma esklużi mir-riżultati kif aġġustati – dan għaliex huwa meqjus internament li jagħti stampa aktar ċara tal-prestazzjoni tal-management.

L-ewwel waħda minn dawn l-entrati tirreferi għall-qligħ fuq id-disponiment tal-interess ta' sħubija tal-bank fil-Visa Europe. Fl-ewwel nofs tal-2016 Visa Inc. ikkonkludiet l-akkwiżizzjoni ta' Visa Europe. Bħala riżultat ta' dik it-transazzjoni, il-bank irċieva sew dħul dirett ta' flus kemm ishma privileġġjati. It-total tal-introjtu rikonoxxut fir-riżultati kif rapportati għar-rigward ta' din it-transazzjoni kien ta' €10.8m.

It-tieni entrata tirrappreżenta provediment ta' €8m imwarrba b'rabta ma' falliment operazzjonali u regolatorju li seħħ snin ilu fin-negozju ta' *brokerage*, issa magħluq, li kellu l-bank. Din is-somma tirrifletti l-istima tal-ispiża neċessarja biex nassiguraw li l-klijenti milquta minn dil-kwestjoni ma jkunux żvantaġġjati, kif jitlob l-impenn tagħna li nsegwu l-ogħla standards ta' kondotta u ekwità.

F'din il-materja, il-bank identifika u rraporta lilu nnifsu lir-regolatur, l-Awtorità għas-Servizzi Finanzjarji ta' Malta (l-MFSA). Il-kwestjoni tirreferi għan-nuqqas tal-bank li jagħmel it-test tal-approprjatezza kif mitlub mill-MiFID f'każi ta' strumenti kumplessi mixtrija minn klijenti fuq bażi 'execution only'. Il-bank se jagħmel kuntatt direttament mal-klijenti milquta ladarba d-dettalji finali ta' kif se tiġi riżolta l-kwestjoni jkunu miftiehma mal-MFSA u jkun ikkonfermat l-ammont finali tal-ispejjeż.

	2016	2015
	€000	€000
Profitt qabel it-taxxa kif irrappurtat	**62,221**	46,772
Entrati ta' aġġustament:		
Naqqas il-qligħ fuq it-transazzjoni tal-VISA	**(10,787)**	–
Żid il-provediment tal-ispejjeż biex jagħmlu tajjeb għall-*brokerage*	**8,000**	–
Żid il-provediment għall-irtirar kmieni volontarju	**–**	14,668
Profitt qabel it-taxxa kif aġġustat	**59,434**	61,440

The world in 2017 – HSBC believes that the Maltese economy has the potential to stand out, though uncertainty prevails elsewhere.

Furthermore, in March 2016, the ECB lowered its deposit rate to a record negative 40 basis points and the bank effectively had to pay interest for placing its excess liquidity on nostro accounts and in money market deals which traditionally earned interest. The reduction in interest expense on deposits partially mitigated the drop in the interest income due to further decline in deposit rates and the continued shift of liability balances towards shorter dates.

Non-interest income decreased by 11% compared with 2015. This was largely a result of risk management actions taken during the year including the demise of stockbroking business and re-shaping of parts of our client portfolio to align to our risk appetite. In addition, the bank saw a decrease in card fees as the new regulation which introduced the reductions in interchange fees came into effect from the end of 2015. At the same time, the bank recorded higher proceeds from the sale of repossessed properties.

HSBC Life Assurance (Malta) Limited reported a profit before tax of €7.3m, a decline of 17% compared to 2015. While the new protection business generation was up year on year, net revenue decreased due to lower premiums on the existing insurance policies, adverse impact of yield curve movement and lower management fees on the run-off portfolio of investment policies.

Operating expenses were €110.3m, €8.5m or 7.1% lower compared with previous year. The provision for the early voluntary retirement programme of €14.7m launched at the end of 2015 was the main driver for higher 2015 costs. At the same time, operating expenses of 2016 included the non-recurring costs of the provision for brokerage remediation of €8m.

Id-dħul nett mill-interessi niżel b'0.5% għal €126.4m meta mqabbel mal-2015. Ix-xejra ta' mgħaxijiet baxxi kompliet tippersisti fl-2016 u baqgħet ikollha impatt ħażin fuq il-marġni tas-self sew personali kemm kummerċjali. Ir-rendità fuq l-investimenti tal-bank kompliet tinżel hekk kif ir-rati ta' rijinvestiment kienu ħafna aktar baxxi u l-għażliet ta' investiment ġdid baqgħu limitati. Barra minn hekk, f'Marzu 2016, il-Bank Ċentrali Ewropew baxxa r-rata tad-depożitu għal-livell rekord ta' 40 punt bażi fin-negattiv u l-bank effettivament kellu jħallas l-interessi biex iqiegħed il-likwidità żejda tiegħu f'kontijiet *nostro* u fi transazzjonijiet tas-suq tal-flus li normalment kienu jaqilgħu l-imgħax. It-tnaqqis fl-ispiża tal-interessi fuq id-depożiti taffa parzjalment il-waqgħa fid-dħul mill-imgħax billi r-rati tad-depożitu komplew neżlin u l-bilanċi tal-obligazzjonijiet komplew ixaqilbu lejn skadenzi iqsar.

Dħul mhux mill-imgħax naqas bi 11% meta mqabbel mal-2015. Dan ġara l-iżjed minħabba azzjoni meħuda matul is-sena relatata mal-immaniġġjar tar-riskju, inkluż l-għeluq tan-negozju ta' *stockbroking* u r-ristrutturar ta' partijiet mill-portafoll tal-klijenti biex jaqbel iżjed mad-dispożizzjoni għar-riskju li għandu l-bank. Id-dħul mill-kummerċ tal-kards ukoll naqas, peress li r-regolament il-ġdid li ġab it-tnaqqis fid-drittijiet għal servizzi reċiproċi fuq il-kards daħal b'effett mill-aħħar tal-2015. Fl-istess ħin, il-bank irreġistra dħul ogħla mill-bejgħ ta' proprjetajiet maqbuda.

L-HSBC Life Assurance (Malta) Limited irrapporta profitt qabel it-taxxa ta' €7.3m, li hu 17% inqas milli fl-2015. Waqt li sena b'sena l-ġenerazzjoni tan-negozju l-ġdid ta' protezzjoni kien ogħla, id-dħul nett xorta waqa' minħabba primjums aktar baxxi fuq poloz ta' assigurazzjoni eżistenti, kif ukoll minħabba l-effett negattiv taċ-ċaqliq fir-renditi u d-drittijiet aktar baxxi tal-amministrazzjoni tal-portafoll tal-poloz ta' investiment.

Chief Executive Officer's Review (continued)

The bank continued to bring its deep international capability to Malta with presentations by experts such as David Bloom, renowned HSBC economist and FX strategist.

On an adjusted basis, excluding the above-mentioned non-recurring items, operating expenses were down 2% compared with 2015 which was a good outcome. The implementation of the early voluntary retirement programme during the year had a positive impact on staff costs which were 2% lower than the 2015 level despite further investment in risk and compliance and the annual pay increase agreed under the newly signed collective agreement. Administrative expenses were well controlled and decreased by 1.5% as a result of cost management actions and the favourable effect of currency fluctuations on the cost of outsourced services.

The adjusted cost efficiency ratio, that compares normalised operating expenses to normalised net operating income, was 60%, compared with 59% in 2015.

Loan impairment charges were reduced by 17% compared with 2015. The decrease was largely attributable to better collection on defaulted retail exposures. The bank continued to exercise a cautious approach to provisioning for non-performing loans.

Net loans and advances to customers rose by 1% and stood at €3,320m. The growth was primarily observed in mortgages – this product continued to experience an increased level of demand as the government extended the incentives for first time buyers. The bank continued to monitor the developments in the real estate market closely and to maintain prudent lending practices. In the persisting low interest rate environment, early prepayments in both retail and corporate loan books remained at a high level creating a pressure on the margin and offsetting the effect of the record gross new lending.

L-ispejjeż tal-operat ammontaw għal €110.3m, li hu €8.5m jew 7.1% anqas meta mqabbel mas-sena ta' qabel. Il-kawża ewlenija li l-ispejjeż tal-2015 kienu ogħla kien il-provediment ta' €14.7m għall-programm ta' rtirar kmieni volontarju li kien imniedi f'dik is-sena. Mill-banda l-oħra, l-ispejjeż tal-operat fl-2016 kienu jinkludu l-ispiża ta' darba għal provediment ta' €8m biex jagħmel tajjeb għall-irrimedjar fil-*brokerage.*

Fiċ-ċifri aġġustati, li jeskludu l-entrati li ma jirrepetux ruħhom imsemmja hawn fuq, l-ispejjeż tal-operat naqsu bi 2% meta mqabbla mal-2015, li hu riżultat sodisfaċenti. L-implimentazzjoni tal-programm ta' rtirar kmieni volontarju matul is-sena kellu effett pożittiv fuq l-ispiża tal-impjegati, li kienet 3% inqas milli fl-2015 minkejja li komplejna ninvestu aktar fil-qasam tar-riskju u l-konformità mar-regolamenti, u minkejja ż-żieda ta' kull sena fil-pagi skont il-ftehim kollettiv il-ġdid. L-ispejjeż amministrattivi kienu kontrollati tajjeb u naqsu b'1.5% riżultat ta' kontrolli effettivi u tal-impatt favorevoli taċ-ċaqliq fil-kambju fuq il-prezz tas-servizzi kuntrattati.

Iċ-ċifra aġġustata tal-*cost efficiency ratio,* li jqabbel l-ispejjeż normalizzati tal-operat mad-dħul nett normalizzat mill-operat, kienet ta' 60%, imqabbla ma' 59% fl-2015.

L-ammont debitat għall-indeboliment tas-self naqas bi 17% meta mqabbel mal-2015. It-tnaqqis huwa attribwit l-aktar għal sforz aħjar biex jinġabru ammonti dovuti ta' self personali li kienu ma tħallsux. Il-bank baqa' jieħu pożizzjoni kawta fil-provediment għal self li ma jirrendix.

Asset quality further improved in 2016 with non-performing exposures at 6.4% of gross loans and advances to customers compared to 7% in 2015. This was achieved through proactive engagement with defaulted borrowers which led to higher recoveries.

Customer accounts increased by 1% to €5,001m in 2016. Deposits from retail customers, the most stable form of funding, increased by 2% as the bank focused on expanding its primary-banked customer base. The bank sustained a robust liquidity position with the advances-to-deposits ratio remaining at 66% when compared with 2015.

The available-for-sale financial investments portfolio decreased by 13% year on year. The bank maintains its investment portfolio as a high-quality liquidity buffer and invests only in highly rated securities of sovereign and supranational issuers. Record low and often negative yields of many European sovereign bonds coupled with the limited availability of local government bonds made it extremely difficult for the bank to replenish its investment portfolio.

All three main business lines, Retail Banking and Wealth Management, Commercial Banking and Global Banking and Markets, continued to be profitable during 2016.

Retail Banking and Wealth Management (RBWM)

The persistent low interest rate environment made 2016 a challenging year for RBWM. Despite these conditions, RBWM achieved a stronger revenue performance year on year. Our customers continued to save and invest their money with HSBC resulting in a further increase in deposits compared to the previous year, confirming the trust and confidence placed in the bank by our depositors.

RBWM has delivered well against financial expectations with a record year on lending, helping circa 2,000 customers buy a new home. We also saw the introduction of a market leading credit card offering, Visa Platinum, through the re-launch of our fee-free Advance proposition, catering to those customers who use HSBC as their main bank.

Investments were bolstered through the introduction of HSBC Select in the first quarter which accounted for nearly 30% of all investment flows received in 2016.

2016 has seen a change in the leadership team of RBWM with a view to better reflect the opportunities and requirements of the local market. Our strategy is simple and focused on our people and our customers. Earlier in the year, we launched HSBC Malta's Facebook page which is already seen as market-leading amongst the banks.

Is-self nett lill-klijenti tela' b'1% għal €3,320m. It-tkabbir ewlieni kien fis-self għad-djar – dan il-prodott baqa' jattira domanda dejjem tiżdied hekk kif il-gvern estenda l-inċentivi għal min jixtri l-ewwel dar. Il-bank baqa' jżomm għajnejh fuq l-iżviluppi fis-suq tal-proprjetà u kompla jeżerċita l-prudenza fis-self. B'rati tal-imgħax li huma persistentement baxxi, ikun hemm ħafna klijenti sew personali kemm kumpaniji li jippreferu jagħmlu l-ħlasijiet lura kmieni u b'hekk joħolqu pressjoni fuq il-marġni u jikkanċellaw l-effett vantaġġjuż tas-self ġdid gross, li laħaq livell rekord.

Il-kwalità tal-assi wkoll marret 'il quddiem fl-2016. Is-self li ma jirrendix kien ta' 6.4% tas-self gross lill-klijenti, imqabbel ma' 7% fl-2015. Dan irnexxilna niksbuh b'ħidma proattiva mal-klijenti li kienu waqgħu lura fil-ħlas, li wasslet biex jinġabru lura ammonti akbar.

Il-kontijiet tal-klijenti żdiedu b'1% għal €5,001m fl-2016. Id-depożiti minn klijenti personali, li huma l-aktar forma stabbli ta' fondi, telgħu bi 2% hekk kif il-bank iffoka biex iwessa' l-bażi tal-klijentela primarja tiegħu. Il-bank baqa' jżomm pożizzjoni robusta ta' likwidità, u l-proporzjon tas-self mad-depożiti żamm fil-livell ta' 66%, kif kien fl-2015.

Il-portafoll ta' investimenti finanzjarji *available-for-sale* naqas bi 13% sena b'sena. Il-bank iżomm il-portafoll tal-investimenti tiegħu bħala appoġġ ta' kwalità għal-likwidità u jinvesti biss f'titoli ta' grad għoli ta' emittenti sovrani jew supranazzjonali. F'ambjent fejn ħafna bonds sovrani Ewropej kienu qed joffru mgħaxijiet li niżlu rekord fil-baxx jew kienu spiss negattivi, u fejn l-opportunitajiet ta' xiri ta' bonds lokali tal-gvern kienu limitati, kien diffiċli ferm għall-bank li jġedded il-portafoll tal-investimenti tiegħu.

It-tliet linji ewlenin tan-negozju tal-bank – is-Servizzi Bankarji Personali (RBWM), is-Servizzi Bankarji Kummerċjali (CMB) u s-Servizzi Bankarji u s-Swieq Globali (GBM) – kollha ħallew profitt matul l-2016.

Is-Servizzi Bankarji Personali (l-RBWM)

Bir-rati baxxi tal-imgħax li baqgħu jiddominaw, l-2016 kienet sena ta' sfida għall-RBWM. Minkejja dawn il-kundizzjonijiet, l-RBWM kiseb riżultati ta' dħul aqwa minn tas-sena ta' qabel. Il-klijenti tagħna baqgħu jfaddlu u jinvestu flushom mal-HSBC, bid-depożiti jkomplu jiżdiedu fuq is-sena ta' qabel. Dan jikkonferma r-rabta u l-fiduċja li d-depożitanti għandhom fil-bank.

L-RBWM kellha prestazzjoni li tħabbatha sew mal-aspettativi finanzjarji, u kellha rekord ta' self billi għenet madwar 2,000 klijent jixtru dar ġdida. Rajna wkoll l-introduzzjoni ta' karta ta' kreditu li tinsab fuq quddiem fis-suq, il-Visa Platinum, bit-tnedija mill-ġdid tal-proposta bla ħlas tal-Advance, li taqdi lil dawk il-klijenti li jużaw lill-HSBC bħala l-bank ewlieni tagħhom.

Group General Manager and Head of Commercial Banking Europe, Ian Stuart, visited Malta and noted that HSBC has a duty of care to its very loyal customer base in Malta.

We have implemented an employee lead change programme focusing on finding solutions to the things that our teams and customers believe should be changed in order to provide a better service. In 2016 alone we saw over 40 changes to procedures saving time for our people and our customers at the frontline.

Commercial Banking (CMB)

In 2016 our CMB business delivered improved financial results, with both revenues and profitability higher compared to the previous year. This positive performance is underlined by prudent credit policies, increased income and strict cost management.

These results are commendable as these were achieved in a challenging environment which besides increased competition and tighter lending margins, also necessitated undertaking remediation activities to upgrade and de-risk the business in line with HSBC Financial Crime Risk standards. Achieving the latter to the necessary high level is not an easy task and remains an ongoing process. However, we are confident that this work will benefit our customers and all stakeholders. This also augurs well for a sustainable future.

During 2016 we continued to invest in up-skilling our people through various training courses, offsite meetings and team building activities. We also implemented new office processes and made system changes to streamline our service, attain greater efficiencies and benefit from economies of scale.

L-investimenti ngħataw spinta bid-dħul tal-HSBC Select fl-ewwel kwart tas-sena, li ġab kważi 30% tal-investimenti kollha li daħlu fl-2016.

Fl-2016 kien hemm tibdil fit-tim ta' tmexxija tal-RBWM, bil-għan li jirrifletti aħjar l-opportunitajiet u l-ħtiġijiet tas-suq lokali. L-istrateġija tagħna hija sempliċi u ffokata fuq in-nies u l-klijenti tagħna. Aktar kmieni fis-sena varajna l-paġna tal-Facebook tal-HSBC Malta, li diġà hija meqjusa fuq quddiem fis-suq fost il-banek.

Qed inħaddmu wkoll programm għall-bidla fost l-impjegati li jikkonċentra fuq soluzzjonijiet għal dawk l-affarijiet li t-timijiet u l-klijenti tagħna jaħsbu li għandhom jinbidlu biex nagħtu servizz aħjar. Fl-2016 biss għamilna 'l fuq minn 40 bidla fil-proċeduri biex niffrankaw il-ħin għall-ħaddiema u l-klijenti fil-fergħat tagħna.

Is-Servizzi Bankarji Kummerċjali (is-CMB)

Fl-2016, ix-xogħol tas-CMB ħalla riżultati finanzjarji aħjar, fejn id-dħul u l-profittabilità t-tnejn kienu aqwa minn dawk tas-sena ta' qabel. Dan irnexxilna niksbuh permezz ta' politika ta' kreditu prudenti, dħul akbar, u kontroll strett fuq l-ispejjeż.

Dawn ir-riżultati huma ta' min ifaħħarhom għax inkisbu f'ambjent ta' sfida fejn, apparti mill-kompetizzjoni aktar ħarxa u marġni ta' self aktar dojoq, kien jeħtieġ li noffru rimedju u li ngħollu l-livell u nnaqqsu r-riskju tan-negozju skont ma hu mistenni mill-HSBC Financial Crime Risk standards. Mhijiex biċċa xogħol faċli li nilħqu dawn l-istandards fil-livell għoli mitlub, u l-proċess għadu għaddej. Imma aħna fiduċjużi li x-xogħol se jiswa ta' ġid għall-klijenti u għal kull min għandu interess. Dan jawgura tajjeb ukoll għal futur sostenibbli.

Fl-2016 komplejna ntejbu l-ħiliet tal-impjegati b'diversi korsijiet ta' taħriġ, laqgħat *offsite*, u attivitajiet ta' ħidma flimkien. Daħħalna wkoll proċessi ġodda fl-uffiċji u wettaqna tibdil fis-sistemi biex is-servizz tagħna jimxi aktar lixx, niksbu effiċjenzi akbar, u ngawdu mill-ekonomija fil-kobor.

Nemmnu bis-sod li l-akbar assi tagħna huma l-impjegati. Ir-riżultati tajbin inkisbu biss bil-professjonalità, ix-xogħol iebes u l-impenn tal-ħaddiema. Hu għalhekk li nieħdu gost ninnotaw dak li ħareġ minn riċerka esterna li saret fuq il-Commercial Banking Relationship Managers tagħna, li wriet livell għoli ta' sodisfazzjon fl-aspetti kollha tas-servizz li jingħata lill-klijenti. Kellhom marki għolja ħafna fuq diversi punti, pereżempju kemm jifhmu l-ħtiġijiet kummerċjali tal-klijenti, kif isolvu l-problemi, kemm huma affidabbli

We firmly believe that our people are our greatest asset. Achieving good results can only be realised through the professionalism, hard work and commitment of our staff. That is why it is reassuring to note that external research conducted on our Commercial Banking Relationship Managers (RMs), showed a high level of satisfaction across all aspects of service provided to clients. RMs scored very highly in such areas as understanding business needs, problem resolution, being trustworthy and ethical, adding value and building long-term relationships. These are results to be truly proud of and we will continue to focus on improving the Customer Experience.

Our ongoing commitment to the Maltese business community was demonstrated through the continued partnership with Trade Malta and the Malta Chamber of Commerce, Industry and Enterprise to promote Malta. We also part sponsored for another year the EY Malta Attractiveness Conference and were again the lead sponsors of The Economist event. In addition we organised several thought leadership events for our customers which included bringing to Malta two of HSBC's renowned global economists to discuss and interact with our customers directly. Such activity surely positions HSBC Malta as the bank of choice for business.

The Malta Trade for Growth initiative and the €75m fund launched in June 2015, built on the success of the first €50m fund, has been well received by a range of stakeholders. By the end of 2016, more than 90% of the fund had been utilised.

Global Banking and Markets (GB&M)

The overall performance of GB&M was lower in 2016 as it continued to face external market challenges. Balance sheet management, which manages Interest Rate Risk on the bank's balance sheet and deploys surplus liquidity, delivered a decent result under the unprecedented negative interest rate environment. However, revenues were down on last year, as the bank continues to have significant surplus liquidity. The available-for-sale portfolio is mainly re-invested in investment grade securities rated A- or higher, reflecting our conservative risk appetite but delivering very low to negative performance. Revenues from foreign exchange are also down on last year due to lower volume of transacted business, reflecting bank's de-risking strategy and tightened competition.

Collaboration with CMB remains one of GB&M's strategic priorities. It allows CMB clients to benefit from GB&M's product expertise, in particular for foreign exchange, interest rate risk and commodities risk management, where we see a good potential for growth, especially as the interest rates start to pick up.

u etiċi, kemm joffru valur miżjud u kemm jibnu relazzjonijiet fit-tul. Dawn huma riżultati li għandna nkunu kburin bihom u li jħeġġuna nkomplu niffokaw fuq it-titjib tal-esperjenza tal-klijent.

L-impenn kontinwu tagħna lejn il-komunità kummerċjali Maltija ntwera bis-sħubija li għad għandna ma' Trade Malta u mal-Kamra tal-Kummerċ, Intrapriża u Industrija biex nirreklamaw lil Malta. Għal sena oħra sponsorjajna wkoll in parti l-EY Malta Attractiveness Conference u konna għal darb'oħra l-isponsors ewlenin ta' The Economist Event. Barra minn hekk organizzajna diversi attivitajiet ta' *thought leadership* għall-klijenti, inkluż li ġibna Malta żewġ ekonomisti tal-HSBC magħrufin mad-dinja biex jitkellmu u jiddiskutu direttament mal-klijenti tagħna. Attivitajiet bħal dawn ma jistgħux ma jagħmlux lill-HSBC Malta l-bank tal-għażla għal min hu fin-negozju.

L-inizjattiva Malta Trade for Growth, flimkien mal-fond ta' €75m imniedi f'Ġunju 2015, li bena fuq is-suċċess tal-ewwel fond ta' €50m, intlaqgħet tajjeb minn diversi partijiet, tant li sal-aħħar tal-2016 kien utilizzat aktar minn 90% tal-fond.

Is-Servizzi Bankarji u s-Swieq Globali (il-GB&M)

Il-prestazzjoni ġenerali tal-GB&M marret lura fl-2016 minħabba li kompliet tiffaċċa sfidi esterni fis-suq. Il-ġestjoni tal-karta tal-bilanċ, li tieħu ħsieb kif tikkontrolla r-Riskju tar-Rata tal-Imgħax fuq il-karta tal-bilanċ u fejn tqassam il-likwidità żejda tal-bank, ħalliet riżultat mhux ħażin meta tqis il-kondizzjoni negattiva bla preċedent tar-rati tal-imgħax. Madankollu d-dħul naqas mis-sena l-oħra, għax il-bank għadu qed ikollu ħafna likwidità żejda. Il-portafoll ta' titoli *available-for-sale* jerġa' jiġi investit prinċipalment f'titoli ta' grad ta' investiment ikklassifikati A- jew ogħla, b'konformita mad-dispożizzjoni għar-riskju konservattiva tagħna, imma mbagħad jagħtu rendita baxxa ħafna jew anke negattiva. Id-dħul mill-kambju wkoll naqas mis-sena l-oħra għax kien hemm volum iżgħar ta' transazzjonijiet, rifless tal-istrateġija tal-bank li jnaqqas ir-riskju u tal-kompetizzjoni aktar ħarxa.

Il-kollaborazzjoni mas-CMB tibqa' waħda mill-prijoritajiet strateġiċi tal-GB&M. Permezz tagħha, il-klijenti tas-CMB igawdu mit-tagħrif espert li dawk tal-GB&M ikollhom fuq il-prodotti, speċjalment fil-ġestjoni tal-muniti barranin, tar-riskju tar-rati tal-imgħax, u tar-riskju tal-prodotti kummerċjali, li fihom naraw potenzjal tajjeb għat-tkabbir, l-aktar meta l-interessi jerġgħu jibdew telgħin.

GB&M has organised a number of seminars for CMB clients and invited industry leading specialists, including one from HSBC's Global Head of FX Strategy. CMB clients also continue to benefit from the digital solution for foreign exchange and we witnessed growth in the value of transactions processed online in 2016.

HSBC Operations, Services & Technology (HOST)

The HOST teams have continued to support the bank's businesses and functions to streamline their processes, identify simpler ways of working and enhance customer experience. One example of this streamlining is the process of HSBC Advance account opening that significantly shortened the processing time.

In 2016 the Operations team continued to build on the work done the previous year and delivered a number of initiatives that focused on simplifying our operations. Amongst the key initiatives delivered were the outsourcing of the courier services within the branches and head office, a reorganisation of the operations team to drive greater focus on strategic management, and an intensive re-engineering exercise of a number of key processes resulting in the simplification and automation of processes. Furthermore, we have also invested in our people by providing formal training on operational efficiency.

Our IT team has upgraded a number of working tools that impacted all employees. This upgrade made it easier to work by transforming how our colleagues connect, communicate and collaborate across our organisation. We have modernised our card embossing infrastructure in order to improve service availability and resilience and comply with security standards.

Another key initiative was the implementation of a new improved financial planning platform for RBWM that is more customer centric. We have also installed free Wi-Fi internet access in all branches to help our customers get online while they bank. Our branch colleagues can now assist customers to download our Mobile Banking app and demonstrate its features and benefits.

The IT function has continued to provide systems that are used to meet regulatory requirements and increase the fight against financial crime. We increased our focus on protecting our business through stronger mitigation controls against operational risk, financial crime and meet regulatory requirements such as Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standard (CRS). We also enhanced existing tools to facilitate investigation and reporting on transaction monitoring. Furthermore, a number of changes have been implemented to our payments systems to provide more transparency when effecting cross-border transfer payments.

Il-GB&M tella' numru ta' seminars għall-klijenti tas-CMB fejn stieden speċjalisti fuq quddiem fl-industrija, inkluż wieħed mill-Global Head of FX Strategy tal-HSBC. Il-klijenti tas-CMB għadhom igawdu wkoll mis-soluzzjoni diġitali għall-kambju, u nnotajna li kien hemm tkabbir fil-valur tat-transazzjonijiet ipproċessati *online* fl-2016.

L-Operazzjonijiet, is-Servizzi u t-Teknoloġija tal-HSBC (HOST)

It-timijiet tal-HOST komplew jagħtu l-appoġġ lid-dipartimenti kummerċjali u amministrattivi tal-bank biex il-proċessi jimxu aħjar, isibu metodi iżjed sempliċi kif isir ix-xogħol u jgħinu l-klijent ikollu esperjenza aħjar. Eżempju wieħed ta' dan huwa l-ftuħ tal-kont tal-HSBC Advance li qsar b'mod notevoli fil-proċess tiegħu.

Fl-2016 it-tim tal-Operazzjonijiet kompla jibni fuq ix-xogħol tas-sena ta' qabel u ħareġ għadd ta' inizjattivi li jfittxu li jissimplifikaw l-operazzjonijiet. Fost dawk ewlenin hemm l-għoti ta' kuntratt għas-servizzi ta' kurrier bejn il-fergħat u l-uffiċċju ewlieni, ir-rijorganizzazzjoni tat-tim tal-operazzjonijiet biex jiffokaw b'aktar enfasi fuq it-tmexxija strateġika, u eżerċizzju intensiv biex jitfasslu mill-ġdid ċerti proċessi importanti li wassal biex isiru aktar sempliċi u awtomatiċi. Barra minn hekk, għamilna wkoll investiment fin-nies tagħna billi tajniehom taħriġ formali fuq l-effiċjenza operazzjonali.

It-tim tal-IT ħareġ verżjonijiet ġodda ta' numru ta' għodod informatiċi li laqtu lill-impjegati kollha. Dawn l-għodod il-ġodda għamlu x-xogħol eħfef għax ittrasformaw il-mod kif il-kollegi tagħna jikkomunikaw u jikkolaboraw minn tarf għall-ieħor tal-organizzazzjoni. Immodernizzajna l-infrastruttura tal-*embossing* tal-kards biex is-servizz jasal aħjar, ikun aktar robust u jikkonforma mal-istandards tas-sigurtà.

Inizjattiva kruċjali oħra kienet l-implementazzjoni ta' pjattaforma ġdida għall-ippjanar finanzjarju għall-RBWM li tpoġġi lill-klijent aktar fiċ-ċentru. Installajna l-aċċess b'xejn għall-Wi-Fi f'kull fergħa biex il-klijenti jkunu jistgħu jaqbdu mal-internet waqt li jkunu l-bank. Il-kollegi tagħna fil-fergħat issa jistgħu jgħinu lill-klijenti jniżżlu l-app tal-Mobile Banking tagħna u juruhom il-faċilitajiet u l-vantaġġi tagħha.

Il-funzjoni tal-IT kompliet toħroġ aktar sistemi biex jgħinuna nlaħħqu mal-ħtiġijiet regolatorji u nsaħħu l-glieda kontra r-reati finanzjarji. Iffokajna aktar fuq il-ħarsien tan-negozju tagħna permezz ta' kontrolli ta' mitigazzjoni aktar b'saħħithom kontra r-riskju operazzjonali u r-reati finanzjarji u biex nissodisfaw ir-rekwiżiti regolatorji bħall-FATCA u s-CRS. Tejjibna l-għodod eżistenti biex il-monitoraġġ tat-transazzjonijiet ikun jista' jiġi investigat u rrapportat. U għamilna

In order to ensure that the bank would be able to continue to provide its critical services to its customers, a significant investment was made to upgrade the bank's contingency site.

As part of HOST, our Corporate Real Estate team worked on the restoration of the façade of our headquarters in Valletta. Our team worked with preservation experts so that the highest priority was given to maintaining the heritage of the structure but also to safeguard the principles of restoration interventions. The project included the comprehensive façade cleaning, re-pointing of all bricks and internal masonry and restoration of the windows.

As part of the bank's commitment to operate using more energy efficient sources, HOST continued the implementation of the Simply Electric programme by installing 131 photovoltaic panels at five of our branches and offices. This brings the total of photovoltaic panels to 614.

Our people

Investing in our people is paramount in order to continue achieving our goals as a leading financial organisation in the country.

In 2016, we launched an enhanced diversity and inclusion policy, centred on meritocracy of opportunity. As part of this new policy, employees on child care leave are guaranteed flexible working on an opt-out basis. Moreover, a minimum of one female employee is now being shortlisted for any senior management vacancies. We are proud to have been the first private organisation to sign the Women Directors Malta charter aimed at increasing female representation on boards in Malta.

In February 2016, we signed the long-standing Collective Agreement which runs until the end of 2018. The original Collective Agreement had expired at the end of 2013. The new agreement has led to improved relations with the union and has provided more certainty to our colleagues.

Throughout the year, we launched a well-being strategy focused on mental and physical welfare. Over 90 of our line managers will be attending the mental health first aid two-day programme which helps identify colleagues who might be suffering from mental health issues and provides help on how to support them. On the physical well-being side, we have expanded the range of gyms for employees to attend at no charge across Malta and Gozo.

għadd ta' tibdiliet fis-sistemi ta' pagament tagħna biex nipprovdu aktar trasparenza meta nagħmlu pagamenti ta' trasferiment lejn pajjiżi barranin.

Bil-għan li nassiguraw li l-bank ikun jista' jibqa' jagħti s-servizzi kritiċi lill-klijenti, għamilna investiment sostanzjali biex ngħollu l-livell tas-sit ta' kontinġenza tal-bank.

Bħala parti mill-HOST, it-tim responsabbli mill-Proprjetà tal-Kumpanija ħadem fuq ir-restawr tal-faċċata tas-sede tagħna fil-Belt Valletta. It-tim ħadem ma' esperti tal-konservazzjoni ħalli tingħata l-ewwel prijorità biex ma jintilifx il-patrimonju tal-istruttura, imma wkoll biex jitħarsu l-prinċipji li japplikaw f'interventi ta' restawr. Il-proġett kien jinvolvi t-tindif komplet tal-faċċata, it-tikħil mill-ġdid tal-ħajt kollu u xogħol tal-ġebel fl-intern u restawr tat-twieqi.

Bħala parti mill-impenn tal-bank biex juża sorsi ta' enerġija aktar effiċjenti, il-HOST baqgħet għaddejja bil-programm Simply Electric billi installat 131 pannelli fotovoltajiċi f'ħames fergħat u uffiċċji. B'hekk it-total ta' pannelli fotovoltajiċi installati tela' għal 614.

In-nies tagħna

L-investiment fin-nies tagħna huwa ta' importanza suprema biex inkomplu nilħqu l-miri tagħna bħala waħda mill-organizzazzjonijiet finanzjarji ewlenin f'pajjiżna.

Fl-2016, inawgurajna politika ġdida ta' diversità u inklużjoni, iċċentrata fuq il-meritokrazija tal-opportunità. Bħala parti minn din il-politika, impjegati li jkunu bil-frank biex jieħdu ħsieb it-tfal għandhom garanzija li jibqgħu jaħdmu b'orarju flessibbli, jekk iridu. Barra minn hekk, meta jkun hemm vakanza fil-livelli għoljin tal-management, il-lista mqassra tal-kandidati magħżulin issa qed tkun tinkludi almenu mara waħda. Aħna kburin li konna l-ewwel organizzazzjoni privata li ffirmajna l-karta tal-Women Directors ta' Malta, li għandha l-għan li twessa' r-rappreżentanza tan-nisa fuq il-bordijiet f'Malta.

Fi Frar 2016 iffirmajna l-Ftehim Kollettiv li jwassal sal-aħħar tal-2018. Il-ftehim oriġinali kien għalaq fl-2013. Il-ftehim il-ġdid wassal biex jitjiebu r-relazzjonijiet mal-*union* u ta aktar ċertezza lill-kollegi tagħna.

Matul is-sena varajna strateġija ta' *well-being* ibbażata fuq is-serħan mentali u fiżiku. Aktar minn 90 maniġer fl-uffiċċji tagħna se jattendu kors ta' jumejn tal-ewwel għajnuna fis-saħħa mentali, biex jitgħallmu jagħrfu jekk xi kollega jkunx qed ibati minn xi problemi ta' saħħa mentali u kif għandhom jgħinuhom. Fuq il-lat fiżiku, żidna l-lista ta' *gyms* f'Malta u Għawdex fejn l-impjegati tagħna jistgħu jattendu b'xejn.

Chairman Sonny Portelli together with CEO Andy Beane and a group of HSBC Malta colleagues with the prestigious 'Best Bank of the Year' in Malta 2016 award during the Financial Times 'The Banker' ceremony in London.

In terms of our people development agenda, we have concluded the roll-out of a one-day programme aimed at enabling employees to be at their best both at work and in their private life. In total, over 1,300 colleagues attended the programme which aims to support employees in bringing their whole selves to work and adopting an appropriate, values-led framework to help in daily decision making processes.

In 2016, we have provided training to employees on Financial Crime Risk (FCR), especially Anti Money Laundering and Sanctions. More training on FCR is being rolled out in 2017. Considerable work has gone in expanding the size of the Financial Crime Risk function, thus creating new roles and development opportunities in Malta.

Compliance

HSBC is committed to the highest global standards of financial crime compliance and during 2016 this remained a key priority for the bank. While HSBC appreciates that our high standards can at times cause inconvenience for clients as we ask more questions regarding how they use their accounts and request more documents, we believe that this important work provides security to the financial system and all those who use it. High compliance standards in the banking system is a source of strength and competitive advantage not only for our customers but also for the country as we work diligently to support growth in Malta's economy by facilitating new business and cross-border trade.

HSBC is committed to continue this important work in 2017 as we approach a seminal point for the country with the next Moneyval inspection of Malta's compliance with international obligations. A positive outcome of this review is an essential building block for the next phase of the country's economic growth.

Fejn tidħol l-aġenda tagħna għall-iżvilupp tan-nies tagħna, ikkonkludejna l-organizzazzjoni ta' programm ta' jum immirat biex jgħin lill-impjegati jħossuhom fl-aħjar tagħhom fix-xogħol u fil-ħajja privata. B'kollox attendew il-programm 'il fuq minn 1,300 kollega. Il-programm kellu l-għan li jgħin lill-impjegati jkunu kollhom hemm meta jkunu għax-xogħol u jadottaw qafas li jixraq u mmexxi mill-valuri li jiggwidawhom fil-proċess tad-deċiżjonijiet ta' kuljum.

Fl-2016 tajna taħriġ lill-impjegati fuq ir-Riskju tar-Reati Finanzjarji (FCR), l-aktar fuq il-Prevenzjoni tal-Ħasil tal-Flus u s-Sanzjonijiet. Se nagħtu aktar taħriġ fl-FCR fl-2017. Sar ħafna xogħol biex inkabbru d-daqs tal-funzjoni tal-FCR, li bih ħloqna rwoli ġodda u opportunitajiet ġodda ta' żvilupp f'Malta.

L-osservanza tar-regolamenti

L-HSBC huwa kommess li jżomm l-ogħla standards fl-osservanza kontra r-reati finanzjarji, u fl-2016 din il-prijorità baqgħet minn ta' quddiem nett għall-bank. Nifhmu li l-istandards għoljin tagħna jistgħu xi drabi jkunu ta' inkonvenjent għall-klijenti għax nitolbu aktar informazzjoni u dokumenti dwar kif qed jużaw il-kontijiet tagħhom, imma nemmnu li dan ix-xogħol importanti jġib sigurtà fis-sistema finanzjarja u għal kull min jużaha. Standards għoljin ta' osservanza fis-sistema bankarja huma sors ta' saħħa u vantaġġ kompetittiv mhux biss għall-klijenti imma wkoll għall-pajjiż għax naħdmu bil-għaqal biex insostnu t-tkabbir fl-ekonomija Maltija billi nagħmluha eħfef li jkun hawn negozju ġdid u kummerċ ma' barra.

L-HSBC huwa impenjat li jkompli dan ix-xogħol importanti fl-2017 hekk kif qed noqorbu lejn mument seminali għall-pajjiż, meta se ssir l-ispezzjoni li jmiss tal-Moneyval fuq kif Malta qed tosserva l-obbligi internazzjonali. Eżitu pożittiv minn din iż-żjara jkun pass ieħor essenzjali fil-fażi li jmiss għall-bini ta' ekonomija Maltija aktar b'saħħitha.

Executive Committee (EXCO)

The bank's Executive Committee at the date of this report is made up of the following team members:

Andrew Beane	Chief Executive Officer
Nikolaos Fertakis	Chief Operating Officer
Rashid Daurov	Chief Financial Officer
Daniel Robinson	Head of RBWM
Michel Cordina	Head of CMB
Irina Seylanyan	Head of GB&M
Gareth Williams	Head of Human Resources
Joyce Grech	Chief Risk Officer
Anna Camilleri	Head of Internal Audit
Joseph Sammut	General Counsel
Sonya Khosla	Head of Financial Crime Compliance
Philip Head	Head of Financial Crime Compliance Transformation
Anthony P. Abela	Head of Regulatory Compliance
Franco Aloisio	Head of Communications
George Brancaleone	Company Secretary

Outlook

The local economy continues to perform well and the outlook remains favourable, although it is important that there is continued focus on diversification to avoid an undue level of concentration in certain sectors. However, banking is experiencing a more challenging environment driven by negative interest rates, increased regulatory expectations for higher levels of capital adequacy and for compliance with the highest global standards of financial crime risk management and the need to concurrently fund investment into new digital technology.

In the context of these challenges I believe HSBC Malta is uniquely well positioned. We continue to exceed our end-point capital adequacy requirements. We have made transformational investments in financial crime risk management and we are well on the path to bring new digital innovation to Malta. Indeed we were particularly pleased to be recognised by The Banker Magazine as Malta's best bank for 2016.

I would like to thank our customers, colleagues, shareholders, management and our Board of Directors for their support and dedication in 2016.

Andrew Beane, *Chief Executive Officer*
21 February 2017

Il-Kumitat Eżekuttiv (EXCO)

Il-Kumitat Eżekuttiv tal-bank fid-data ta' dan ir-rapport huwa magħmul minn dawn il-membri:

Andrew Beane	Kap Eżekuttiv
Nikolaos Fertakis	Kap Operattiv
Rashid Daurov	Kap tal-Finanzi
Daniel Robinson	Kap tal-RBWM
Michel Cordina	Kap tas-CMB
Irina Seylanyan	Kap tal-GB&M
Gareth Williams	Kap tar-Riżorsi Umani
Joyce Grech	Kap tar-Riskju
Anna Camilleri	Kap tal-Verifika Interna
Joseph Sammut	Kunsill Ġenerali
Sonya Khosla	Kap tal-Konformità dwar Reati Finanzjarji
Philip Head	Kap tat-Trasformazzjoni għall-Konformità dwar Reati Finanzjarji
Anthony P. Abela	Kap tal-Osservanza Regolatorja
Franco Aloisio	Kap tal-Komunikazzjoni
George Brancaleone	Segretarju tal-Kumpanija

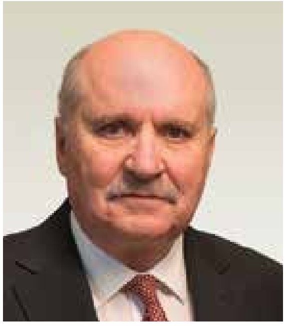
Ħarsa 'l quddiem

L-ekonomija lokali għadha sejra tajjeb u l-prospetti jidhru sbieħ, għalkemm huwa importanti li jibqa' jkun hemm enfasi kontinwa fuq id-diversifikazzjoni biex tkun evitata l-konċentrazzjoni qawwija f'ċerti setturi. Mill-banda l-oħra, l-ambjent tal-qasam bankarju qiegħed jesperjenza sfidi kbar, imbuttati minn rati tal-imgħax negattivi, minn aspettattivi regolatorji aktar ambizzjużi għal-livelli ogħla ta' suffiċjenza ta' kapital u għal konformità mal-ogħla standards globali tal-immaniġġjar tar-riskju tar-reati finanzjarji, u mill-ħtieġa li fl-istess ħin isir investiment fit-teknoloġija ġdida diġitali.

Fil-kuntest ta' dawn l-isfidi nemmen li l-HSBC Malta jinsab f'pożizzjoni unika. Ir-rekwiżiti għas-suffiċjenza tal-kapital mhux talli lħaqnihom imma qbiżnihom. Għamilna investiment biex nittrasformaw l-immaniġġjar tar-riskju tar-reati finanzjarji u qbadna sew it-triq biex inġibu innovazzjoni diġitali ġdida f'Malta. Tabilħaqq, huwa ta' pjaċir kbir li ġejna rikonoxxuti minn The Banker Magazine bħala l-aqwa bank f'Malta għall-2016.

Nixtieq ngħid grazzi lill-klijenti tagħna, lill-kollegi, 'l-azzjonisti, 'il-management, u 'l-Bord tad-Diretturi għall-appoġġ u d-dedikazzjoni tagħhom fl-2016.

Board of Directors and Company Secretary



Saviour sive Sonny Portelli, NON-EXECUTIVE CHAIRMAN

Appointed Chairman of HSBC Bank Malta p.l.c. on 31 May 2013 after having served as Director on the Board since 9 October 2006. Mr Portelli also has directorships in companies forming part of the Malta University Group. He has a background in tourism, the hospitality industry, telecoms and general management, with significant international experience. In connection with these roles, Mr Portelli served on a number of boards and trade organisations. His previous roles included being Chairman of the Board and of the Executive Committee of GO p.l.c., Executive Chairman of Air Malta p.l.c., Director of Forthnet SA (Greece), and Chairman of the Malta Council for Economic and Social Development. Mr Portelli is also former Chairman of the bank's Audit and Risk Committee and is presently Chairman of the bank's Remuneration and Nomination Committee.

Andrew Beane, DIRECTOR AND CHIEF EXECUTIVE OFFICER

Appointed Chief Executive Officer in November 2015 and Director in March 2016.

Prior to taking up his appointment in Malta, Mr Beane was Chief of Staff to the CEO of HSBC Europe, Middle East and Africa in which capacity he served as a member of the Executive and Risk Committees of HSBC Bank plc. He is also a Non-executive Director of HSBC Bank Armenia. Mr Beane has been with the HSBC Group since 2002 and his previous roles include assignments in the United Kingdom, United Arab Emirates, Hong Kong and the United States, principally in the areas of Commercial Banking and Strategy & Planning.

Christopher Davies, NON-EXECUTIVE DIRECTOR

Appointed Director of the bank on 9 May 2014. Holds the roles of Group General Manager and Chief Executive Officer International, HSBC Bank plc. Mr Davies also has directorships in companies forming part of the HSBC Group. Former Deputy Chief Executive Officer and Executive Director, HSBC Bank (China) Company Limited. Prior to moving to China, Mr Davies ran HSBC's Commercial Banking business in North America, following a series of senior appointments across all of HSBC's major business lines, principally in the UK and the Americas.

Alison Hewitt, TO BE APPOINTED NON-EXECUTIVE DIRECTOR

The bank announced on 1 February 2017 the proposed appointment of Ms Hewitt as Director, subject to regulatory approval. Presently HSBC Group's Head of Regulatory Compliance in Europe since 2014. Previously, held various roles in compliance within Lloyds Banking Group, and also various positions with the FSA and UK Government Legal Service. She holds an LLB (Hons) (Law) Degree and a Post Graduate Certification in EU Law from King's College, London, and attended an RMA/Wharton advanced Risk Management Programme.

Philip Farrugia Randon, NON-EXECUTIVE DIRECTOR

Director of HSBC Bank Malta p.l.c. since June 2004. Graduated LL.D. in 1973 and joined the bank in 1974 as a legal adviser. Held the posts of Company Secretary and of Head of Group Legal Department of the bank for several years. Retired from the bank in May 2008. Member of the bank's Audit and Risk Committees and former member of the bank's Remuneration and Nomination Committee.

John Bonello, NON-EXECUTIVE DIRECTOR

Appointed Director of the bank on 15 July 2013. Chairman of the bank's Audit Committee and member of the bank's Risk Committee and former Chairman of the bank's Remuneration and Nomination Committee. He is a Chartered Accountant and a Certified Public Accountant and holds three other directorships in Maltese public listed and private companies. He was formerly the Chairman and Senior Partner of PricewaterhouseCoopers in Malta from where he retired in December 2009. Member of the Joint Disciplinary Board of the Accountancy Board and Fellow of the Malta Institute of Accountants. Also contact member in Malta for the Institute of Chartered Accountants in England and Wales.

Maryanne sive Sue Vella, NON-EXECUTIVE DIRECTOR

Appointed Director of the bank on 27 May 2016. Presently Senior Lecturer at the University of Malta on Social Policy and a member of the National Centre for Family Research within the president's Foundation for Social Wellbeing. Former Chief Executive of Malta Enterprise Corporation and of the Employment and Training Corporation respectively, and former Vice-President of the EU's Employment Committee. Doctor of Philosophy in Social Policy & Social Work, Master of Science in Social Policy & Planning and Bachelor of Arts in Psychology. Member of the bank's Remuneration and Nomination Committee.

Andrew Muscat, NON-EXECUTIVE DIRECTOR

Appointed Director of the bank on 16 January 2014. Partner at Mamo TCV Advocates where he heads the Corporate & Banking Department. Professor at the Faculty of Laws of the University of Malta. Professor Muscat also has two directorships in two different groups of companies and two other directorships in other companies. Former Director of Mid-Med Bank p.l.c. and also former member of the Board of Governors of the Malta Financial Services Authority. Presently member of the bank's Remuneration and Nomination Committee.

Gordon Cordina, NON-EXECUTIVE DIRECTOR

Dr Cordina was appointed Director of the bank on 1 February 2017. Presently operates as a consultant on economic matters at E-Cubed Consultants Ltd, where he is an Executive Director. Dr Cordina also holds a visiting position at the Department of Economics at the University of Malta. Dr Cordina formerly held the following roles: Economist/Head of the Economic Research Department at the Central Bank of Malta, Director General of the National Statistics Office, Head of the Economics Department of the University of Malta and Economic Advisor to the Malta Council for Economic and Social Development. Dr Cordina also occupied the role of Non-Executive Director at Bank of Valletta p.l.c. up to 2013. Holds a B.Com (Hons.) and a doctorate in Economics from the University of Malta and read a Masters in Economics at University of Cambridge.

George Brancaleone, COMPANY SECRETARY

Company Secretary of HSBC Bank Malta p.l.c. since June 2004. Joined the bank in 1980, graduated LL.D. in 1988 and read an MA Degree in Contemporary European Studies (Sussex University 1993). Company Secretary of various HSBC subsidiaries in Malta since 2001.

Executive Committee

Andrew Beane, DIRECTOR AND CHIEF EXECUTIVE OFFICER

Appointed Chief Executive Officer in November 2015 and Director in March 2016. Prior to taking up his appointment in Malta, Mr Beane was Chief of Staff to the CEO of HSBC Europe, Middle East and Africa in which capacity he served as a member of the Executive and Risk Committees of HSBC Bank plc. He is also a Non-executive Director of HSBC Bank Armenia. Mr Beane has been with the HSBC Group since 2002 and his previous roles include assignments in the United Kingdom, United Arab Emirates, Hong Kong and the United States, principally in the areas of Commercial Banking and Strategy & Planning.

Nikolaos Fertakis, CHIEF OPERATING OFFICER

Appointed Chief Operating Officer in April 2016. Mr Fertakis has over 22 years of experience in the banking sector with specialisation in Information Systems and Operations. He joined HSBC in Greece in 2011 initially assuming the duties of IT Director and two years later was promoted to the role of Head of IT Operations International Europe. Since early 2014 Mr Fertakis was appointed Chief Operating Officer of the HSBC's operations in Greece. He holds a Degree in Mechanical Engineering, an MSc in Information Systems from Kingston University and an MBA with specialisation in Banking and Finance from Kingston University – ICBS Athens Business School.

Rashid Daurov, CHIEF FINANCIAL OFFICER

Appointed Chief Financial Officer on 29 November 2014. Holds an MSc Degree in Management from University of Bristol, UK and is a Certified Public Accountant (US). Mr Daurov joined HSBC in 2010 and worked as Head of Group Reporting and Planning in Kazakhstan and most recently as Chief Financial Officer for HSBC Kazakhstan. Prior to HSBC, Mr Daurov worked in audit and financial advisory with Ernst and Young, and Deloitte.

Daniel Robinson, HEAD OF RETAIL BANKING AND WEALTH MANAGEMENT

Appointed to the current role in April 2016. Mr Robinson has extensive experience in a range of Senior RBWM leadership roles in the HSBC Group, including Programme Director, Head of Business Management and Performance Director at HSBC UK RBWM. Mr Robinson holds a Bachelor of Engineering in Automotive Engineering from Oxford Brookes University.

Michel Cordina, HEAD OF COMMERCIAL BANKING

Appointed Head of Commercial Banking on 1 June 2011. Prior to taking up this appointment, Mr Cordina was Deputy Head of CMB. Mr Cordina is a banking professional and has over 32 years experience with HSBC. He has worked in the United Kingdom as the Head of Sales Performance for CMB, in the branch network in Malta for both retail and commercial banking and in a number of Head Office departments, where he was Deputy Head of Operations and Head of Business Transformation.

Irina Seylanyan, HEAD OF GLOBAL BANKING AND MARKETS

Appointed Head of Global Banking and Markets in May 2016. Ms Seylanyan has extensive background in Global Banking and Markets, most notably as Deputy CEO and Head of Global Banking and Markets of HSBC Bank Armenia. Prior to taking up her appointment in Malta, Ms Seylanyan held a senior managerial role with HSBC Global Commercial Banking in London, where she was responsible for regulatory change. Ms Seylanyan is an Automated Systems engineer and a fellow of the Association of Chartered Certified Accountants.

Gareth Williams, HEAD OF HUMAN RESOURCES

Appointed as Head of HR Malta in April 2016. Mr Williams has 33 years service with HSBC Group, with 17 years HR experience. Previous experience within the Group includes management/leadership roles in Retail Banking, Commercial Banking and Credit. For the six years preceding his current role, Mr Williams was Regional Head of HR, Europe HSBC Operations, Services & Technology and previously Head of HR International, based in Jersey. A Chartered Fellow of the Institute of Financial Services and Chartered Fellow of the Chartered Institute of Personnel and Development.

Joyce Grech, CHIEF RISK OFFICER

Appointed Chief Risk Officer in April 2013. Ms Grech has worked with HSBC for 20 years. During her career, Ms Grech has undertaken a number of roles, principally in Malta. Ms Grech started her career in Trade Finance and Commercial Banking before moving to the bank's Credit department where she spent over five years, the last three of which she was the Deputy Head of Credit. Before taking up her role as Chief Risk Officer she worked in the bank's Retail Banking and Wealth Management division where she headed the Customer Value Management department.

Anna Camilleri, HEAD OF INTERNAL AUDIT

Appointed as Head of Internal Audit on 16 November 2015. Prior to joining the bank Ms Camilleri held the post of Senior Manager – Governance, Risk & Compliance Services at PwC. Ms Camilleri is a fellow of the Association of Chartered Certified Accountants, holds a Maltese Practising Certificate in Auditing and is a retired Information Systems and Controls specialist. She has a strong auditing background and has managed numerous complex internal audit and business process re-engineering assignments both in Malta and internationally.

Joseph Sammut, GENERAL COUNSEL

Appointed General Counsel in July 2016. Joined the bank in 1981, then Mid-Med Bank, and subsequently read law at the University of Malta, where he graduated in 1989. He obtained his postgraduate degree in European Law at the College of Europe in Bruges in 1989. At the bank's Legal Office he worked for some years as a contracts lawyer and subsequently focused mainly on financial services. Since 1999 he was entrusted with leading the legal advice team and in 2010 worked at HSBC Head Office in London on a short term legal assignment. He was appointed Deputy General Counsel in 2012.

Executive Committee (continued)

Philip Head, HEAD OF FINANCIAL CRIME COMPLIANCE TRANSFORMATION

Joined HSBC Bank Malta in April 2016 and appointed as Head of FCC, transferring to his current role as Head of FCC Transformation in February 2017. Mr Head joined from Standard Chartered Bank, London, where he held the position of Head of FCC for their UK operation, he was previously with Wells Fargo Bank holding a regional FCC risk role. He has over 30 years banking experience in a variety of roles with the past 17 years being spent within the FCC environment with top tier global banks.

Anthony P. Abela, HEAD OF REGULATORY COMPLIANCE

Appointed as Head of Regulatory Compliance for HSBC Bank Malta p.l.c. in March 2014. With 21 years experience in banking and financial services at HSBC, Mr Abela held senior management positions in fund management, securities services, internal audit and compliance. He holds a Bachelor's Degree in Economics and Psychology, and a Master's Degree in Business Administration.

Sonya Khosla, HEAD OF FINANCIAL CRIME COMPLIANCE

Appointed Head of Financial Crime Compliance on 1 February 2017. Previously Ms Khosla worked in HSBC London as a Senior Manager in a regional Financial Crime Compliance role looking after a portfolio of European countries including Malta. Before joining the HSBC Group in January 2016 Ms Khosla was the Head of Financial Crime and Regulatory Compliance at the Bank of East Asia. Prior to that she worked at PwC in their London Financial Services Regulatory Practice and for over 10 years as a specialist in Financial Crime and Regulatory Compliance. Originally started her career at Lloyds Banking Group.

Franco Aloisio, HEAD OF COMMUNICATIONS

With 21 years of experience in communications, marketing, media and market research, Mr Aloisio joined HSBC Malta in 2011 as Head of Communications responsible for the bank's internal and external relations, as well as supporting the bank's investor relations activities. Mr Aloisio previously worked with GO p.l.c. and its mobile arm – GO Mobile. He also worked with Global Capital plc and, in the early part of his career, Mr Aloisio was a senior journalist with The Malta Business Weekly and The Malta Independent on Sunday. He holds a BA Hons. Degree in Sociology.

George Brancaleone, COMPANY SECRETARY

Company Secretary of HSBC Bank Malta p.l.c. since June 2004. Joined the bank in 1980, graduated LL.D. in 1988 and read a MA Degree in Contemporary European Studies (Sussex University 1993). Company Secretary of various HSBC subsidiaries in Malta since 2001.

Principal activities

Principal activities of HSBC Bank Malta p.l.c.

The bank provides a comprehensive range of banking and financial related services. The bank is authorised to carry on the business of banking, under the Banking Act, 1994 as a credit institution. It is also a licensed financial intermediary in terms of the Financial Markets Act, 1990. The bank also holds Category 3 and Category 4 Investment Services licences issued by the Malta Financial Services Authority in terms of the Investment Services Act, 1994. These licences authorise the bank to provide investment services to third parties and custodian services for collective investment schemes respectively. As at 31 December 2016 the bank had 28 branches and agencies in Malta three of which are located in Gozo.

The local group comprised the following subsidiaries at 31 December 2016: HSBC Life Assurance (Malta) Limited and HSBC Global Asset Management (Malta) Limited.

Principal activities of subsidiaries

HSBC Life Assurance (Malta) Limited is authorised by the Malta Financial Services Authority to carry on business of insurance in Malta under the Insurance Business Act, 1998. It offers a range of protection and investment life assurance products distributed mainly through HSBC Bank Malta p.l.c. which is enrolled as a tied insurance intermediary for HSBC Life Assurance (Malta) Limited under the Insurance Intermediaries Act, 2006.

HSBC Global Asset Management (Malta) Limited is the investment solutions provider of the HSBC Group in Malta. It manages an array of funds which have exposure to both Maltese and international financial markets. HSBC Global Asset Management (Malta) Limited specialises in the provision of tailor-made discretionary portfolio management services for institutions and family offices.

Business and strategy

The purpose of the local group is to connect customers to opportunities, enable businesses to thrive and ultimately help people to fulfil their hopes and realise their ambitions. The group is part of HSBC, which has more than 235,000 employees working around the world to provide more than 37 million customers with a broad range of banking products and services to meet their financial needs.

In this respect, the local group conducts its business through supporting the sustained success of its people, customers and communities. The local group sees investment in capabilities, employees and processes as a source of long-term competitive advantage. The way the local group carries out its business strengthens the durability of its earnings and its ability to return value to shareholders.

HSBC values underpin how the local group carries out business. It is open to differences and believe diversity makes it stronger. The bank is connected, and deems personal relationships are essential to the way of doing business. The bank is dependable in fulfilling its responsibilities in society and delivering on commitments.

Consequently, the local group's strategy and strategic direction is embedded in HSBC's strategy, which aims to capture value from its international network. It is built around long-term trends, which is reinforced by increasing global connectivity through increased international flow of goods, services and finance, aided by the development of technology and data in personal and commercial exchanges. The unrivalled global presence of HSBC reflects the local group's distinctive advantages.

In line with HSBC's global banking model, the local group manages its products and services to serve its customers, from individual savers to large multinational corporations, through three businesses: RBWM; CMB and GB&M.

This banking model enables the local group to effectively meet clients' diverse financial needs, support a strong capital and funding base, reduce risk profile and volatility, and generate stable returns for shareholders.

Conduct

The local group has maintained our commitment to high standards of conduct, with the launch of a 'Charter' which brings together for all employees, HSBC's purpose and values, and how they can be used to make better decisions, always with the local group's customers in mind.

The local group has also continued to embed good conduct practice across all businesses, with a range of initiatives to further improve the service and experience the local group offers its customers.

HSBC's values are also maintained in respecting human rights as it is considered a fundamental part of the local group's responsibility to operate fairly and sustainably.

Results for 2016

HSBC Bank Malta p.l.c. (the bank) and its subsidiaries (collectively referred to as the local group) reported a profit before tax of €62.2m for the year under review. The local group's profit attributable to shareholders was €40.2m.

A gross interim ordinary dividend of 7.1 cent per share was paid on 9 September 2016. The Directors have proposed a gross final dividend of 4.1 cent per ordinary share. The final dividend will be payable to shareholders on the bank's register as at 14 March 2017.

Further information about the results of the local group is provided in the Income Statements and the Statements of Comprehensive Income on pages 57 and 58 respectively.

Moreover, a detailed review of the financial performance including key performance indicators, important events affecting the local group's results and an indication of future developments are included in the Chief Executive Officer's Review.

The Board of Directors does not monitor any specific non-financial KPIs. However, it is evaluating the use of certain metrics in respect of customers, people, culture and values including customer service satisfaction, employee involvement and engagement, and diversity and sustainability.

Employees

Building a more diverse and inclusive workforce is critical to developing a sustainable and successful business. The local group aims to increase and leverage diversity of thought to improve workforce agility, enhance risk management capability, drive innovation and grow markets. The local group's diversity and inclusion ambitions are focused on attracting, developing and retaining talent and deploying that talent effectively to anticipate and address expectations.

The local group supports this strategy and focuses on gender, age, working parents/carers and ability. Particularly, there is increased focus on improving gender balance within senior leadership and all global businesses and functions are progressing actions to support those aspirations and embed more inclusive processes throughout the employee life cycle.

There are also training programmes that reinforce a culture grounded in HSBC's values. In 2016, the local group completed a three-year programme of values-led leadership training for all employees.

As from 2015, the local group has embedded behaviour ratings in the performance review processes, which are factored into variable pay considerations and in 2016, 'At Our Best' online recognition tool for all employees was introduced. The tool allows employees to recognise colleagues' actions by awarding points that are redeemed for gifts and benefits.

In February 2016, the local group signed a new Collective Agreement with the employee representative Unions. This agreement will be due for consultation by the end of 2018. This was a significant and positive achievement towards effective employee relations after a lengthy period of negotiation.

Whistleblowing

The local group has a whistleblowing policy based on a global whistleblowing platform, HSBC Confidential, which allows employees to report matters of concern confidentially. Common themes of cases raised concern matters regarding staff behaviour and recruitment practices, allegations of fraud perpetrated by staff, and weaknesses in incentive arrangements and information security.

The stewardship of the policy is entrusted to one of the non-executive Directors.

Diversity and inclusion

Diversity and inclusion are core components at HSBC. We aim to promote and embed diversity and inclusion into our culture, values and practices both within HSBC as well as in the communities in which we operate.

In line with this commitment, in 2010, the HSBC Malta Foundation was set up to invest in the communities in which HSBC operates. This substituted the former HSBC Cares for Children Fund, HSBC Cares for the Environment Fund and HSBC Cares for Malta's Heritage Fund. The Foundation makes it a point to support various projects to help young people reach their potential.

In 2001, HSBC Bank Malta introduced Corporate Social Responsibility (CSR) Day, an annual event held on 19 March, where staff from responsible corporates volunteer a day's work in aid of charity homes. Since then, the local group has worked with leading companies to carry out structural repairs and other necessary works in homes which help vulnerable groups facing social problems.

More detail about the local group's corporate social activities can be found within the 'Statement of Compliance with the Code of Principles of Good Corporate Governance', specifically under Principle 12.

Health and safety

The maintenance of a safe place of work and business for our employees and customers is a key responsibility for all managers. The local group is committed to proactively manage health and safety risk through the identification, assessment and mitigation of hazards that may otherwise result in injury, fire events and operational failure.

Group policies, standards and guidance for the management of health and safety are set by Global Corporate Real Estate. Achieving these in the local group is the responsibility of the Chief Operating Officer with support and coordination provided by the Health and Safety Coordinator.

Group Security Risk continuously monitors potential threats from terrorism and violent crime and ensure that HSBC maintains effective measures to protect its staff, buildings, assets and information.

The local group remains committed to maintaining its preparedness for foreseeable risk and in ensuring health and safety compliance.

Sustainability

Managing our own environmental footprint supports business efficiency and is part of our long-term contribution to society.

During 2016, the local group continued to invest in green energy by installing a further 131 photo voltaic panels at five of the bank's branches, bringing the total number of panels to 614. With more panels being installed in the first quarter of 2017, total green energy generation will account to around 6% of the local group's total energy needs. Total carbon emission avoidance is estimated to be at 186 tonnes per annum.

The bank also continued to invest in energy efficient technology. All lamps in the 24-hour self-service machine lobbies were replaced with more efficient LED technology reducing energy use by 35%. Furthermore, the bank's seven 'electric vehicles' which replaced equivalent 'internal combustion engine' vehicles travelled a total of 58,969 kilometres during 2016 offsetting 8.85 tonnes of CO_2 emissions from our road network.

Anti-bribery and corruption

During the year, the Executive Committee monitored the local group's progress on the implementation of Global Standards. The local group continues to strengthen efforts to protect customers and the wider financial system from financial crime. In 2016, this included further upgrades to systems, as well as additional training for employees.

The Executive Committee also reviewed the activities underway to address key bribery and corruption risks and progress with the implementation of a revised, more robust anti-bribery and corruption compliance framework.

Risk management

The local group is exposed to a mixed blend of risks and hence operates a risk management strategy with the objective of controlling and minimising their impact on the financial performance and position of the local group.

An established risk governance framework and ownership structure ensures oversight of accountability for the effective management of risk. The local group's risk management framework fosters the continuous monitoring of the risk environment and an integrated evaluation of risks and their interactions. The local group's risk management framework is designed to provide appropriate risk monitoring and assessment.

Specifically, the local group's banking risks are credit risk, operational risk, market risk, liquidity and funding risk, regulatory, compliance risk and reputational risk. Owing to the group's insurance operation in Malta, the local group is also exposed to insurance risk.

A detailed review of the risk management policies employed by the local group together with the exposures to credit risk, liquidity risk, market risk and insurance risk is included in note 4 on the Financial Statements.

Additional regulatory disclosures

Banking Rule 07 (Publication of Annual Report and Audited Financial Statements of Credit Institutions Authorised under the Banking Act 1994) partly repealed by certain provisions in the Capital Requirements Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (CRR) is related to market discipline and aims to make credit institutions more transparent by requiring them to publish specific disclosures on the credit institution's risk and capital management under the Basel III framework. However the local group is considered as a significant subsidiary of HSBC Holdings plc and therefore exempt, in terms of Article 24 of the revised BR 07 and Article 13 of the CRR, from certain risk disclosure requirements under Pillar 3, on the basis that such disclosures are required at the consolidated level which is HSBC Holdings plc level. HSBC Holdings plc publishes full Pillar 3 disclosures as a separate document on the HSBC Group Investor Relations website.

Shareholder register information pursuant to Listing Rule 5.64

The bank's authorised share capital is €141,000,000. The issued and fully paid up capital is €108,091,829.70 divided into 360,306,099 ordinary shares of a nominal value of 30 cent each. The issued share capital consists of one class of ordinary shares with equal voting rights attached and are freely transferable.

The largest single shareholder of the bank, provided it holds at least thirty three per cent (33%) of the ordinary issued share capital of the bank, shall be entitled to appoint the Chairman from amongst the Directors appointed or elected to the Board.

Every shareholder owning eleven per cent (11%) of the ordinary issued share capital, shall be entitled to appoint one Director for each and every eleven per cent (11%) of the ordinary issued share capital of the bank owned by such shareholder. Any fractional shareholding not so utilised in the appointment of Director(s) shall be entitled to participate in the voting for the election of further Directors.

There is a Restricted Share Awards scheme in existence whereby employees in the GCB3 grade and higher can be awarded shares in HSBC Holdings plc. Share awards will be released to the individual staggered over three years, provided the participant remains continuously employed within the Group. Vesting of these awards are generally not subject to performance conditions. During the 3-year period the employee has no voting rights whatsoever.

The rules governing the appointment of Board members are contained in Articles 77 to 80 of the bank's Articles of Association. An extraordinary resolution approved by the shareholders in the general meeting is required to amend the Articles of Association.

The powers of the Directors are outlined in Articles 73, 74 and 85 of the bank's Articles of Association. In terms of Article 12 of the said Articles of Association, the bank may, subject to the provisions of the Companies Act, 1995, acquire or hold any of its shares.

The Collective Agreement regulates redundancies, early retirement, resignation or termination of employment of employees. There are no contracts between the bank and the Directors on the bank's Board providing for compensation on resignation or termination of directorship.

It is hereby declared that the requirements pursuant to Listing Rules 5.64.7 and 5.64.10 that deal with agreements pertaining to changes in control of the bank did not apply to the bank as at 31 December 2016.

Shareholder register information

Directors' interest in the share capital of the bank at 31 December 2016 was as follows:

Saviour sive Sonny Portelli	5,804 shares
Philip Farrugia Randon	7,903 shares
John Bonello	40,742 shares

None of the shares in the bank's subsidiary companies were held by Directors.

There were no changes to Directors' interest from 31 December 2016 to 31 January 2017.

Shareholders holding five per cent (5%) or more of the equity capital at 31 January 2017:

HSBC Europe B.V.	70.03%

Number of shareholders at 31 January 2017:

One class of shares	9,808 shareholders

(All shares have equal voting rights)

Number of shareholders analysed by range

	31 January 2017	
Range of shareholding	*Total shareholders*	*Shares*
1 – 500	1,506	461,982
501 – 1,000	1,251	943,792
1,001 – 5,000	4,132	10,474,658
5,001 and over	2,919	348,425,667
Total shareholding	9,808	360,306,099

Standard licence conditions applicable under the Investment Services Act, 1994

In accordance with SLC 7.35 of the Investment Services Rules for Investment Services Providers regulated by the Malta Financial Services Authority, licence holders are required to include breaches of standard licence conditions applicable under the Investment Services Act, 1994, in the Report of the Directors. Accordingly, the Directors confirm that no breaches of the standard licence conditions and no other breach of regulatory requirements under the Investment Services Act, 1994, which were subject to administrative penalty or regulatory sanction, were reported.

During the reporting period, the Financial Intelligence Analysis Unit (FIAU) imposed an administrative penalty of €40,000 on the bank for failure to comply with all its obligations under the Prevention of Money Laundering and Funding of Terrorism Regulations (PMLFTR) with respect to a corporate customer.

With respect to another customer serviced by the bank under the 2014 Investment Registration Scheme, the FIAU reprimanded the bank for not meeting its obligations under the PMLFTR when it failed to obtain sufficient evidence to prove the customer's provenance of funds.

Both cases were identified during 2015, and the bank cooperated fully during its engagement with the FIAU.

Apart from this, the Directors confirm that there were no other breaches of the standard licence conditions and regulatory requirements.

Board of Directors

The Directors who served during the year and up till the date of this report are as follows:

Saviour sive Sonny Portelli
Andrew Beane
Tanuj Kapilashrami (appointed 27 May 2016 and resigned 15 December 2016)
Philip Farrugia Randon
John Bonello
Andrew Muscat
Christopher Davies
Caroline Zammit Testaferrata Moroni Viani (resigned 15 April 2016)
Juanito Camilleri (resigned 1 February 2017)
Gordon Cordina (appointed 1 February 2017)
Maryanne sive Sue Vella (appointed 27 May 2016)

Executive Committee

As at 31 December 2016, the bank's Executive Committee of the local group was composed of the following:

Andrew Beane	Chief Executive Officer
Nikolaos Fertakis	Chief Operating Officer
Rashid Daurov	Chief Financial Officer
Daniel Robinson	Head of RBWM
Michel Cordina	Head of CMB
Irina Seylanyan	Head of GB&M
Gareth Williams	Head of Human Resources
Joyce Grech	Chief Risk Officer
Anna Camilleri	Head of Internal Audit
Joseph Sammut	General Counsel
Philip Head	Head of Financial Crime Compliance
Anthony P. Abela	Head of Regulatory Compliance
Peter May	Head of Financial Crime Compliance Transformation
Franco Aloisio	Head of Communications
George Brancaleone	Company Secretary

Auditors

PricewaterhouseCoopers have expressed their willingness to continue in office as auditors of the bank and the local group and a resolution proposing their reappointment will be put at the forthcoming Annual General Meeting.

Going concern

As required by Listing Rule 5.62, upon due consideration of the bank's profitability and statement of financial position, capital adequacy and solvency, the Directors confirm the bank's ability to continue operating as a going concern for the foreseeable future.

Statement by the Directors pursuant to Listing Rule 5.70.1

Pursuant to Listing Rule 5.70.1 there were no material contracts to which the bank, or anyone of its subsidiary undertakings, was party to and in which anyone of the Directors was directly or indirectly interested.

Statement by the Directors pursuant to Listing Rule 5.68

We, the undersigned, declare that to the best of our knowledge, the financial statements prepared in accordance with the requirements of International Financial Reporting Standards as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the bank and its subsidiaries and that this report includes a fair review of the development and performance of the business and the position of the bank and its subsidiaries, included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

Signed on behalf of the Board on 21 February 2017 by:

Sonny Portelli, *Chairman*

Andrew Beane, *Chief Executive Officer*

Directors' Responsibilities Statement

The Companies Act, 1995 requires the Directors of HSBC Bank Malta p.l.c. to prepare financial statements which give a true and fair view of the financial position of the local group and the bank as at the end of each period and of the profit or loss for that period. In preparing the financial statements, the Directors are responsible for:

- ensuring that the financial statements have been drawn up in accordance with the requirements of International Financial Reporting Standards as adopted by the EU;
- ensuring that the financial statements have been properly prepared in accordance with the provisions of the Companies Act, 1995 and the Banking Act, 1994;
- selecting and applying consistently suitable accounting policies;
- making accounting judgments and estimates that are reasonable; and
- ensuring that the financial statements are prepared on the going concern basis unless it is inappropriate to presume that the local group and the bank will continue in business as a going concern.

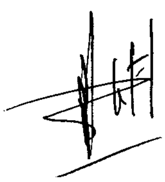
The Directors also assume responsibility for publishing Additional Regulatory Disclosure prepared in accordance with Pillar 3 quantitative and qualitative disclosure requirements as governed by Banking Rule 07 (Publication of Annual Report and Audited Financial Statements of Credit Institutions Authorised under the Banking Act 1994) and Regulation (EU) No 575/2013 (Capital Requirements Regulation). The local group is exempt from full regulatory disclosure requirements on the basis that such disclosures are required on a consolidated basis at the level of HSBC Holdings plc.

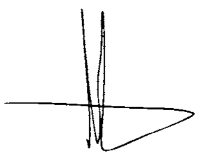
The Directors are also responsible for safeguarding the assets of the local group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Through oversight of management, the Directors are responsible for ensuring that the bank and the local group establish and maintain internal control to provide reasonable assurance with regard to reliability of financial reporting, effectiveness and efficiency of operations, compliance with applicable laws and regulations, and as far as possible, the orderly and efficient conduct of the local group's business. This responsibility includes establishing and maintaining controls pertaining to the preparation of financial statements and for managing risks that may give rise to material misstatements in those financial statements, whether due to fraud or error.

The financial statements of HSBC Bank Malta p.l.c. for the year ended 31 December 2016 are included in the Annual Report 2016, which is being published in printed form and made available on the bank's website. The Directors are responsible for the maintenance and integrity of the Annual Report on the website in view of their responsibility for the controls over, and the security of, the website. Access to information published on the bank's website is available in other countries and jurisdictions, where legislation governing the preparation and dissemination of financial statements may differ from requirements or practice in Malta.

Signed on behalf of the Board of Directors by:





Sonny Portelli, *Chairman*

Andrew Beane, *Chief Executive Officer*

The Board of Directors (the 'Board') of HSBC Bank Malta p.l.c. is committed to the HSBC global values of dependability, openness to different ideas and cultures, and connection with customers, communities, regulators and each other. The Board ensures that each employee, through ongoing training, is aware of the obligation to ensure that his or her conduct consistently matches the bank values so as to serve positively the customers who entrust their financial needs to HSBC.

The Board is proud of the fact that the bank and its subsidiaries (the 'local group') has a solid corporate governance framework that is built around the principles of control and accountability. This culture stems from a philosophy that puts the protection of investors and the interest of customers at the forefront.

Corporate governance is subject to regulation by the Malta Financial Services Authority Listing Rules. As a company whose equity securities are listed on a regulated market, HSBC Bank Malta p.l.c. endeavours to adopt the Code of Principles of Good Corporate Governance (the 'Code' or 'Principles') embodied in Appendix 5.1 to Chapter 5 of the Listing Rules. In terms of Listing Rule 5.94, the bank is obliged to disclose compliance and non-compliance with the provisions of the said Code. The bank strives to maintain the highest standards of disclosure in reporting the effective measures adopted to ensure compliance with the Principles, and to explain the instances of non-compliance.

Compliance with the Code

Principle 1: The Board

The bank is headed by an effective Board that leads and controls the business. The Board is composed of members who are honest, competent and solvent, and thus fit and proper to direct the business of the bank. Directors, individually and collectively, are of the appropriate calibre, having the necessary skills and experience to provide leadership, integrity and judgement in directing the bank. The courageous integrity, honesty and diligence of the Directors guarantee that the bank adheres to HSBC Group's (the 'Group') highly ethical business values and this is reflected in the bank's decision and policy-making process. Through their effective contribution Directors enhance shareholders value, protect the bank's assets and safeguard the interest of third parties.

Board members are accountable for their performance and that of their delegates to shareholders and relevant stakeholders. Besides having a broad knowledge of the bank's business they are also conversant with the statutory and regulatory requirements regulating this business.

The Board determines the bank's strategic aims and organisational structures and regularly reviews management performance. It ensures that the bank has the appropriate financial and human resources to meet its objectives. Moreover, it exercises prudent and effective controls which enable risk to be assessed and managed in order to achieve the short and long term sustainability of the business.

During the year the Board delegated specific responsibilities to a number of committees, namely the Audit Committee, the Risk Committee, the Remuneration and Nomination Committee and the Executive Committee. Further detail in relation to the committees and their responsibilities can be found under principle 4 of this statement.

The process of appointment of Directors is conducted in terms of the Memorandum and Articles of Association of the company which state that the Board is to consist of not more than nine Directors who are appointed/elected by the shareholders. Every shareholder owning 11 per cent of the ordinary share capital is entitled to appoint one Director for each 11 per cent shareholding. The majority shareholder therefore has the right to appoint six Directors. Furthermore, any excess fractional shareholding not so utilised may be used to participate in the voting for the election of further Directors. Shareholders who own less than 11 per cent of the ordinary share capital participate in the election of the remaining three Directors. The largest single shareholder (subject to a minimum 33 per cent holding of the ordinary issued share capital of the bank) is entitled to appoint a Chairman from amongst the Directors appointed or elected to the Board.

Principle 2: Chairman and Chief Executive Officer

The position of the Chairman and that of the Chief Executive Officer are occupied by different individuals. There is a clear division of responsibilities between the running of the Board and the Chief Executive Officer's responsibility in managing the bank's business. This separation of roles of the Chairman and Chief Executive Officer avoids concentration of authority and power in one individual and differentiates the function of leadership of the Board from that of running the business.

The Chairman leads the Board, sets the agenda and ensures that the Directors receive precise, timely and objective information and at the same time ensures effective communication with shareholders. During Board meetings, he encourages active engagement by all Board members for the discussion of complex and contentious issues and ensures that Directors constructively challenge senior management.

The Chief Executive Officer develops, drives and delivers performance within strategic goals, commercial objectives and business plans agreed by the Board. He effectively leads the senior management in the day-to-day running of the bank, ensures compliance with appropriate policies and procedures and maintains an effective framework of internal controls over risk in relation to the business. He is also responsible for the recruitment and appointment of senior management, after consultation with the Remuneration and Nomination Committee.

Principle 3: Composition of the Board

Experience has shown that the size of the Board is appropriate to ensure the effective management and oversight over the bank's operations. For the major part of the year the Board was composed of nine Directors. As noted under Principle 5, late in 2016 a Director appointed by the majority shareholder resigned from all the positions in the Group. At year end the proposed replacement was still awaiting regulatory approval. Each of the Directors is skilful, competent, knowledgeable and experienced to fulfil one's role diligently. The Directors who held office during the year possess the requisite ability to assess business risk and to identify key performance indicators.

The Board Diversity Policy covers diversity in its widest aspect of ethnicity, age, culture and gender, all underpinned by the meritocracy criteria.

As at 31 December 2016 the Board was composed of a non-executive Chairman, an executive Director and six non-executive Directors, five of whom are deemed to be independent. The non-executive Directors bring an external perspective to the Board when they constructively challenge and help develop proposals on strategy, scrutinise the performance of management, and monitor the risk profile and the reporting of performance.

In accordance with the Code Provision 3.2, the independent non-executive Directors as at 31 December 2016 were the following:

John Bonello
Juanito Camilleri
Philip Farrugia Randon
Andrew Muscat
Maryanne sive Sue Vella

In determining the independence or otherwise of its Directors, the Board has considered, inter alia, the principles relating to independence embodied in the Code, the local group's own practice as well as general principles of good practice.

The Board has determined that the fact that Professor Muscat is a partner in a Law firm which provides legal services to the bank does not in any way impair this Director's ability to consider appropriately the issues which are brought before the Board. On the other hand, in accordance with Code Provision 3.2.1, the Board believes that Chris Davies' employment with the Group renders this Director non-independent from the bank. This should not however, in any manner, detract from the non-independent Directors' ability to maintain independence of free judgement and character at all times.

In terms of Principle 3.4, each non-executive Director has confirmed in writing to the Board that he/she undertook:

- to maintain in all circumstances his/her independence of analysis, decision and action;
- not to seek or accept any unreasonable advantages that could be considered as compromising his/her independence; and
- to clearly express his/her opposition in the event that he/she finds that a decision of the Board may harm the bank.

Principle 4: The Responsibilities of the Board

The Board develops the bank's strategy, policies and business plans. A board meeting held at the beginning of 2016 focused on strategy review and development. The Board of Directors monitors effectively the implementation of strategy and policy by management within the parameters of all relevant laws, regulations and codes of best practice. The Board ensures that a balance is maintained between enterprise and control.

The evaluation of management's implementation of corporate strategy and financial obligations is based on the use of key performance indicators enabling the bank to adopt expedient corrective measures. These key business risk and performance indicators are benchmarked against industry norms so as to ensure that the bank's performance is effectively evaluated.

The Board ensures that the bank has appropriate policies and procedures in place that guarantee that the bank and its employees adhere to the highest standards of corporate conduct and comply with the applicable laws, regulations, business and ethical standards.

The Board ensures that its level of power is known by all Directors and the senior management of the bank. Any delegation of responsibility and functions is clearly documented in the Terms of Reference (TOR) embodied in the corporate governance framework.

The Board delegates specific responsibilities to Committees, which operate under their respective formal TOR:

Audit Committee

At the beginning of 2016 the former Audit and Risk Committee was separated into two separate Committees. The TOR of this Committee which have been amended to reflect this separation are modelled on the recommendations in the Cadbury Report, the UK Walker Review, and are compliant with the Listing Rules and Banking Rule 12.

The Committee protects the interests of the bank's shareholders and assists Directors in conducting their role effectively so that the bank's decision-making capability and the accuracy of its reporting and financial results are maintained at the highest level at all times. This Committee has non-executive responsibility for oversight of, and advice to, the Board on matters relating to financial reporting. Hence, it monitors the integrity of the bank's financial statements, and any formal announcements relating to the bank's financial performance or supplementary, regulatory information, reviewing significant financial reporting judgements contained in them.

An important function of the Audit Committee is to monitor and review the effectiveness of the Internal Audit function, consider major findings of internal investigations and management's response, and ensure that the Internal Audit Function is adequately resourced and is free from constraint by management.

This Committee approves the internal audit work plan, which will include assessment of controls relating to financial reporting, conduct financial crime and other risks as appropriate.

The Audit Committee also has the responsibility to review and monitor the external auditor's independence and the effectiveness of the audit process. In this regard the Committee has to satisfy itself that there is the appropriate co-ordination between the internal and external auditors.

This Committee scrutinises and approves related party transactions. It considers the materiality and the nature of the related party transactions carried out by the bank to ensure that the arms' length principle is adhered to at all times.

The Committee met six times during 2016. The members of the Audit Committee were Mr John Bonello (Chairman), Dr Philip Farrugia Randon LL.D. and Professor Juanito Camilleri as members.

Attendance at the meetings of this Committee was as follows:

Members	*Attended*
John Bonello	6 out of 6
Philip Farrugia Randon	5 out of 6
Juanito Camilleri	6 out of 6

During the year numerous informal meetings were held between the Chairman of this Committee and members of Senior Management especially the Chief Executive Officer, the Head of Internal Audit and the Chief Financial Officer.

Senior Managers of the bank are invited to attend any of the Audit Committee's meetings as directed by the Committee.

The Chief Executive Officer, the Chief Risk Officer, the Chief Financial Officer and representatives of the external auditors attend all the meetings. In line with Listing Rule 5.131, the Head of Internal Audit is also always present for its meetings and has a right of direct access to the Chairman of the Committee at all times.

Mr Bonello was appointed by the Board as the Director who is independent and competent in accounting and/or auditing in terms of Listing Rule 5.117 on the basis that he is a Fellow of the Institute of Chartered Accountants in England and Wales and is also a Certified Public Accountant, Auditor and Fellow of the Malta Institute of Accountants. He was formerly the Chairman and Senior Partner of PricewaterhouseCoopers in Malta from where he retired in 2009.

In terms of Listing Rule 5.127.7, the Audit Committee is responsible for developing and implementing policy on the engagement of the external auditor to supply non-audit services. Since HSBC Holdings plc is a Securities Exchange Commission (SEC) registered company, non-audit services provided by the external auditor are regulated in terms of the SEC rules.

Risk Committee

This Committee is responsible for advising the Board on high level risk related matters. In providing such oversight and advice to the Board, the Committee oversees: current and forward looking risk exposures, the bank's risk appetite and future risk strategy, including capital and liquidity management strategy, and management of risk within the bank.

In undertaking its responsibility to review the effectiveness of the bank's risk management framework and internal controls it has to inter alia satisfy itself that that there are adequate procedures for monitoring in a sufficiently timely and accurate manner, large exposures or risk types whose relevance may become of critical importance. It also has to consider any material findings from regulatory reviews and interactions with regulators in relation to risk governance or risk assessment or management process. Moreover, it needs to discuss the internal control systems with management to ensure that management has discharged its duty to have an effective internal control system

The Committee met five times during 2016. The members of the Audit Committee were Professor Juanito Camilleri (Chairman), Dr Philip Farrugia Randon LL.D. and Mr John Bonello as members.

Attendance at the meetings of this Committee was as follows:

Members	*Attended*
Juanito Camilleri	5 out of 5
Philip Farrugia Randon	4 out of 5
John Bonello	5 out of 5

Senior Managers of the bank are invited to attend any of the meetings as directed by the Committee.

The Chief Executive Officer, the Chief Risk Officer, the Chief Financial Officer, the Head of Financial Crime Compliance and the Head of Regulatory Compliance and representatives of the external auditors are invited to attend the meetings.

Remuneration and Nomination Committee (REMNOM Committee)

The remuneration aspect of this Committee is dealt with under the Remuneration Report, which also includes the Remuneration Statement in terms of Code Provision 8.A.4.

In its nomination function, the Committee is primarily tasked with identifying and nominating new Board and Board Committees' candidates for the approval of the Board and to periodically assess the structure, size, composition and performance of the Board and make recommendations to the Board with regard to any changes. It is also tasked with considering issues related to succession planning and reviewing the policy of the Board for selection and appointment of senior management.

This Committee is also responsible to periodically assess the skills, knowledge and experience of individual Directors and report on this to the Board.

During 2016 REMNOM met nine times and this shows the important role it is playing in performing the 'fit and proper' assessments of prospective Board Members. The results of these assessments are then submitted to the Regulator as an integral part of the Regulator's due diligence exercise.

The members of the REMNOM were Mr Sonny Portelli (Chairman), Professor Andrew Muscat and Dr Maryanne sive Sue Vella as members.

Executive Committee (EXCO)

EXCO meets on a monthly basis to oversee the overall day-to-day management of the bank in accordance with such policies and directions as the Board may from time to time determine. The Chief Executive Officer chairs this Committee which is composed of members of the senior management of the bank. EXCO is empowered by its TOR to sub-delegate its powers to sub-committees:

- **The Risk Management Meeting (RMM)**

  This Committee meets on a monthly basis and is chaired by the Chief Risk Officer, with the Chief Executive Officer as alternate chairman. Membership also includes the Chief Operating Officer, the Chief Financial Officer, the Head of Retail Banking and Wealth Management, the Head of Commercial Banking, the Head of Global Banking and Markets, the Head of Wholesale and Markets Risk, the Head of Internal Audit, General Counsel, Head of Regulatory Compliance and Head of Financial Crime Compliance. Other regular attendees are the Head of Credit Risk Management, Analytics and Systems, the Head of Security and Fraud Risk, Senior Manager Assurance and Oversight and Head of Communications.

  The objective of this Committee is to exercise oversight of the risk/reward framework for the bank and its subsidiaries.

  This Committee is responsible for all risks in all businesses, functions and subsidiaries under the ownership of HSBC Bank Malta p.l.c., including inter alia Credit Risk, Market Risk, Operational Risk, Concentration Risk, Legal and Regulatory Risk, Security and Fraud Risk and Reputational Risk. The Risk Management Committee is also responsible for the setting and monitoring of a Risk Appetite Framework for EXCO and Board approval, signing off on material credit risk models, and consideration of top and emerging risks and scenario analysis. Individual risk acceptance and approval is not within the TOR of the Committee, and continues to be approved under existing delegated authorities within the management structure of the bank.

  Minutes of meetings of this Committee are circulated to the members of the Board. The Chief Risk Officer is also invited to attend Board meetings and meetings of the Audit and Risk Committee in which representations are made about the overall risk profile associated with the business including a comprehensive assessment of the bank's management of risk.

- **The Asset and Liability Management Committee (ALCO)**

  ALCO is responsible for managing the balance sheet with a view to achieve efficient allocation and utilisation of all resources.

  This Committee reviews the financial risks of the local group and oversees the prudent management of interest rate risk, liquidity and funding risk, capital, foreign exchange risk, solvency risk, market sector risk and country risk. Furthermore, ALCO monitors the external environment and measures the impact on profitability of factors such as interest rate volatility, market liquidity, exchange rate volatility, monetary and fiscal policies and competitor banks' activity. ALCO monitors the liquidity and capital adequacy, making use of capital forecasts to ensure that enough capital is readily available at all times to meet the demand arising from business expansion and regulation. ALCO monitors and reviews the duration and cash flow matching of insurance assets and liabilities.

  The Chief Executive Officer has primary responsibility for ensuring efficient development of Asset and Liability Management. Membership consists of senior executives with responsibility for the following functions: commercial banking, retail banking and wealth management, global banking and markets, finance, insurance services, asset and liability capital management, customer value management and payments and cash management. ALCO, which is chaired by the Chief Financial Officer and deputised by the Chief Executive Officer, meets once a month. The Chief Accounting Officer is also a member of this Committee.

- **The Financial Crime Compliance EXCO (FCC EXCO)**

  This Committee was established in order to provide on-going oversight, management and communication of Financial Crime Compliance (FCC) risks, issues and changes impacting the business lines. FCC includes Anti-Money Laundering (AML), Sanctions, Anti-Bribery and Corruption. The membership of this Committee, which is chaired by the bank's Chief Executive Officer, is composed of all the bank's EXCO team, the Head of Anti-Money Laundering/Money Laundering Reporting Officer and the Sanctions and Anti-Bribery and Corruption Lead.

Principle 5: Board Meetings

The Board meets as often and as frequently required to discharge its duties effectively. During the period under review the Board held seven meetings.

The Chairman ensures that all relevant issues are on the agenda and supported by all the available information. The agenda strikes a balance between long-term strategic objectives and short term performance issues. Notice of the dates of Board meetings together with supporting materials are circulated to the Directors well in advance of the meetings.

During the meetings Board members have ample opportunity to discuss issues set on the board agenda, convey their opinions and challenge management. The Chairman facilitates presentation of views pertinent to the relevant issues on the agenda. Moreover, Directors are encouraged to discuss any issue which they deem appropriate.

Minutes are prepared during Board meetings that record faithfully attendance, discussed matters and decisions. These minutes are subsequently circulated to all the Directors as soon as practicable after the meeting. Besides attending formal Board meetings and Committee meetings of which they form part, Directors attend on frequent and regular basis meetings where their presence is required for the proper discharge of their duties. All the Directors dedicate the necessary time and attention to their duties as Directors of the bank.

Directors' Attendance at Board Meetings:

Members	*Attended*
Saviour sive Sonny Portelli	7 out of 7
Andrew Beane (appointed on 31 March 2016)	4 out of 4
John Bonello	7 out of 7
Juanito Camilleri	5 out of 7
Christopher Davies	5 out of 7
Philip Farrugia Randon	6 out of 7
Andrew Muscat	7 out of 7
Tanuj Kapilashrami (appointed on 27 May 2016 – resigned on 15 December 2016)	1 out of 3
Maryanne sive Sue Vella (appointed on 27 May 2016)	3 out of 3
Caroline Zammit Testaferrata Moroni Viani (resigned on 15 April 2016)	3 out of 3

Principle 6: Information and Professional Development

The Board appoints the Chief Executive Officer of the bank upon guidance and recommendation by the HSBC Group and by the REMNOM Committee. The Board, through the REMNOM Committee, is actively involved in the appointment of other members of senior management. In this regard the bank benefits from the vast wealth of competence, talent and experience found across the Group.

Full, formal and tailored induction programmes, with particular emphasis on the systems of risk management and internal controls are arranged for newly appointed Directors. The programmes consist of a series of meetings with senior executives to enable new Directors to familiarise themselves with the bank's strategy, risk appetite, operations and internal controls. Directors also receive comprehensive guidance on Directors' duties and liabilities.

A structured Board training and development programme is organised for the Directors and facilitated by an External Accounting Firm. The key objective of the programme is to improve the Board's awareness in risk, regulation, and compliance developments in the financial services sector. Topics covered during these awareness sessions range from the new regulatory environment to managing risk.

Directors are given opportunities to update and develop their skills and knowledge, through briefings by senior executives and externally-run seminars throughout their directorship. Moreover, Directors have access to independent professional advice, at the bank's expense.

Directors also have access to the advice and services of the Company Secretary who is responsible for adherence to Board procedures as well as for effective information flows within the Board, its Committees and with senior management.

The Chairman of the Board and the Chairman of the Audit and Risk Committee attend on an annual basis the Group Chairman's Non-Executive Directors' Forum and the Audit Committee Chairmen Forum where they are updated on the latest Group's strategy and global financial and economic developments.

As part of succession planning and talent management, the Board and the Chief Executive Officer ensure that the bank implements appropriate schemes to recruit, retain and motivate high quality executive officers. They also encourage members of management to move to the higher ranks within the organisation and seek to maintain high morale amongst the bank's personnel.

Principle 7: Evaluation of the Board Performance

During the year the Board undertook an evaluation of its own performance, the Chairman's performance and that of its Committees through a Board Effectiveness Questionnaire modelled on a questionnaire adopted by Group. This process was conducted by the REMNOM Committee through the support of the Company Secretary. No material changes in the governance structures and organisation resulted from this Board evaluation exercise.

Principle 8: Committees

The Remuneration and Nomination Committee is covered under Principle 4 and in the Remuneration Report, which also includes the Remuneration Statement in terms of Code provisions 8.A.4.

Principles 9 and 10: Relations with Shareholders, with the Market, and with Institutional Shareholders

The bank maintains on-going communication with its shareholders and the market on its strategy and performance in order to enhance trust and confidence in the bank. During the period under review the bank issued various company announcements and media releases to explain ongoing corporate developments and material events and transactions which have taken place and their impact on the financial position of the bank.

The bank communicates with shareholders in the following ways:

- through the 'Annual Report and Accounts' which is mailed to every shareholder and is available on the bank's website;
- through the publication of company announcements and media releases; and
- at the Annual General Meeting and Extraordinary General Meetings (further detail is provided under the section 'General Meetings').

The bank also holds meetings for stockbrokers, financial intermediaries and the media to explain the salient features of the interim and annual financial results.

The bank maintains an open channel of communication with its shareholders through the Company Secretarial Office and through the Head of Communications. Meetings have also been held between the Chief Executive Officer and the Malta Association of Small Shareholders.

The Chairman ensures that the views of shareholders are communicated to the Board. Moreover, the Chairmen of the Audit Committee, of the Risk Committee and of the REMNOM Committee are available to answer questions during the Annual General Meeting. The conduct of the meeting is conducive to valid discussion and appropriate decision making.

In terms of the bank's Articles of Association, the Directors shall, on the request of members of the company holding not less than one-tenth of the paid up share capital, proceed duly to convene an Extraordinary General Meeting of the bank.

Principle 11: Conflicts of Interests

Directors are aware that their primary responsibility is always to act in the interest of the bank and its shareholders as a whole, irrespective of who appointed them to the Board. This requires that they avoid conflicts of interest at all times and that their personal interests never take precedence over those of the bank and its shareholders.

In line with HSBC Group best practice, the Board operates a Conflicts Policy. In terms of this policy a Director is to avoid situations in which he or she has, or could have, a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the bank. Without prejudice to Articles 136A (3)(C) and 143 of the Companies Act, this policy stipulates that a director must obtain an authorisation from the Board before a situational conflict arises. Notably, in accordance with this policy, all directorships and other non-HSBC appointments should be authorised by the Board.

By virtue of the bank's Articles of Association, a Director is bound not to vote at a Board meeting on any contract or arrangement or any other proposal in which he has a material interest, either directly or indirectly.

On joining the Board and regularly thereafter, Directors are informed and reminded of their obligations on dealing in securities of the bank within the parameters of law and the Listing Rules. A proper procedure of reporting advance notices to the Chairman by a Director who intends to deal in the bank's shares has been endorsed by the Board in line with the Principles, the Listing Rules and the internal Code of Dealing.

Principle 12: Corporate Sustainability

HSBC's Corporate Sustainability (CS) activities take place within the context of the Group wide strategy. Sustainability is core to the way the local group operates and it is recognised that the bank has a responsibility that spreads far wider. We continue to recognise that we have a role within, and responsibility towards, the community we serve. To discharge these roles and responsibilities, during 2016, the bank continued to utilise its resources in order to carry out a series of initiatives and projects designed to provide value to various sectors within the community.

In Malta the bank fulfils the Group's CS strategy primarily through the HSBC Malta Foundation (the 'Foundation'). The three pillars of the HSBC Malta Foundation, with a yearly budget of more than €300K aim to improve the quality of life and education for children, especially those disadvantaged, to promote and work towards a more sustainable environment and to preserve Malta's rich and unique historical heritage. The total funds donated to Corporate Sustainability projects between 2000 and 2016 is circa €5m.

Voluntary work is highly encouraged and pride is taken in HSBC staff who contribute to the charities and causes that they feel passionate about and are encouraged to take an active role in initiatives supported by the Foundation with an extra day's leave granted for voluntary work. During 2016 HSBC colleagues volunteered for more than 257 days on a range of projects around the country.

The HSBC Malta Water Programme – Catch the Drop Campaign (a national environmental and educational water conservation campaign) continued to reach every student in Malta and Gozo (total 50,000 students), as well as various local councils, with the main emphasis on water shortage, water consumption reduction and water harvesting. It raises awareness about the water scarcity issue, and provides information and tips as to how people can tackle it. This campaign was supported by a €540K grant from the HSBC Group. Our employees are at the heart of this campaign with over 500 members of staff volunteering to deliver the information sessions in all 172 schools around Malta and Gozo.

With the support of the HSBC Malta Foundation, Malta became the first country outside of the UK to introduce one of The Prince's Trust's long-standing educational programmes in its secondary schools. One of its most successful programmes, xl/achieve programme, is now available to young people in Malta to help them develop the skills and confidence they need to reach a positive future, through relevant, engaging and informal learning. The xl/achieve programme has initially been introduced in seven schools during the scholastic year 2015 – 2016 across Malta and Gozo with the full support of the Minister for Education Evarist Bartolo, and the number of schools increased to 20 as from this scholastic year 2016 – 2017.

HSBC Malta installed 614 photovoltaic panels and commissioned seven electric vehicles including six charging points at the bank's operations centre in Qormi. The PV panels, which are installed on top of 10 of the bank's offices, power our 37 offsite ATMs. As a result of this initiative – called 'Simply Electric' – the Bank's emissions have reduced by an estimated 148 tonnes of CO_2 per year. At the concluding session of the last Commonwealth Business Forum HRH the Prince of Wales who touched upon the various forces hindering human and social development in the context of the then impending COP21 talks in Paris said "We do have a responsibility to act now, seize this opportunity, and build a truly resilient future, There are thankfully signs that things are being done, to help businesses navigate this new operative environment. I'm enormously grateful to a number of very central players, including HSBC."

Non-Compliance with the Code

Principle 4 (Code Provision 4.2.7)

Code Provision 4.2.7 recommends 'the development of a succession policy for the future composition of the Board of Directors and particularly the executive component thereof, for which the Chairman should hold key responsibility'. The bank discloses that it has not formalised a Board succession policy. However, in practice the REMNOM Committee is actively involved in the board succession, specifically in recommending the appointment of new members and also by evaluating any newly proposed appointees.

Principle 9 (Code Provision 9.2)

This Code Provision recommends the bank to have in place a mechanism to resolve conflicts between minority shareholders and controlling shareholders. Although the bank does not have such mechanism in place there is ongoing open dialogue between the bank's senior management and the non-executive Directors to ensure that no such conflicts arise.

In terms of Code Provision 9.4 minority shareholders should be allowed to formally present an issue to the Board of Directors. The bank discloses that it does not have a policy in terms of this code provision, Listing Rule 5.97.4.

Internal control

The Board is ultimately responsible for the bank's system of internal control and for reviewing its effectiveness. Such procedures are designed to manage and mitigate rather than to eliminate the risk of failure, to achieve business objectives and can only provide reasonable and not absolute assurance against material error, losses or fraud. The Group has reviewed the risk management and internal control structure referred to as the 'three lines of defence' to ensure we achieve our commercial aims while meeting regulatory, legal as well as Group requirements. It is a key part of our operational risk management framework.

- First line – The First Line of Defence consists of 'Risk Owners' and 'Control Owners'. The bank's Global Business employees are the 'Risk Owners'. They own the risk, set the risk appetite and are accountable for managing the risk associated with their commercial activities. In managing the risk they are responsible to both manage their own controls and work closely with other Control Owners who sit outside of their area. 'Control Owners' exist in Global Businesses, Global Functions and HTS (HSBC Technology Services). They are accountable for the controls required to manage the risk associated with our commercial activities. They are required to monitor and provide an opinion on the effectiveness of the controls relied upon by the Risk Owners to manage their risk(s).
- Second line – The Second Line of Defence consists of 'Risk Stewards' and their teams. It is made up in part (but not exclusively) by leaders within Global Risk and other Global Functions. They set policy, give advice and provide independent challenge. In doing this, they oversee and assess the risk management activities carried out by the First Line. The Risk Stewards set the overall maximum risk appetite for their particular risk type (e.g. financial crime risk, regulatory compliance risk, legal risk, tax risk, accounting risk, people risk, fraud risk) and support the Risk Owners with setting their risk appetite within Group's overall risk appetite.
- Third line – The Third Line of Defence is Global Internal Audit, and it independently assures that the design and operating effectiveness of Group's framework of risk management, governance and internal control are adequate.

The local group's key risk management and internal control procedures include the following:

- Global standards. Functional, operating, financial reporting and certain management reporting standards are established by global function management committees, for application throughout HSBC globally. These are supplemented by operating standards set by functional and local management as required for the type of business and geographical location of each subsidiary.
- Delegation of authority within limits set by the Board. The Board has delegated specific, clear and unequivocal authority to the Chief Executive Officer to manage the day-to-day affairs of the business for which he is accountable within limits set by the Board. Delegation of authority from the Board requires the CEO to maintain appropriate apportionment of significant responsibilities and to oversee the establishment and maintenance of systems of control that are appropriate to the business.
- Risk identification and monitoring. Systems and procedures are in place to identify, control and report on the major risks facing the bank including credit, market, liquidity, capital, financial management, model, reputational, strategic, sustainability and operational (including accounting, tax, legal, compliance, fiduciary, information, external fraud, internal fraud, political, physical, business continuity, systems operations, project and people risk). Exposure to these risks is monitored by the Risk Management Meeting, Asset and Liability Committee and Executive Committee.

- Changes in market conditions/practices. Processes are in place to identify new risks arising from changes in market conditions/practices or customer behaviours, which could expose the bank to heightened risk of loss or reputational damage. During 2016, there was increased focus on actions to address the risks arising from the bank's exposure to Financial Crime risks. In addition attention remained focused on regulatory developments including the first year of the Single Supervisory Mechanism; regulatory commitments and consent orders including the Deferred Prosecution Agreement; challenges to achieving our strategy in a downturn; internet crime and fraud; level of change creating operational complexity and heightened execution risk; information security risk.
- IT operations. Centralised functional control is exercised over all IT developments and operations. In order to ensure consistency and benefit from economies of scale Common Group systems are employed for similar business processes wherever practicable.
- Comprehensive annual financial plans are prepared, reviewed and approved by the Board. Results are monitored and progress reports are prepared on a monthly basis to enable comparisons with plan. Financial accounting and management reporting standards have been established.
- Responsibilities for financial performance against plans and for capital expenditure, credit exposures and market risk exposures are delegated with limits to executive management. In addition, functional management in the bank has been given the responsibility to implement HSBC policies, procedures and standards for business and product lines; finance; legal and regulatory compliance; internal audit; human resources; credit risk; market risk; operational risk; computer systems and operations and property management.
- The Chief Risk Officer is responsible for the management of specific risks within the bank including credit risk in the wholesale and retail portfolios, markets risk and operational risk. Risks are monitored via Risk Management Meeting which meets regularly and via reporting to the Executive Committee, the Risk Committee and to the Board.
- Internal Audit. The establishment and maintenance of appropriate systems of risk management and internal control is primarily the responsibility of business management. The Internal Audit function reports to the Board. It provides independent and objective assurance in respect of adequacy of the design and operating effectiveness of the bank's framework of risk management, control and governance processes focusing on the areas of greatest risk to the bank using a risk-based approach. The Head of Internal Audit also reports to the Head of Global Internal Audit in so far as independence and resourcing are concerned.
- Internal Audit issues. Executive management is responsible for ensuring that any issues raised by the Internal Audit function are remediated within an appropriate and agreed timetable. Confirmation to this effect must be provided to Internal Audit who subsequently validate the remediation.
- The bank's Compliance Department ensures that the local group maintains the highest standards of corporate conduct including compliance with all the local and international regulatory obligations and HSBC Group ethical standards and regulations.
- Through the Audit Committee and Risk Committee, the Board reviews the processes and procedures to ensure the effectiveness of the system of internal control of the bank and its subsidiaries, which are monitored by Internal Audit.

Listing Rule 5.97.5

The information required by this Listing rule is found in the Directors' Report.

General meetings

The General Meeting is the highest decision making body of the bank. A General Meeting is called by twenty-one days' notice and it is conducted in accordance with the Articles of Association of the bank.

The Annual General Meeting deals with what is termed as 'ordinary business', namely the receiving or adoption of the annual financial statements, the declaration of a dividend, the appointment and remuneration of the Board (which may or may not involve an election), the appointment of the external auditors and the grant of the authority to the Board to fix the external auditors' emoluments. Other business which may be transacted at a General Meeting will be dealt with as Special Business.

All shareholders registered in the shareholders' Register on the record date as defined in the Listing Rules, have the right to attend, participate and vote in the General Meeting. A shareholder or shareholders holding not less than 5% in nominal value of all the shares entitled to vote at the General Meeting may request the bank to include items on the agenda of a General Meeting and/or table draft resolutions for items included in the agenda of a general meeting. Such requests are to be received by the bank at least forty-six days before the date set for the relative General Meeting. A shareholder who is unable to participate in the General Meeting can appoint a proxy by written or electronic notification to the bank. Every shareholder represented in person or by proxy is entitled to ask questions which are pertinent and related to items on the agenda of the General Meeting and to have such questions answered by the Directors or such persons as the Directors may delegate for that purpose.

Governance

Role of the Remuneration Committee

The bank's Remuneration and Nomination Committee (the Committee) within its remuneration oversight responsibilities is primarily responsible for making recommendations on the reward policy, on fixed and variable pay, and for ensuring their implementation.

The Committee works in conjunction with the HSBC Group Remuneration Committee (the 'Group's Committee'). However it has its own Terms of Reference, which sets out its key responsibilities in relation to HSBC Bank Malta p.l.c.

Membership & Meetings

At the beginning of the year, the Committee was composed of Mr Saviour sive Sonny Portelli as Chairman, and Mrs Caroline Zammit Testaferrata Moroni Viani and Professor Andrew Muscat as members. With effect from 16 April 2016 Dr Maryanne sive Sue Vella replaced Mrs Caroline Zammit Testaferrata Moroni Viani on the Committee.

Nine meetings were held by the Committee during 2016 and were attended as follows:

Saviour sive Sonny Portelli	(9 out of 9)
Andrew Muscat	(9 out of 9)
Maryanne sive Sue Vella	(4 out of 4)
Caroline Zammit Testaferrata Moroni Viani	(4 out of 5)

During the year, the Chief Executive Officer attended all the Committee's meetings. The Head of HR and the Chief Risk Officer attended some of the meetings of the Committee when deemed appropriate. None of the executives participated in the discussion regarding their own remuneration.

In 2016, the Committee did not engage any external adviser. It will only seek specific legal and/or remuneration advice independently as and when it considers this to be necessary.

Remuneration Strategy and Policy, and the link to Performance and Risk

HSBC Bank Malta p.l.c. remuneration policy

The bank's remuneration strategy is designed to reward competitively the achievement of long-term sustainable performance and attract and motivate the very best people who are committed to a long-term career with the HSBC Group in the long-term interests of our shareholders.

In 2014, new regulatory requirements were introduced under the EU's Capital Requirements Directive (CRD) IV. The consequential changes to the remuneration rules have influenced the bank's remuneration policy, particularly with respect to those employees identified as having a material impact on the bank's risk profile, being termed as Material Risk Takers (MRTs).

No material changes to the remuneration policy were introduced during 2016 and none are being envisaged during 2017.

The bank's reward policy is aligned to the Banking Rule 12, the Capital Requirements Directive and the Group's reward strategy.

In determining remuneration levels for 2016, the Committee applied the bank's remuneration strategy and policy, which takes into account the interests of shareholders, HSBC Group and the broader external context.

The Bank's Reward Strategy

The quality and long-term commitment of all employees is fundamental to the bank's success. The bank therefore aims to attract, retain and motivate the very best people who are committed to maintaining a long-term career with the bank, and who will perform their role in the long-term interests of the shareholders. HSBC's reward package comprises three key elements:

a Fixed Pay;
b Benefits; and
c Variable Pay.

These elements support the achievement of the bank's objectives through balancing reward for both short-term and long-term sustainable performance. This strategy is designed to reward only success, and aligns employees' remuneration with the bank's risk framework and risk outcomes.

For senior employees, where appropriate, part of their reward is deferred, and thereby subject to malus, that is, it can be cancelled if warranted by events. In order to ensure alignment between what the bank pays its employees and the bank's business strategy, individual performance is assessed against annual and long-term financial and non-financial objectives summarised in performance scorecards. This assessment also takes into account adherence to the HSBC Values of being 'open, connected and dependable' and acting with 'courageous integrity'. Altogether, performance is therefore judged not only on what is achieved over the short and long-term but also importantly on how it is achieved, as the bank believes the latter contributes to the long-term sustainability of the business.

Structure of Remuneration

The following table shows the purpose and relevant features of each of the three key elements of the HSBC's reward package. For the purposes of the Annual Variable Pay element, Material Risk Takers represent those members of staff whose professional activities have a material impact on the risk profile of the bank.

Description	Purpose, relevant features and link to strategy	Senior management	Non-executive Directors
Fixed Pay	Fixed pay reflects the individual's role, experience and responsibility. It comprises the base salary and in some cases a fixed pay allowance and/or a pension.		
	Base salary Base salaries are paid in cash on a monthly basis and are benchmarked on an annual basis against relevant comparator groups.	Y	
	Fixed pay allowance This is typically paid in cash on a monthly basis.	Y	
	Pensions These consist of cash allowances in lieu of personal/ occupational pension arrangements of international assignees appointed to Senior Executive position.	Y	
	Non-executive Directors' fees These refer to fees payable to non-executive Directors and reflect the time commitment and responsibilities required of them. Fees are determined by benchmark against other companies and banks.		Y
Benefits	Benefits take account of local market practice and include the provision of medical insurance, health assessment, life assurance, car lease allowance and tax assistance where appropriate.	Y	

Description	Purpose, relevant features and link to strategy	Senior management	Non-executive Directors
Variable Pay – annual incentive	Drives and rewards performance against annual financial and non-financial measures and adherence to HSBC Values which are consistent with the medium to long-term strategy and aligns to shareholder interests. Performance targets are set taking into account the economic environment, strategic priorities and risk appetite. Variable pay is delivered in the form of cash and shares. Where variable pay for Material Risk Takers is more than € 100,000 or for lower values more than 100% of fixed pay, a minimum of 50% of awards are made in shares. Total awards are subject to deferral and vest over a period of three years or such other period as determined by the Committee, and hence subject to malus or clawback provisions. The award is non-pensionable.	Y	

Variable Pay Funding

Funding of the bank's annual variable pay pool is determined in the context of profitability and affordability. The Committee considers many factors in approving the overall variable pay pool. These include, but are not limited to, the performance of the bank and the performance of the HSBC Group, considered within the context of the bank's risk appetite. The variable pay pool is also shaped by risk considerations and factors that may arise from any local or Group-wide notable events. The commercial requirement to remain competitive in the market is also taken into account.

Consideration of Individual Performance

Variable pay is discretionary and recommendations are made subject to an individual's performance and behaviour during the relevant performance year. These recommendations are then reviewed by the bank's Remuneration and Nomination Committee and subsequently approved by the Board. The bank's remuneration philosophy is based on meritocracy which takes into account an individual's total compensation.

Whilst individual Variable Pay decisions are discretionary, in addition to individual performance assessment a number of factors are also considered, including how the performance goals were reached and uses HSBC Values and Business Principles Behaviour Guide. The relevant business unit performance and overall affordability are also key considerations in determining the overall spend.

Performance Measurement and Risk Adjustment

Under the bank's remuneration framework, decisions relating to remuneration of individuals are made based on a combination of: performance against objectives, general individual performance of the role, and adherence to the HSBC values, business principles, Group risk-related policies and procedures and Global Standards.

In order to reward genuine performance, individual awards are made on the basis of a risk adjusted view of both financial and non-financial performance. In light of this, the bank has discretion to reduce an employee's current year variable pay to reflect detrimental conduct or involvement in Group-wide notable events or local issues.

The Committee can also seek advice from the Group Remuneration Committee, at the level of HSBC Holdings plc, to reduce or cancel all or part of any unvested deferred award under the applicable malus and clawback provision. Appropriate circumstances include (but are not limited to) conduct detrimental to the business; past performance being materially worse than originally understood; restatement, correction or amendment of any financial statements; or improper or inadequate risk management. The Group Remuneration Committee can also recommend the forfeiture of unvested awards granted in prior years.

Adjustments would generally be made to the current year variable pay before application of malus and clawback is considered. Details of the circumstances where an adjustment, malus and/or clawback will be considered are set out below:

Type of action	Type of variable pay award affected	Circumstances where it may apply (including, but not limited to):
Adjustment	Current year variable pay	• Detrimental conduct or conduct which brings the business into disrepute. • Involvement in Group-wide events resulting in significant operational losses, including events which have caused or have the potential to cause significant harm to HSBC. • Non-compliance with HSBC Values and other mandatory requirements. • For specified individuals, insufficient yearly progress in developing an effective AML and sanctions compliance programme or non-compliance with the DPA and other relevant orders.
Malus	Unvested deferred awards granted in prior years	• Detrimental conduct or conduct which brings the business into disrepute. • Past performance being materially worse than originally reported. • Restatement, correction or amendment of any financial statements. • Improper or inadequate risk management.
Clawback	Vested or paid awards	• Participation in or responsibility for conduct which results in significant losses. • Failing to meet appropriate standards of fitness and propriety. • Reasonable evidence of misconduct or material error that would justify, or would have justified, summary termination of a contract of employment. • HSBC or a business unit suffers a material failure of risk management within the context of Group risk management standards, policies and procedures.

Remuneration Policy – Non Executive Directors

Non-executive Directors are not employees and receive a fee for their services as Directors. In addition, it is common practice for non-executive Directors to be reimbursed expenses incurred in performing their role and any related tax. They are not eligible to receive a base salary, fixed pay allowance, benefits, pension or any variable pay.

The fee levels payable reflect the time commitment and responsibilities required of a non-executive Director. Fees are determined by reference to other Maltese companies and comparable entities within the HSBC Group.

The Board reviews each component of the fees periodically to assess whether, individually and in aggregate, they remain competitive and appropriate in light of changes in roles, responsibilities, and/or the time commitment required for the non-executive Directors and to ensure that individuals of the appropriate calibre are retained or can be appointed. The Board may approve changes to the fees within the aggregate amount approved by Shareholders at the Annual General Meeting. The Board may also introduce any new component of fee for non-executive Directors subject to the principles, parameters and other requirements set out in the remuneration policy.

The Directors' fees are approved in aggregate by the shareholders at the Annual General Meeting.

Remuneration amounts – Non Executive Directors

Details of non-executive Directors' fees for the financial year under review were as follows:

	€
Saviour sive Sonny Portelli	67,550
Caroline Zammit Testaferrata Moroni Viani	7,000
Philip Farrugia Randon	44,263
John Bonello	53,663
Andrew Muscat	32,713
Juanito Camilleri	53,663
Maryanne sive Sue Vella	25,713
Total	284,565

Directors who are employed with the bank or with HSBC Group are not paid any fees for their directorship.

Remuneration Policy – Material Risk Takers including Executive Directors and Senior Management

Individuals have been identified as MRTs based on qualitative and quantitative criteria set out in the Regulatory Technical Standard EU 604/2014 that came into force in June 2014. Amongst others, MRTs include all Executive Committee members, members of the ALCO and the Risk Management Committee as well as staff that have the authority to approve or veto a decision on any credit transaction representing 0.5% of the bank's CET 1 capital.

Standard contracts for Senior Executives and other Material Risk Takers employed locally would generally be indefinite. Normal retirement from the bank would be in line with local legislation. A three month notice period is required for Senior Executives, who would similarly be entitled to a notice of a minimum of three months in the event that the bank terminates the employment on grounds of redundancy.

International assignees appointed to Senior Executive positions are covered by the standard Group contracts policy. The period of notice required to be given to terminate by either party can be up to six months.

For the purposes of information provided hereunder 'Senior Executives'/'Senior Management' shall mean Executive Committee members.

Remuneration amounts – MRTs

The aggregate remuneration expenditure in the table below includes salary and incentives awarded in respect of performance in the year 2016 (including deferred component) and any pension or benefits outside of policy.

	Global business aligned				
	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	**Non-global business aligned**	**Total**
	€000	**€000**	**€000**	**€000**	**€000**
Aggregate remuneration expenditure	1,776	627	469	3,806	6,678

Remuneration – fixed and variable amounts

	2016			**2015**
	Senior management	MRTs (non-senior management)	Total	Total
Number of MRTs	15	27	46	66
	€000	**€000**	**€000**	**€000**
Fixed Pay				
Cash-based remuneration	2,669	1,636	4,305	4,710
Other remuneration				
– Pensions	90	39	129	221
– Benefits	748	328	1,076	1,345
Total fixed pay	3,507	2,003	5,510	6,276
Variable pay				
Cash	641	302	943	1,022
Non-deferred shares	93	–	93	181
Deferred cash	70	–	70	121
Deferred shares	62	–	62	138
Total variable pay	866	302	1,168	1,462
Total remuneration	4,373	2,305	6,678	7,738

The number of International Assignees reduced from 11 to 8 between 2015 and 2016, consistent with the bank's strategy to develop and promote local talent. Whilst proactively managing the international assignee population downwards, there remains a need to attract resources with specialist skills which are not readily available in Malta. The associated average total compensation of this population also decreased during the period.

All international assignees are employed on a time specific contract and as such, do not benefit from the collective agreement which provides significant benefits such as security of employment and other financial/non-financial benefits

The regulatory environment continues to change and the requirements to manage the associated risk have increased in complexity. This has required a significant increase in the number of individuals dealing with Financial Crime Risk and with it, increased costs. Professionals with specialist experience were recruited in 2016 to manage the compliance function and support the transformation required to meet our regulatory obligations. These skills, with international experience, were not available locally and compensation was commensurate to attract the appropriate calibre of individuals.

The enhanced capability of the compliance function will better protect the bank for ongoing sustainability in the future as regulation continues to grow in this area.

All MRTs are remunerated less than €1 million per annum.

Deferred remuneration

	2016			2015
	Senior management	MRTs (non-senior management)	Total	Total
	€000	**€000**	**€000**	**€000**
Deferred remuneration at 31 December 2016				
Outstanding, unvested	283	141	424	471
Awarded during the year	121	73	194	280
Paid out	70	34	104	411
Reduced through malus	–	–	–	–

Deferred remuneration is typically granted through a Restricted Share Awards scheme, whereby MRTs are awarded ordinary shares in HSBC Holdings plc to which the employee will become entitled, generally between one and three years from the date of the award, and normally subject to the individual remaining in employment.

Sign-on and severance payments

During 2016, no severance payments were made. No sign-on payments were made during the year.

Payments to past Directors

During 2016, no payments were made to past Directors.

Independent Auditor's Report to the Shareholders of HSBC Bank Malta p.l.c.

Report on the audit of the financial statements

Our opinion

In our opinion:

– HSBC Bank Malta p.l.c.'s consolidated and stand-alone parent company financial statements (the 'financial statements') give a true and fair view of the financial position of the local group and bank as at 31 December 2016, and of their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU; and
– The financial statements have been prepared in accordance with the requirements of the Banking Act (Cap. 371) and the Maltese Companies Act (Cap. 386).

What we have audited

HSBC Bank Malta p.l.c.'s financial statements, set out on pages 57 to 165, comprise:

– the consolidated and parent company statements of financial position as at 31 December 2016;
– the consolidated and parent company statements of comprehensive income for the year then ended;
– the consolidated and parent company statements of changes in equity for the year then ended;
– the consolidated and parent company statements of cash flows for the year then ended; and
– the notes to the financial statements, which include a summary of significant accounting policies.

Basis for opinion

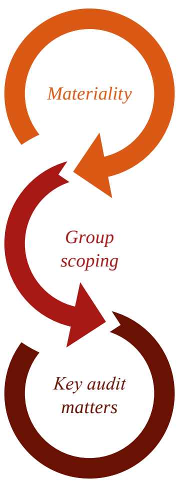
We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

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

Our audit approach

Overview



– Overall group materiality: €2.7 million, which represents 5% of profit before tax adjusted for one-time gains.

– The audit carried out by the group engagement team covered all the components within the local group as at and for the year ended 31 December 2016 comprising HSBC Bank Malta p.l.c. and its subsidiaries HSBC Life Assurance (Malta) Limited and HSBC Global Asset Management (Malta) Limited, which are all based in Malta.

– Impairment of loans and advances to customers

– Measurement of life insurance contract liabilities and of the Present Value of in-force Business (PVIF)

– Provision for brokerage remediation costs

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

Materiality

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

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

Overall group materiality	€2,682,000
How we determined it	5% of profit before tax adjusted for one-time gains
Rationale for the materiality benchmark applied	We chose profit before tax adjusted for one-time gains as the benchmark because, in our view, it is the benchmark against which the performance of the Group is most commonly measured by users, and is a generally accepted benchmark. We chose 5% which is within the range of acceptable quantitative materiality thresholds in auditing standards.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above €268,000 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Key audit matters

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

Key audit matter

Impairment of loans and advances to customers of the local group and bank

Impairment allowances in respect of loans and advances to customers represent management's best estimate of the losses incurred within the loan portfolios at the balance sheet date.

Impairment losses are calculated on an individual basis for significant loans and on a collective basis for homogeneous portfolios of loans that are not considered individually significant. A collective impairment assessment is also performed to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment.

The calculation of both collective and individual impairment allowances is inherently judgemental; judgement is applied to determine appropriate parameters and assumptions used to calculate impairment.

Collective impairment allowances are calculated using statistical models, which approximate the impact of current economic and credit conditions on portfolios of loans.

How our audit addressed the key audit matter

The policies and methodologies used by the bank in respect of impairment of loans and advances were discussed with the Audit Committee. Changes to inputs within the collective allowance models as well as individually significant loan impairments are discussed at Audit Committee and Risk Committee meetings. For collective allowances the appropriateness of the modelling policy and methodology used was independently assessed by reference to the requirements of accounting standards and market practices.

We understood and critically assessed the models used for collective allowances. Since modelling assumptions and parameters are based on historic data, we assessed whether historic experience was representative of current circumstances and of the recent losses incurred within the portfolios. The appropriateness of management's judgements was also independently considered in respect of calculation methodologies and segmentation, economic factors and judgemental overlays, period of historical loss rates used and loss emergence periods. Model calculations were tested through re-performance utilising our independent models. We tested the completeness and accuracy of data extracted from underlying systems that is utilised in the models.

Based on the evidence obtained, we found that the model assumptions, data used within the models and overlays to be reasonable.

Key audit matter	How our audit addressed the key audit matter
Impairment of loans and advances to customers of the local group and bank (continued)	

For incurred but not yet identified impairments, these models are based on the bank's historical loss experience in portfolios of similar risk characteristics, generally by sector, the estimated period between impairment occurring and loss recognition, and management's judgement as to whether current economic and credit conditions are such that the actual level of inherent losses at the balance sheet date is likely to be greater or less than that suggested by historical experience. For impairment losses in homogenous portfolios, the models used are based on roll rate methodology which employs statistical analyses of historical data and experience of delinquency and default to reliably estimate the amount of loans that will eventually be written off as a result of the events occurring before the balance sheet date and which the group is not able to identify individually.

The inputs to these models are subject to management judgment and model overlays are often required. Key assumptions and judgements include the emergence period used for unidentified impairment and the historical loss rate for loans and advances across a number of sectors.

The methodologies used by the bank to calculate collective impairment allowances are relatively standard which means that modelling risk is low but changes in individual inputs can have a significant bearing on the impairment charge.

For specific impairments, judgement is required to determine when an impairment event has occurred and then to estimate the expected future cash flows related to that loan, which are dependent on parameters or assumptions such as the valuation of collateral for secured lending. Discounted cash flow models are utilised in this respect.

We focused on impairment due to the subjective nature of the calculations and the subjective judgements involved in both timing of recognition of impairment and the estimation of the size of any such impairment.

Relevant references in the Annual Report and Financial Statements:

- Accounting policy: Note 3(d)(ii);
- Credit risk management: Note 4;
- Note on Loan impairment charges: Note 16;
- Note on Loans and advances to customers: Note 26; and
- Critical accounting judgements and estimates: Note 58(a).

For specific allowances the appropriateness of provisioning methodologies and policies was independently assessed across portfolios. We understood and evaluated the processes for identifying impairment events within loan portfolios, as well as the impairment assessment processes.

The controls management has established to identify which loans and advances are impaired were tested. For specific impairment charges on individual loans this includes controls over the compilation and review of the credit watch list and the credit file review processes. In particular, we tested the design and operating effectiveness of the key controls to determine which loans and advances are impaired, including testing controls over the timely identification of impaired loans and advances. We determined that we could rely on these controls for the purposes of our audit.

We assessed critically the criteria used for determining whether an impairment event had occurred and therefore whether there was a requirement to compute a specific impairment allowance. We tested a sample of loans with characteristics that might imply an impairment event had occurred (for example a customer experiencing financial difficulty) to challenge whether impairment events had actually occurred and to assess whether impairment events had been identified by management in a timely manner. We also haphazardly selected a sample of performing loans, which had not been identified by management as potentially impaired, to form our own judgement as to whether that was appropriate and to further challenge whether all relevant events had been identified by management. For a sample of individually impaired loans we understood the latest developments at the level of the borrower and the basis of measuring the impairment provisions and considered whether key judgments were appropriate given the borrowers' circumstances. An independent view was formed on the levels of provisions booked based on the detailed loan and customer information in the credit file. Calculations within the discounted cash flow models were re-performed. In addition, we tested key inputs to the impairment calculation including the expected future cash flows and valuation of collateral held, and challenged management to demonstrate that the valuations were up to date, consistent with the strategy being followed in respect of the particular borrower and appropriate for the purpose.

Testing the estimation of the future expected cash flows from customers including from realisation of collateral held for a sample of loans, involved assessing the work performed by external experts used by the bank to value the collateral or to assess the estimates of future cash flows. We used our experts to assess the appropriateness of valuations and estimates utilised.

Key audit matter	How our audit addressed the key audit matter
Impairment of loans and advances of the local group and bank (continued)	In the case of some impairment provisions, we formed a different view from that of management, but in our view the differences were within a reasonable range of outcomes.
Measurement of life insurance contract liabilities and of the Present Value of in-force Business (PVIF) of the local group	
Management's valuation of the provisions for the settlement of future claims attributable to life insurance contracts and of the PVIF involves complex and subjective judgements about future events, both internal and external to the business, for which small changes in assumptions can result in material impacts to the valuation of these items. Economic assumptions (investment return and associated discount rates) and non-economic assumptions (mortality, lapse rates and expenses associated with servicing policies), including the respective margins, applied are the key inputs to which the carrying amounts of these long-term liabilities and intangible asset are highly sensitive. Relevant references in the Annual Report and Financial Statements: – Accounting policy: Note 3(n)(iii) and note 3(n)(iv); – Note on Liabilities under insurance contracts: Note 41; – Note on Financial assets designated at fair value attributable to insurance operations: Note 23; and – Critical accounting judgements and estimates: Note 58(c).	Our audit procedures addressing the valuation of the local group's life insurance contract liabilities and of the PVIF included the following procedures, using our actuarial specialist team members: – we tested the accuracy of the underlying data utilised for the purposes of measurement by reference to its source; – we applied our industry knowledge and experience in comparing the methodology, models and assumptions used to recognised actuarial practices; and – we tested management's controls in respect of the valuation and assumption setting processes and we assessed management's key judgements throughout the processes. In respect of the assumptions underlying the measurement of the life insurance contract liabilities, we performed the following procedures using our actuarial specialist team members: – we assessed the assumptions for investment mix and projected investment returns by reference to company-specific and market observable data (euro swap curve); – we considered the appropriateness of the mortality assumptions by reference to company and industry data on historical mortality experience and expectations of future mortality; and – we tested the future expense assumption by understanding and challenging the basis on which expenses are allocated between new business and renewals and by reference to market observable data (inflation curve). The following procedures addressing the assumptions underlying the valuation of the local group's PVIF were performed also through the involvement of our actuarial specialist team members: – we leveraged the testing performed in relation to those assumptions that are aligned with the insurance contract liability valuation, reviewing the differences in margins applied between the two; and – we considered the appropriateness of the lapse rate assumptions by reference to company data, considering the results of management's analysis of recent lapse experience.

Key audit matter	How our audit addressed the key audit matter
Measurement of life insurance contract liabilities and of the Present Value of in-force Business (PVIF) of the local group (continued)	
	In respect of all the assumptions referred to above, we have reviewed management's approach to setting the assumptions, assessed the assumptions' appropriateness based on internal and external data, and tested management's governance and controls over the assumption basis review. We also reviewed the modelled results and manual adjustments, and we assessed the reasonableness of management's analysis of the changes in the carrying amounts. Based on the results of our work we concluded that the data and assumptions used by management were reasonable.
Provision for brokerage remediation costs of the local group and bank	
As reflected in notes 17 and 42 to the local group's consolidated financial statements, during the current financial year, the Bank has recognised in profit or loss provisions for a customer remediation programme as a result of the bank not performing the appropriateness test for customers who have invested in 'complex instruments' utilising the bank on an 'execution-basis' only arrangement during the period between 2007 and 2014. This has been considered as a key audit matter as judgement is needed to assess whether an obligation exists at 31 December 2016 in order to determine if: – it is likely that an economic outflow such as a payment will occur; and – the amount of the payment (or other economic outflow) can be estimated reliably. Judgement is also necessary to assess whether the bank's obligation arose in prior periods, on the basis that reliable information: – was available when financial statements for those periods were authorised for issue; and – could reasonably be expected to have been obtained and taken into account in the preparation and presentation of these financial statements. The measurement of such a provision requires significant judgement by the management of the bank to estimate the future remediation payments to be effected to customers. The bank has developed a calculation methodology to determine the amount of the provision, utilising internal actuarial specialists. The key inputs and assumptions within the model include: – the nominal amount of units of investments purchased, sold or transferred and the corresponding unit price; – a notional benchmark growth rate; – income earned assumed in line with the benchmark rate;	In view of the significant judgements involved in the measurement of the provision we have evaluated the methodology utilised by the bank for measuring the provision for brokerage remediation costs and challenged the appropriateness of the key assumptions used. Our procedures included: – validating the completeness and accuracy of the data used within the bank's model, which data dates back to November 2007; – assessing the bank's classification of instruments as complex or non-complex instruments taking cognisance of the external professional advice obtained to support the bank's view; – assessing the classification of the bank's clients into in-scope clients or otherwise; and – determining the sensitivity of the model to different assumptions such as those relating to corporate actions, the income expected to have been earned by clients throughout the period and the selection of the benchmark instrument and the related yield. Our work comprised reviewing internal documents in relation to this matter, including minutes of the various Board Committees and other internal reporting documents, as well as correspondence with the supervisory authorities in this respect. We have discussed the outcome of any meetings at the supervisory authorities with the Audit Committee. We considered the sensitivity of the provision to possible variations in those assumptions. This results in a different amount to that determined by management, but in our view these differences were within a reasonable range of outcomes in the context of the degree of uncertainty. We also tested the disclosures on the sensitivity of the provisions to changes in the underlying assumptions.

Key audit matter	How our audit addressed the key audit matter
Provision for brokerage remediation costs of the local group and bank (continued)	
– the obligation period for any losses incurred on the purchase of a complex instrument assumed to run till the date of notification; – losses and gains on complex instruments are netted off in line with external legal advice obtained to corroborate the bank's views; and – it has been assumed that corporate actions, including stock splits, reverse stock splits and spin offs, have given rise to a loss in the number of units attributable to that instrument. Relevant references in the Annual Report and Financial Statements: – Note on Provision for brokerage remediation costs: Note 17; – Note on Provisions for liabilities and other charges: Note 42; and – Critical accounting judgements and estimates: Note 58(d).	With respect to the period in which the obligation arose, we assessed the characteristics and circumstances of this case in detail and agreed that no error, omission or misstatement can be attributed to prior periods on the basis that the bank formed its intention to compensate clients only towards the latter part of 2016. Accordingly, in substance no constructive obligation existed prior to 1 January 2016. Thus, while reliable information was available in prior periods, the information could not have been reasonably expected to be taken into account in the preparation and presentation of prior period financial statements. We assessed the disclosures within the notes to the consolidated financial statements to determine whether they were sufficiently clear regarding the uncertainties that existed in relation to the measurement of the provision.

How we tailored our group audit scope

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

The local group is composed of three components: HSBC Bank Malta p.l.c. (the parent company), and its subsidiaries HSBC Life Assurance (Malta) Limited, which is determined to be a financially significant entity and HSBC Global Asset Management (Malta) Limited. We tailored the scope of our audit in order to perform sufficient work on all components to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the local group, the accounting processes and controls, and the industry in which the local group operates, and local statutory requirements.

The audit team of the local group performed all of this work by applying the overall materiality at the level of the local group's consolidated financial statements, together with additional procedures performed on the consolidation. This gave us sufficient appropriate audit evidence for our opinion on the local group financial statements as a whole.

Other information

The Directors are responsible for the other information. The other information comprises the Report of the Directors (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 Chairman's Statement, the Chief Executive Officer's Review, the Directors' Responsibilities Statement, the Remuneration Report and the Additional Regulatory Disclosures, which is expected to be made available to us after that date.

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

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. With respect to the Report of the Directors, we also considered whether the Report of the Directors includes the disclosures required by Article 177 of the Maltese Companies Act (Cap. 386).

Based on the work we have performed, in our opinion:

- the information given in the Report of the Directors for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Report of the Directors has been prepared in accordance with the Maltese Companies Act (Cap. 386).

In addition, in light of the knowledge and understanding of the local group and its environment obtained in the course of the audit, we are required to report if we have identified material misstatements in the Report of the Directors and other information that we obtained prior to the date of this auditor's report. We have nothing to report in this regard. When we read the Chairman's Statement, the Chief Executive Officer's Review, the Directors' Responsibilities Statement, the Remuneration Report and the Additional Regulatory Disclosures, if we conclude that there is a material misstatement therein, we are required to communicate the matter in accordance with International Standards on Auditing.

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

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

In preparing the financial statements, the Directors are responsible for assessing the local group's and 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 local group and the bank or to cease operations, or has no realistic alternative but to do so. Those charged with governance are responsible for overseeing the local group's and the bank's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the local group's and 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 local group's and the bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the local group and the bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the local group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit. We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

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

Report on other legal and regulatory requirements

Report on the statement of compliance with the Principles of Good Corporate Governance

The Listing Rules issued by the Malta Listing Authority require the Directors to prepare and include in their Annual Report a Statement of Compliance providing an explanation of the extent to which they have adopted the Code of Principles of Good Corporate Governance and the effective measures that they have taken to ensure compliance throughout the accounting period with those Principles. The Listing Rules also require the auditor to include a report on the Statement of Compliance prepared by the Directors.

We read the Statement of Compliance and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements included in the Annual Report. Our responsibilities do not extend to considering whether this statement is consistent with any other information included in the Annual Report. We are not required to, and we do not, consider whether the Board's statements on internal control included in the Statement of Compliance cover all risks and controls, or form an opinion on the effectiveness of the Company's corporate governance procedures or its risk and control procedures.

In our opinion, the Statement of Compliance set out on pages 33 to 42 has been properly prepared in accordance with the requirements of the Listing Rules issued by the Malta Listing Authority.

Other matters on which we are required to report by exception

We also have responsibilities under the Maltese Companies Act (Cap. 386) to report to you if, in our opinion:
- Adequate accounting records have not been kept, or that returns adequate for our audit have not been received from branches not visited by us.
- The financial statements are not in agreement with the accounting records and returns.
- We have not received all the information and explanations we require for our audit.
- Certain disclosures of Directors' remuneration specified by law are not made in the financial statements, giving the required particulars in our report.

We have nothing to report to you in respect of these responsibilities.

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Fabio Axisa (Partner) for and on behalf of

PricewaterhouseCoopers
Registered Auditors
78 Mill Street, Qormi, Malta

21 February 2017

pwc

Income Statements for the year ended 31 December 2016

		Group		*Bank*	
		2016	2015	**2016**	2015
	Note	**€000**	€000	**€000**	€000
Interest and similar income					
– on loans and advances, balances with Central Bank of Malta and Treasury Bills	*7*	**127,561**	134,294	**127,678**	134,601
– on debt and other fixed income instruments	*7*	**14,501**	16,273	**14,303**	15,921
Interest expense	*8*	**(15,635)**	(23,531)	**(15,673)**	(23,634)
Net interest income		**126,427**	127,036	**126,308**	126,888
Fee income		**25,703**	29,072	**21,030**	23,423
Fee expense		**(1,951)**	(2,509)	**(1,376)**	(1,801)
Net fee income	*9*	**23,752**	26,563	**19,654**	21,622
Net trading income	*10*	**7,276**	8,390	**7,276**	8,390
Net income from financial instruments designated at fair value attributable to insurance operations		**23,564**	31,999	**–**	–
Net gains on sale of available-for-sale financial investments	*11*	**10,787**	682	**10,787**	683
Dividend income	*12*	**–**	–	**10,567**	1,231
Net insurance premium income	*13*	**53,378**	55,243	**–**	–
Movement in present value of in-force long-term insurance business		**(1,689)**	(3,017)	**–**	–
Net other operating income	*14*	**1,384**	549	**1,336**	502
Total operating income		**244,879**	247,445	**175,928**	159,316
Net insurance claims, benefits paid and movement in liabilities to policyholders	*15*	**(63,337)**	(71,090)	**–**	–
Net operating income before loan impairment charges and provisions		**181,542**	176,355	**175,928**	159,316
Loan impairment charges	*16*	**(9,030)**	(10,826)	**(9,030)**	(10,826)
Provision for brokerage remediation costs	*17*	**(8,000)**	–	**(8,000)**	–
Net operating income		**164,512**	165,529	**158,898**	148,490
Employee compensation and benefits	*18*	**(52,652)**	(68,485)	**(49,953)**	(65,267)
General and administrative expenses	*19*	**(42,905)**	(43,554)	**(38,437)**	(39,115)
Depreciation of property, plant and equipment	*33*	**(3,545)**	(3,575)	**(3,541)**	(3,567)
Amortisation and impairment of intangible assets	*34*	**(3,189)**	(3,143)	**(3,133)**	(3,089)
Profit before tax	*19*	**62,221**	46,772	**63,834**	37,452
Tax expense	*20*	**(22,008)**	(17,292)	**(21,141)**	(13,991)
Profit for the year		**40,213**	29,480	**42,693**	23,461
Earnings per share	*21*	**11.2c**	8.5c		

The notes on pages 63 to 165 are an integral part of these financial statements.

Statements of Comprehensive Income for the year ended 31 December 2016

		Group		*Bank*	
		2016	2015	**2016**	2015
	Note	**€000**	€000	**€000**	€000
Profit for the year		**40,213**	29,480	**42,693**	23,461
Other comprehensive income					
Items that will be reclassified subsequently to profit or loss when specific conditions are met:					
Available-for-sale investments:					
– fair value (losses)/gains	*46*	**(585)**	4,938	**(432)**	5,187
– fair value gains reclassified to profit or loss on disposal	*46*	**(10,787)**	(682)	**(10,787)**	(683)
– income taxes	*46*	**3,980**	(1,489)	**3,926**	(1,576)
		(7,392)	2,767	**(7,293)**	2,928
Items that will not be reclassified subsequently to profit or loss:					
Properties:					
– surplus arising on revaluation	*46*	**2,554**	–	**2,554**	–
– income taxes on revaluation surplus	*46*	**(255)**	–	**(255)**	–
– income taxes determined on the basis applicable to disposals	*46*	**–**	1,199	**–**	1,201
		2,299	1,199	**2,299**	1,201
Other comprehensive income for the year, net of tax		**(5,093)**	3,966	**(4,994)**	4,129
Total comprehensive income for the year		**35,120**	33,446	**37,699**	27,590

The notes on pages 63 to 165 are an integral part of these financial statements.

Statements of Financial Position at 31 December 2016

		Group		*Bank*	
		2016	2015	**2016**	2015
	Note	**€000**	€000	**€000**	€000
Assets					
Balances with Central Bank of Malta, Treasury Bills and cash	22	**122,418**	187,563	**122,418**	187,563
Items in course of collection from other banks		**16,796**	12,559	**16,796**	12,559
Financial assets designated at fair value attributable to insurance operations	23	**1,383,606**	1,372,484	**–**	–
Held for trading derivatives	24	**11,440**	11,492	**11,335**	10,897
Loans and advances to banks	25	**1,077,859**	841,411	**996,091**	728,918
Loans and advances to customers	26	**3,320,332**	3,284,615	**3,320,363**	3,292,815
Available-for-sale financial investments	27	**1,053,200**	1,203,638	**1,048,549**	1,198,792
Prepayments and accrued income	28	**31,178**	40,863	**20,373**	31,305
Current tax assets		**12,963**	11,792	**7,235**	2,356
Reinsurance assets	29	**85,228**	83,088	**–**	–
Non-current assets held for sale	30	**9,750**	11,347	**9,750**	11,347
Investments in subsidiaries	31	**–**	–	**30,859**	34,541
Investment property	32	**13,026**	15,458	**10,180**	10,876
Property, plant and equipment	33	**59,147**	58,559	**59,252**	58,659
Intangible assets	34	**65,765**	69,653	**5,424**	7,610
Deferred tax assets	35	**22,163**	22,642	**22,163**	22,590
Other assets	36	**21,093**	13,959	**16,610**	8,124
Total assets		**7,305,964**	7,241,123	**5,697,398**	5,618,952
Liabilities					
Deposits by banks	37	**10,770**	14,286	**10,770**	14,286
Customer accounts	38	**5,000,836**	4,950,257	**5,060,845**	5,028,318
Held for trading derivatives	24	**12,600**	11,732	**11,731**	11,630
Accruals and deferred income	39	**17,171**	30,073	**14,864**	23,898
Current tax liabilities		**177**	3,508	**–**	–
Liabilities under investment contracts	40	**930,937**	987,008	**–**	–
Liabilities under insurance contracts	41	**645,561**	616,657	**–**	–
Provisions for liabilities and other charges	42	**17,631**	17,133	**17,231**	16,609
Deferred tax liabilities	35	**34,586**	32,249	**5,262**	4,299
Subordinated liabilities	43	**87,418**	87,363	**88,172**	88,146
Other liabilities	44	**74,753**	29,741	**68,129**	26,359
Total liabilities		**6,832,440**	6,780,007	**5,277,004**	5,213,545
Equity					
Called up share capital	45	**108,092**	108,092	**108,092**	108,092
Revaluation reserve	46	**41,333**	46,476	**41,224**	46,268
Retained earnings	46	**324,099**	306,548	**271,078**	251,047
Total equity		**473,524**	461,116	**420,394**	405,407
Total liabilities and equity		**7,305,964**	7,241,123	**5,697,398**	5,618,952
Memorandum items					
Contingent liabilities	47	**118,469**	133,771	**118,469**	133,771
Commitments	48	**1,225,232**	1,292,605	**1,253,263**	1,292,802

The notes on pages 63 to 165 are an integral part of these financial statements.

The financial statements on pages 57 to 165 were approved and authorised for issue by the Board of Directors on 21 February 2017 and signed on its behalf by:

Sonny Portelli, *Chairman*

Andrew Beane, *Chief Executive Officer*

Statements of Changes in Equity for the year ended 31 December 2016

	Note	*Share capital* €000	*Revaluation reserve* €000	*Retained earnings* €000	*Total equity* €000
Group					
At 1 January 2016		**108,092**	**46,476**	**306,548**	**461,116**
Profit for the year		**–**	**–**	**40,213**	**40,213**
Other comprehensive income					
Available-for-sale investments:					
– fair value losses, net of tax	*46*	**–**	**(380)**	**–**	**(380)**
– fair value gains reclassified to profit or loss on disposal, net of tax	*46*	**–**	**(7,012)**	**–**	**(7,012)**
Properties:					
– surplus arising on revaluation, net of tax	*46*	**–**	**2,299**	**–**	**2,299**
– transfer to retained earnings upon realisation through disposal, net of tax	*46*	**–**	**(50)**	**50**	**–**
Total other comprehensive income		**–**	**(5,143)**	**50**	**(5,093)**
Total comprehensive income for the year		**–**	**(5,143)**	**40,263**	**35,120**
Transactions with owners, recognised directly in equity					
Contributions by and distributions to owners:					
– share-based payments		**–**	**–**	**5**	**5**
– dividends	*50*	**–**	**–**	**(22,717)**	**(22,717)**
Total contributions by and distributions to owners		**–**	**–**	**(22,712)**	**(22,712)**
At 31 December 2016		**108,092**	**41,333**	**324,099**	**473,524**
At 1 January 2015		97,281	42,510	305,314	445,105
Profit for the year		–	–	29,480	29,480
Other comprehensive income					
Available-for-sale investments:					
– fair value gains, net of tax	*46*	–	3,211	–	3,211
– fair value gains reclassified to profit or loss on disposal, net of tax	*46*	–	(444)	–	(444)
Properties:					
– deferred taxes on revaluation surplus determined on the basis applicable to disposals	*46*	–	1,199	–	1,199
Total other comprehensive income		–	3,966	–	3,966
Total comprehensive income for the year		–	3,966	29,480	33,446
Transactions with owners, recognised directly in equity					
Contributions by and distributions to owners:					
– share-based payments		–	–	20	20
– dividends	*50*	–	–	(17,455)	(17,455)
– bonus issue	*45*	10,811	–	(10,811)	–
Total contributions by and distributions to owners		10,811	–	(28,246)	(17,435)
At 31 December 2015		108,092	46,476	306,548	461,116

The notes on pages 63 to 165 are an integral part of these financial statements.

	Note	Share capital €000	Revaluation reserve €000	Retained earnings €000	Total equity €000
Bank					
At 1 January 2016		**108,092**	**46,268**	**251,047**	**405,407**
Profit for the year		**–**	**–**	**42,693**	**42,693**
Other comprehensive income					
Available-for-sale investments:					
– fair value losses, net of tax	*46*	**–**	**(281)**	**–**	**(281)**
– fair value gains reclassified to profit or loss on disposal, net of tax	*46*	**–**	**(7,012)**	**–**	**(7,012)**
Properties:					
– surplus arising on revaluation, net of tax	*46*	**–**	**2,299**	**–**	**2,299**
– transfer to retained earnings upon realisation through disposal, net of tax	*46*	**–**	**(50)**	**50**	**–**
Total other comprehensive income		**–**	**(5,044)**	**50**	**(4,994)**
Total comprehensive income for the year		**–**	**(5,044)**	**42,743**	**37,699**
Transactions with owners, recognised directly in equity					
Contributions by and distributions to owners:					
– share-based payments		**–**	**–**	**5**	**5**
– dividends	*50*	**–**	**–**	**(22,717)**	**(22,717)**
Total contributions by and distributions to owners		**–**	**–**	**(22,712)**	**(22,712)**
At 31 December 2016		**108,092**	**41,224**	**271,078**	**420,394**
At 1 January 2015		97,281	42,139	255,837	395,257
Profit for the year		–	–	23,461	23,461
Other comprehensive income					
Available-for-sale investments:					
– fair value gains, net of tax	*46*	–	3,372	–	3,372
– fair value gains reclassified to profit or loss on disposal, net of tax	*46*	–	(444)	–	(444)
Properties:					
– deferred taxes on revaluation surplus determined on the basis applicable to disposals	*46*	–	1,201	–	1,201
Total other comprehensive income		–	4,129	–	4,129
Total comprehensive income for the year		–	4,129	23,461	27,590
Transactions with owners, recognised directly in equity					
Contributions by and distributions to owners:					
– share-based payments		–	–	15	15
– dividends	*50*	–	–	(17,455)	(17,455)
– bonus issue	*45*	10,811	–	(10,811)	–
Total contributions by and distributions to owners		10,811	–	(28,251)	(17,440)
At 31 December 2015		108,092	46,268	251,047	405,407

The notes on pages 63 to 165 are an integral part of these financial statements.

Statements of Cash Flows for the year ended 31 December 2016

		Group		*Bank*	
		2016	2015	**2016**	2015
	Note	**€000**	€000	**€000**	€000
Cash flows from operating activities					
Interest, fees and premium receipts		**229,786**	243,524	**166,605**	171,969
Interest, fees and claims payments		**(198,728)**	(173,162)	**(19,459)**	(28,489)
Payments to employees and suppliers		**(105,839)**	(90,812)	**(98,624)**	(85,804)
Cash flows (used in)/from operating activities before changes in operating assets/liabilities		**(74,781)**	(20,450)	**48,522**	57,676
(Increase)/decrease in operating assets:					
Financial assets designated at fair value		**2,309**	107,715	**–**	–
Reserve deposit with Central Bank of Malta		**(62)**	(1,594)	**(62)**	(1,594)
Loans and advances to customers and banks		**(94,257)**	(85,835)	**(86,087)**	(82,779)
Treasury Bills		**44,999**	(51,000)	**44,999**	(51,000)
Other receivables		**592**	6,680	**1,381**	(1,054)
Increase/(decrease) in operating liabilities:					
Customer accounts and deposits by banks		**67,378**	40,730	**48,058**	55,303
Other payables		**79,132**	(24,699)	**(2,599)**	(5,468)
Net cash from/(used in) operating activities before tax		**25,310**	(28,453)	**54,212**	(28,916)
Tax paid		**(19,853)**	(25,566)	**(20,839)**	(18,153)
Net cash from/(used in) operating activities		**5,457**	(54,019)	**33,373**	(47,069)
Cash flows from investing activities					
Dividends received		**–**	–	**10,567**	–
Interest received from financial investments		**33,435**	54,037	**24,838**	25,223
Purchase of financial investments		**(100,609)**	(312,346)	**(99,647)**	(301,614)
Proceeds on sale and maturity of financial investments		**227,414**	323,562	**225,518**	300,985
Purchase of property, plant and equipment, investment property and intangible assets		**(990)**	(4,640)	**(969)**	(4,585)
Proceeds on sale of property, plant and equipment, and intangible assets		**2,639**	3	**709**	2
Proceeds on redemption of shares in subsidiary company		**–**	–	**3,682**	–
Net cash flows from investing activities		**161,889**	60,616	**164,698**	20,011
Cash flows from financing activities					
Dividends paid		**(22,717)**	(17,455)	**(22,717)**	(17,455)
Net increase/(decrease) in cash and cash equivalents		**144,629**	(10,858)	**175,354**	(44,513)
Cash and cash equivalents at beginning of year		**793,723**	827,685	**681,230**	748,847
Effect of exchange rate changes on cash and cash equivalents		**504**	(23,104)	**504**	(23,104)
Cash and cash equivalents at end of year	*51*	**938,856**	793,723	**857,088**	681,230

The notes on pages 63 to 165 are an integral part of these financial statements.

1 Reporting entity

HSBC Bank Malta p.l.c. (the 'local group') is a limited liability company domiciled and incorporated in Malta.

The consolidated financial statements of the local group as at and for the year ended 31 December 2016 comprise the bank and its subsidiaries. All amounts have been rounded to the nearest thousand, unless otherwise stated.

2 Basis of preparation

a *Compliance with IFRSs as adopted by the EU*

These consolidated financial statements have been prepared in accordance with the requirements of International Financial Reporting Standards (IFRSs) as adopted by the EU.

These financial statements have also been drawn up in accordance with the provisions of the Banking Act, 1994 and the Companies Act, 1995, enacted in Malta.

b *Historical cost convention*

These financial statements have been prepared on the historical cost basis, except for the intangible asset reflecting the present value of in-force long-term insurance business, and the following items that are measured at fair value:

– Held for trading derivatives;

– Financial assets designated at fair value through profit or loss;

– Available-for-sale financial investments;

– Property within 'Property, plant and equipment' and 'Investment property'; and

– Liabilities under investment contracts.

c *New and amended standards adopted by the local group*

During 2016, the bank adopted a number of interpretations and amendments to standards which had an insignificant effect on the consolidated financial statements of the local group and the separate financial statements of the bank.

d *New standards and interpretations not yet adopted*

Certain new accounting standards and interpretations have been published that are not mandatory for 31 December 2016 reporting periods and have not been early adopted by the local group.

Future accounting developments

IFRS 9 'Financial Instruments'

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

Classification and measurement

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

2 Basis of preparation *(continued)*

d *New standards and interpretations not yet adopted (continued)*

More specifically, the local group conducted an assessment of potential classification and measurement changes to financial assets based on the composition of the balance sheet as at 31 December 2016. This may not be fully representative of the impact as at 1 January 2018 because IFRS 9 requires that business models are assessed based on the facts and circumstances from the date of initial application. In addition, the contractual terms and conditions of the financial assets assessed as at 31 December 2016 may not reflect the contractual terms and conditions of the local group's financial assets at transition. However, based on the assessment of financial assets carried out in June 2015 on balances as at 31 December 2014 and expectations around changes to balance sheet composition, the local group expects that generally:

- loans and advances to banks and to customers that are classified as loans and receivables under IAS 39 will be measured at amortised cost under IFRS 9;
- financial assets designated at FVTPL will remain at FVTPL, because it is required under IFRS 9 or designation will continue;
- debt securities classified as available-for-sale will primarily be measured at amortised cost or FVOCI either because of their contractual cash flow characteristics or the business model within which they are held;
- treasury bills classified as available-for-sale will be measured at amortised cost or FVOCI depending upon the business model in which they are held; and
- equity securities will remain measured at fair value, with fair value movements recognised in other comprehensive income, since the equity securities currently held by the local group are held for reasons other than to generate a capital return.

Impairment

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

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

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

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

Hedge accounting

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link with risk management strategy and permitting hedge accounting to be applied to a greater variety of hedging instruments and risks, but do not explicitly address macro hedge accounting strategies, which are particularly important for banks. As a result, IFRS 9 includes an accounting policy choice to remain with IAS 39 hedge accounting.

Although the local group deploys a number of hedging strategies to mitigate or offset risk that arise from its activities, none of its strategies achieve hedge accounting in terms of IAS 39. Accordingly, the local group expects that IFRS 9 will have no impact in this regard.

2 Basis of preparation *(continued)*

d *New standards and interpretations not yet adopted (continued)*

Transition

The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. The mandatory application date for the standard as a whole is 1 January 2018. Thus, the local group does not intend to restate its comparative periods. Accordingly, all adjustments resulting from the transition will be applied by adjusting the opening balance sheet as at 1 January 2018.

IFRS 9 implementation programme

Within the HSBC Group, a joint Global Risk and Global Finance IFRS 9 Implementation Programme (the Programme) was set up in 2012 to prepare for implementation of IFRS 9 and significant preparatory and design work has taken place. The Programme is sponsored by the Group Chief Risk Officer and Group Finance Director. In the local group a Steering Committee comprising senior management from Risk, Finance and HSBC Operations, Services and Technology has been established, in line with all significant change programmes in HSBC. The Programme is managed according to the Group's business transformation framework.

Delivery of the required changes are undertaken by individual workstreams, with Global Risk leading the work to calculate impairments and Global Finance leading the development of financial reporting systems and processes. In this respect, the local group has established a steering committee to manage implementation locally, within this global framework.

To date, the Programme has been directed towards preliminary impact analysis, documenting Group accounting policy, developing the operating and system target operating models and developing risk modelling methodologies for the calculation of impairment. In addition, an impact assessment of the classification and measurement requirements was performed. The Programme's focus is now on the impairment models and processes.

The Group intends to perform a parallel run during the second half of 2017 to gain a better understanding of the potential effect of the new standard and for the governance framework to gain experience. The local group plans to participate in the parallel run scheduled for the second half of 2017. As a result, the local group intends to quantify the potential impact of IFRS 9 once it is practicable to provide reliable estimates, which will be subsequent to such parallel run but no later than in the Annual Report and Accounts 2017.

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

Comparison of IAS 39 accounting policies with IFRS 9

The accounting policies and critical accounting estimates and judgements for the impairment of loans and advances and available-for-sale financial assets (in accordance with IAS 39 'Financial Instruments') are set out in note 3(d). Their equivalents for financial assets at amortised cost and at FVOCI (in accordance with IFRS 9) are being developed, but the following similarities and differences are likely to be important in understanding the potential effect of the change in accounting policy resulting from the implementation of IFRS 9 'Financial Instruments':

Amortised cost

The accounting policies in accordance with IAS 39 generally make a distinction between individually significant loans and homogeneous groups of loans which are assessed collectively. This distinction has less relevance in developing IFRS 9 accounting policies. However, under IFRS 9, whether the loans are managed through wholesale credit risk systems or retail credit risk systems becomes the more relevant distinction because of differences in the types of information available and the way credit risk is managed.

Stage 3

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

For wholesale loans, individual discounted cash flow calculations will continue to be performed. Changes may be made to these calculations to ensure the measurement requirements of IFRS 9 are met.

2 Basis of preparation *(continued)*

d *New standards and interpretations not yet adopted (continued)*

Transition *(continued)*

In accordance with IAS 39, statistical methods are used to determine impairment losses on a collective basis for homogeneous groups of loans that are not considered individually significant using either roll rate methodologies or historical loss rate experience for loans. Under these methodologies, impairment allowances are recognised at a portfolio level. However, loans are classified as impaired for presentation purposes when they are more than 90 days past due or have been renegotiated for credit risk reasons. Under IFRS 9, the local group expects to determine stage 3 for these populations by considering the relevant objective evidence, primarily whether contractual payments of either principal or interest are past due for more than 90 days, or a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition, or the loan is otherwise considered to be in default. HSBC does not expect to rebut the presumption in IFRS 9 that loans which are 90 days past due are in default for retail loans.

The impairment allowance is expected to be determined by the same calculation used for stage 2, with the probability of default set to 1. The result may, therefore, not be the same as that determined by the current statistical methods and the population disclosed as stage 3 will not necessarily correspond with that disclosed as impaired in accordance with IAS 39.

The policy on write-off of loans and advances is expected to remain unchanged.

With respect to 'renegotiated' loans, the current treatment will remain the same under IFRS 9, except for new loans recognised as a result of the original loan being derecognised following a renegotiation. These loans will be classified as originated credit-impaired and will retain this classification until derecognition. For all other modifications, the general policy on derecognition will apply.

Other than originated credit-impaired loans, all other modified loans could be transferred out of stage 3 if they no longer exhibit any evidence of being credit impaired or, in the case of renegotiated loans, there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows and there are no other indicators of impairment.

Stage 2

In accordance with IFRS 9, financial assets are considered to be in stage 2 when their credit risk has increased significantly since initial recognition so it is appropriate to recognise lifetime ECL. Since this is not a concept in IAS 39, it is likely to result in increased allowances as the result of the recognition of lifetime ECL for populations that are not considered to be credit impaired.

The analysis of credit risk is taking into consideration a number of factors and the determination of whether a specific factor is relevant and its weight compared with other factors will depend on the type of product, the characteristics of the financial instrument and the borrower. Therefore, it is not possible to provide a single set of criteria that will determine what is considered to be a significant increase in credit risk. Since the concept is relative and significance in part depends on the credit risk at initial recognition, credit quality disclosures that report credit grades as at the balance sheet date may not reflect the populations in stage 2 or those that are at risk of moving to stage 2.

For wholesale portfolios and significant retail portfolios, the local group intends to consider whether credit risk has increased significantly since initial recognition using a combination of individual and collective information, and will reflect the increase in credit risk at the individual loan level to the extent practicable.

The main factor that will be considered is a lifetime probability of default (PD) or a 12-month PD where this provides a reasonable approximation of changes in the lifetime risk of default, adjusted to be consistent with the current economic conditions and the expected future economic conditions which are expected to affect credit risk. The PD will be derived from the customer risk rating for wholesale portfolios and from the credit scores for retail portfolios. The PD for wholesale is determined on an obligor level and for retail at the level of the individual facility. In situations where a 12-month PD would not be appropriate, for example, where the financial instrument only has significant payment obligations beyond the next 12 months, additional factors will be considered or adjustments made to ensure that the lifetime credit risk is appropriately considered.

The PDs will also be adjusted to incorporate the effect of economic assumptions, such as interest rates, unemployment rates and GDP forecasts that can be statistically related to changes in PD which have an impact beyond the next 12 months. These statistical relationships are expected to be established through the processes developed for stress testing. In addition, other relevant factors which may not be adequately reflected in the information used to derive PDs, including past due status and whether the financial asset is subject to additional monitoring through the watch list process for wholesale portfolios, will be taken into account.

2 Basis of preparation *(continued)*

d *New standards and interpretations not yet adopted (continued)*

Transition *(continued)*

The local group is in the process of calibrating and testing the thresholds or magnitude of change required and mechanisms for transfer from stage 1 to stage 2 (and vice versa) across different portfolios so it is not possible to provide further detail at this time. The aim is to establish the points where the change in credit risk is considered meaningful in risk management terms and to test these points against subsequent stage movements and defaults. Where less sophisticated default metrics are used or credit scores are not available, as tends to apply with the less significant retail portfolios, a consistent but simplified approach is expected to be used. In particular, for any retail portfolio days past due will be considered in determining loans transferred to stage 2 and for the more significant portfolios the bank will supplement this information with additional mechanisms linked to PDs.

Stage 1

In accordance with IAS 39, incurred but not yet identified impairment is recognised on individually assessed loans for which no evidence of impairment has been specifically identified by estimating a collective allowance determined after taking into account factors including the estimated period between impairment occurring and the loss being identified. This is assessed empirically on a periodic basis and may vary over time. Similarly, for homogeneous groups of loans and advances which are assessed under IAS 39 on a collective basis, the inherent loss is determined using risk factors including the period of time between loss identification and write-off which is regularly benchmarked against actual outcomes. Under IFRS 9, financial assets which are not considered to have experienced significant increase in credit risk have loss allowances measured at an amount equal to 12-month ECL. This 12-month time horizon is likely to be equal to or longer than the period estimated under IAS 39 (typically between 6 and 12 months), which will tend to result in IFRS 9 allowances being larger.

e *Functional and presentation currency*

The functional currency of the bank is euro, which is also the presentation currency of the consolidated financial statements of the local group.

f *Critical accounting estimates and judgements*

The preparation of financial information in accordance with the requirements of IFRSs as adopted by the EU requires the use of estimates and judgements about future conditions. In view of the inherent uncertainties and the high level of subjectivity involved in the recognition or measurement of items listed below, it is possible that the outcomes in the next financial year could differ from those on which management's estimates are based, resulting in materially different conclusions from those reached by management for the purposes of the 2016 Financial Statements. Management's selection of the local group's accounting policies which contain critical estimates and judgements is listed below; it reflects the materiality of the items to which the policies are applied, the high degree of judgement and estimation uncertainty involved:

– Impairment of loans and advances: Note 3(d)(ii) and note 16;

– Valuation of financial instruments: Note 5;

– Policyholder claims and benefits: Note 3(n)(ii) and note 15;

– Present value of in-force long-term assurance business (PVIF): Note 3(n)(iv) and note 34.

– Provision for brokerage remediation costs: Note 17.

Further information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment, related to the matters highlighted above, is included in note 58.

In management's view, apart from judgements involving estimations as reflected above, there are no significant or critical judgements made in the process of applying the local group's accounting policies that have a more significant effect on the amounts recognised in the financial statements.

3 Significant accounting policies

This note provides a list of the significant accounting policies adopted in the preparation of these consolidated financial statements. These policies have been consistently applied to all the years presented, unless otherwise stated.

a *Basis of consolidation*

i Consolidation

HSBC Bank Malta p.l.c. controls and consequently consolidates an entity when it is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Control is initially assessed based on consideration of all facts and circumstances, and is subsequently reassessed when there are significant changes to the initial setup. The local group is considered to have power over an entity when it has existing rights that give it the current ability to direct the relevant activities. For the local group to have power over an entity, it must have the practical ability to exercise those rights.

Where an entity is governed by voting rights, the group would consolidate when it holds, directly or indirectly, the necessary voting rights to pass resolutions by the governing body. In all other cases, the assessment of control is more complex and requires judgement of other factors, including having exposure to variability of returns, power over the relevant activities or holding the power as agent or principal. The local group may have power over an entity even though it holds less than a majority of the voting rights, if it holds additional rights arising through other contractual arrangements or substantive potential voting rights which give it power.

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured at the fair value of the consideration, including contingent consideration, given at the date of exchange. Acquisition-related costs are recognised as an expense in profit or loss in the period in which they are incurred. The acquired identifiable assets, liabilities and contingent liabilities are generally measured at their fair values at the date of acquisition. Goodwill is measured as the excess of the aggregate of the consideration transferred, the amount of non-controlling interest and the fair value of the local group's previously held equity interest, if any, over the net of the amounts of the identifiable assets acquired and the liabilities assumed. On an acquisition-by-acquisition basis, the amount of non-controlling interest is measured either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. For acquisitions achieved in stages, the previously held equity interest is remeasured at the acquisition-date fair value with the resulting gain or loss recognised in profit or loss.

Changes in the parent's ownership interest in a subsidiary that do not result in a loss of control are treated as transactions between equity owners of the local group and the net impact is reported within equity.

Subsidiaries are fully consolidated from the date on which control is transferred to the local group. They are deconsolidated from the date that control ceases.

ii Structured entities

A structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, for example when any voting rights relate to administrative tasks only, and key activities are directed by contractual arrangements. Structured entities often have restricted activities and a narrow and well defined objective.

Structured entities are assessed for consolidation in accordance with the local group's accounting policy set out above.

When assessing whether to consolidate HSBC managed investment funds, the local group reviews all facts and circumstances to determine whether the local group, as fund manager, is acting as agent or principal. The local group may be deemed to be a principal, and hence would control and consolidate the funds, i) when it acts as fund manager and cannot be removed without cause, ii) has variable returns through significant unit holdings and/or a guarantee provided, and iii) is able to influence the returns of the funds by exercising its power.

iii Transactions eliminated on consolidation

All intra-group balances and income and expenses arising from intra-group transactions, are eliminated on consolidation. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment of the transferred asset.

3 Significant accounting policies *(continued)*

b *Financial assets*

i Initial recognition

The local group 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 local group commits to purchase or sell the asset. Accordingly, the local group uses trade date accounting for regular way contracts when recording financial asset transactions.

ii Classification

The local group classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables and available-for-sale investments. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

1 Financial assets at fair value through profit or loss

This category comprises two sub-categories: financial assets classified as held for trading, and financial assets designated by the local group as at fair value through profit or loss upon initial recognition.

a Held for trading

A financial instrument is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivatives are also categorised as held for trading unless they are designated and considered effective as hedging instruments.

b Financial instruments designated at fair value through profit or loss

Financial instruments, other than those held for trading, are classified in this category if they meet one or more of the criteria set out below, and are so designated irrevocably at inception. The local group designates financial instruments at fair value when the designation:

– eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise from measuring financial instruments (financial assets or financial liabilities), or recognising gains and losses from related positions, on different bases. Under this criterion, the financial instruments designated by the local group comprise financial assets under unit-linked insurance contracts and unit-linked investment contracts and financial liabilities under unit-linked investment contracts.

  Liabilities to customers under unit-linked contracts are determined based on the fair value of the assets held in the linked funds, with changes recognised in profit or loss. If no fair value designation was made for the assets related to these customer liabilities, the assets would be classified as available-for-sale, with the changes in fair value recorded in other comprehensive income. The related financial assets and financial liabilities are managed and reported to management on a fair value basis. Designation at fair value of the financial assets and related liabilities under investment contracts allows the changes in fair values to be recorded in profit or loss and presented in the same line.

– applies to groups of financial instruments (financial assets, financial liabilities or combinations thereof) that are managed, and their performance evaluated, on a fair value basis in accordance with a documented risk management or investment strategy, and where information about the groups of financial instruments is reported to management on that basis. Certain financial assets held to meet liabilities under non-linked insurance contracts are the main class of financial instruments designated at fair value through profit or loss under this criterion. The local group has documented risk management and investment strategies designed to manage and monitor market risk of those assets on a net basis after considering non-linked liabilities.

Financial instruments classified within this category are recognised initially at fair value; transaction costs are taken directly to profit or loss. Subsequent to initial recognition, changes in fair values are recognised in profit or loss within 'Net income from financial instruments designated at fair value attributable to insurance operations'.

3 Significant accounting policies *(continued)*

b *Financial assets (continued)*

ii Classification (continued)

2 Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

– those that the local group intends to sell immediately or in the short-term, which are classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss;

– those that the local group upon initial recognition designates as available-for-sale; or

– those for which the holders may not recover substantially all of their initial investment, other than because of credit deterioration.

The local group's loans and receivables principally comprise loans and advances to banks and customers. Loans and receivables are recognised when cash is advanced to a borrower or funds placed with a counterparty. They are initially recorded at fair value – which is the case consideration to originate or purchase the loan – plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less impairment allowance. Amortised cost is the initial measurement amount adjusted for the amortisation of any difference between the initial and maturity amounts using the effective interest method.

3 Available-for-sale financial investments

Available-for-sale investments are financial assets that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices, or that are not classified as loans and receivables or financial assets at fair value through profit or loss. Treasury Bills, debt securities and equity securities intended to be held on a continuing basis, other than those designated at fair value, are classified as available-for-sale.

Available-for-sale financial assets are initially measured at fair value plus direct and incremental transaction costs. They are subsequently re-measured at fair value, and changes therein are recognised in other comprehensive income until the financial assets are either sold or become impaired. When available-for-sale financial investments are sold, the cumulative gains or losses previously recognised in other comprehensive income are reclassified to profit or loss as 'Net gains on sale of available-for-sale financial investments'.

Interest income is recognised in profit or loss over the debt asset's expected life using the effective interest method. Premiums and/or discounts arising on the purchase of dated debt securities are included in the interest recognised. Dividends from equity assets are recognised in profit or loss when the right to receive payment is established. Foreign currency gains and losses arising on retranslation of monetary assets classified as available-for-sale are recognised in profit or loss.

Unquoted equity securities, the fair value of which cannot be reliably measured, are carried at cost less impairment.

iii Derecognition of financial assets

Financial assets are derecognised when the contractual rights to receive cash flows from the assets have expired or when the local group has transferred its contractual right to receive the cash flows of the financial assets, and either:

– substantially all the risks and rewards of ownership have been transferred; or

– the local group has neither retained nor transferred substantially all the risks and rewards, but has not retained control.

c *Derivative financial instruments*

Derivatives are initially recognised and are subsequently re-measured at fair value. Fair values of exchange traded derivatives are obtained from quoted market prices. Fair values of over-the-counter derivatives are obtained using valuation techniques, including discounted cash flow models and option pricing models. Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative.

3 Significant accounting policies *(continued)*

c *Derivative financial instruments (continued)*

Embedded derivatives are bifurcated from the host contract when their economic characteristics and risks are not clearly and closely related to those of the host non-derivative contract, their contractual terms would otherwise meet the definition of a stand-alone derivative and the combined contract is not held for trading or designated at fair value through profit or loss. The bifurcated embedded derivatives are measured at fair value with changes therein recognised in profit or loss.

All the local group's derivative financial instruments are designated as held for trading as they are not designated as hedging instruments in accordance with the requirements of IAS 39.

Accordingly, all gains and losses from changes in the fair values of derivatives that do not qualify for hedge accounting are recognised immediately in profit or loss. These gains and losses are reported in Net trading income, except where derivatives are managed in conjunction with financial instruments designated at fair value through profit or loss in which case gains and losses are reported in 'Net income/(expense) from financial instruments designated at fair value attributable to insurance operations'.

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d *Impairment of financial assets*

i *Financial investments: available-for-sale securities*

Available-for-sale financial assets are assessed at each reporting date for objective evidence of impairment. If such evidence exists as a result of one or more events that occurred after the initial recognition of the financial asset (a 'loss event') and that loss event has an impact, which can be reliably measured, on the estimated future cash flows of the financial asset an impairment loss is recognised.

If the available-for-sale financial asset is impaired, the difference between the financial asset's acquisition cost (net of any principal repayments and amortisation) and the current fair value, less any previous impairment loss recognised in profit or loss, is reclassified from other comprehensive income and recognised in profit or loss as a reclassification adjustment.

In assessing objective evidence of impairment at the reporting date in relation to available-for-sale debt securities, the local group considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in recovery of future cash flows. Financial difficulties of the issuer, as well as other factors such as information about the issuers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees may be considered individually, or in combination, to determine if there is objective evidence of impairment.

The primary indicators of potential impairment are considered to be adverse fair value movements and the disappearance of an active market for a security, while changes in credit ratings are of secondary importance.

Objective evidence of impairment for available-for-sale equity securities may include specific information about the issuer as detailed above, but may also include information about significant changes in technology, markets, economics or the law that provides evidence that the cost of the equity securities may not be recovered.

A significant or prolonged decline in the fair value of the equity security classified as available-for-sale below its cost is also objective evidence of impairment. In assessing whether it is significant, the decline in fair value is evaluated against the original cost of the asset at initial recognition. In assessing whether it is prolonged, the decline is evaluated against the continuous period in which the fair value of the asset has been below its original cost at initial recognition.

Once an impairment loss has been recognised on an available-for-sale financial asset, the subsequent accounting treatment for changes in the fair value of that asset differs depending on the type of asset:

- for an available-for-sale debt security, a subsequent decline in the fair value of the instrument is recognised in profit or loss when there is further objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, or the instrument is no longer impaired, the impairment loss is reversed through profit or loss.

3 Significant accounting policies *(continued)*

d *Impairment of financial assets (continued)*

i Financial investments: available-for-sale securities (continued)

– for an available-for-sale equity security, all subsequent increases in the fair value of the instrument are treated as a revaluation and are recognised in other comprehensive income. Impairment losses recognised on the equity security are not reversed through profit or loss. Subsequent decreases in the fair value of the available-for-sale equity security are recognised in profit or loss, to the extent that further cumulative impairment losses have been incurred.

ii Loans and receivables

Losses for impaired loans are recognised promptly when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Impairment allowances are calculated on individual loans and on groups of loans assessed collectively, are recorded as charges in profit or loss, and are recorded against the carrying amount of impaired loans through the use of impairment allowance accounts. Losses which may arise from future events are not recognised.

Individually assessed loans and advances

The factors considered in determining whether a loan is individually significant for the purposes of assessing impairment include:

– the size of the loan;

– the number of loans in the portfolio; and

– the importance of the individual loan relationship, and how this is managed.

Loans that are determined to be individually assessed for impairment, except when volumes of defaults and losses are sufficient to justify treatment under a collective assessment methodology.

For all loans that are considered individually significant, the local group considers on a case-by-case basis at each reporting date whether there is any objective evidence that a loan is impaired. The criteria used by the local group to make this assessment include:

– known cash flow difficulties experienced by the borrower;

– contractual payments of either principal or interest being past due for more than 90 days;

– the probability that the borrower will enter bankruptcy or other financial realisation;

– a concession granted to the borrower for economic or legal reasons relating to the borrower’s financial difficulty that results in forgiveness or postponement of principal, interest or fees, where the concession is not insignificant; and

– there has been deterioration in the financial condition or outlook of the borrower such that its ability to repay is considered doubtful.

For loans where objective evidence of impairment exists, impaired losses are determined considering the following factors:

– the local group’s aggregate exposure to the customer;

– the viability of the customer’s business model and their capability to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;

– the amount and timing of expected receipts and recoveries;

– the likely dividend available on liquidation or bankruptcy;

– the extent of other creditors’ commitments ranking ahead of, or pari passu with, the local group and the likelihood of other creditors continuing to support the customer;

– the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;

– the realisable value of security (or other credit risk mitigants) and likelihood of successful repossession; and

– the likely costs of obtaining and selling collateral as part of foreclosure.

3 Significant accounting policies *(continued)*

d *Impairment of financial assets (continued)*

ii Loans and receivables (continued)

Individually assessed loans and advances (continued)

Determination of the realisable value of security is based on the current market value when the impairment assessment is performed. The value is not adjusted for expected future changes in market prices, though adjustments are made to reflect local conditions, such as forced sale discounts.

Impairment losses are calculated by discounting the expected future cash flows of a loan, which includes expected future receipts of contractual interest, at the loan's original effective interest rate and comparing the resultant present value with the loan's current carrying amount. The impairment allowances on individually significant accounts are reviewed at least annually and more regularly when circumstances necessitate review. This normally encompasses re-assessment of the enforceability of any collateral held and the timing and amount of actual and anticipated receipts. Individually assessed impairment allowances are only released when there is reasonable and objective evidence of a reduction in the established loss estimate.

Collectively assessed loans and advances

Impairment is assessed on a collective basis:

– to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment; and

– for homogeneous groups of loans that are not considered individually significant.

a Incurred but not yet identified impairment

Individually assessed loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for a collective impairment assessment. These credit risk characteristics may include type of business involved, type of products offered, security obtained or other relevant factors. This assessment captures impairment losses that the local group has incurred as a result of events occurring before the reporting date, which the local group is not able to identify on an individual loan basis, and that can be reliably estimated. These losses would only be identified individually in the future. When information becomes available which identifies losses on individual loans within the group, those loans are removed from the group and assessed on an individual basis.

The collective impairment allowance is determined after taking into account:

– historical loss experience in portfolios of similar risk characteristics (for example, by industry sector, loan grade or product);

– the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against the individual loan; and

– management's judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses at the reporting date is likely to be greater or less than that suggested by historical experience.

The period between a loss occurring and its identification is estimated by local management for each identified portfolio based on economic and market conditions, customer behaviour, portfolio management information, credit management techniques and collection and recovery experiences in the market. As it is assessed empirically on a periodic basis the estimated period between a loss occurring and its identification may vary over time as these factors change.

3 Significant accounting policies *(continued)*

d *Impairment of financial assets (continued)*

ii Loans and receivables (continued)

Collectively assessed loans and advances (continued)

b Homogeneous groups of loans and advances

For homogeneous groups of loans that are not considered individually significant, two alternative methods are used to calculate allowances on a portfolio basis:

– When appropriate empirical information is available, the local group utilises roll rate methodology. This methodology employs statistical analysis of historical data and experience of delinquency and default to estimate the amount of the loans that will eventually be written off as a result of the events occurring before the reporting date but which the group is not able to identify individually. Individual loans are grouped using ranges of past due days; statistical analysis is then used to estimate the likelihood that loans in each range will progress through the various stages of delinquency and become irrecoverable. In applying this methodology, adjustments are made to estimate the periods of time between a loss event occurring and its discovery, for example through a missed payment, (known as the emergence period) and the period of time between discovery and write-off (known as the outcome period). Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss.

– When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll rate methodology, the local group adopts a formulaic approach based on historical loss rate experience. Where a basic formulaic approach is undertaken, the period between a loss event occurring and its identification is explicitly estimated by local management.

The inherent loss within each portfolio is assessed on the basis of statistical models using historical data observations, which are updated periodically to reflect recent portfolio and economic trends. When the most recent trends arising from changes in economic, regulatory or behavioural conditions are not fully reflected in the statistical models, they are taken into account by adjusting the impairment allowances derived from the statistical models to reflect these changes as at the reporting date.

Write-off of loans and advances

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realisation of security. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write-off may be earlier.

Reversals of impairment

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. The reversal is recognised in profit or loss.

Assets acquired in exchange for loans

When non-financial assets acquired in exchange for loans as part of an orderly realisation are held for sale, these assets are recorded as ‘Assets held for sale’ and reported in ‘Non-current assets held for sale’.

Renegotiated loans

Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired. The carrying amounts of loans that have been classified as renegotiated retain this classification until maturity or derecognition.

A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement made on substantially different terms, or if the terms of an existing agreement are modified, such that the renegotiated loan is substantially a different financial instrument. Any new agreements arising due to derecognition events will continue to be disclosed as renegotiated loans.

3 Significant accounting policies *(continued)*

e *Financial liabilities*

The local group recognises a financial liability on its statement of financial position when it becomes a party to the contractual provisions of the instrument. The local group's financial liabilities are classified into two categories: i) financial liabilities which are designated at fair value through profit or loss and ii) other liabilities (not at fair value through profit or loss). The criteria for designating financial liabilities at fair value and their measurement are described in note 3(b)(ii).

Financial liabilities not at fair value through profit or loss are recognised initially at fair value, being the fair value of consideration received, net of transaction costs that are directly attributable to the acquisition or the issue of the financial liability. These liabilities are subsequently measured at amortised cost using the effective interest rate method to amortise the difference between proceeds received, net of directly attributable transaction costs incurred, and the redemption amount over the expected life of the instrument.

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

Financial liabilities measured at amortised cost comprise principally subordinated liabilities, deposits by banks and customer accounts.

f *Reverse repurchase and repurchase agreements*

When securities are sold subject to a commitment to repurchase them at a predetermined price, they remain on the statement of financial position and a liability is recorded in respect of the consideration received. Securities purchased under commitments to resell are not recognised on the statement of financial position and the right to receive back the initial consideration paid is recorded in 'Loans and advances to banks' or 'Loans and advances to customers' as appropriate. The difference between the sale and repurchase price or between the purchase and resale price is treated as interest and recognised in net interest income over the life of the agreement, for loans and advances to banks and customers. Securities lending and borrowing transactions are generally secured against cash or non-cash collateral. Securities lent or borrowed do not normally result in derecognition or recognition on the statement of financial position. Cash collateral advanced or received is recorded as an asset or a liability respectively.

g *Offsetting financial assets and financial liabilities*

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

h *Investments in subsidiaries*

The local group classifies investments in entities which it controls as subsidiaries.

The bank's investments in subsidiaries are stated at cost less impairment losses. Impairment losses recognised in prior periods are reversed through profit or loss if there has been a change in the estimates used to determine the investment's recoverable amount since the last impairment loss was recognised.

i *Intangible assets*

Intangible assets are recognised when they are separable or arise from contractual or other legal rights, and their fair value can be measured reliably.

Where intangible assets have a finite useful life, except for 'Present value of in-force long-term insurance business', they are stated at cost less accumulated amortisation and impairment losses.

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

Intangible assets are subject to impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

The accounting policy in respect of the present value of in-force long-term insurance business is reflected within note 3(n)(iv).

3 Significant accounting policies *(continued)*

j *Property, plant and equipment*

All property, plant and equipment is initially recorded at historical cost, including transaction costs. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Freehold and long leasehold properties (land and buildings) are subsequently measured at fair value based on periodic valuations by external professionally qualified and independent valuers, less subsequent depreciation for buildings. Valuations are carried out on a regular basis such that the carrying amount of property does not differ materially from that which would be determined using fair values at the end of the reporting period. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset, and the net amount is restated to the revalued amount of the asset.

All other property, plant and equipment is subsequently stated at historical cost less accumulated depreciation and impairment losses.

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

Increases in the carrying amount arising on revaluation of land and buildings are credited to other comprehensive income and shown as a revaluation reserve in shareholders' equity. Decreases that offset previous increases of the same asset are charged to other comprehensive income and debited against the revaluation reserve directly in equity; all other decreases are charged to profit or loss.

Land is not depreciated as it is deemed to have an indefinite life. Depreciation on all other assets recognised in profit or loss is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives, as follows:

– long leaseholds, freehold buildings and improvements 50 years;

– short leaseholds and improvements to rented property over term of lease; and

– equipment, furniture and fittings 3 – 10 years.

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 (see note 3(l)).

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised in profit or loss. When revalued assets are sold, the amounts included in the revaluation reserve relating to that asset are transferred to retained earnings.

k *Investment property*

Property held for long-term rental yields or for capital appreciation or both that is not occupied by the local group is classified as investment property.

Investment properties are measured initially at historical cost, including transaction costs. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent to initial recognition, investment properties are stated at fair value, representing open market value determined annually, which reflects market conditions at the end of the reporting period.

Gains or losses arising from changes in the fair value of investment properties are included in profit or loss in the year in which they arise. Subsequent expenditure is capitalised to the asset's carrying amount only when it is probable that future economic benefits associated with the item will flow to the local group and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to the profit or loss during the financial period in which they are incurred.

3 **Significant accounting policies** *(continued)*

k *Investment property (continued)*

The fair value of investment properties is based on the nature, location and condition of the specific asset. Fair values are determined by external professionally qualified and independent valuers who apply recognised valuation techniques. Any gain or loss on the disposal of an investment property is recognised in profit or loss. When the use of property changes such that it is reclassified as property, plant and equipment, its fair value at the date of reclassification becomes its carrying amount for subsequent accounting.

l *Impairment of non-financial assets*

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

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separate identifiable cash inflows (cash-generating units). An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in profit or loss, unless the asset is carried at a revalued amount.

The recoverable amount of non-financial assets is the greater of their fair value less cost to sell and value in use. 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.

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 the reversal can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss on non-financial assets 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.

m *Non-current assets held for sale*

Non-current assets are classified as held for sale when their carrying amounts will be recovered principally through sale rather than through continuing use, they are available-for-sale in their present condition and their sale is highly probable. Immediately before the initial classification as held for sale, the carrying amount of the assets is measured in accordance with the local group's accounting policies. Non-current assets classified as held for sale are generally measured at the lower of their carrying amount and fair value less cost to sell. Impairment losses for any initial or subsequent write-down of an asset to fair value less costs to sell are recognised in profit or loss. Gains for any subsequent increase in fair value less costs to sell of an asset are recognised only up to the extent of the cumulative impairment loss recognised, and are reflected within profit or loss.

n *Insurance and investment contracts*

Through its insurance subsidiary, the local group issues contracts to customers that contain insurance risk, financial risk or a combination thereof. A contract under which the local group accepts significant insurance risk from another party by agreeing to compensate that party on the occurrence of a specified uncertain future event, is classified as an insurance contract. An insurance contract may also transfer financial risk, but is accounted for as an insurance contract if the insurance risk is significant.

i Net insurance premium income

Premiums for life insurance contracts are accounted for when receivable, except in unit-linked business where premiums are accounted for when liabilities are established.

Reinsurance premiums are accounted for in the same accounting period as the premiums for the direct insurance contracts to which they relate.

3 Significant accounting policies *(continued)*

n *Insurance and investment contracts (continued)*

ii Net insurance claims, benefits paid and movement in liabilities to policyholders

Gross insurance claims for life insurance contracts reflect the total cost of claims arising during the year, including claim handling costs and any policyholder bonuses allocated in anticipation of a bonus declaration. Claims arising during the year include maturities, surrenders and death claims. Maturity claims are recognised when due for payment. Surrenders are recognised when paid or at an earlier date on which, following notification, the policy ceases to be included within the calculation of the related insurance liabilities. Death claims are recognised when notified.

Reinsurance recoveries are accounted for in the same period as the related claims.

iii Liabilities under insurance contracts

Liabilities under non-linked life insurance contracts are calculated based on actuarial principles.

Liabilities under unit-linked life insurance contracts are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices.

A liability adequacy test is carried out on insurance liabilities to ensure that the carrying amount of the liabilities is sufficient in the light of current estimates of future cash flows. When performing the liability adequacy test, all contractual cash flows are discounted and compared with the carrying value of the liability. When a shortfall is identified it is charged immediately to profit or loss.

iv Present value of in-force long-term insurance business

The value placed on insurance contracts that are classified as long-term insurance business and are in force at the reporting date, is recognised as an asset.

The asset represents the present value of the equity holders' interest in the issuing insurance company's profits expected to emerge from these contracts written at the reporting date. The PVIF is determined by discounting the equity holders' interest in future profits expected to emerge from business currently in force using appropriate assumptions in assessing factors such as future mortality, lapse rates and levels of expenses, and a risk discount rate that reflects the risk premium attributable to the respective contracts. The PVIF asset is presented gross of attributable tax in the balance sheet and movements in the PVIF asset are included in 'Movement in present value of in-force long-term insurance business' on a gross of tax basis.

v Investment contracts

Investment contracts are those contracts where there is no significant insurance risk. A contract under which the local group accepts insignificant insurance risk from another party is not classified as an insurance contract, but is accounted for as a financial liability.

Customer liabilities under unit-linked investment contracts and the linked financial assets are designated at fair value through profit or loss, and the movements in fair value are recognised in profit or loss in 'Net income from financial instruments designated at fair value attributable to insurance operations'. Liabilities under unit-linked investment contracts are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices.

Premiums receivable and amounts withdrawn are accounted for as increases or decreases in the liability recorded in respect of investment contracts.

Investment management fees receivable are recognised in profit or loss over the period of the provision of the investment management services in 'Net fee and commission income'.

The incremental costs directly related to the acquisition of new investment contracts or renewal of existing investment contracts are deferred and amortised over the period during which the investment management services are provided.

3 Significant accounting policies *(continued)*

o *Provisions*

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a current legal or constructive obligation which has arisen as a result of past events, and for which a reliable estimate can be made. A provision for restructuring is recognised when the local group has approved a detailed and formal restructuring plan and the restructuring either has commenced or has been announced publicly. Future operating losses are not provided for.

p *Contingent liabilities*

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security, as well as contingent liabilities related to legal proceedings or regulatory matters, 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 local group; or are present obligations that have arisen from past events but are not recognised because it is not probable that settlement will require the outflow of economic benefits, or because the amount of the obligations cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

q *Financial guarantee contracts*

Financial guarantees are contracts that require the local group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Liabilities under financial guarantee contracts are recorded initially at their fair value, which is generally the fee received or present value of the fee receivable. The initial fair value is amortised over the term of the financial guarantee contract. Subsequently, financial guarantee liabilities are measured at the higher of the initial fair value, less cumulative amortisation, and the best estimate of the expenditure required to settle the obligations.

r *Interest income and expense*

Interest income and expense for all interest-bearing financial instruments except those classified as held for trading or designated at fair value through profit or loss are recognised in 'Net interest income' in profit or loss using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability (and groups of financial assets or financial liabilities) and of allocating the 'Net interest income' over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the local group estimates cash flows considering all contractual terms of the financial instrument but excluding future credit losses. The calculation includes all fees and points paid or received by the local group that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts.

Interest on impaired financial assets is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

s *Non-interest income*

i Net fee and commission income

Fee income is earned from a diverse range of services provided by the local group to its customers. Fee income is accounted for as follows:

– income earned on the execution of a significant act is recognised as revenue when the act is completed;

– income earned from the provision of services is recognised as revenue as the services are provided; and

– income that forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate and recorded in 'Interest income'.

3 Significant accounting policies *(continued)*

s *Non-interest income (continued)*

ii Dividend income

Dividend income is recognised when the right to receive payment is established. This is the ex-dividend date for listed equity securities, and usually the date when shareholders have approved the dividend for unlisted equity securities.

iii Net income from financial instruments designated at fair value attributable to insurance operations

Net income from financial instruments designated at fair value includes:

– all gains and losses from changes in the fair value of financial assets and financial liabilities designated at fair value through profit or loss, including liabilities under investment contracts; and

– interest income and expense and dividend income in respect of financial assets and financial liabilities designated at fair value through profit or loss.

t *Employee benefits*

i Contributions to defined contribution pension plan

The local group contributes towards the State defined contribution pension plan in accordance with local legislation in exchange for services rendered by employees and to which it has no commitment beyond the payment of fixed contributions. Obligations for contributions are recognised as an employee benefit in profit or loss in the periods during which services are rendered by employees.

ii Termination benefits

The local group recognises a liability and expense for termination benefits when the local group can no longer withdraw the offer of those benefits. For termination benefits payable as a result of an employee's decision to accept an offer of benefits in exchange for the termination of employment, the time when the group can no longer withdraw the offer of termination benefits is the earlier of:

– when the employee accepts the offer; and

– when a restriction on the group's ability to withdraw the offer takes effect.

For termination benefits payable as a result of the local group's decision to terminate an employee's employment, the local group can no longer withdraw the offer when it has communicated to the affected employees a plan of termination meeting all of the following criteria:

– actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made;

– the plan identifies the number of employees whose employment is to be terminated, their job classifications or functions and the expected completion date; and

– the plan establishes the termination benefits that employees will receive in sufficient detail that employees can determine the type and amount of benefits they will receive when their employment is terminated.

iii Share-based payments

The local group enters into equity-settled share-based payment arrangements with its employees as compensation for services provided by employees.

The cost of share-based payment arrangements with employees is measured by reference to the fair value of equity instruments on the date they are granted and recognised as an expense on a straight-line basis over the vesting period, with a corresponding credit to retained earnings.

Fair value is determined by using appropriate valuation models. Vesting conditions include service conditions and performance conditions; any other features of the arrangement are non-vesting conditions. Market performance conditions and non-vesting conditions are taken into account when estimating the fair value of the award at the date of the award. Vesting conditions, other than market performance conditions, are not taken into account in the initial estimate of the fair value at the grant date. They are taken into account by adjusting the number of equity instruments included in the measurement of the transaction.

t *Employee benefits (continued)*

iii Share-based payments (continued)

HSBC Holdings is the grantor of its equity instrument for all share awards and share options across the Group. The credit to retained earnings over the vesting period on expensing an award represents the effective capital contribution from HSBC Holdings. To the extent the local group will be, or has been, required to fund a share-based payment arrangement, this capital contribution is reduced and the fair value of shares expected to be released to employees is recorded within liabilities.

u *Operating Leases*

All leases which do not transfer to the lessee substantially all the risks and rewards incidental to the ownership of assets are classified as operating leases. As a lessor, the local group presents assets subject to operating leases within the statement of financial position. Impairment losses are recognised to the extent that the carrying values are not fully recoverable. As a lessee, leased assets are not recognised on the statement of financial position with the exception of long leasehold interests.

Rentals payable and receivable under operating leases are spread on a straight-line basis over the lease periods and are recognised in 'General and administrative expenses' and in 'Net other operating income' respectively.

v *Foreign currencies*

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange at the reporting date. Any resulting exchange differences are recognised in profit or loss. Non-monetary assets and liabilities that are measured at historical cost in a foreign currency are translated into the functional currency using the rate of exchange at the date of the initial transaction. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined. Any foreign exchange component of a gain or loss on a non-monetary item is recognised either in other comprehensive income or in profit or loss depending where the gain or loss on the underlying non-monetary item is recognised.

w *Income tax*

Income tax comprises current tax and deferred tax. Income tax is recognised in profit or loss except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case it is recognised in the same statement in which the related item appears.

Current tax is the tax expected to be payable on the taxable profit for the year, calculated using tax rates enacted or substantively enacted by the reporting date, and any adjustment to tax payable in respect of previous years. Current tax assets and liabilities are offset when the local group intends to settle on a net basis and the legal right to offset exists.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the statement of financial position and the amounts attributed to such assets and liabilities for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences and unutilised tax losses can be utilised.

Deferred tax is calculated using the tax rates expected to apply in the periods in which the assets will be realised or the liabilities settled based on tax rates and laws enacted, or substantively enacted, by the reporting date. Deferred tax assets and liabilities are offset when they arise in the same tax reporting group and relate to income taxes levied by the same taxation authority, and when the local group has a legal right to offset.

x *Cash and cash equivalents*

Cash and cash equivalents comprise cash balances, highly liquid investments and deposits with contractual maturity of three months or less. Cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition. 'Loans and advances to banks' and 'Deposits by banks' that are repayable on demand or have a contractual maturity of three months or less and which form an integral part of the local group's cash management are included as a component of cash and cash equivalents for the purpose of the Statements of Cash Flows.

3 Significant accounting policies *(continued)*

y *Segment analysis*

Measurement of segmental assets, liabilities, income and expenses is in accordance with the local group's accounting policies. Segmental income and expenses include transfers between segments and these transfers are conducted on arm's length terms and conditions. Shared costs are included in segments on the basis of the actual recharges made.

z *Equity instruments*

Financial instruments issued are classified as equity when there is no contractual obligation to transfer cash, other financial assets or issue a variable number of own equity instruments. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

4 Financial risk management

a *Introduction*

The nature of the local group's core banking operations implies that financial instruments are extensively used in the course of its routine business. The local group's financial instruments include cash balances with banks, loans and advances to customers, securities and amounts due to banks and customers.

The local group is exposed to a mixed blend of risks and hence operates a risk management strategy with the objective of controlling and minimising their impact on local group financial performance and position.

All of the local group's activities involve to varying degrees, the analysis, evaluation, acceptance and management of risks or combination of risks.

An established risk governance framework and ownership structure ensures oversight of and accountability for the effective management of risk. The local group's risk management framework fosters the continuous monitoring of the risk environment and an integrated evaluation of risks and their interactions.

The local group's risk management framework is designed to provide appropriate risk monitoring and assessment. The bank's Risk Committee focuses on risk governance and provides a forward-looking view of risks and their mitigation.

The Risk Committee is a committee of the Board and has responsibility for oversight and advice to the Board on, inter alia, the bank's risk appetite, tolerance and strategy, systems of risk management, internal control and compliance.

The Risk Committee maintains and develops a supportive culture in relation to the management of risk, appropriately embedded by executive management through procedures, training and leadership actions.

In carrying out its responsibilities, the Risk Committee is closely supported by the Chief Risk Officer, the Chief Financial Officer, the Head of Internal Audit and the Head of Compliance, together with other business functions on risks within their respective areas of responsibility.

The most important types of risk include financial risk, which comprises credit risk, market risk and liquidity risk. These categories of risk in relation to life insurance business are described in note 4(f).

b *Credit risk excluding Insurance credit risk which is reported under 4(f)*

i Credit risk management

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from lending, trade finance and treasury business, mainly through the holdings of debt securities but also from off-balance sheet products such as guarantees. The local group has standards, policies and procedures dedicated to control and monitor the risk arising from all such activities.

Within the overall framework of the local group policy, the local group has an established risk management process encompassing credit approvals, the control of exposures, credit policy direction to business units and the monitoring and reporting of exposures both on an individual and a portfolio basis which includes the management of adverse trends. Management is responsible for the quality of its credit portfolios and follows a credit process involving delegated approval authorities and credit procedures, the objective of which is to build and maintain risk assets of high quality. Regular reviews are undertaken to assess and evaluate levels of risk concentrations by market sector and product.

4 Financial risk management *(continued)*

b *Credit risk excluding Insurance credit risk which is reported under 4(f) (continued)*

i Credit risk management (continued)

The bank's credit risk rating systems and processes differentiate exposures in order to highlight those with greater risk factors and higher potential severity of loss. In the case of individually significant accounts, risk ratings are reviewed regularly and any amendments are implemented promptly.

The principal objectives of the local group's credit risk management are:

– to maintain a strong culture of responsible lending and a robust risk policy and control framework;

– to both partner and challenge global businesses in defining, implementing, and continually re-evaluating risk appetite under actual and scenario conditions; and

– to ensure there is independent, expert scrutiny of credit risks.

Within the bank, the credit risk function's responsibilities include:

– formulating credit policy;

– guiding business on appetite for credit risk exposure to specified market sectors, activities and banking products and controlling exposures to certain higher-risk sectors;

– undertaking an independent review and objective assessment of risk and exposures over designated limits, prior to the facilities being committed to customers or transactions being undertaken;

– monitoring the performance and management of portfolios;

– controlling exposure to sovereign entities, banks and other financial institutions, as well as debt securities;

– setting policy on large credit exposures, ensuring that concentrations of exposure by counterparty, sector or geography do not become excessive in relation to the capital base, and remain within internal and regulatory limits;

– maintaining and developing the risk rating framework and systems and overseeing risk rating system governance for both wholesale and retail businesses; and

– reporting on retail portfolio performance, high risk portfolios, risk concentrations, large impaired accounts, impairment allowances and stress testing results.

Special attention is paid to problem exposures in order to accelerate remedial action. The local group uses specialist units to provide customers with support in order to help them avoid default wherever possible.

Internal approval limits are in place depending on the magnitude and particular risks attached to the respective facility. The bank has set limits of authority for the business and the credit risk functions, ensuring segregation of duties so as to maintain independence during the approval process. The local group structures the level of credit risk it undertakes by placing limits in relation to products, counterparties, sectors and other parameters. Certain actual exposures against limits are monitored at end of day and on a real-time basis too.

Maximum exposure to credit risk

The following table presents the maximum exposure to credit risk from balance sheet and off-balance sheet financial instruments, before taking account of any collateral held or other credit enhancements. For financial assets recognised on the balance sheet, the maximum exposure to credit risk equals their carrying amount; for financial guarantees granted, it is the maximum amount that the local group would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments that are irrevocable over the life of the respective facilities, it is generally the full amount of the committed facilities.

4 Financial risk management *(continued)*

b *Credit risk excluding Insurance credit risk which is reported under 4(f) (continued)*

i Credit risk management (continued)

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Balances with Central Bank of Malta and Treasury Bills	**88,573**	152,256	**88,573**	152,256
Items in the course of collection from other banks	**16,796**	12,559	**16,796**	12,559
Held for trading derivatives	**11,440**	11,492	**11,335**	10,897
Loans and advances to banks	**1,077,859**	841,411	**996,091**	728,918
Loans and advances to customers	**3,320,332**	3,284,615	**3,320,363**	3,292,815
Available-for-sale financial investments	**1,053,200**	1,203,638	**1,048,549**	1,198,792
Other assets	**38,823**	41,471	**28,076**	31,989
Off-balance sheet				
– guarantees and assets pledged as collateral security	**118,469**	133,771	**118,469**	133,771
– undrawn formal standby facilities, credit lines and other commitments to lend	**1,225,232**	1,292,605	**1,253,263**	1,292,802
	6,950,724	6,973,818	**6,881,515**	6,854,799

ii Concentration of credit risk exposure

Concentrations of credit risk arise when a number of counterparties or exposures have comparable economic characteristics, or such counterparties are engaged in similar activities, or operate in the same geographical areas or industry sectors, so that their collective ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions. The local group uses a number of controls and measures to minimise undue concentration of exposure in its portfolios across industry, country and customer groups. These include portfolio and counterparty limits, approval and review controls, and stress testing.

Available-for-sale financial investments

The local group's holdings of available-for-sale debt securities are spread across a range of issuers in both 2016 and 2015, with the exception of 55% (2015: 56%) invested in local government debt securities.

Derivatives

The local group participates in transactions exposing it to counterparty credit risk. Counterparty credit risk is the risk of financial loss if the counterparty to a transaction defaults before completing the satisfactory settlement of the transaction, which varies in value by reference to a market factor such as interest rate or exchange rate. It arises principally from OTC derivatives.

Derivative assets were €11,440,000 at 31 December 2016 (2015: €11,492,000).

Items in the course of collection from other banks

Settlement risk arises in any situation where a payment in cash, securities or equities is made with the expectation of a corresponding receipt of cash, securities or equities. Daily settlement limits are established for counterparties to cover the aggregate amount of transactions with each counterparty on any single day.

The local group substantially mitigates settlement risk on many transactions, particularly those involving securities and equities, by settling through assured payment systems, or on a delivery-versus-payment basis.

4 Financial risk management *(continued)*

b *Credit risk excluding Insurance credit risk which is reported under 4(f) (continued)*

ii Concentration of credit risk exposure (continued)

Loans and advances to customers

The following table analyses the bank's loans and advances including impaired loans by business segment.

	Gross loans and advances to customers	*Gross loans by business segment as a % of total gross loans*	*Impaired loans and advances to customers*	*Impaired loans by business segment as a % of sector gross loans*
	€000	**%**	€000	%
As at 31 December 2016				
Personal				
– residential mortgages	**1,722,780**	**51.09**	**58,622**	**3.40**
– other personal	**286,170**	**8.49**	**15,879**	**5.55**
Corporate and commercial				
– commercial real estate and other property-related	**392,065**	**11.63**	**90,350**	**23.04**
– governments	**135,197**	**4.01**	**–**	**–**
– other commercial	**835,512**	**24.78**	**49,204**	**5.89**
Total gross loans and advances to customers	**3,371,724**	**100**	**214,055**	**6.35**
As at 31 December 2015				
Personal				
– residential mortgages	1,586,300	47.50	49,607	3.13
– other personal lending	326,778	9.79	18,464	5.65
Corporate and commercial				
– commercial real estate and other property-related	461,138	13.81	94,665	20.53
– governments	191,827	5.74	–	–
– other commercial	773,464	23.16	70,281	9.09
Total gross loans and advances to customers	3,339,507	100	233,017	6.98

The amount of gross loans and advances to customers of the local group stood at €3,371,693,000 (2015: €3,331,307,000) at 31 December 2016. During 2016, a loan of €8,200,000 which was payable to the bank by HSBC Life Assurance (Malta) Limited, was repaid. As at 31 December 2016, HSBC Life Assurance (Malta) Limited had an overdraft balance of €31,000.

A detailed sectorial analysis of the bank's on-balance sheet loans and advances to customers, before and after taking into account collateral held or other credit enhancements is presented in the following page.

With respect to collateral values used within the table, in the case of exposures secured by mortgages on immovable property, the value is limited to 70% of the market value of the property in case of residential property and 50% of the market value of the property in the case of commercial property.

Collateral included under 'Securities/Cash' comprise euro and foreign denominated cash and sovereign debt securities. Euro denominated cash is included at its full value, whilst foreign denominated cash is included at 90% of the cash value. A 20-50% haircut is applied to the value of sovereign debt securities, depending on the external credit rating assigned to such collateral. Moreover, the local group holds the following collateral, included in the table as 'Other eligible collateral':

- guarantees from the Government of Malta to cover exposures of public entities and corporations, included at 100% of the guarantee amount;
- guarantees from the Housing Authority to cover mortgage lending as part of social housing schemes, included at 100% of the guarantee amount;
- prime bank guarantees, included at 100% of the guarantee amount; and
- saving and endowment policies included at 100% of the surrender value, and pension plans included at 50% of the net asset value.

4 Financial risk management *(continued)*

b *Credit risk excluding Insurance credit risk which is reported under 4(f) (continued)*

ii Concentration of credit risk exposure (continued)

Loans and advances to customers (continued)

	Gross on-balance sheet exposure	*Collateral*				*Net on-balance sheet exposure*
		Residential property	*Commercial property*	*Securities/ cash*	*Other eligible collateral*	
	€000	**€000**	**€000**	**€000**	**€000**	**€000**
As at 31 December 2016						
Electricity, gas, water supply and waste management	**134,867**	**–**	**459**	**2,051**	**33,288**	**99,069**
Construction, real estate activities and accommodation	**412,286**	**28,283**	**207,114**	**43,029**	**212**	**133,648**
Wholesale and retail trade and repairs	**315,229**	**11,247**	**69,473**	**32,173**	**3,777**	**198,559**
Services activities	**420,333**	**4,945**	**117,034**	**30,760**	**102,382**	**165,212**
Manufacturing, agriculture and fishing	**80,059**	**872**	**42,957**	**10,357**	**7**	**25,866**
Household and individuals	**2,008,950**	**1,783,496**	**29,967**	**34,516**	**13,461**	**147,510**
	3,371,724	**1,828,843**	**467,004**	**152,886**	**153,127**	**769,864**
As at 31 December 2015						
Electricity, gas, water supply and waste management	165,982	4,320	5,699	3,183	55,118	97,662
Construction, real estate activities and accommodation	467,630	24,388	250,195	46,540	443	146,064
Wholesale and retail trade and repairs	333,239	19,533	73,171	43,623	1,875	195,037
Services activities	360,922	10,502	57,727	20,880	80,746	191,067
Manufacturing, agriculture and fishing	98,656	5,276	38,604	13,893	582	40,301
Household and individuals	1,913,078	1,656,474	55,374	35,936	30,143	135,151
	3,339,507	1,720,493	480,770	164,055	168,907	805,282

4 Financial risk management *(continued)*

b *Credit risk excluding Insurance credit risk which is reported under 4(f) (continued)*

iii Credit quality of financial assets

As outlined previously, the local group's credit risk rating processes are designed to highlight exposures which require closer management attention because of their greater probability of default and potential loss. The credit quality of unimpaired loans is assessed by reference to the local group's standard credit rating system.

The five credit quality classifications below describe the credit quality of the local group's lending, debt securities and derivatives.

– Strong: exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss. Personal accounts operate within product parameters and only exceptionally show any period of delinquency.

– Good: exposures require closer monitoring and demonstrate good capacity to meet financial commitments, with low to moderate default risk. Personal accounts typically show only short periods of delinquency, with any losses expected to be minimal following the adoption of recovery processes.

– Satisfactory: exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk. Personal accounts typically show only short periods of delinquency, with any losses expected to be minor following the adoption of recovery processes.

– Sub-standard: exposures require varying degrees of special attention and default risk is of greater concern. Personal portfolio segments show longer delinquency periods of generally up to 90 days past due and/or expected losses are higher due to a reduced ability to mitigate these through security realisation or other recovery processes.

– Impaired: exposures have been assessed, individually or collectively, as impaired.

As illustrated in the table below, these classifications each encompass a range of more granular, internal credit rating grades assigned to corporate and personal lending business as well as external rating grades, attributed by external agencies to debt securities. There is no direct correlation between the internal and external ratings at granular level, except to the extent each falls within a single quality classification.

Quality classification	*Debt securities and other bills – External credit rating*	*Wholesale and retail lending – Internal credit rating*
Strong	A- and above	CRR 1 to CRR 2
Good	BBB+ to BBB-	CRR 3
Satisfactory	BB+ to B and unrated	CRR 4 to CRR 5
Sub-standard	B- and below	CRR 6 to CRR 8
Impaired	Impaired	CRR 9 to CRR 10

The Customer Risk Rating (CRR) 10-grade scale assigned to corporate and personal lending business summarises a more granular underlying CRR scale for these customer segments; this combines obligor and facility/product risk factors in a composite measure.

For debt securities and certain other financial instruments, external ratings have been aligned to the five quality classifications.

4 Financial risk management *(continued)*

b *Credit risk excluding Insurance credit risk which is reported under 4(f) (continued)*

iii Credit quality of financial assets (continued)

Distribution of financial instruments by credit quality

	Performing					*Non-performing*		
	Strong	*Good*	*Satisfactory*	*Sub-Standard*	*Past due not impaired*	*Impaired*	*Impairment Allowances*	*Total*
	€000	**€000**	**€000**	**€000**	**€000**	**€000**	**€000**	**€000**
As at 31 December 2016								
Balances with Central Bank of Malta and Treasury Bills	**88,573**	**–**	**–**	**–**	**–**	**–**	**–**	**88,573**
Items in the course of collection from other banks	**16,796**	**–**	**–**	**–**	**–**	**–**	**–**	**16,796**
Held for trading derivatives	**1,054**	**–**	**10,281**	**–**	**–**	**–**	**–**	**11,335**
Loans and advances to banks	**996,091**	**–**	**–**	**–**	**–**	**–**	**–**	**996,091**
Loans and advances to customers								
– Personal	**844,504**	**326,519**	**718,175**	**7,053**	**38,197**	**74,501**	**(14,750)**	**1,994,199**
– Corporate and Commercial	**226,265**	**113,883**	**720,691**	**104,090**	**58,292**	**139,554**	**(36,611)**	**1,326,164**
Available-for-sale financial investments	**1,047,802**	**747**	**–**	**–**	**–**	**–**	**–**	**1,048,549**
Accrued income	**10,367**	**974**	**5,299**	**682**	**421**	**1,635**	**–**	**19,378**
Other assets	**4,202**	**–**	**4,470**	**26**	**–**	**–**	**–**	**8,698**
	3,235,654	**442,123**	**1,458,916**	**111,851**	**96,910**	**215,690**	**(51,361)**	**5,509,783**

The amount of past due but not impaired financial instruments as at 31 December 2016 reported in the table above of €96,910,000 consists of an amount of €69,451,000 which have a 'Satisfactory' credit quality classification and an amount of €27,459,000 which have a 'Sub-standard' credit quality classification.

4 Financial risk management *(continued)*

b *Credit risk excluding Insurance credit risk which is reported under 4(f) (continued)*

iii Credit quality of financial assets (continued)

Distribution of financial instruments by credit quality (continued)

	Performing				*Past due not impaired*	*Non-performing*		
	Strong	*Good*	*Satisfactory*	*Sub-Standard*		*Impaired*	*Impairment Allowances*	*Total*
	€000	€000	€000	€000	€000	€000	€000	€000
As at 31 December 2015								
Balances with Central Bank of Malta and Treasury Bills	152,256	–	–	–	–	–	–	152,256
Items in the course of collection from other banks	12,559	–	–	–	–	–	–	12,559
Held for trading derivatives	3,803	–	7,094	–	–	–	–	10,897
Loans and advances to banks	728,918	–	–	–	–	–	–	728,918
Loans and advances to customers								
– Personal	748,715	268,163	769,515	5,714	53,125	68,042	(8,374)	1,904,900
– Corporate and Commercial	255,161	96,627	744,143	100,251	65,076	164,975	(38,318)	1,387,915
Available-for-sale financial investments	522,488	676,304	–	–	–	–	–	1,198,792
Accrued income	14,479	1,530	8,858	965	994	3,160	–	29,986
Other assets	1,452	–	551	–	–	–	–	2,003
	2,439,831	1,042,624	1,530,161	106,930	119,195	236,177	(46,692)	5,428,226

The amount of past due but not impaired financial instruments as at 31 December 2016 reported in the table above of €119,195,000 consists of an amount of €87,605,000 which have a ‘Satisfactory’ credit quality classification and an amount of €31,590,000 which have a ‘Sub-standard’ credit quality classification.

4 Financial risk management *(continued)*

b *Credit risk excluding Insurance credit risk which is reported under 4(f) (continued)*

iii Credit quality of financial assets (continued)

a Past due but not impaired gross loans and advances to customers

Past due but not impaired loans and advances to customers are those loans where although customers have failed to make payments in accordance with the contractual terms of their facilities, they have not met the impaired loan criteria described below.

Ageing analysis of days past due but not impaired gross loans and advances to customers:

	2016	2015
	€000	€000
Personal		
Past due by up to 29 days	**29,084**	37,897
Past due by up to 59 days	**5,547**	9,207
Past due by up to 89 days	**3,566**	6,021
Corporate and commercial		
Past due by up to 29 days	**48,596**	60,965
Past due by up to 59 days	**9,505**	2,645
Past due by up to 89 days	**191**	1,466
	96,489	118,201

b Impaired loans and advances to customers

Impaired loans and advances are those that are classified as Customer Risk Rating (CRR) 9 or CRR 10. These grades are assigned when the bank considers that either the customer is unlikely to pay its credit obligations in full, without recourse to security, or when the customer is more than 90 days past due on any material credit obligation to the local group.

Impaired loans and advances also include renegotiated loans and advances that have been subject to a change in contractual cash flows as a result of a concession which the bank would not otherwise consider, and where it is probable that without the concession the borrower would be unable to meet the contractual payment obligations in full, unless the concession is insignificant and there are no other indicators of impairment. Renegotiated loans remain classified as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment.

Impairment allowances on loans and advances to customers by business segment:

	Individually assessed	*Collectively assessed*	*Total*	*Individually assessed*	*Collectively assessed*	*Total*
	2016	**2016**	**2016**	2015	2015	2015
	€000	**€000**	**€000**	€000	€000	€000
Personal	**11,784**	**2,966**	**14,750**	5,944	2,430	8,374
Corporate and commercial	**32,182**	**4,429**	**36,611**	33,561	4,757	38,318
As at 31 December	**43,966**	**7,395**	**51,361**	39,505	7,187	46,692

Renegotiated loans and advances to customers and forbearance

The contractual terms of a loan may be modified for a number of reasons including changing market conditions, customer retention and other factors not related to the current or potential credit deterioration of a customer. 'Forbearance' describes concessions made on the contractual terms of a loan in response to an obligor's financial difficulties. The bank classifies and reports loans on which concessions have been granted under conditions of credit distress as 'renegotiated loans' when their contractual payment terms have been modified, because the bank has significant concerns about the borrowers' ability to meet contractual payments when due.

4 Financial risk management *(continued)*

b *Credit risk excluding Insurance credit risk which is reported under 4(f) (continued)*

iii Credit quality of financial assets (continued)

b Impaired loans and advances to customers (continued)

Renegotiated loans and advances to customers and forbearance (continued)

On renegotiation, where the existing agreement is cancelled and a new agreement is made on substantially different terms, or if the terms of an existing agreement are modified, such that the renegotiated loan is substantially a different financial instrument, the loan would be derecognised and recognised as a new loan, for accounting purposes. However, newly recognised loans retain the 'renegotiated loans' classification.

A range of forbearance strategies is employed in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid default, foreclosure or repossession. They include extended payment terms, a reduction in interest or principal repayments, approved external debt management plans, debt consolidations, the deferral of foreclosures, and other forms of loan modifications and re-ageing.

The bank's policies and practices are based on criteria which enable management to judge whether repayment is likely to continue. These typically provide a customer with terms and conditions that are more favourable than those provided initially. Loan forbearance is only granted in situations where the customer has showed a willingness to repay the borrowing and is expected to be able to meet the revised obligations.

For personal lending the bank's credit risk management policy sets out restrictions on the number and frequency of renegotiations, the minimum period an account must have been opened before any renegotiation can be considered and the number of qualifying payments that must be received.

When the bank grants a concession to a customer that the bank would not otherwise consider, as a result of their financial difficulty, this is objective evidence of impairment and impairment losses are measured accordingly. A renegotiated loan is presented as impaired when there has been a change in contractual cash flows as a result of a concession which the lender would otherwise not consider; and it is probable that without the concession, the borrower would be unable to meet contractual payment obligations in full. Accordingly, where the customer is not meeting contractual repayments or it is evident that they will be unable to do so without the renegotiation, there will be a significant concern regarding their ability to meet contractual payments, and the loan will be disclosed as impaired, unless the concession granted is insignificant. The renegotiated loan will continue to be disclosed as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment.

Renegotiated loans are classified as unimpaired where the renegotiation has resulted from significant concern about a borrower's ability to meet their contractual payment terms but the renegotiated terms are based on current market rates and contractual cash flows are expected to be collected in full following the renegotiation.

Unimpaired renegotiated loans also include previously impaired renegotiated loans that have demonstrated satisfactory performance over a period of time or have been assessed based on all available evidence as having no remaining indicators of impairment.

Loans that have been identified as renegotiated retain this designation until maturity or derecognition. When a loan is restructured as part of a forbearance strategy and the restructuring results in a derecognition of the existing loan, the new loan is disclosed as renegotiated. A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement made on substantially different terms, or if the terms of an existing agreement are modified, such that the renegotiated loan is substantially a different financial instrument.

When determining whether a loan that is restructured should be derecognised and a new loan recognised, the bank considers the extent to which the changes to the original contractual terms result in the renegotiated loan, considered as a whole, being a substantially different financial instrument.

4 Financial risk management *(continued)*

b *Credit risk excluding Insurance credit risk which is reported under 4(f) (continued)*

iii Credit quality of financial assets (continued)

b Impaired loans and advances to customers (continued)

Renegotiated loans and advances to customers and forbearance (continued)

The following tables show the amounts net of suspended interest of the bank's holdings of renegotiated loans and advances to customers by business segment and credit quality classification:

	Neither past due nor impaired	*Past due but not impaired*	*Impaired*	*Total*
	€000	**€000**	**€000**	**€000**
At 31 December 2016				
Personal				
– residential mortgages	**13,033**	**2,863**	**15,711**	**31,607**
– other personal lending	**3,182**	**107**	**6,416**	**9,705**
Corporate and commercial				
– commercial real estate and other property-related	**1,435**	**493**	**78,012**	**79,940**
– other commercial	**36,215**	**8**	**40,252**	**76,475**
	53,865	**3,471**	**140,391**	**197,727**
% of loans and advances				**5.86%**
Total impairment allowances for renegotiated loans				
– individually assessed	**–**	**–**	**20,653**	**20,653**
– collectively assessed	**118**	**8**	**308**	**434**
	118	**8**	**20,961**	**21,087**
Collateral held	**21,043**	**2,893**	**85,550**	**109,486**
At 31 December 2015				
Personal				
– residential mortgages	17,992	258	17,411	35,661
– other personal lending	1,965	107	4,614	6,686
Corporate and commercial				
– commercial real estate and other property-related	912	841	63,137	64,890
– other commercial	38,763	155	64,539	103,457
	59,632	1,361	149,701	210,694
% of loans and advances				6.31%
Total impairment allowances for renegotiated loans				
– individually assessed	–	–	18,738	18,738
– collectively assessed	128	3	322	453
	128	3	19,060	19,191
Collateral held	25,062	395	83,848	109,305

4 Financial risk management *(continued)*

b *Credit risk excluding Insurance credit risk which is reported under 4(f) (continued)*

iii Credit quality of financial assets (continued)

b Impaired loans and advances to customers (continued)

Renegotiated loans and advances to customers and forbearance (continued)

	2016	2015
	€000	€000
Total renegotiated loans and advances to customers as a percentage of total gross loans and advances to customers	**5.82%**	6.27%
Interest income recognised in respect of forborne assets	**3,068**	3,271
Movement in forbearance activity during the year:		
1 January	**209,225**	243,149
Loans renegotiated without derecognition	**13,089**	24,585
Repayments/amounts written off	**(26,054)**	(58,509)
At 31 December	**196,260**	209,225

Impairment of loans and advances to customers

The following tables analyse the loan impairment charges for the year and the impairment allowances recognised for impaired loans and advances that are either individually assessed or collectively assessed, and collective impairment allowances on loans and advances classified as not impaired.

Movement in impairment allowances accounts for loans and advances to customers:

	Individually assessed	*Collectively assessed*	*Individually assessed*	*Collectively assessed*
	2016	**2016**	2015	2015
	€000	**€000**	€000	€000
At 1 January	**39,505**	**7,187**	39,332	7,546
Amounts written off	**(3,328)**	**–**	(11,223)	–
Recoveries of amounts written off in previous years	**1,291**	**–**	3,078	–
Discount unwind	**(2,465)**	**–**	(2,893)	–
Exchange differences	**89**	**–**	270	–
Loan impairment charge	**8,874**	**208**	10,941	(359)
At 31 December	**43,966**	**7,395**	39,505	7,187
Personal	**11,784**	**2,966**	5,944	2,430
Corporate and commercial	**32,182**	**4,429**	33,561	4,757
At 31 December	**43,966**	**7,395**	39,505	7,187

4 Financial risk management *(continued)*

b *Credit risk excluding Insurance credit risk which is reported under 4(f) (continued)*

iii Credit quality of financial assets (continued)

b Impaired loans and advances to customers (continued)

Impairment of loans and advances to customers (continued)

In 2016, interest income amounting to €2,465,000 (2015: €2,893,000) was recognised in profit or loss on loans for which individually assessed impairment provisions existed.

Loan impairment charge to income statement by business segment:

	Individually assessed	*Collectively assessed*	*Individually assessed*	*Collectively assessed*
	2016	**2016**	2015	2015
	€000	**€000**	€000	€000
New allowance	**14,461**	**5,080**	35,676	5,940
Release of allowance no longer required	**(4,296)**	**(4,872)**	(21,657)	(6,299)
Recoveries of amounts previously written off	**(1,291)**	**–**	(3,078)	–
Total loan impairment charge at 31 December	**8,874**	**208**	10,941	(359)
Personal				
– residential mortgages	**4,078**	**(325)**	2,962	360
– other personal lending	**78**	**861**	649	352
Corporate and commercial				
– commercial real estate	**2,606**	**288**	1,103	951
– other corporate lending	**2,112**	**(616)**	6,227	(2,022)
Total loan impairment charge at 31 December	**8,874**	**208**	10,941	(359)

Collateral and other credit enhancements

It is the local group's practice to lend on the basis of the customer's ability to meet their obligations out of their cash flow resources rather than rely on the value of security offered. Depending on the customer's standing and the type of product, facilities may be provided unsecured. For other lending a charge over collateral is obtained and considered in determining the credit decision and pricing. In the event of a default, the group may utilise the collateral as a source of repayment. Depending on its form, collateral can have a significant financial effect in mitigating exposure to credit risk.

The principal collateral types are as follows:

- In the personal sector, mortgages over residential properties, cash and securities; and
- In the commercial real estate sector, charges over the properties being financed;

The local group is required to implement guidelines on the acceptability of specific classes of collateral or credit risk mitigation, and determine suitable valuation parameters. Such parameters are expected to be conservative, reviewed regularly and supported by empirical evidence. Security structures and legal covenants are required to be subject to regular review to ensure that they continue to fulfil their intended purpose and remain in line with local market practice.

Depending on the customer's standing and the type of product, facilities may be provided unsecured. For other lending a charge over collateral is obtained and considered in determining the credit decision and pricing. In the event of a default, the local group may utilise the collateral as a source of repayment. Depending on its form, collateral can have a significant financial effect in mitigating exposure to credit risk.

The tables below show loans and advances to customers by level of collateral. The collateral measured in the tables below consists of fixed first charges on real estate and charges over cash and marketable financial instruments. The values in the tables represent the expected market value on an open market basis; no adjustment has been made to the collateral for any expected costs of recovery. Cash is valued at its nominal value and marketable securities at their fair value.

4 Financial risk management *(continued)*

b *Credit risk excluding Insurance credit risk which is reported under 4(f) (continued)*

iii Credit quality of financial assets (continued)

b Impaired loans and advances to customers (continued)

Collateral and other credit enhancements (continued)

The LTV ratios presented are calculated by directly associating loans and advances with the collateral that individually and uniquely supports each facility.

Where collateral assets are shared by multiple loans and advances, the collateral value is pro-rated across the loans and advances protected by the collateral. Other types of collateral which are commonly taken for corporate and commercial lending such as unsupported guarantees and floating charges over the assets of a customer's business are not measured in the tables below. While such mitigants have value, often providing rights in insolvency, their assignable value is not sufficiently certain and they are therefore assigned no value for disclosure purposes.

The value of real estate collateral is determined by using a combination of professional and internal valuations and physical inspections. Revaluations are sought with greater frequency as concerns over the performance of the collateral or the direct obligor increase.

Corporate and commercial lending

Corporate and commercial lending includes the financing of corporate, institutional and high net worth individuals investing primarily in income producing assets and, to a lesser extent construction and development of the same. The business focuses mainly on traditional core asset classes such as retail, offices, light industrial and residential building projects.

The collateral measured in the table below consists of fixed first charges on real estate. The values in the table represent the expected market value on an open market basis.

Other types of collateral which are commonly taken for corporate and commercial lending such as unsupported guarantees and floating charges over the assets of a customer's business are not measured in the tables below. While such mitigants have value, often providing rights in insolvency, their assignable value is not sufficiently certain and they are therefore assigned no value for disclosure purposes. The value of commercial real estate collateral is determined by using a combination of professional and internal valuations and physical inspections. Due to the complexity of valuing collateral for commercial real estate, local valuation policies determine the frequency of review on the basis of local market conditions. Revaluations are sought with greater frequency as concerns over the performance of the collateral or the direct obligor increase.

4 Financial risk management *(continued)*

b *Credit risk excluding Insurance credit risk which is reported under 4(f) (continued)*

iii Credit quality of financial assets (continued)

b Impaired loans and advances to customers (continued)

Corporate and commercial lending (continued)

	2016	2015
	€000	€000
Non-impaired loans and advances (CRR 1 to 8)		
– Not collateralised	**514,147**	517,066
Fully collateralised		
– 51% to 75% LTV	**490,779**	463,657
– 76% to 90% LTV	**10,995**	10,476
– 91% to 100% LTV	**137,490**	145,765
	639,264	619,898
Partially collateralised		
– greater than 100% LTV	**69,779**	124,552
– of which:		
collateral value	**25,640**	67,878
Impaired loans and advances (CRR 9 to 10)		
– Not collateralised	**46,021**	67,160
Fully collateralised		
– Less than 50% LTV	**–**	–
– 51% to 75% LTV	**66,399**	66,827
– 76% to 90% LTV	**2,268**	2,527
– 91% to 100% LTV	**10,806**	10,922
	79,473	80,276
Partially collateralised		
– greater than 100% LTV	**14,090**	17,477
– of which:		
collateral value	**5,114**	6,534
At 31 December	**1,362,774**	1,426,429

Personal lending

The bank provides a broad range of secured and unsecured personal lending products to meet customer needs. Personal lending includes advances to customers for asset purchases such as residential property where the loans are secured by the assets acquired. The bank also offers loans secured on existing assets, such as first charges on residential property, and unsecured lending products such as overdrafts, credit cards and card loans.

The collateral measured in the following table consists of fixed charges held over borrowers' real estate. The value of collateral is determined using professional valuations and excludes any adjustment for obtaining and selling the collateral. Loans shown as not collateralised or partially collateralised may also benefit from other forms of credit mitigants.

4 Financial risk management *(continued)*

b *Credit risk excluding Insurance credit risk which is reported under 4(f) (continued)*

iii Credit quality of financial assets (continued)

b Impaired loans and advances to customers (continued)

Personal lending (continued)

	2016	2015
	€000	€000
Non-impaired loans and advances (CRR 1 to 8)		
– Not collateralised	**113,482**	132,263
Fully collateralised		
– Less than 50% LTV	**742,518**	707,495
– 51% to 75% LTV	**610,448**	526,892
– 76% to 90% LTV	**393,550**	386,410
– 91% to 100% LTV	**65,468**	83,871
	1,811,984	1,704,668
Partially collateralised		
– greater than 100% LTV	**6,958**	8,043
– of which:		
collateral value	**3,036**	3,988
Impaired loans and advances (CRR 9 to 10)		
– Not collateralised	**3,292**	3,708
Fully collateralised		
– Less than 50% LTV	**36,172**	29,209
– 51% to 75% LTV	**19,089**	26,694
– 76% to 90% LTV	**2,432**	5,675
– 91% to 100% LTV	**1,395**	1,301
	59,088	62,879
Partially collateralised		
– greater than 100% LTV	**14,146**	1,517
– of which:		
collateral value	**5,327**	845
At 31 December	**2,008,950**	1,913,078

The local group typically does not hold collateral against financial assets designated at fair value, financial investments and loans to banks, and no such collateral was held at 31 December 2016 and 2015.

4 Financial risk management *(continued)*

b *Credit risk excluding Insurance credit risk which is reported under 4(f) (continued)*

iii Credit quality of financial assets (continued)

c Treasury Bills and debt securities

Debt securities and other bills by rating agency (S&P Rating Agency) designation of the local group excluding HSBC Life Assurance (Malta) Limited, are reported in the table below. Information relating to the HSBC Life insurance business is disclosed in note 4(f)ii.

	Treasury Bills	*Debt securities*	*Total*
	€000	**€000**	**€000**
At 31 December 2016			
AAA	**–**	**394,495**	**394,495**
AA- to AA+	**–**	**70,383**	**70,383**
A-	**39,998**	**582,924**	**622,922**
	39,998	**1,047,802**	**1,087,800**
At 31 December 2015			
AAA	–	448,588	448,588
AA- to AA+	–	73,899	73,899
A- to BBB-	103,998	669,208	773,206
	103,998	1,191,695	1,295,693

d Derivatives

The bank participates in transactions exposing it to counterparty credit risk. Counterparty credit risk is the risk of financial loss if the counterparty to a transaction defaults before satisfactorily settling it and it arises principally from OTC derivatives. Transactions vary in value by reference to a market factor such as interest rate, exchange rate or asset price. The bank manages its derivative market risk positions principally through back-to-back derivative transactions with HSBC Group entities. The counterparty risk from derivative transactions is taken into account when reporting the fair value of derivative positions. The adjustment to the fair value is known as the credit value adjustment (CVA).

For transactions with HSBC Group entities, the bank has an International Swaps and Derivatives Association (ISDA) Master Agreement in place. It provides the contractual framework within which dealing activity across a full range of OTC products is conducted, and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement if either party defaults or other preagreed termination events occur. In this respect, gross derivative assets amounting to €11,440,000 (2015: €11,492,000) are subject to enforceable netting agreement, however, they are not offset in the balance sheet as they do not meet the on-balance sheet offsetting criteria for financial reporting purposes. Similarly, gross derivative liabilities amounting to €12,600,000 (2015: €11,732,000) are subject to enforceable netting agreement, however, they are not offset in the balance sheet as they do not meet the on-balance sheet offsetting criteria for financial reporting purposes.

c *Liquidity risk*

Liquidity risk is the risk that the local group does not have sufficient financial resources to meet its financial obligations when they fall due or will have to do so at excessive cost. This risk principally arises from mismatches in the timing of cash flows. Funding risk (a form of liquidity risk) arises when the liquidity needed to fund illiquid asset positions cannot be obtained on the expected terms and when required.

The objective of the local group's liquidity and funding management is to ensure that all foreseeable funding commitments and deposit withdrawals can be met when due. To this end, the local group maintains a diversified and stable funding base. The funding base comprises core personal and corporate customer deposits, wholesale funding and portfolios of highly liquid assets with the objective of enabling the local group to respond quickly and smoothly to unforeseen liquidity requirements.

4 Financial risk management *(continued)*

c *Liquidity risk (continued)*

The bank maintains strong liquidity positions and manages the liquidity profiles of assets, liabilities and commitments with the objective of ensuring that cash flows are balanced appropriately and that all anticipated obligations can be met when due.

The bank employs a number of measures to monitor liquidity risk. The local group also manages its intra-day liquidity positions so that it is able to meet payment and settlement obligations on a timely basis. Expected peak payment flows and large time-critical payments are monitored during the day.

The local group's liquidity and funding management processes include:

- projecting cash flows by major currency under various stress scenarios considering the level of liquid assets necessary in relation thereto;
- monitoring liquidity ratios against internal and regulatory requirements;
- maintaining a diverse range of funding sources with adequate back-up facilities;
- managing the concentration and profile of debt maturities;
- monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensure a satisfactory overall funding mix; and
- maintaining liquidity and funding contingency plans. These plans identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systematic or other crisis while minimising adverse long-term implications for the business.

Primary sources of funding

Customer deposits in the form of current accounts and savings deposits payable on demand or at short notice form a significant part of the local group's funding, and thus considerable importance is placed on maintaining their stability. For deposits, stability depends upon maintaining depositor confidence in the local group's capital strength and liquidity, and on competitive and transparent pricing.

The local group also accesses the local wholesale funding market by issuing unsecured debt securities to align asset and liability maturities and to maintain a presence in the local wholesale market.

Management of liquidity and funding risk

The bank's liquidity and funding risk management framework employs two key measures to define, monitor and control the liquidity and funding risk. The Net Stable Funding Ratio (NSFR) ratio is used to monitor the structural long-term funding position of the bank, and the Liquidity Coverage Ratio (LCR) ratio metric designed to promote the short-term resilience of the bank's liquidity profile. The bank also monitors the contractual maturity ladder, which provides insight into the extent to which the bank relies on maturity transformation in respect of contractual cash flows. More precisely, the maturity ladder is used by the bank to determine the availability of liquid assets to meet the liquidity gaps for diverse time horizons.

The bank's ALCO focuses on the management process with respect to liquidity and funding risks. Compliance with established limits is monitored by the local ALCO.

i Liquidity Coverage Ratio

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

4 Financial risk management *(continued)*

c *Liquidity risk (continued)*

i Liquidity Coverage Ratio (continued)

The table below displays the LCR year endlevels for the bank.

	2016	2015
	%	%
At 31 December		
Actual LCR Ratio	**479**	526
Regulatory Minimum	**100**	100

During the year ended 31 December 2016 and 2015 the LCR ratio was within both the regulatory minimum and the risk appetite set by the bank.

ii Net stable funding ratio

The NSFR requires institutions to maintain sufficient stable funding relative to required stable funding, and reflects a bank's long-term funding profile (funding with a term of more than a year). It is designed to complement the LCR.

The European calibration of NSFR is pending following the European Commission's proposal in November 2016. As a result, the bank calculates NSFR in line with Basel Committee on Banking Supervision publication 295, pending its implementation in Europe. This calculation requires various interpretations of the text, and therefore HSBC's NSFR may not be directly comparable with the ratios of other institutions.

	2016	2015
	%	%
At 31 December		
Actual NSFR Ratio	**136**	147
Regulatory Minimum	**100**	100

During the year ended 31 December 2016 and 2015 the NSFR was within both the regulatory minimum and the risk appetite set by the bank.

iii Depositor Concentration

The LCR and NSFR metrics assume a stressed outflow based on a portfolio of depositors within each deposit segment. The validity of these assumptions is challenged if the underlying depositors do not represent a large enough portfolio so that a depositor concentration exists. The bank is exposed to term re-financing concentration risk if the current maturity profile results in future maturities being overly concentrated in any defined period.

As at 31 December 2016, the bank was within the risk tolerance levels set for depositor concentration and term funding maturity concentration.

4 Financial risk management *(continued)*

c *Liquidity risk (continued)*

iv Contractual maturity ladder

The following is an analysis of financial assets and liabilities (excluding financial instruments relating to HSBC Life Assurance (Malta) Limited) by remaining contractual maturities at the reporting date. Information relating to HSBC Life insurance business is disclosed in note 4(f)(iii):

	Not more than 3 months	*Between 3 and 6 months*	*Between 6 months and 1 year*	*Between 1 year and 5 years*	*More than 5 years*	*No maturity date*	*Total*
	€000	**€000**	**€000**	**€000**	**€000**	**€000**	**€000**
Group							
At 31 December 2016							
Assets							
Cash	**33,845**	**–**	**–**	**–**	**–**	**–**	**33,845**
Balances with Central Bank of Malta and Treasury Bills	**40,253**	**–**	**–**	**–**	**–**	**48,320**	**88,573**
Items in the course of collection from other banks	**16,796**	**–**	**–**	**–**	**–**	**–**	**16,796**
Loans & advances to banks	**827,473**	**343**	**830**	**137,445**	**30,000**	**–**	**996,091**
Loans & advances to customers	**261,312**	**7,936**	**156,681**	**336,983**	**2,557,420**	**–**	**3,320,332**
Available-for-sale financial investments	**27,847**	**14,679**	**179,210**	**763,709**	**63,107**	**–**	**1,048,552**
Other assets	**28,794**	**2,344**	**1,886**	**2,103**	**4,284**	**–**	**39,411**
Total assets	**1,236,320**	**25,302**	**338,607**	**1,240,240**	**2,654,811**	**48,320**	**5,543,600**
Liabilities							
Deposits by banks	**10,647**	**123**	**–**	**–**	**–**	**–**	**10,770**
Customer accounts	**4,016,148**	**118,490**	**503,768**	**349,383**	**13,047**	**–**	**5,000,836**
Other liabilities	**73,626**	**2,453**	**2,033**	**2,183**	**4,831**	**–**	**85,126**
Subordinated liabilities	**58,219**	**–**	**–**	**29,199**	**–**	**–**	**87,418**
Total equity and liabilities	**4,158,640**	**121,066**	**505,801**	**380,765**	**17,878**	**–**	**5,184,150**
Notional value:							
Liquidity gap	**(2,922,320)**	**(95,764)**	**(167,194)**	**859,475**	**2,636,933**		
Cumulative liquidity gap	**(2,922,320)**	**(3,018,084)**	**(3,185,278)**	**(2,325,803)**	**311,130**		

4 Financial risk management *(continued)*

c *Liquidity risk (continued)*

iv Contractual maturity ladder (continued)

	Not more than 3 months	*Between 3 and 6 months*	*Between 6 months and 1 year*	*Between 1 year and 5 years*	*More than 5 years*	*No maturity date*	*Total*
	€000	€000	€000	€000	€000	€000	€000
Group							
At 31 December 2015							
Assets							
Cash	35,307	–	–	–	–	–	35,307
Balances with Central Bank of Malta and Treasury Bills	103,998	–	–	–	–	48,258	152,256
Items in the course of collection from other banks	12,559	–	–	–	–	–	12,559
Loans & advances to banks	609,222	3,907	8,306	107,483	–	–	728,918
Loans & advances to customers	272,645	63,962	72,936	365,289	2,509,783	–	3,284,615
Available-for-sale financial investments	27,429	25,003	178,493	871,071	96,799	–	1,198,795
Other assets	33,484	2,164	1,098	2,022	4,118	–	42,886
Total assets	1,094,644	95,036	260,833	1,345,865	2,610,700	48,258	5,455,336
Liabilities							
Deposits by banks	13,354	488	444	–	–	–	14,286
Customer accounts	3,587,175	186,087	554,732	351,934	270,329	–	4,950,257
Other liabilities	33,599	2,340	1,727	2,172	4,789	–	44,627
Subordinated liabilities	–	–	–	88,146	–	–	88,146
Total liabilities	3,634,128	188,915	556,903	442,252	275,118	–	5,097,316
Notional value:							
Liquidity gap	(2,539,484)	(93,879)	(296,070)	903,613	2,335,582		
Cumulative liquidity gap	(2,539,484)	(2,633,363)	(2,929,433)	(2,025,820)	309,762		

4 **Financial risk management** *(continued)*

c *Liquidity risk (continued)*

iv Contractual maturity ladder (continued)

	Not more than 3 months	*Between 3 and 6 months*	*Between 6 months and 1 year*	*Between 1 year and 5 years*	*More than 5 years*	*No maturity date*	*Total*
	€000	**€000**	**€000**	**€000**	**€000**	**€000**	**€000**
Bank							
At 31 December 2016							
Assets							
Cash	**33,845**	**–**	**–**	**–**	**–**	**–**	**33,845**
Balances with Central Bank of Malta and Treasury Bills	**40,253**	**–**	**–**	**–**	**–**	**48,320**	**88,573**
Items in the course of collection from other banks	**16,796**	**–**	**–**	**–**	**–**	**–**	**16,796**
Loans & advances to banks	**827,473**	**343**	**830**	**137,445**	**30,000**	**–**	**996,091**
Loans & advances to customers	**261,312**	**7,936**	**156,681**	**337,014**	**2,557,420**	**–**	**3,320,363**
Available-for-sale financial investments	**27,844**	**14,679**	**179,210**	**763,709**	**63,107**	**–**	**1,048,549**
Other assets	**28,794**	**2,344**	**1,886**	**2,103**	**4,284**	**–**	**39,411**
Total assets	**1,236,317**	**25,302**	**338,607**	**1,240,271**	**2,654,811**	**48,320**	**5,543,628**
Liabilities							
Deposits by banks	**10,647**	**123**	**–**	**–**	**–**	**–**	**10,770**
Customer accounts	**4,076,157**	**118,490**	**503,768**	**349,383**	**13,047**	**–**	**5,060,845**
Other liabilities	**73,626**	**2,453**	**2,033**	**2,183**	**4,831**	**–**	**85,126**
Subordinated liabilities	**58,219**	**–**	**–**	**29,953**	**–**	**–**	**88,172**
Total liabilities	**4,218,649**	**121,066**	**505,801**	**381,519**	**17,878**	**–**	**5,244,913**
Notional value:							
Liquidity gap	**(2,982,332)**	**(95,764)**	**(167,194)**	**858,752**	**2,636,933**		
Cumulative liquidity gap	**(2,982,332)**	**(3,078,096)**	**(3,245,290)**	**(2,386,538)**	**250,395**		

4 Financial risk management *(continued)*

c *Liquidity risk (continued)*

iv Contractual maturity ladder (continued)

	Not more than 3 months	*Between 3 and 6 months*	*Between 6 months and 1 year*	*Between 1 year and 5 years*	*More than 5 years*	*No maturity date*	*Total*
	€000	€000	€000	€000	€000	€000	€000
Bank							
At 31 December 2015							
Assets							
Cash	35,307	–	–	–	–	–	35,307
Balances with Central Bank of Malta and Treasury Bills	103,998	–	–	–	–	48,258	152,256
Items in the course of collection from other banks	12,559	–	–	–	–	–	12,559
Loans & advances to banks	609,222	3,907	8,306	107,483	–	–	728,918
Loans & advances to customers	272,645	63,962	72,936	373,490	2,509,782	–	3,292,815
Available-for-sale financial investments	27,426	25,003	178,493	871,071	96,799	–	1,198,792
Other assets	33,484	2,164	1,098	2,022	4,118	–	42,886
Total assets	1,094,641	95,036	260,833	1,354,066	2,610,699	48,258	5,463,533
Liabilities							
Deposits by banks	13,354	488	444	–	–	–	14,286
Customer accounts	3,665,236	186,087	554,732	351,934	270,329	–	5,028,318
Other liabilities	33,599	2,340	1,727	2,172	4,789	–	44,627
Subordinated liabilities	–	–	–	88,146	–	–	88,146
Total liabilities	3,712,189	188,915	556,903	442,252	275,118	–	5,175,377
Notional value:							
Liquidity gap	(2,617,548)	(93,879)	(296,070)	911,814	2,335,581		
Cumulative liquidity gap	(2,617,548)	(2,711,427)	(3,007,497)	(2,095,683)	239,898		

Current accounts and savings deposits payable on demand or at short notice amounted to €3,781 million at 31 December 2016 (2015: €3,576 million). This amount is disclosed within the 'Not more than 3 months' maturity grouping. However, in practice these deposits are maintained with the bank for longer periods; hence the effective date of repayment is later than the contractual date. This form represents a significant part of the local group's funding. The local group places considerable importance on maintaining the stability of these deposits.

Overdraft and debt balances amounted to €262 million at 31 December 2016 (2015: €297 million). This amount is disclosed within the 'Not more than 3 months' maturity grouping.

4 Financial risk management *(continued)*

c *Liquidity risk (continued)*

v *Cash flows payable by the local group under financial liabilities by remaining maturities*

The following is an analysis by relevant maturity groupings of undiscounted cash flows payable under the principal non-derivative financial liabilities (excluding financial instruments relating to HSBC Life Assurance (Malta) Limited) by remaining contractual maturities at the reporting date. Information relating to HSBC Life insurance business is disclosed in note 4(f)(iii):

	Due within 3 months	*Due between 3 and 12 months*	*Due between 1 and 5 years*	*Due after 5 years*	*Gross nominal inflow/ outflow*	*Carrying amount*
	€000	**€000**	**€000**	**€000**	**€000**	**€000**
Group						
Financial liabilities						
At 31 December 2016						
Deposits by banks	**10,652**	**123**	**–**	**–**	**10,775**	**10,770**
Customer accounts	**4,026,522**	**627,944**	**360,544**	**14,052**	**5,029,062**	**5,000,836**
Subordinated liabilities	**60,459**	**1,770**	**31,770**	**–**	**93,999**	**87,418**
Other financial liabilities	**66,762**	**1,070**	**–**	**–**	**67,832**	**67,832**
	4,164,395	**630,907**	**392,314**	**14,052**	**5,201,668**	**5,166,856**
Commitments	**768,809**	**141,143**	**315,268**	**12**	**1,225,232**	
At 31 December 2015						
Financial liabilities						
Deposits by banks	13,748	451	93	–	14,292	14,286
Customer accounts	3,587,581	742,216	356,954	271,307	4,958,058	4,950,257
Subordinated liabilities	1,339	3,109	93,114	–	97,562	88,146
Other financial liabilities	24,747	449	100	–	25,296	25,296
	3,627,415	746,225	450,261	271,307	5,095,208	5,077,985
Commitments	792,449	159,128	341,014	14	1,292,605	
Bank						
Financial liabilities						
At 31 December 2016						
Deposits by banks	**10,652**	**123**	**–**	**–**	**10,775**	**10,770**
Customer accounts	**4,078,656**	**627,944**	**360,544**	**14,052**	**5,081,196**	**5,060,845**
Subordinated liabilities	**60,459**	**1,770**	**31,770**	**–**	**93,999**	**88,172**
Other financial liabilities	**66,762**	**1,070**	**–**	**–**	**67,832**	**67,832**
	4,216,529	**630,907**	**392,314**	**14,052**	**5,253,802**	**5,227,619**
Commitments	**768,840**	**141,143**	**315,268**	**12**	**1,225,263**	
At 31 December 2015						
Financial liabilities						
Deposits by banks	13,748	451	93	–	14,292	14,286
Customer accounts	3,665,830	742,216	356,954	271,307	5,036,307	5,028,318
Subordinated liabilities	1,339	3,109	93,114	–	97,562	88,146
Other financial liabilities	24,747	449	100	–	25,296	25,296
	3,705,664	746,225	450,261	271,307	5,173,457	5,156,046
Commitments	792,646	159,128	341,014	14	1,292,802	

4 Financial risk management *(continued)*

c *Liquidity risk (continued)*

v Cash flows payable by the local group under financial liabilities by remaining maturities (continued)

Cash flows payable by the local group under investment contracts and insurance contracts issued are disclosed in note 4f(iii).

The balances in the above table do not agree with the balances in the 'Statement of financial position' as the table incorporates all cash flows, on an undiscounted basis, related to principal as well as those associated with all future interest payments.

The following is an analysis by relevant maturity groupings of undiscounted cash flows relating to the local group's derivative financial instruments by remaining contractual maturities at the reporting date:

Contracted undiscounted cash flows

	Less than 3 months	*Between 3 months and 1 year*	*Between 1 year and 5 years*	*Over 5 years*	*Total*
	€000	**€000**	**€000**	**€000**	**€000**
Group/Bank					
As at 31 December 2016					
Inflows	**39,231**	**102,105**	**8,134**	**1,552**	**151,022**
Outflows	**(39,201)**	**(101,989)**	**(8,004)**	**(1,538)**	**(150,732)**
	30	**116**	**130**	**14**	**290**
As at 31 December 2015					
Inflows	105,380	146,587	7,163	3,070	262,200
Outflows	(105,333)	(146,502)	(7,058)	(3,022)	(261,915)
	47	85	105	48	285

d *Encumbered and unencumbered assets*

The objective of this disclosure is to facilitate an understanding of available and unrestricted assets that could be used to support potential future funding and collateral needs.

An asset is defined as encumbered if it has been pledged as collateral against an existing liability, and as a result is no longer available to the group to secure funding, satisfy collateral needs or be sold to reduce the funding requirement. The disclosure is not designed to identify assets which would be available to meet the claims of creditors or to predict assets that would be available to creditors in the event of a resolution or bankruptcy.

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Total assets at 31 December	**7,305,964**	7,241,123	**5,697,398**	5,618,952
Less:				
Assets pledged against the provision of credit lines by Central Bank of Malta				
– Debt securities	**64,785**	67,451	**64,785**	67,451
– Loans and advances to customers	**11,637**	90,496	**11,637**	90,496
Less:				
Debt securities pledged in terms of Depositor Compensation Scheme	**27,698**	29,981	**27,698**	29,981
Less:				
Other assets that cannot be pledged as collateral	**1,700,977**	1,683,033	**189,604**	179,559
Assets available to support funding and collateral needs at 31 December	**5,500,867**	5,370,162	**5,403,674**	5,251,465

e *Market risk*

Market risk is the risk that movements in market risk factors, including foreign exchange rates, interest rates and market prices will impact the local group's income or the value of its portfolios. Exposure to market risk arises from positions that primarily arise from the interest rate management of the local group's retail and commercial banking assets and liabilities and financial investments designated as available-for-sale.

The objective of the local group's market risk management is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with the local group's status as a premier provider of financial products and services.

Market risk is managed and controlled through limits approved by HSBC Holdings and the global businesses. These limits are allocated across business lines and agreed with the Group's legal entities. The management of market risk is principally undertaken using risk limits allocated from the risk appetite. Limits are set for portfolios, products and risk types, with market liquidity being a principal factor in determining the level of limits set. Risk, as an independent function, is responsible for market risk management and measurement techniques. The bank has an independent market risk management and control function which is responsible for measuring market risk exposures in accordance with policies, and monitoring and reporting these exposures against the prescribed limits on a daily basis.

Each line of business is requested to assess the market risks which arise on each product in the business and, where there is a risk that can be hedged in the markets, this is transferred to the local Global Banking and Markets Unit for management. Where market risk is identified but there is no viable hedge in the market then the risk is managed under the local ALCO.

Monitoring and limiting market risk exposure

The bank uses a range of tools to monitor and limit market risk exposures including sensitivity analysis, value at risk (VaR), and stress testing.

i Sensitivity analysis

Sensitivity analysis measures the impact of individual market factor movements on specific instruments or portfolios including interest rates, foreign exchange rates and equity prices such as the impact of a one basis point change in yield. The bank uses sensitivity measures to monitor the market risk positions within each risk type, for example, the present value of a basis point movement in interest rates for interest rate risk. Sensitivity limits are set for portfolios, products and risk types, with the depth of the market being one of the principal factors in determining the level of limits set.

ii Value at risk (VaR)

VaR is a technique that estimates the potential losses on risk positions in a portfolio as a result of movement in market rates and prices over a specified time horizon and to a given level of confidence. The use of VaR is integrated into market risk management.

The VaR model used by the local group is based predominantly on historical simulation. This model derives plausible future scenarios from past series of recorded market rates and prices, taking into account inter-relationships between different markets and rates such as interest rates and foreign exchange rates.

The historical simulation models used incorporate the following features:

- historical market rates and prices are calculated with reference to foreign exchange rates, interest rates, equity prices and the associated volatilities;
- potential market movements utilised for VaR are calculated with reference to data from the past two years; and
- VaR measures are calculated to a 99 per cent confidence level and use a one-day holding period.

4 Financial risk management *(continued)*

e *Market risk (continued)*

ii Value at risk (VaR) (continued)

The nature of VaR models means that an increase in observed market volatility will lead to an increase in VaR without any changes in the underlying positions. The local group routinely validates the accuracy of the VaR models by back-testing the hypothetical daily results. Although a valuable guide to risk, VaR should always be viewed in the context of its limitations. For example:

– the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;

– the use of a holding period assumes that all positions can be liquidated or the risks offset during that period. This may not fully reflect the market risk arising at times of severe illiquidity, when the holding period may be insufficient to liquidate or hedge all positions fully;

– the use of a 99 per cent confidence level, by definition does not take into account losses that might occur beyond this level of confidence;

– VaR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures; and

– VaR is unlikely to reflect loss potential on exposures that only arise under significant market movements.

The local group recognises these limitations and thus resorts to the use of other tools.

The VaR for the bank was as follows:

	2016	2015
	€000	**€000**
At 31 December	**657**	968
Average	**732**	988
Minimum	**663**	998
Maximum	**798**	977

iii Stress testing

Stress testing is an important tool that is integrated into the local group's market risk management to evaluate the potential impact on portfolio values of more extreme, although plausible, events or movements in a set of financial variables. In such abnormal scenarios, losses can be much greater than those predicted by VaR modelling. A standard set of scenarios is utilised consistently across the Group, which are however tailored in order to capture the relevant events or market movements happening locally. The risk appetite around potential stress losses is set and monitored against referral limits.

iv Interest rate risk

Interest rate risk in the bank's portfolios arises principally from mismatches between the future yield on assets and their funding cost, as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on embedded optionality within certain product areas such as the incidence of mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand such as current accounts.

Interest rate risk is assessed and managed according to 'business as usual' conditions. The bank's aim in this respect is to mitigate the effect of prospective interest rate movements which could reduce future net interest income. The bank's ALCO is responsible for oversight over the bank's interest rate risk management process and monitors actively the interest rate risk measures utilised.

4 Financial risk management *(continued)*

e *Market risk (continued)*

iv Interest rate risk (continued)

Sensitivity of net interest income

A principal element of the local group's management of interest rate risk is monitoring the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling). The local group applies a combination of scenarios and assumptions which are required throughout the HSBC Group.

Projected net interest income sensitivity figures represent the effect of the pro forma movements in net interest income based on the projected yield curve scenarios and the current interest rate risk profile. This effect, however, does not incorporate actions which would probably be taken by the local group to mitigate the effect of interest rate risk. In reality, the local group seeks actively to change the interest rate risk profile to minimise losses and optimise net revenues.

The net interest income sensitivity calculations assume that interest rates of all maturities move by the same amount in the 'up-shock' scenario. Rates are not assumed to become negative in the 'down-shock' scenario which may, in certain currencies, effectively result in non-parallel shock. In addition, the net interest income sensitivity calculations take account of the effect on net interest income of anticipated differences in changes between interbank interest rates and interest rates over which the bank has discretion in terms of the timing and extent of rate changes.

The table below sets out the impact on future net income of an incremental 100 basis points parallel fall or rise in yield curves based on current financial position/risk profiles and current managed interest rate policy. This calculation is taking into account the bank's strategy that negative rates are never passed through to customers.

During 2016, the policy to monitor interest rate risk has been changed to include all current accounts as part of the category of rate sensitive liabilities. 2015 figures have been restated to reflect this change.

	Impact on profit for the year	*Impact on profit for the year*
	2016	2015
	€000	**€000**
Group/Bank		
+ 100 basis points	**12,442**	9,952
- 100 basis points	**(1,481)**	(315)

4 Financial risk management *(continued)*

e *Market risk (continued)*

iv Interest rate risk (continued)

Sensitivity of net interest income (continued)

The table below discloses the mismatch of the dates on which interest on financial assets and financial liabilities (excluding financial instruments relating to HSBC Life Assurance (Malta) Limited) are next reset to market rates on a contractual basis or, if earlier, the dates on which the instruments mature as at 31 December. Information relating to HSBC Life insurance business is disclosed in note 4(f). Actual reset dates may differ from contractual dates owing to prepayments and the exercise of options. In addition, contractual terms may not be representative of the behaviour of financial assets and liabilities.

	Not more than 3 months	*Between 3 and 6 months*	*Between 6 months and 1 year*	*Between 1 year and 5 years*	*More than 5 years*	*Total*
	€000	**€000**	**€000**	**€000**	**€000**	**€000**
Group						
At 31 December 2016						
Assets						
Balances with Central Bank of Malta and Treasury Bills	**88,573**	**–**	**–**	**–**	**–**	**88,573**
Loans & advances to banks	**827,473**	**343**	**830**	**137,445**	**30,000**	**996,091**
Loans & advances to customers	**2,403,583**	**136,216**	**560,215**	**197,338**	**22,980**	**3,320,332**
Available-for-sale financial investments	**27,847**	**14,679**	**179,210**	**763,709**	**63,107**	**1,048,552**
Total assets	**3,347,476**	**151,238**	**740,255**	**1,098,492**	**116,087**	**5,453,548**
Liabilities						
Deposits by banks	**10,647**	**123**	**–**	**–**	**–**	**10,770**
Customer accounts	**4,016,148**	**118,490**	**503,768**	**349,383**	**13,047**	**5,000,836**
Subordinated liabilities	**58,219**	**–**	**–**	**29,199**	**–**	**87,418**
Total liabilities	**4,085,014**	**118,613**	**503,768**	**378,582**	**13,047**	**5,099,024**
Interest rate sensitivity gap	**(737,538)**	**32,625**	**236,487**	**719,910**	**103,040**	
Cumulative interest rate sensitivity gap	**(737,538)**	**(704,913)**	**(468,426)**	**251,484**	**354,524**	

4 Financial risk management *(continued)*

e *Market risk (continued)*

iv *Interest rate risk (continued)*

Sensitivity of net interest income (continued)

	Not more than 3 months	*Between 3 and 6 months*	*Between 6 months and 1 year*	*Between 1 year and 5 years*	*More than 5 years*	*Total*
	€000	€000	€000	€000	€000	€000
Group						
At 31 December 2015						
Assets						
Balances with Central Bank of Malta and Treasury Bills	152,256	–	–	–	–	152,256
Loans & advances to banks	609,222	3,907	8,306	107,483	–	728,918
Loans & advances to customers	1,618,017	24,003	644,409	960,875	37,311	3,284,615
Available-for-sale financial investments	27,429	25,003	178,113	871,071	97,179	1,198,795
Total assets	2,406,924	52,913	830,828	1,939,429	134,490	5,364,584
Liabilities						
Deposits by banks	13,354	488	444	–	–	14,286
Customer accounts	3,587,175	186,087	554,732	351,934	270,329	4,950,257
Subordinated liabilities	–	–	–	88,146	–	88,146
Total liabilities	3,600,529	186,575	555,176	440,080	270,329	5,052,689
Interest rate sensitivity gap	(1,193,605)	(133,662)	275,652	1,499,349	(135,839)	
Cumulative interest rate sensitivity gap	(1,193,605)	(1,327,267)	(1,051,615)	447,734	311,895	

4 Financial risk management *(continued)*

e *Market risk (continued)*

iv Interest rate risk (continued)

Sensitivity of net interest income (continued)

	Not more than 3 months	*Between 3 and 6 months*	*Between 6 months and 1 year*	*Between 1 year and 5 years*	*More than 5 years*	*Total*
	€000	**€000**	**€000**	**€000**	**€000**	**€000**
Bank						
At 31 December 2016						
Assets						
Balances with Central Bank of Malta and Treasury Bills	**88,573**	**–**	**–**	**–**	**–**	**88,573**
Loans & advances to banks	**827,473**	**343**	**830**	**137,445**	**30,000**	**996,091**
Loans & advances to customers	**2,403,583**	**136,216**	**560,215**	**197,369**	**22,980**	**3,320,363**
Available-for-sale financial investments	**27,844**	**14,679**	**179,210**	**763,709**	**63,107**	**1,048,549**
Total assets	**3,347,473**	**151,238**	**740,255**	**1,098,523**	**116,087**	**5,453,576**
Liabilities						
Deposits by banks	**10,647**	**123**	**–**	**–**	**–**	**10,770**
Customer accounts	**4,076,157**	**118,490**	**503,768**	**349,383**	**13,047**	**5,060,845**
Subordinated liabilities	**58,219**	**–**	**–**	**29,953**	**–**	**88,172**
Total liabilities	**4,145,023**	**118,613**	**503,768**	**379,336**	**13,047**	**5,159,787**
Interest rate sensitivity gap	**(797,550)**	**32,625**	**236,487**	**719,187**	**103,040**	
Cumulative interest rate sensitivity gap	**(797,550)**	**(764,925)**	**(528,438)**	**190,749**	**293,789**	

4 Financial risk management *(continued)*

e *Market risk (continued)*

iv Interest rate risk (continued)

Sensitivity of net interest income (continued)

	Not more than 3 months	*Between 3 and 6 months*	*Between 6 months and 1 year*	*Between 1 year and 5 years*	*More than 5 years*	*Total*
	€000	€000	€000	€000	€000	€000
Bank						
At 31 December 2015						
Assets						
Balances with Central Bank of Malta and Treasury Bills	152,256	–	–	–	–	152,256
Loans & advances to banks	609,222	3,907	8,306	107,483	–	728,918
Loans & advances to customers	1,618,017	24,003	644,409	969,075	37,311	3,292,815
Available-for-sale financial investments	27,426	25,003	178,493	871,071	96,799	1,198,792
Total assets	2,406,921	52,913	831,208	1,947,629	134,110	5,372,781
Liabilities						
Deposits by banks	13,354	488	444	–	–	14,286
Customer accounts	3,665,236	186,087	554,732	351,934	270,329	5,028,318
Subordinated liabilities	–	–	–	88,146	–	88,146
Total liabilities	3,678,590	186,575	555,176	440,080	270,329	5,130,750
Interest rate sensitivity gap	(1,271,669)	(133,662)	276,032	1,507,549	(136,219)	
Cumulative interest rate sensitivity gap	(1,271,669)	(1,405,331)	(1,129,299)	378,250	242,031	

A positive interest rate sensitivity gap exists where more assets than liabilities re-price during a given period. Although a positive gap position tends to benefit net interest income in a rising interest rate environment, the actual effect will depend on a number of factors, including the extent to which repayments are made earlier or later than the contracted date and variations in interest rates within re-pricing periods and among currencies. Similarly, a negative interest rate sensitivity gap exists where more liabilities than assets re-price during a given period. A negative gap position tends to benefit net interest income in a declining interest rate environment, but the actual effect will depend on the same factors as for positive interest rate gaps.

v Foreign exchange risk

Foreign exchange risk arises principally from the local group's exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

The table below shows an analysis of financial assets and liabilities (excluding financial instruments relating to HSBC Life Assurance (Malta) Limited) between balances denominated in euro and those denominated in other currencies. Information relating to HSBC Life insurance business is disclosed in note 4(f).

4 Financial risk management *(continued)*

e *Market risk (continued)*

v *Foreign exchange risk (continued)*

	Reporting currency	*In USD*	*In GBP*	*Other currencies*	*Total*
	2016	**2016**	**2016**	**2016**	**2016**
	€000	**€000**	**€000**	**€000**	**€000**
Group					
Assets					
Balances with Central Bank of Malta, Treasury Bills and cash	**120,353**	**875**	**971**	**219**	**122,418**
Items in the course of collection from other banks	**16,316**	**113**	**354**	**13**	**16,796**
Held for trading derivatives	**7,781**	**2,653**	**900**	**1**	**11,335**
Available-for-sale financial investments	**730,312**	**179,142**	**132,482**	**6,613**	**1,048,549**
Loans and advances to banks	**788,595**	**72,314**	**23,686**	**111,496**	**996,091**
Loans and advances to customers	**3,303,859**	**12,088**	**2,728**	**1,657**	**3,320,332**
Other assets	**20,016**	**7,487**	**424**	**149**	**28,076**
Total assets	**4,987,232**	**274,672**	**161,545**	**120,148**	**5,543,597**
Liabilities					
Held for trading derivatives	**7,070**	**3,755**	**903**	**3**	**11,731**
Deposits by banks	**2,041**	**8,729**	**–**	**–**	**10,770**
Customer accounts	**4,473,072**	**251,667**	**156,401**	**119,696**	**5,000,836**
Subordinated liabilities	**87,418**	**–**	**–**	**–**	**87,418**
Other liabilities	**60,948**	**11,490**	**452**	**203**	**73,093**
Total liabilities	**4,630,549**	**275,641**	**157,756**	**119,902**	**5,183,848**
Net open position	**356,683**	**(946)**	**3,789**	**246**	

	Reporting currency	*In USD*	*In GBP*	*Other currencies*	*Total*
	2015	2015	2015	2015	2015
	€000	€000	€000	€000	€000
Group					
Assets					
Balances with Central Bank of Malta, Treasury Bills and cash	185,059	1,355	940	209	187,563
Items in the course of collection from other banks	12,331	84	134	10	12,559
Held for trading derivatives	6,984	3,811	94	8	10,897
Available-for-sale financial investments	858,514	185,489	149,756	5,033	1,198,792
Loans and advances to banks	577,658	133,802	36,872	93,079	841,411
Loans and advances to customers	3,248,564	29,465	4,596	1,990	3,284,615
Other assets	29,831	1,636	494	28	31,989
Total assets	4,918,941	355,642	192,886	100,357	5,567,826
Liabilities					
Held for trading derivatives	7,264	4,258	98	10	11,630
Deposits by banks	3,254	10,955	–	77	14,286
Customer accounts	4,333,265	331,349	186,197	99,446	4,950,257
Subordinated liabilities	87,363	–	–	–	87,363
Other liabilities	30,173	2,186	585	53	32,997
Total liabilities	4,461,319	348,748	186,880	99,586	5,095,533
Net open position	457,622	6,894	6,006	771	

4 **Financial risk management** *(continued)*

e *Market risk (continued)*

v Foreign exchange risk (continued)

	Reporting currency	*In USD*	*In GBP*	*Other currencies*	*Total*
	2016	**2016**	**2016**	**2016**	**2016**
	€000	**€000**	**€000**	**€000**	**€000**
Bank					
Assets					
Balances with Central Bank of Malta, Treasury Bills and cash	**120,353**	**875**	**971**	**219**	**122,418**
Items in the course of collection from other banks	**16,316**	**113**	**354**	**13**	**16,796**
Held for trading derivatives	**7,781**	**2,653**	**900**	**1**	**11,335**
Available-for-sale financial investments	**730,310**	**179,142**	**132,482**	**6,615**	**1,048,549**
Loans and advances to banks	**788,595**	**72,314**	**23,686**	**111,496**	**996,091**
Loans and advances to customers	**3,303,890**	**12,087**	**2,728**	**1,658**	**3,320,363**
Other assets	**20,016**	**7,487**	**424**	**149**	**28,076**
Total assets	**4,987,261**	**274,671**	**161,545**	**120,151**	**5,543,628**
Liabilities					
Held for trading derivatives	**7,071**	**3,755**	**903**	**2**	**11,731**
Deposits by banks	**2,041**	**8,729**	**–**	**–**	**10,770**
Customer accounts	**4,521,134**	**259,502**	**160,496**	**119,713**	**5,060,845**
Subordinated liabilities	**88,172**	**–**	**–**	**–**	**88,172**
Other liabilities	**60,948**	**11,490**	**452**	**203**	**73,093**
Total liabilities	**4,729,766**	**283,476**	**161,851**	**119,918**	**5,244,611**
Net open position	**257,495**	**(8,805)**	**(306)**	**233**	

	Reporting currency	*In USD*	*In GBP*	*Other currencies*	*Total*
	2015	2015	2015	2015	2015
	€000	€000	€000	€000	€000
Bank					
Assets					
Balances with Central Bank of Malta, Treasury Bills and cash	185,059	1,355	940	209	187,563
Items in the course of collection from other banks	12,331	84	134	10	12,559
Held for trading derivatives	6,984	3,811	94	8	10,897
Available-for-sale financial investments	858,514	185,489	149,756	5,033	1,198,792
Loans and advances to banks	465,165	133,802	36,872	93,079	728,918
Loans and advances to customers	3,256,764	29,465	4,596	1,990	3,292,815
Other assets	29,831	1,636	494	28	31,989
Total assets	4,814,648	355,642	192,886	100,357	5,463,533
Liabilities					
Held for trading derivatives	7,264	4,258	98	10	11,630
Deposits by banks	3,254	10,955	–	77	14,286
Customer accounts	4,399,423	338,224	191,219	99,452	5,028,318
Subordinated liabilities	88,146	–	–	–	88,146
Other liabilities	30,173	2,186	585	53	32,997
Total liabilities	4,528,260	355,623	191,902	99,592	5,175,377
Net open position	286,388	19	984	765	

4 Financial risk management *(continued)*

e *Market risk (continued)*

v *Foreign exchange risk (continued)*

The bank essentially manages this risk by matching asset and liability positions in each respective foreign currency, as much as is practicable. The bank maintains exposures to foreign currencies within prescribed limits. The bank's ALCO is responsible for oversight over the foreign currency risk management process, whereby oversight and intra-day net positions are monitored.

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f *Insurance risk*

The local group operates an integrated bancassurance model which provides wealth and protection insurance products principally for customers with whom the local group has a banking relationship. Insurance products are sold through all global businesses, predominantly by RBWM and CMB. The subsidiary also holds a portfolio of unit-linked investment products and non-linked insurance products that were transferred from HSBC Life (Europe) Limited during 2014.

The majority of the risk in the local group's insurance business derives from manufacturing activities and can be categorised as insurance risk and financial risk. Insurance risk is the risk, other than financial risk, of loss transferred from the holder of the insurance contract to the issuer, the local group's insurance subsidiary company.

The risk under any insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, this risk is random and therefore unpredictable.

For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the principal risk that the local group faces under its insurance contracts is that the actual claims and benefit payments exceed the carrying amount of the insurance liabilities. This could occur because the frequency or severity of claims and benefits are greater than estimated. Insurance events are random and the actual number and amount of claims and benefits will vary from year to year and from the estimate established using statistical techniques.

Experience shows that the larger the portfolio of similar insurance contracts, the smaller the relative variability about the expected outcome will be. The local group uses reinsurance appropriately to reduce variability of the expected outcome. Factors that aggravate insurance risk include lack of risk diversification in terms of type and amount of risk and geographical location. For contracts with Discretionary Participation Feature (DPF), the participating nature of these contracts result in a significant portion of the insurance risk being shared with the insured party.

Frequency and severity of claims

For contracts where death is the insured risk, the most significant factors that could increase the overall frequency of claims are epidemics or wide spread changes in lifestyle resulting in earlier or more claims than expected.

At present these risks do not vary significantly in relation to the location of the risk insured by the local group. However, undue concentration by amounts could have an impact on the severity of benefit payments on a portfolio basis.

For contracts with fixed and guaranteed and fixed future premiums, there are no mitigating terms and conditions that reduce the insurance risk accepted. For contracts with DPF, the participating nature of the contracts results in a portion of the insurance risk being reduced over the term of the policy. Investment contracts with DPF carry negligible insurance risk.

The local group manages its insurance risk through strict underwriting limits and claims management; approval procedures for new products and pricing reviews; close monitoring of reinsurance arrangements and monitoring of emerging issues.

The local group's underwriting strategy is intended to ensure that the risks underwritten are well diversified in terms of type of risk and the level of insured benefits. For example, the local group balances death risk across its portfolio. Medical selection is also included in the local group's underwriting procedures, with premium varied to reflect the health condition and family medical history of the applicants.

4 **Financial risk management** *(continued)*

f *Insurance risk (continued)*

Sources of uncertainty in the estimation of future benefit payments and premium receipts

Uncertainty in the estimation of future benefit payments and premium receipts for long-term insurance contracts arises from the unpredictability of long-term changes in overall levels of mortality, and the variability in contract holder behaviour. The local group uses appropriate base tables of standard mortality according to the type of contract being written. The local group does not take credit for future lapses in determining the liability of long-term contracts.

The technical provisions in respect of long-term life insurance contracts are subject to quarterly valuations by the Approved Actuary based on data and information provided by the local group. The technical provisions are calculated in accordance with the Insurance Business (Assets and Liabilities) Regulations, 2007.

The following table provides an analysis of the insurance risk exposures by type of business:

	2016	2015
	€000	€000
Life insurance (non-linked)		
Insurance contracts with discretionary participation feature	**324,996**	316,298
Term assurance and other long-term contracts	**114,976**	109,145
Total non-linked	**439,972**	425,443
Life insurance (linked)	**205,589**	191,214
Liabilities under insurance contracts issued	**645,561**	616,657

The local group's insurance subsidiary company is exposed to financial risk through its financial assets, financial liabilities (investment contracts), reinsurance assets and insurance liabilities. In particular, the key financial risk is that the proceeds from its financial assets are not sufficient to fund the obligation arising from its insurance and investment contracts. The most important components of this financial risk are market risk, credit risk and liquidity risk.

General nature of participation feature and unit-linked contracts

The local group offers savings with-profit policies which participate in the investment returns of the with-profit funds. At least 90% of the eligible investment return is attributed to the contract holders. Policyholders receive regular (reversionary) bonus. A Regular bonus rate is declared yearly in advance. This rate may be reviewed upwards during the course of the year based on the performance of the fund. This provides a progressive build-up of guaranteed benefits over the lifetime of the policy. Regular bonuses are set by the Board on the recommendation of the Appointed Actuary. Therefore, on assets held to back the with-profits portfolio, the local group's exposure to financial risk is limited to 10%.

For unit-linked insurance and investment contracts, the local group matches all the liabilities on which the unit prices are based with assets in the unit-linked portfolios. There is therefore no equity price, currency, credit or interest risk exposure for these contracts which is borne by the local group.

HSBC's life insurance business is exposed to a range of financial risks, including market risk, credit risk and liquidity risk. The nature and management of these risks is described below.

i Market risk

Interest rate risk

The insurance subsidiary's exposure to interest rate changes is concentrated in its non-linked investment portfolio. Changes in investment values attributable to interest rate changes are mitigated by partially offsetting changes in the economic value of insurance provisions. The local group monitors this exposure through periodic reviews of its asset and liability positions. Estimates of future cash flows, as well as the impact of interest rate fluctuations on its investment portfolio and insurance liabilities, are modelled and reviewed quarterly. Interest rate risks in the insurance subsidiary company is minimised primarily by matching estimated future cash outflows to be paid to policyholders by expected cash flows from assets. The pool of investments backing liabilities is managed within strict duration limits that ensure that the net effect of interest rate changes on assets and liabilities is manageable.

4 Financial risk management *(continued)*

f *Insurance risk (continued)*

i Market risk (continued)

Exchange risk

The insurance subsidiary company is exposed to currency risk on its investment portfolio and to 10% of the investments backing contracts with DPF. The net exposure amounts to €4,261,000 and a sensitivity analysis is not deemed necessary.

The insurance subsidiary company hedges a selection of foreign currency-denominated securities using foreign exchange forward contracts, in order to mitigate the risk that the principal value of cash flows on these investments fluctuate as a result of changes in foreign exchange rates.

Equity price risk

The insurance subsidiary company manages the equity risk arising from its holdings of equity securities by setting limits on the maximum market value of equities that it may hold. Equity risk is also monitored by estimating the effect of predetermined movements in equity prices on the profit and total net assets of the insurance underwriting business.

Sensitivity analysis

The local group performs various sensitivity analysis on these assumptions. An immediate and permanent movement in interest yield curves or equity prices as at the reporting date would have the following impact on the profit for the year and net assets at that date:

	Impact on profits and net assets for the year	
	2016	2015
	€000	€000
+100 basis points shift in yield curves	**(248)**	81
-100 basis points shift in yield curves	**(79)**	(283)
+10 per cent shift in equity prices	**756**	346
-10 per cent shift in equity prices	**(782)**	(347)

The impact of the above sensitivity analysis on other comprehensive income in respect of the available-for-sale investments held by the insurance subsidiary company is negligible.

ii Credit risk

The main areas where the insurance subsidiary company is exposed to credit risk are:

– reinsurers' share of insurance liabilities;

– amounts due from reinsurers in respect of claims already paid;

– investment portfolios of debt securities; and

– call and term deposits.

The insurance subsidiary company structures the levels of credit risk it accepts by placing limits on its exposure to investment grade single counterparty, or groups of counterparties, and to geographical and industry segments. Investment credit exposures positions are reviewed on a quarterly basis by the insurance subsidiary company's Asset Liability Committee.

The selection of reinsurers also includes restrictions designed to minimise the risk of credit exposure.

The insurance subsidiary company currently manages the majority of reinsurance risk through using AA-reinsurers. The creditworthiness of reinsurers is confirmed from public rating information and considered on an annual basis by reviewing their financial strength prior to finalisation of any contract.

The third party banks with whom cash and cash equivalents are held are rated A and above.

Investments in bonds are made within the credit limits permitted within the investment credit risk mandate conferred by HSBC Group.

4 Financial risk management *(continued)*

f *Insurance risk (continued)*

ii Credit risk (continued)

The following table presents the analysis of debt securities within the insurance business by rating agency (Standard and Poor's Rating Agency):

	Debt securities – Unit linked		*Debt securities – Others*		*Total*	
	2016	2015	**2016**	2015	**2016**	2015
	€000	€000	**€000**	€000	**€000**	€000
AAA	**11,651**	12,042	**16,479**	13,395	**28,130**	25,437
AA+ to AA-	**7,655**	14,217	**78,819**	74,573	**86,474**	88,790
A+ to A-	**57,918**	34,946	**138,353**	46,921	**196,271**	81,867
BBB+ to BBB-	**61,163**	69,668	**42,178**	130,214	**103,341**	199,882
BB+ to B-	**149,026**	97,329	**1,642**	–	**150,668**	97,329
Lower than B-	**19,001**	10,501	**–**	–	**19,001**	10,501
Unrated	**49,024**	99,005	**10,900**	10,002	**59,924**	109,007
Total	**355,438**	337,708	**288,371**	275,105	**643,809**	612,813

iii Liquidity risk

It is an inherent characteristic of almost all insurance contracts that there is uncertainty over the amount and the timing of settlement of claims liabilities that may arise, and this leads to liquidity risk. As part of the management of this exposure, estimates are prepared for most lines of insurance business of cash flows expected to arise from insurance funds at the reporting date. The insurance subsidiary company actively manages its assets in such a manner as to match the profile of liabilities while achieving a competitive rate of return within the prevailing risk objectives delineated by asset liquidity and credit quality.

The following table shows the expected maturity of insurance and investment liabilities as well as the residual maturity of financial assets as at reporting date.

	No fixed maturity	*Due within 3 months*	*Due between 3 and 12 months*	*Due between 1 year and 5 years*	*Due after 5 years*	*Total*
	€000	**€000**	**€000**	**€000**	**€000**	**€000**
At 31 December 2016						
Financial investments	**750,607**	**13,715**	**47,055**	**177,593**	**405,446**	**1,394,416**
Reinsurance assets	**85,228**	**–**	**–**	**–**	**–**	**85,228**
Cash	**141,175**	**–**	**–**	**–**	**–**	**141,175**
	977,010	**13,715**	**47,055**	**177,593**	**405,446**	**1,620,819**

	On demand	*Due within 3 months*	*Due between 3 and 12 months*	*Due between 1 year and 5 years*	*Due after 5 years*	*Total*
	€000	**€000**	**€000**	**€000**	**€000**	**€000**
Liabilities to customers:						
– insurance contracts	**–**	**20,376**	**60,717**	**231,483**	**377,204**	**689,780**
– investment contracts	**898,760**	**230**	**521**	**6,113**	**29,746**	**935,370**
	898,760	**20,606**	**61,238**	**237,596**	**406,950**	**1,625,150**

4 Financial risk management *(continued)*

f *Insurance risk (continued)*

iii Liquidity risk (continued)

	No fixed maturity	*Due within 3 months*	*Due between 3 and 12 months*	*Due between 1 year and 5 years*	*Due after 5 years*	*Total*
	€000	€000	€000	€000	€000	€000
At 31 December 2015						
Financial investments	771,353	17,681	49,046	189,217	356,869	1,384,166
Reinsurance assets	83,088	–	–	–	–	83,088
Cash	183,302	–	–	–	–	183,302
	1,037,743	17,681	49,046	189,217	356,869	1,650,556

	On demand	*Due within 3 months*	*Due between 3 and 12 months*	*Due between 1 year and 5 years*	*Due after 5 years*	*Total*
	€000	€000	€000	€000	€000	€000
Liabilities to customers:						
– insurance contracts	–	17,053	41,957	164,293	437,243	660,546
– investment contracts	955,990	419	3,894	4,939	27,875	993,117
	955,990	17,472	45,851	169,232	465,118	1,653,663

The methodology used for estimating liquidity risk can be found below:

- Linked Insurance Reserves are derived via undiscounted cash flows on a statutory basis. No future premiums are assumed and investment returns are not included in the provisions. All decrements are considered.
- Linked Investment Reserves are also derived via undiscounted cash flows on a statutory basis but only consider contractual maturities and no other form of decrement.
- Non-Linked Reserve is derived via undiscounted statutory reserves run-off on a reporting basis. All future premiums are considered and provisions based on all expected decrements. The timing of cash flows is based on the expected run-off of the reserve.

5 Fair value of financial and non-financial instruments

i *Valuation of financial instruments*

All financial instruments are recognised initially at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of a financial instrument on initial recognition is generally its transaction price (that is, the fair value of the consideration given or received). However, sometimes the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the local group recognises a trading gain or loss on day 1, being the difference between the transaction price and the fair value. When significant unobservable parameters are used, the entire day 1 gain or loss is deferred and is recognised in the income statement over the life of the transaction until the transaction matures, is closed out, the valuation inputs become observable, or when the local group enters into an offsetting transaction.

5 Fair value of financial and non-financial instruments *(continued)*

i Valuation of financial instruments (continued)

The fair value of financial instruments is generally measured on an individual basis. However, in cases where HSBC manages a group of financial assets and liabilities according to its net market or credit risk exposure, the local group measures the fair value of the group of financial instruments on a net basis but presents the underlying financial assets and liabilities separately in the financial statements, unless they satisfy the IFRS offsetting criteria as described in note 3(g).

ii Control framework

Fair values are subject to a control framework designed to ensure that they are either determined, or validated, by a function independent of the risk-taker.

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilised. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, the local group will source alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable. The factors that are considered in this regard are, inter alia:

– the extent to which prices may be expected to represent genuine traded or tradable prices;

– the degree of similarity between financial instruments;

– the degree of consistency between different sources;

– the process followed by the pricing provider to derive the data;

– the elapsed time between the date to which the market data relates and the reporting date; and

– the manner in which the data was sourced.

For fair values determined using a valuation model, the control framework may include, as applicable, development or validation by independent support functions of (i) the logic within valuation models; (ii) the inputs to those models; (iii) any adjustments required outside the valuation models; and, where possible, (iv) model outputs. Valuation models are subject to a process of due diligence and calibration before becoming operational and are calibrated against external market data on an ongoing basis.

iii Fair value hierarchy

Fair values are determined according to the following hierarchy:

a *Level 1 – valuation technique using quoted market price:* financial instruments with quoted prices for identical instruments in active markets.

b *Level 2 – valuation technique using observable inputs:* financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

c *Level 3 – valuation technique with significant unobservable inputs:* financial instruments valued using models where one or more significant inputs are unobservable.

5 Fair value of financial and non-financial instruments *(continued)*

iv Critical accounting estimates and judgements

The best evidence of fair value is a quoted price in an actively traded market. The fair values of financial instruments that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities issued. Where a financial instrument has a quoted price in an active market, the fair value of the total holding of the financial instrument is calculated as the product of the number of units and quoted price.

The judgement as to whether a market is active may include, but is not restricted to, the consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads. The bid/offer spread represents the difference in prices at which a market participant would be willing to buy compared with the price at which they would be willing to sell.

In the event that the market for a financial instrument is not active, a valuation technique is used. Valuation techniques may incorporate assumptions about factors that other market participants would use in their valuations, including:

- the likelihood and expected timing of future cash flows on the instrument. Judgement may be required to assess the counterparty's ability to service the instrument in accordance with its contractual terms. Future cash flows may be sensitive to changes in market rates;
- selecting an appropriate discount rate for the instrument. Judgement is required to assess what a market participant would regard as the appropriate spread of the rate for an instrument over the appropriate risk-free rate;
- judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivative products.

A range of valuation techniques is employed, dependent on the instrument type and available market data. Most valuation techniques are based upon discounted cash flow analyses, in which expected future cash flows are calculated and discounted to present value using a discounting curve. Prior to considering credit risk, the expected future cash flows may be known, as would be the case for the fixed leg of an interest rate swap, or may be uncertain and require projection, as would be the case for the floating leg of an interest rate swap. 'Projection' utilises market forward curves, if available. In option models, the probability of different potential future outcomes is considered. In addition, the value of some products are dependent on more than one market factor, and in these cases is typically necessary to consider how movements in one market factor may affect the other market factors.

The model inputs necessary to perform such calculations include interest rate yield curves, exchange rates, volatilities, correlations, prepayment and default rates.

The majority of valuation techniques employ only observable market data. However certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are unobservable, and for them the derivation of fair value is more judgemental. An instrument in its entirety is classified as valued using significant unobservable inputs if, in the opinion of management, a significant proportion of the instrument's inception profit ('day 1 gain or loss') or greater than 5% of the instrument's carrying value is driven by unobservable inputs. 'Unobservable' in this context means that there is little or no current market data available from which to determine the price at which an arm's length transaction would be likely to occur. It generally does not mean that there is no data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used).

5 Fair value of financial and non-financial instruments *(continued)*

v Disclosures in respect of fair values of financial instruments carried at fair value

The following table sets out the financial instruments by fair value hierarchy:

	Valuation techniques			
	Quoted market price	*Using observable inputs*	*With significant unobservable inputs*	
	Level 1	Level 2	Level 3	Total
	€000	**€000**	**€000**	**€000**
Group				
At 31 December 2016				
Assets				
Treasury bills	**–**	**39,998**	**–**	**39,998**
Held for trading derivatives	**–**	**11,440**	**–**	**11,440**
Financial assets designated at fair value attributable to insurance operations	**1,277,490**	**100,276**	**5,840**	**1,383,606**
Available-for-sale financial investments	**1,052,451**	**2**	**747**	**1,053,200**
	2,329,941	**151,716**	**6,587**	**2,488,244**
Liabilities				
Held for trading derivatives	**–**	**12,600**	**–**	**12,600**
Liabilities under investment contracts	**840,578**	**89,074**	**1,285**	**930,937**
	840,578	**101,674**	**1,285**	**943,537**
At 31 December 2015				
Assets				
Treasury bills	–	103,998	–	103,998
Held for trading derivatives	–	11,492	–	11,492
Financial assets designated at fair value attributable to insurance operations	1,206,807	163,276	2,401	1,372,484
Available-for-sale financial investments	1,196,538	7,078	22	1,203,638
	2,403,345	285,844	2,423	2,691,612
Liabilities				
Held for trading derivatives	–	11,732	–	11,732
Liabilities under investment contracts	863,225	121,381	2,402	987,008
	863,225	133,113	2,402	998,740
Bank				
At 31 December 2016				
Assets				
Treasury bills	**–**	**39,998**	**–**	**39,998**
Held for trading derivatives	**–**	**11,335**	**–**	**11,335**
Available-for-sale financial investments	**1,047,802**	**–**	**747**	**1,048,549**
	1,047,802	**51,333**	**747**	**1,099,882**
Liabilities				
Held for trading derivatives	**–**	**11,731**	**–**	**11,731**
	–	**11,731**	**–**	**11,731**
At 31 December 2015				
Assets				
Treasury bills	–	103,998	–	103,998
Held for trading derivatives	–	10,897	–	10,897
Available-for-sale financial investments	1,191,695	7,097	–	1,198,792
	1,191,695	121,992	–	1,313,687
Liabilities				
Held for trading derivatives	–	11,630	–	11,630
	–	11,630	–	11,630

5 Fair value of financial and non-financial instruments *(continued)*

v Disclosures in respect of fair values of financial instruments carried at fair value (continued)

No transfers of financial instruments between different levels of the fair value hierarchy have occurred during the financial years ended 31 December 2016 and 2015. The following table shows a reconciliation of the fair value measurements in Level 3 of the fair value hierarchy:

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Level 3				
Financial assets designated at fair value through profit or loss				
At 1 January	**2,402**	6,553	**–**	–
Disposal of assets	**(1,027)**	(4,195)	**–**	–
Purchases	**4,555**	–	**–**	–
(Losses)/gains recognised in profit or loss - offset through loss on linked liabilities	**(90)**	44	**–**	–
At 31 December 2016	**5,840**	2,402	**–**	–
Available-for-sale financial investments				
At 1 January	**–**	–	**–**	–
Acquisition of preferred stock in Visa Inc.	**747**	–	**747**	–
At 31 December 2016	**747**	–	**747**	–

The financial assets at fair value through profit or loss categorised within Level 3 comprise holding of units in collective investment schemes. These holdings consist of shares in alternative funds which are unlisted and have illiquid price sources. In view of the absence of quoted market prices or observable inputs for modelling value, the fair value of the shares held is derived using the net asset value as sourced from the respective custodians, which is not supported by audited financial statements.

The units in collective investment schemes categorised as Level 3 are held to cover linked liabilities and accordingly, corresponding liabilities to customers under investment contracts are also categorised as Level 3. Investment risk attributable to these Level 3 assets is borne by the policyholder in view of the policyholder's decision to invest in such assets. Accordingly, the disclosure of key unobservable inputs to Level 3 financial instruments and the sensitivity of Level 3 fair value to reasonably possible alternatives in respect of significant unobservable assumptions was not deemed necessary and relevant.

The available-for-sale financial assets categorised within Level 3 relate predominantly to the local group's investment in the preferred stock of Visa Inc. acquired as part of the consideration for the purchase of Visa Europe Limited by Visa Inc. (refer to notes 11 and 27).

The purpose of the preferred stock categorised as Level 3 is to provide protection to Visa Inc. against potential risk associated with multilateral interchange fees linked to the activity of Visa Europe Limited. The fair value of this stock is dependent on changes in the risk of litigation, in particular around the assumption on the percentage of successful claims that will be settled over time which will reduce the outstanding preferred stock. Based on the fair value of preferred stock the Directors deemed that any changes to significant assumptions will be immaterial and the sensitivity analysis in respect of significant unobservable assumptions is deemed unnecessary.

vi Disclosures in respect of fair values of non-financial instruments carried at fair value

Fair valuation of property

The local group's land and buildings within property, plant and equipment and investment property, were revalued on 31 December 2016 by an independent firm of property valuers having appropriate recognised professional qualifications and experience in the location and category of the property being valued. The Directors have reviewed the carrying amounts of the properties as at 31 December 2016, on the basis of the valuations carried out by the independent property valuers.

5 Fair value of financial and non-financial instruments *(continued)*

vi Disclosures in respect of fair values of non-financial instruments carried at fair value (continued)

Fair valuation of property (continued)

Valuations were made on the basis of open market value taking cognisance of the specific location of the properties, the size of the sites together with their development potential, the availability of similar properties in the area, and whenever possible, having regard to recent market transactions for similar properties in the same location.

As reflected in note 33 ‘Property, plant and equipment’, the carrying amounts of the local group’s land and buildings within property, plant and equipment as at 31 December 2016 were adjusted to reflect the properties’ estimated open market value. No adjustments to the carrying amount of the local group’s land and buildings were deemed necessary during 2015. The carrying amount of investment property both at 31 December 2016 and 2015 was adjusted to reflect the properties’ estimated open market value on an individual asset level.

The local group is required to analyse non-financial assets carried at fair value by level of the fair value hierarchy within which the recurring fair value measurements are categorised in their entirety (Level 1, 2 or 3). The different levels of the fair value hierarchy have been defined above as fair value measurements using:

– Quoted prices (unadjusted) in active markets for identical assets (Level 1);

– Inputs other than quoted prices included within Level 1 that are observable for the asset, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2);

– Inputs for the asset that are not based on observable market data (that is, unobservable inputs) (Level 3).

The local group’s land and buildings, within property, plant and equipment, comprised, commercial branches, bank offices and other operational premises. Investment property comprises commercial property leased out as offices to third parties including the local group’s intermediate parent (note 53). All the recurring property fair value measurements at 31 December 2016 and 2015 use significant unobservable inputs and are accordingly categorised within Level 3 of the fair valuation hierarchy.

The local group’s policy is to recognise transfers into and out of fair value hierarchy levels as of the beginning of the reporting period. There were no transfers between different levels of the fair value hierarchy during the years ended 31 December 2016 and 2015.

A reconciliation from the opening balance to the closing balance of land and buildings for recurring fair value measurements categorised within Level 3 of the value hierarchy for both owner occupied and investment property is reflected in the tables in notes 32 and 33 respectively.

Valuation Processes

The valuations of the properties are performed regularly on the basis of valuation reports prepared by independent and qualified valuers. These reports are based on both:

– information provided by the local group which is derived from the bank’s financial systems and is subject to the bank’s overall control environment; and

– assumptions and valuation models used by the valuers – the assumptions are typically market-related. These are based on professional judgement and market observation.

The information provided to the valuers, together with the assumptions and the valuation models used by the valuers, are reviewed by the Chief Financial Officer (CFO). This includes a review of fair value movements over the period. When the CFO considers that the valuation report is appropriate, the valuation report is recommended to the Audit Committee. The Audit Committee considers the valuation report as part of its overall responsibilities.

At the end of every reporting period, the CFO assesses whether any significant changes or developments have been experienced since the last external valuation. This is supported by an assessment performed by the independent firm of property valuers.

5 Fair value of financial and non-financial instruments *(continued)*

vi Disclosures in respect of fair values of non-financial instruments carried at fair value (continued)

Valuation Techniques

The external valuations of the Level 3 property have been performed using predominantly the traditional investment method of valuation based on the capitalised rentals approach. In view of the limited market information available, the valuations have been performed using unobservable inputs. In relation to the capitalised rentals approach, the significant unobservable inputs include a capitalisation rate applied at 5.50% – 8.00% (2015: 5.80% – 9.22%), which is effectively the discount rate adjusted for anticipated growth, and the expected annual rental value (ERV) taking into account the rental rate per square metre for comparable properties located in proximity to the local group's property with adjustments for differences in the size, age, exact location and condition of the property. Effectively, the capitalisation rate indicates the return the investor expects to receive through annual rental value.

	At 31 December 2016			
Description by class based on highest and best use	*Fair value*	*Valuation technique*	*Significant unobservable input*	*Range of unobservable inputs (weighted average)*
	€000			**€**
Current use as commercial branches, bank offices and other related premises	**43,935**	Capitalised Rental Approach	Rental Rate per square metre	40 – 200 (100)
Current use as third party offices	**10,180**	Capitalised Rental Approach	Rental Rate per square metre	(150)

	At 31 December 2015			
Description by class based on highest and best use	*Fair value*	*Valuation technique*	*Significant unobservable input*	*Range of unobservable inputs (weighted average)*
	€000			€
Current use as commercial branches, bank offices and other related premises	41,743	Capitalised Rental Approach	Rental Rate per square metre	40 – 200 (120)
Current use as third party offices	10,876	Capitalised Rental Approach	Rental Rate per square metre	(150)

The higher the rental rate per square metre, the higher the resultant fair valuation. Conversely, the lower the capitalisation rate the higher the fair value. The highest and best use of the properties reflected in the tables above is equivalent to their current use.

5 Fair value of financial and non-financial instruments *(continued)*

vii Disclosures in respect of fair values of financial instruments not carried at fair value

Certain financial assets and liabilities are either carried at amortised cost or cost less impairment. The fair values of these financial assets and liabilities are not disclosed given that the carrying amount is a reasonable approximation of fair value because these are either re-priced to current market rates frequently or are short-term in nature.

The following table sets out the carrying amounts of these financial assets and liabilities:

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Assets				
Balances with Central Bank of Malta and cash	**82,420**	83,565	**82,420**	83,565
Items in the course of collection from other banks	**16,796**	12,559	**16,796**	12,559
Loans and advance to banks	**1,077,859**	841,411	**996,091**	728,918
Loans and advance to customers	**3,320,332**	3,284,615	**3,320,363**	3,292,815
Accrued interest	**28,767**	37,852	**18,541**	28,475
Other assets	**8,698**	2,003	**8,698**	2,003
	4,534,872	4,262,005	**4,442,909**	4,148,335
Liabilities				
Deposits by banks	**10,770**	14,286	**10,770**	14,286
Customer accounts	**5,000,836**	4,950,257	**5,060,845**	5,028,318
Subordinated liabilities	**87,418**	87,363	**88,172**	88,146
Accrued interest	**5,538**	7,718	**5,265**	7,701
Other liabilities	**74,456**	28,678	**67,832**	25,296
	5,179,018	5,088,302	**5,232,884**	5,163,747

Loans and advances to banks and customers

Fair values are estimated using discounted cash flows, applying market rates, and are fairly close to carrying amounts principally in view of the local group's ability to reprice at its discretion. These estimates are considered Level 2 fair value estimates.

Deposits by banks and customer accounts

Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of a deposit repayable on demand is approximated by its carrying value. These are considered Level 2 fair value estimates.

Subordinated liabilities

The fair value of these liabilities based on quoted market prices at the reporting date, without deduction for transaction costs, amounts to €90,067,000 as at 31 December 2016 (2015: €90,713,000). The fair value is determined under Level 1 of the fair value hierarchy.

6 Capital risk management

The local group's approach to capital management is driven by its strategic and organisational requirements, taking into account the regulatory, economic and commercial environment in which it operates. The local group's objective is to maintain a strong capital base to support the risks inherent in its business and to meet regulatory capital requirements at all times. To achieve this, the local group manages capital within the context of an annual capital plan which is approved by the Board and which determines the optimal amount and mix of capital required to support planned business growth and meet regulatory capital requirements. Capital generated in excess of planned requirements is returned to shareholders in the form of dividends.

The impact of the local group's capital plan on shareholder returns is therefore recognised by the level of equity capital employed for which the local group seeks to maintain a prudent balance between the advantages and flexibility afforded by a strong capital position and the higher returns on equity from increased leverage.

The local group manages its capital requirements based on internal targets, which are set above the prescribed minimum levels established within the CRR.

For regulatory purposes, the local group's capital base is divided into two main categories, namely Common Equity Tier 1 (CET1) capital and Tier 2 capital, depending on the degree of permanency and loss absorbency exhibited. CET 1 capital is the highest quality form of capital, comprising shareholders' equity. Under the CRR various capital deductions and regulatory adjustments are made against these items – these include deductions for intangible assets and deferred tax assets that rely on future profitability. Tier 2 capital comprises eligible subordinated debt issued.

The local group's assessment and measurement of capital adequacy is aligned with regulatory requirements and with the bank's assessment of risk, including credit, market and operational risks. To determine the capital required for Pillar 1 risks, the local group utilises the Standardised Approach for credit risk and operational risk and the Basic Method for foreign exchange risk in order to calculate the Pillar 1 minimum capital requirements. For credit risk, under the Standardised Approach, risk weights are determined according to credit ratings provided by internationally recognised credit agencies such as S&P or their equivalents and by using the applicable regulatory risk weights for unrated exposures. For operational risk, the group divides its activities into business lines set out in Article 317 of the CRR and multiply the capital requirements by 12.5% to derive the risk-weighted assets. The Basic Method requires the bank to allocate 8% of its overall net foreign exchange position to calculate the capital requirement for foreign exchange risk.

The local group conducts an internal capital adequacy assessment process (ICAAP) to determine a forward looking assessment of our capital requirements given its business strategy, risk profile, risk appetite and capital plan. This process incorporates the risk management processes and governance framework. A range of stress tests are applied to the base capital plan.

The ICAAP is examined by a joint supervisory team appointed under the SSM regulation as part of its supervisory review and evaluation process, which occurs periodically to enable the regulator to define the individual capital guidance or minimum capital requirements for the bank and the capital planning buffer where required.

Compliance with the capital plan as well as with regulatory capital measures is monitored by the Asset Liability and Capital Management team and reported to ALCO on a monthly basis.

The following is an analysis of the local group's capital base in accordance with the CRR's requirements. 'Group' figures in the table below represent the consolidated capital position of the local group within the meaning of the CRR, which differs from the scope of consolidation for financial reporting under IFRSs. For regulatory reporting purposes, subsidiaries engaged in insurance activities are excluded from the regulatory consolidation and deducted from regulatory capital subject to thresholds.

6 Capital risk management *(continued)*

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Common Equity Tier 1 (CET1) capital				
Called up share capital	**108,092**	108,092	**108,092**	108,092
Retained earnings	**324,099**	306,548	**271,078**	251,047
Revaluation reserve	**24,736**	18,713	**24,734**	18,507
Adjustments:				
– Depositor Compensation Scheme	**(26,932)**	(30,831)	**(26,932)**	(30,831)
– Intangible assets	**(5,424)**	(7,610)	**(5,424)**	(7,610)
– Expected final dividend	**(9,510)**	(6,230)	**(9,510)**	(6,230)
– Retained earnings – HSBC Life Assurance (Malta) Limited	**(52,820)**	(55,905)	**–**	–
– Investment property revaluation reserve	**–**	(2,710)	**–**	(2,710)
– Other	**(36)**	(119)	**5**	243
	362,205	329,948	**362,043**	330,508
Tier 2 capital				
Subordinated loan capital	**10,912**	28,390	**10,912**	28,390
Revaluation reserve	**41,226**	46,476	**41,224**	46,268
Subordinated loan to Life Assurance (Malta) Limited	**–**	(8,200)	**–**	(8,200)
Transitional adjustments to Tier 2 capital:				
– Property revaluation reserve	**(16,274)**	(9,910)	**(16,274)**	(9,910)
– Unrealised gains and losses	**(8,462)**	(8,805)	**(8,462)**	(8,597)
– Investment property revaluation reserve	**–**	1,626	**–**	1,626
	27,402	49,577	**27,400**	49,577
Total own funds	**389,607**	379,525	**389,443**	380,085

7 Interest and similar income

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
On loans and advances to banks	**204**	1,209	**204**	1,209
On loans and advances to customers	**127,350**	133,068	**127,467**	133,375
On balances with Central Bank of Malta	**7**	17	**7**	17
	127,561	134,294	**127,678**	134,601
On debt and other fixed income instruments	**23,869**	25,833	**23,630**	25,425
Amortisation of net premiums	**(9,368)**	(9,560)	**(9,327)**	(9,504)
	14,501	16,273	**14,303**	15,921
	142,062	150,567	**141,981**	150,522

Interest income recognised on impaired loans and advances, which is entirely included in interest income on loans and advances to customers, amounted to €2,465,000 (2015: €2,894,000).

8 Interest expense

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
On deposits by banks	**324**	184	**324**	184
On customer accounts	**10,860**	18,901	**10,898**	19,004
On subordinated liabilities	**4,451**	4,446	**4,451**	4,446
	15,635	23,531	**15,673**	23,634

9 Net fee income

	Group		Bank	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Fee income earned on:				
– financial assets or liabilities not at fair value through profit or loss, other than fees included in effective interest rate calculations	**15,660**	16,242	**17,381**	18,704
– trust and other fiduciary activities where the local group holds or invests in assets on behalf of its customers	**7,289**	9,675	**1,315**	2,089
– other	**2,754**	3,155	**2,334**	2,630
	25,703	29,072	**21,030**	23,423
Fee expense	**(1,951)**	(2,509)	**(1,376)**	(1,801)
	23,752	26,563	**19,654**	21,622

Net fee income amounting to €1,299,000 (2015: €2,059,000) is derived from the investment services activities of the local group.

10 Net trading income

	2016	2015
	€000	€000
Group/Bank		
Net income from foreign exchange activities	**6,874**	8,834
Net income/(loss) from held for trading financial instruments	**402**	(444)
	7,276	8,390

11 Net gains on sale of available-for-sale financial investments

These represent net fair value gains on available-for-sale investments originally recognised in other comprehensive income which have been reclassified to profit or loss upon the sale of the investments.

The amount of €10,787,000 entirely represents the gain on the disposal of the membership interest in Visa Europe Limited.

On 21 June 2016 (the transaction closing date), Visa Inc. completed its purchase of Visa Europe Limited, in which the bank held a €10 redeemable membership share, with limited value attached to the share. The terms of this purchase were such that Visa Europe Limited sells its entire issued share capital to Visa Inc., and member shareholders, including the bank, receive a mixture of cash and preferred stock in Visa Inc. in exchange for their membership share in Visa Europe Limited. The bank's share of consideration was made up as follows:

- Cash consideration of €9,426,000;
- Deferred cash consideration of €864,000 to be paid out on expiry of a three-year period from the transaction closing date; and
- Preferred stock of Visa Inc. with a face value of €3,767,000.

The purpose of the preferred stock is to provide Visa Inc. protection against potential litigation risk associated with multilateral interchange fees linked to the activity of Visa Europe Limited. The bank received newly issued preferred stock of Visa Inc., which is tradeable only among holders of the same stock. The preferred stock will be converted into freely tradeable Class A common stock of Visa Inc. (or an equivalent class of shares) over time. The conversion rate will be periodically adjusted to reflect any change in the litigation risk, in order to reimburse Visa Inc. for the costs of any successful claims; so that over time, the litigation risk and accordingly the outstanding preferred stock should decrease.

Each share of the bank's preferred stock will be convertable into 13.952 shares of Visa Inc. class A common stock. Upon announcement of the transaction, the bank attributed a fair value of €724,000 to its share of preferred stock in Visa Inc. Because quotes from a liquid and active market are not available for the instrument, its fair value has been established with a significant element of internal own assumptions, as explained in note 27.

11 Net gains on sale of available-for-sale financial investments *(continued)*

Should the value of the preferred stock fall to zero, or the cost of litigation in respect of UK & Ireland claims and mainland Europe claims exceed €1 billion, a loss share agreement (LSA) signed by the HSBC Group in November 2015 would allow for a claim to be made by Visa Inc. to cover excess litigation costs.

The current estimate of total future litigation costs is below the threshold which triggers the LSA.

12 Dividend income

Dividend income for the bank amounts to €10,567,000 (2015: €1,231,000) and represents dividend received from a subsidiary company.

13 Net insurance premium income

	Non-linked life insurance	*Linked life insurance*	*Total*
	€000	**€000**	**€000**
Group			
Gross insurance premium income	**35,673**	**22,248**	**57,921**
Reinsurers' share of gross premium income	**(4,543)**	**–**	**(4,543)**
Year ended 31 December 2016	**31,130**	**22,248**	**53,378**
Gross insurance premium income	36,944	22,895	59,839
Reinsurers' share of gross premium income	(4,596)	–	(4,596)
Year ended 31 December 2015	32,348	22,895	55,243

14 Net other operating income

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Operating income				
Rental income from investment property	**907**	910	**815**	806
Gains arising on disposal of re-possessed properties	**940**	377	**940**	377
Other income	**68**	345	**307**	325
	1,915	1,632	**2,062**	1,508
Other operating items	**(9)**	(6)	**(9)**	(6)
Fair value changes in respect of investment property	**(522)**	(1,077)	**(717)**	(1,000)
	(531)	(1,083)	**(726)**	(1,006)
	1,384	549	**1,336**	502

15 Net insurance claims, benefits paid and movement in liabilities to policyholders

	Group	
	2016	2015
	€000	€000
Claims, benefits and surrenders paid	**39,959**	46,384
Movement in liabilities	**28,904**	24,278
Gross claims, benefits paid and movement in liabilities	**68,863**	70,662
Reinsurers' share of claims, benefits and surrenders paid	**(3,413)**	(1,889)
Reinsurers' share of movement in liabilities	**(2,113)**	2,317
Reinsurers' share of claims, benefits paid and movement in liabilities	**(5,526)**	428
	63,337	71,090

16 Loan impairment charges

	2016	2015
	€000	€000
Group/Bank		
Write-downs		
Loans and advances to customers		
– specific allowances	**(11,133)**	(24,453)
– collective allowances	**(5,080)**	(5,940)
– bad debts written off	**(3,328)**	(11,223)
	(19,541)	(41,616)
Other instruments		
– specific allowances	**–**	(244)
Reversals of write-downs		
Loans and advances to customers		
– specific allowances	**4,296**	21,657
– collective allowances	**4,872**	6,299
– bad debts recovered	**1,291**	3,078
	10,459	31,034
Other instruments		
– specific allowances	**52**	–
	(9,030)	(10,826)

17 Provision for brokerage remediation costs

During the year, the local group and the bank recognised a provision amounting to €8,000,000 for a customer remediation programme (refer to note 42) in respect of a legacy operational and regulatory failure in the bank's brokerage business, which has been wound down during 2014. The failure relates to 'execution only' trades effected by customers purchasing complex instruments through the bank, wherein the bank failed to undertake the appropriateness test in accordance with the requirements stipulated within Markets in Financial Instruments Directive (MiFID). The bank has self-identified and self-reported the issue to the supervisory authorities.

In line with HSBC's commitment to the highest standards of conduct and fairness, this amount reflects the estimated cost of ensuring that customers affected by this specific issue are not disadvantaged.

18 Employee compensation and benefits

	Group		Bank	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Wages, salaries and allowances	**47,123**	47,666	**44,619**	45,006
Defined contribution social security costs	**2,672**	2,696	**2,530**	2,560
Termination benefits	**2,610**	17,623	**2,557**	17,209
Share-based payments	**247**	500	**247**	492
	52,652	68,485	**49,953**	65,267
	Number	*Number*	*Number*	*Number*
Average number of employees				
– executive and senior managerial	**296**	299	**275**	277
– other managerial, supervisory and clerical	**1,045**	1,090	**994**	1,038
– others	**16**	25	**16**	25
	1,357	1,414	**1,285**	1,340

During the year ended 31 December 2015, the local group introduced an early retirement scheme for employees. The estimated expenditure attributable to this scheme, recognised in profit or loss during the preceding year and reflected within termination benefits in the table above, amounts to €14,668,000 for the local group and €14,255,000 for the bank. The amount comprises the estimated payments to 140 employees who applied for the scheme.

Termination benefits for 2015 also comprise payments and other costs attributable to other employees that opted for voluntary early retirement prior to the scheme referred to above, together with related expenditure.

Share-based payments

In order to align the interests of staff with those of shareholders, share options in ordinary shares of the ultimate parent company are offered to local group employees under all-employee share plans and restricted share awards are awarded to local group senior management under discretionary incentive plans. The local group offered share options to its employees under savings related share option plans and HSBC Holdings Group share option plans.

In view of the fact that these share option plans are expiring and are being replaced by Share Match (refer to note below), the share-based payment income statement charge attributable to these share option plans is insignificant. Accordingly, the disclosures required by IFRS 2 in relation to these option plans have not been deemed necessary taking cognisance of the impact of these plans on the financial results and financial position of the local group.

Awards to local group employees also comprise restricted share awards (including Group Performance Share Plans GPSP) referred to above. An assessment of performance over the relevant period is used to determine the amount of the award to be granted. Deferred awards generally require employees to remain in employment over the vesting period and are not subject to performance conditions after the grant date. GPSP awards vest after five years, whereas other deferred awards generally vest over a period of three years. Vested shares may be subject to a retention requirement (restriction) post vesting. GPSP awards are retained until cessation of employment.

In view of the insignificant impact of HSBC restricted share awards on the local group's income statement charge, the other IFRS 2 disclosure requirements attributable to share-based payment arrangements are not being presented in these financial statements.

During the preceding financial year, the local group's employees were invited to join Share Match, an HSBC International Employee Share Purchase Plan to acquire shares in HSBC Holdings plc. Under this Plan, HSBC Holdings plc commenced granting matching award shares to the local group's employees subject to a three year service condition. The share-based payment is classified as equity-settled since the share-based payment transactions with the employees are settled by the transfer of shares of HSBC Holdings plc. An employee is required to specify a monthly deduction (subject to a cap) from the salary for buying shares on a quarterly basis at the then current fair value (investment shares). For every three investment shares bought, the employees will receive an additional free share (matching share) on the third anniversary of the scheme (the vesting date) provided the employee remains employed and retains the investment shares until the end of the three-year holding period. The impact of this plan on the local group's financial results and financial position is insignificant, and accordingly the disclosures required by IFRS 2 in relation to share-based payment arrangements have not been deemed necessary.

19 Profit before tax

Profit before tax is stated after charging auditors' fees (excluding VAT) amounting to €220,000 (2015: €220,000) in relation to the annual statutory audit of the financial statements.

General and administration expenses are analysed as follows:

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Premises and equipment costs	**5,084**	4,979	**5,084**	4,979
IT support and telecommunication costs	**9,492**	9,163	**8,593**	8,642
Insurance, security and maintenance costs	**14,032**	14,995	**14,032**	14,995
Investment management and administrator fees	**2,092**	1,635	**–**	–
Actuarial services	**504**	812	**–**	–
Other administrative expenses	**11,701**	11,970	**10,728**	10,499
	42,905	43,554	**38,437**	39,115

Other administrative expenses mainly comprise professional expenses, licences and permits, and other services or expense items which are incurred in the course of the operations of the local group and the bank.

20 Tax expense

The local group's and the bank's tax expense recognised in profit or loss is analysed below:

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
– current	**15,467**	22,607	**16,080**	19,055
– deferred	**6,541**	(5,315)	**5,061**	(5,064)
	22,008	17,292	**21,141**	13,991

The tax recognised in profit or loss on the local group's and the bank's profit before tax differs from the theoretical amount that would arise using the applicable tax rate as follows:

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Profit before tax	**62,221**	46,772	**63,834**	37,452
Tax at the applicable rate of 35%	**21,777**	16,370	**22,342**	13,108
Tax effect of:				
Non-taxable income	**(7)**	–	**(1,397)**	–
Income taxed at different rates	**(321)**	(8)	**(255)**	–
Non-deductible expenses	**294**	483	**186**	484
Disallowed expense arising from depreciation of property, plant and equipment	**186**	189	**186**	189
Deferred taxation on fair value gains arising on property determined on the basis applicable to property disposals	**–**	58	**–**	36
Further allowances on rental income	**(57)**	(56)	**(57)**	(56)
Others	**136**	256	**136**	230
Tax on profit on ordinary activities	**22,008**	17,292	**21,141**	13,991

20 Tax expense *(continued)*

The tax impacts, which are entirely attributable to deferred taxation, relating to components of other comprehensive income and accordingly presented directly in equity are as follows:

	2016			2015		
	Before tax	*Tax (charge) /credit*	*Net of tax*	*Before tax*	*Tax (charge) /credit*	*Net of tax*
	€000	**€000**	**€000**	€000	€000	€000
Group						
Fair valuation of available-for-sale investments:						
– Net changes in fair value	**(585)**	**206**	**(379)**	4,938	(1,727)	3,211
– Fair value gains reclassified to profit or loss on disposal	**(10,787)**	**3,774**	**(7,013)**	(682)	238	(444)
Fair valuation of properties	**2,554**	**(255)**	**2,299**	–	1,199	1,199
	(8,818)	**3,725**	**(5,093)**	4,256	(290)	3,966
Bank						
Fair valuation of available-for-sale investments:						
– Net changes in fair value	**(432)**	**152**	**(280)**	5,187	(1,815)	3,372
– Fair value gains reclassified to profit or loss on disposal	**(10,787)**	**3,774**	**(7,013)**	(683)	239	(444)
Fair valuation of properties	**2,554**	**(255)**	**2,299**	–	1,201	1,201
	(8,665)	**3,671**	**(4,994)**	4,504	(375)	4,129

21 Earnings per share

Basic earnings per share is calculated by dividing the net profit attributable to equity holders of the local group by the weighted average number of ordinary shares in issue during the year. The profit attributable to equity holders of the local group amounted to €40,213,000 (2015: €29,480,000), while the weighted average number of ordinary shares in issue was 360,306,099 (2015: 354,614,103). The basic earnings per share of the local group amounted to 11.2c (2015: 8.5c). The local group has no instruments or arrangements which give rise to dilutive potential ordinary shares, and accordingly diluted earnings per share is equivalent to basic earnings per share.

22 Balances with Central Bank of Malta, Treasury Bills and cash

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Balances with Central Bank of Malta	**48,575**	48,258	**48,575**	48,258
Malta Government Treasury Bills – classified as available-for-sale	**39,998**	103,998	**39,998**	103,998
Cash	**33,845**	35,307	**33,845**	35,307
	122,418	187,563	**122,418**	187,563

The average reserve deposit held for the relevant maintenance period with the Central Bank of Malta in terms of Regulation (EC) No. 1745/2003 of the European Central Bank amounted to €48,873,000 (2015: €48,350,000).

23 Financial assets designated at fair value attributable to insurance operations

	Group	
	2016	2015
	€000	€000
Debt, Treasury Bills and other fixed income instruments	**638,406**	607,970
Equity and other non-fixed income instruments	**765,250**	782,267
Policy loans	**(20,050)**	(17,753)
	1,383,606	1,372,484

a *Debt, Treasury Bills and other fixed income instruments*

	Group	
	2016	2015
	€000	€000
Issued by public bodies		
– local government	**90,851**	98,836
– foreign governments	**136,928**	117,164
Issued by other bodies		
– local banks	**2,774**	3,640
– foreign banks	**127,895**	133,675
– other local issuers	**7,372**	5,810
– other foreign issuers	**272,586**	248,845
	638,406	607,970
Listing status		
– listed on the Malta Stock Exchange	**100,996**	108,285
– listed on other recognised exchanges	**495,500**	434,684
– foreign unlisted	**41,910**	65,001
	638,406	607,970
At 1 January	**607,970**	664,981
Acquisitions	**169,013**	185,518
Disposals	**(211,266)**	(208,871)
Changes in fair value	**72,689**	(33,658)
At 31 December	**638,406**	607,970

23 Financial assets designated at fair value attributable to insurance operations *(continued)*

b *Equity and other non-fixed income instruments*

	Group	
	2016	2015
	€000	€000
Issued by other bodies		
– local banks	**258**	173
– foreign banks	**9,005**	8,870
– other local issuers	**94,286**	84,437
– other foreign issuers	**661,701**	688,787
	765,250	782,267
Listing status		
– listed on the Malta Stock Exchange	**18,949**	16,007
– listed on other recognised exchanges	**164,843**	156,817
– local unlisted	**75,594**	68,602
– foreign unlisted	**505,864**	540,841
	765,250	782,267
At 1 January	**782,267**	770,440
Acquisitions	**141,930**	205,454
Disposals	**(165,066)**	(227,709)
Changes in fair value	**6,119**	34,082
At 31 December	**765,250**	782,267

As at 31 December 2016 and 2015, the bank had no financial assets designated at fair value through profit or loss.

24 Held for trading derivatives

The local group transacts derivatives primarily to create risk management solutions for clients. This includes the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. As part of this process, the local group considers the customers' suitability in respect of the respective risks involved and the business purpose underlying the transaction. The local group's derivative instruments also comprise contracts managed in conjunction with financial instruments designated at fair value, which are attributable to insurance operations.

The local group manages its derivative risk positions principally through offsetting derivative transactions with HSBC Group entities. For accounting purposes, all derivative instruments are classified as held for trading.

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Derivative assets				
Held for trading	**11,440**	11,492	**11,335**	10,897
Derivative liabilities				
Held for trading	**12,600**	11,732	**11,731**	11,630

24 Held for trading derivatives *(continued)*

Derivatives held for trading

	Notional	*Fair value assets*	*Notional*	*Fair value liabilities*
	2016	**2016**	**2016**	**2016**
	€000	**€000**	**€000**	**€000**
Group				
Foreign exchange derivatives				
Currency forwards	**165,663**	**4,622**	**194,367**	**4,435**
Currency options	**2,847**	**265**	**2,847**	**265**
		4,887		**4,700**
Interest rate derivatives				
Interest rate swaps	**181,520**	**6,544**	**181,520**	**7,091**
Equity derivatives				
Equity-indexed options	**6,127**	**9**	**6,673**	**809**
Total derivatives		**11,440**		**12,600**

	Notional	*Fair value assets*	*Notional*	*Fair value liabilities*
	2015	2015	2015	2015
	€000	€000	€000	€000
Group				
Foreign exchange derivatives				
Currency forwards	159,853	3,170	218,751	3,325
Currency options	21,980	868	21,980	870
		4,038		4,195
Interest rate derivatives				
Interest rate swaps	210,796	6,258	210,796	6,840
Equity derivatives				
Equity-indexed options	34,376	1,196	27,413	697
Total derivatives		11,492		11,732

	Notional	*Fair value assets*	*Notional*	*Fair value liabilities*
	2016	**2016**	**2016**	**2016**
	€000	**€000**	**€000**	**€000**
Bank				
Foreign exchange derivatives				
Currency forwards	**70,275**	**4,518**	**72,172**	**4,366**
Currency options	**2,847**	**265**	**2,847**	**265**
		4,783		**4,631**
Interest rate derivatives				
Interest rate swaps	**181,520**	**6,544**	**181,520**	**7,092**
Equity derivatives				
Equity-indexed options	**3,040**	**8**	**3,040**	**8**
Total derivatives		**11,335**		**11,731**

24 Held for trading derivatives *(continued)*

Derivatives held for trading (continued)

	Notional	*Fair value assets*	*Notional*	*Fair value liabilities*
	2015	2015	2015	2015
	€000	€000	€000	€000
Bank				
Foreign exchange derivatives				
Currency forwards	102,922	3,096	102,966	3,245
Currency options	21,980	868	21,980	870
		3,964		4,115
Interest rate derivatives				
Interest rate swaps	210,796	6,258	210,796	6,840
Equity derivatives				
Equity-indexed options	20,449	675	20,449	675
Total derivatives		10,897		11,630

The notional contract amounts of derivatives indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts of risk.

Currency forwards represent commitments to purchase and sell pre-established amounts of currencies, and are gross settled.

Currency options are contractual agreements under which the local group grants the customer the right, but not the obligation, either to buy (a call option) or sell (a put option) at or by a set date or during a set period, a specific amount of a foreign currency at a pre-determined price. These options are negotiated between the local group and customers (OTC).

Interest rate swaps are commitments to exchange one set of cash flows for another (for example, fixed rate for floating rate). Usually, no exchange of principal takes place.

Most of these positions are covered by back-to-back derivative transactions with HSBC Group entities, managing the market risk arising from these positions. Any market risk retained locally is managed within approved local trading mandates.

The local group also enters into equity indexed options to hedge the risk arising from structured deposits which pay a participation reflecting the growth in specific equity indices. The table above includes both the derivatives embedded within the structured deposits, which are separated from the host contract, in accordance with the requirements of IAS 39, as well as the derivatives entered into with HSBC Group entities to offset the financial risks to the local group from such structured deposits.

25 Loans and advances to banks

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Repayable on call and at short notice	**554,552**	715,664	**472,784**	603,171
Term loans and advances	**523,307**	125,747	**523,307**	125,747
	1,077,859	841,411	**996,091**	728,918

26 Loans and advances to customers

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Repayable on call and at short notice	**262,040**	297,472	**262,040**	297,472
Term loans and advances	**3,109,653**	3,033,835	**3,109,684**	3,042,035
Gross loans and advances to customers	**3,371,693**	3,331,307	**3,371,724**	3,339,507
Allowances for uncollectibility	**(51,361)**	(46,692)	**(51,361)**	(46,692)
Net loans and advances to customers	**3,320,332**	3,284,615	**3,320,363**	3,292,815
Allowances for uncollectibility				
– individually assessed allowances	**43,966**	39,505	**43,966**	39,505
– collectively assessed allowances	**7,395**	7,187	**7,395**	7,187
	51,361	46,692	**51,361**	46,692

Interest in suspense as at the end of the reporting period amounted to €23,792,000 (2015: €38,985,000).

Loans with a carrying amount of €11,637,000 (2015: €90,496,000) have been pledged against the provision of credit lines by the Central Bank of Malta. At 31 December 2016, no balances were outstanding under these credit lines.

27 Available-for-sale financial investments

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Debt securities and other fixed income instruments	**1,052,451**	1,196,538	**1,047,802**	1,191,695
Equity and other non-fixed income instruments	**749**	7,100	**747**	7,097
	1,053,200	1,203,638	**1,048,549**	1,198,792

a *Debt securities and other fixed income instruments*

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Issued by public bodies				
– local government	**582,925**	669,208	**582,925**	669,208
– foreign governments	**304,716**	158,918	**300,067**	154,075
Issued by other bodies				
– foreign banks	**–**	109,392	**–**	109,392
– other foreign issuers	**164,810**	259,020	**164,810**	259,020
	1,052,451	1,196,538	**1,047,802**	1,191,695
Listing status				
– listed on the Malta Stock Exchange	**582,925**	669,208	**582,925**	669,208
– listed on other recognised exchanges	**469,526**	527,330	**464,877**	522,487
	1,052,451	1,196,538	**1,047,802**	1,191,695
At 1 January	**1,196,538**	1,153,862	**1,191,695**	1,137,678
Exchange adjustments	**(13,356)**	64,908	**(13,356)**	64,908
Amortisation of premium/discount	**(9,237)**	(9,686)	**(9,196)**	(9,630)
Additions	**109,914**	301,611	**109,914**	301,611
Disposals/redemptions	**(227,110)**	(312,019)	**(227,110)**	(300,985)
Changes in fair value	**(4,298)**	(2,138)	**(4,145)**	(1,887)
At 31 December	**1,052,451**	1,196,538	**1,047,802**	1,191,695

27 Available-for-sale financial investments *(continued)*

a *Debt securities and other fixed income instruments(continued)*

Debt instruments with a carrying amount of €64,785,000 (2015: €67,451,000) have been pledged against the provision of credit lines by the Central Bank of Malta. At 31 December 2016, no balances were outstanding under these credit lines. In addition debt securities with a carrying amount of €27,698,000 (2015: €29,981,000) have been pledged in terms of the Depositor Compensation Scheme (refer to note 46).

The financial investments which are denominated in currencies other than the reporting currency are economically hedged through balances in corresponding currencies mainly forming part of Customer accounts and Deposits by banks. Thus, the exchange adjustment reflected above does not result in an exchange gain or loss recognised in profit or loss.

b *Equity and other non-fixed income instruments*

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Issued by issuers other than public bodies and banks				
– local issuers	**7**	8	**5**	5
– foreign issuers	**742**	7,092	**742**	7,092
	749	7,100	**747**	7,097
Listing status				
– listed on the Malta Stock Exchange	**7**	8	**5**	5
– foreign issuers	**742**	7,092	**742**	7,092
	749	7,100	**747**	7,097
At 1 January	**7,100**	22	**7,097**	19
Acquisitions	**724**	–	**724**	–
Disposals	**(10,787)**	–	**(10,787)**	–
Changes in fair value	**3,712**	7,078	**3,713**	7,078
At 31 December	**749**	7,100	**747**	7,097

Equity instruments predominantly comprise preferred stock of Visa Inc., which were received by the bank in exchange for its membership interest in Visa Europe Limited, as part of a transaction in which Visa Europe Limited was acquired by Visa Inc. (refer to note 11).

The preferred stock are convertible into ordinary shares of Visa Inc. they have no maturity and represent a residual interest in the issuer's net assets. The holder of the preferred stock is exposed to litigation risk borne by their issuer, and hence the value of these shares depends on the level and success of any future litigation, which is for obvious reasons impossible to accurately forecast.

The purpose of the preferred stock is to provide Visa Inc. with protection against all litigation risk associated with interchange fees linked to the activity of Visa Europe Limited. This feature can be considered to be an embedded derivative that doesn't require separation and thus does not alter the available-for-sale equity treatment of the preferred stock.

The conversion ratio adjustment feature transfers specific litigation risk of Visa Inc. to the holders of the preferred stock, including to the bank. The conversion ratio adjustment is dependent upon the uncertain outcome of litigation, which is still in an embryonic stage.

Due to the lack of any more recent developments, it is not possible to create an actuarial model to assess the future litigation costs, and the estimation arrived at for the purposes of these financial statements therefore remains the best available forecast.

As further notifications, claims and settlements evolve, the bank will re-evaluate the likely litigation cost as part of the fair valuation process. The current estimation has been factored into an internal valuation model for the preferred stock, also taking into account the phasing of partial conversions of the preferred stock which was assumed by Visa Europe Limited's legal advisors.

As at the reporting date, there was no impairment loss on the group's equity and other non-fixed income instruments.

28 Prepayments and accrued income

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Accrued income	**30,125**	39,468	**19,378**	29,986
Prepayments	**1,053**	1,395	**995**	1,319
	31,178	40,863	**20,373**	31,305

29 Reinsurance assets

	Group	
	2016	2015
	€000	€000
Life insurance assets (non-linked)		
Long-term insurance contracts	**84,343**	79,011
Claims outstanding	**2,097**	5,316
Other payables	**(1,212)**	(1,239)
	85,228	83,088

30 Non-current assets held for sale

At 31 December 2016, the fair value of assets acquired in satisfaction of debt amounted to €9,750,000 (2015: €11,347,000). Repossessed properties are made available for sale in an orderly fashion, with the proceeds used to reduce or repay the outstanding indebtedness. The local group does not generally occupy repossessed properties for its business use. Repossessed properties consist mainly of immovable property that had been pledged as collateral by customers.

31 Investments in subsidiaries

Bank

Name of company	*Nature of business*	*Equity interest*	**2016**	2015
		%	**€000**	€000
HSBC Life Assurance (Malta) Limited	Life insurance	**99.99**	**28,578**	28,578
HSBC Global Asset Management (Malta) Limited	Portfolio management services	**99.99**	**2,281**	5,940
HSBC Stockbrokers (Malta) Limited	Stockbroking Services	**99.99**	**–**	23
			30,859	34,541

In November 2016, HSBC Global Asset Management (Malta) Limited reduced its ordinary share capital to a level that better reflects the regulatory capital required to support the current level of operations and risks undertaken.

During 2016, the voluntary winding up of HSBC Stockbrokers (Malta) Limited was completed.

Additionally, during the year ended 31 December 2016 HSBC Insurance Management Services (Europe) Limited merged with HSBC Life Assurance (Malta) Limited, its immediate parent company.

All subsidiaries are incorporated in Malta.

32 Investment property

	Fair Value	Cost	Fair Value	Cost
	2016	**2016**	2015	2015
	€000	**€000**	€000	€000
Group				
Freehold land and buildings				
As at 1 January	**15,458**	**10,503**	16,326	10,294
Additions	**35**	**35**	209	209
Disposals	**(1,945)**	**(1,945)**	–	–
Fair value adjustments	**(522)**	**–**	(1,077)	–
At 31 December	**13,026**	**8,593**	15,458	10,503
Bank				
Freehold land and buildings				
As at 1 January	**10,876**	**6,707**	11,667	6,498
Additions	**21**	**21**	209	209
Fair value adjustments	**(717)**	**–**	(1,000)	–
At 31 December	**10,180**	**6,728**	10,876	6,707

During the year ended 31 December 2016, €907,000 (2015: €910,000) was recognised as rental income in profit or loss relating to investment property of the local group. The bank recognised €815,000 (2015: €806,000) as rental income, which was received from a Group company. Related repair and maintenance expenses incurred by the bank and the local group on these properties are reimbursed by the tenant.

The local group's investment property is fair valued annually by an independent firm of property values having appropriate recognised professional qualifications and experience in the location and category of the property being valued. Fair values are determined on the basis of open market value taking cognisance of the specific location of the property, the size of the site together with its development potential, the availability of similar properties in the area and, whenever possible, having regard to recent market transactions for similar properties in the same location.

33 Property, plant and equipment

	Land and buildings	Computer equipment	Others	Total
	€000	**€000**	**€000**	**€000**
Group				
Cost/revaluation				
At 1 January 2016	**43,456**	**19,872**	**47,042**	**110,370**
Additions	**92**	**92**	**1,490**	**1,674**
Revaluation	**1,531**	**–**	**–**	**1,531**
Disposals	**(90)**	**(164)**	**(848)**	**(1,102)**
At 31 December 2016	**44,989**	**19,800**	**47,684**	**112,473**
Accumulated depreciation and impairment losses				
At 1 January 2016	**1,713**	**15,905**	**34,193**	**51,811**
Depreciation charge for the year	**369**	**1,168**	**2,008**	**3,545**
Effects of revaluation	**(1,023)**	**–**	**–**	**(1,023)**
Disposals	**(5)**	**(164)**	**(838)**	**(1,007)**
At 31 December 2016	**1,054**	**16,909**	**35,363**	**53,326**
Carrying amount at 1 January 2016	**41,743**	**3,967**	**12,849**	**58,559**
Carrying amount at 31 December 2016	**43,935**	**2,891**	**12,321**	**59,147**

33 Property, plant and equipment *(continued)*

	Land and buildings	*Computer equipment*	*Others*	*Total*
	€000	€000	€000	€000
Group				
Cost/revaluation				
At 1 January 2015	43,827	19,197	45,001	108,025
Additions	45	737	1,891	2,582
Disposals	–	(62)	(266)	(328)
Reclassifications	(416)	–	416	–
At 31 December 2015	43,456	19,872	47,042	110,370
Accumulated depreciation and impairment losses				
At 1 January 2015	1,314	14,834	32,396	48,544
Depreciation charge for the year	399	1,133	2,043	3,575
Disposals	–	(62)	(246)	(308)
At 31 December 2015	1,713	15,905	34,193	51,811
Carrying amount at 1 January 2015	42,513	4,363	12,605	59,481
Carrying amount at 31 December 2015	41,743	3,967	12,849	58,559

	Land and buildings	*Computer equipment*	*Others*	*Total*
	€000	**€000**	**€000**	**€000**
Bank				
Cost/revaluation				
At 1 January 2016	**43,554**	**19,649**	**46,839**	**110,042**
Additions	**92**	**92**	**1,490**	**1,674**
Revaluation	**1,531**	**–**	**–**	**1,531**
Disposals	**(89)**	**(164)**	**(848)**	**(1,101)**
At 31 December 2016	**45,088**	**19,577**	**47,481**	**112,146**
Accumulated depreciation and impairment losses				
At 1 January 2016	**1,713**	**15,677**	**33,993**	**51,383**
Depreciation charge for the year	**369**	**1,165**	**2,007**	**3,541**
Effects of revaluation	**(1,023)**	**–**	**–**	**(1,023)**
Disposals	**(5)**	**(164)**	**(838)**	**(1,007)**
At 31 December 2016	**1,054**	**16,678**	**35,162**	**52,894**
Carrying amount at 1 January 2016	**41,841**	**3,972**	**12,846**	**58,659**
Carrying amount at 31 December 2016	**44,034**	**2,899**	**12,319**	**59,252**
Cost/revaluation				
At 1 January 2015	43,925	18,974	44,798	107,697
Additions	45	737	1,891	2,673
Disposals	–	(62)	(266)	(328)
Reclassifications	(416)	–	416	–
At 31 December 2015	43,554	19,649	46,839	110,042
Accumulated depreciation and impairment losses				
At 1 January 2015	1,314	14,614	32,196	48,124
Depreciation charge for the year	399	1,125	2,043	3,567
Disposals	–	(62)	(246)	(308)
At 31 December 2015	1,713	15,677	33,993	51,383
Carrying amount at 1 January 2015	42,611	4,360	12,602	59,573
Carrying amount at 31 December 2015	41,841	3,972	12,846	58,659

33 Property, plant and equipment *(continued)*

Land and buildings reported above are all utilised for own activities.

If the land and buildings were stated on the historical cost basis, the carrying amounts would be:

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
At 31 December				
Cost	**15,911**	15,819	**16,228**	16,136
Accumulated depreciation	**(2,082)**	(1,713)	**(2,082)**	(1,713)
Carrying amount	**13,829**	14,106	**14,146**	14,423

Valuations of land and buildings are carried out on a regular basis such that the carrying amount of property does not differ materially from that which would be determined using fair values at the end of the reporting period.

34 Intangible assets

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Software	**5,594**	7,793	**5,424**	7,610
Present value of in-force long-term insurance business	**60,171**	61,860	**–**	–
	65,765	69,653	**5,424**	7,610

a *Software*

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Cost				
At 1 January	**29,399**	27,557	**28,049**	26,339
Additions	**990**	1,842	**947**	1,710
At 31 December	**30,389**	29,399	**28,996**	28,049
Accumulated amortisation and impairment losses				
At 1 January	**21,606**	18,463	**20,439**	17,350
Amortisation and impairment charge for the year	**3,189**	3,143	**3,133**	3,089
At 31 December	**24,795**	21,606	**23,572**	20,439
Carrying amount at 1 January	**7,793**	9,094	**7,610**	8,989
Carrying amount at 31 December	**5,594**	7,793	**5,424**	7,610

Impairment losses, reversal of impairment losses and write-offs are recognised in General and administrative expenses.

34 Intangible assets *(continued)*

b *Present value of in-force long-term insurance business (PVIF)*

	Group	
	2016	2015
	€000	€000
At 1 January	**61,860**	64,877
Addition from current year new business	**5,898**	5,325
Movement from in-force business	**(7,587)**	(8,342)
At 31 December	**60,171**	61,860

The HSBC life insurance business is accounted for using the embedded value approach, which, inter alia, provides a comprehensive framework for the evaluation of insurance and related risks.

The following are the key assumptions used in the computation of the local group's PVIF in the current and comparative periods:

	2016	2015
	%	%
Risk free rate	**Euro Swap Curve**	Euro Swap Curve
Risk adjusted discount rate	**Euro swap curve + 50 Bps Operational Risk Margin**	Euro Swap Curve + 50Bps Operational Risk Margin
Expenses inflation	**French inflation swap curve modified for Malta**	French inflation swap curve modified for Malta
Lapse rate	**Different rates for different products**	Different rates for different products

The following table shows the effect on the PVIF of reasonably possible changes in the main economic assumptions across the life insurance business:

		PVIF Impact	
		2016	2015
Assumptions	**Movement**	**€000**	€000
Risk free rate	+100 basis points	**(2,837)**	(2,232)
Risk free rate	-100 basis points	**7,497**	2,981
Expenses inflation	+10%	**(964)**	(853)
Expenses inflation	-10%	**1,043**	919
Lapse rate	+100 basis points	**1,291**	867
Lapse rate	-100 basis points	**(1,994)**	(1,413)

35 Deferred tax

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

The following amounts determined after appropriate offsetting are shown in the statement of financial position:

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Deferred tax assets	**22,163**	22,642	**22,163**	22,590
Deferred tax liabilities	**(34,586)**	(32,249)	**(5,262)**	(4,299)
	(12,423)	(9,607)	**16,901**	18,291

Deferred taxes are calculated on all temporary differences under the liability method and are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled based on tax rates (and tax laws) that have been substantively enacted by the end of the reporting period. The principal tax rate used is 35% (2015: 35%), with the exception of deferred taxation on the fair valuation of non-depreciable property, which is computed on the basis applicable to disposals of immovable property i.e. principally tax effect of 10% (2015: 10%) of the transfer value.

The balance at 31 December represents temporary differences attributable to:

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Depreciation of property, plant and equipment	**(1,798)**	(1,644)	**(1,790)**	(1,820)
Loan impairment allowances	**24,834**	28,529	**24,834**	28,529
Fair valuation of property	**(5,514)**	(4,761)	**(5,262)**	(4,299)
Fair value movements on available-for-sale investments	**(7,652)**	(11,266)	**(7,699)**	(11,462)
Value of in-force life insurance business	**(21,060)**	(21,651)	**–**	–
Fair value movement on policyholders' investments	**(8,007)**	(6,063)	**–**	–
Provisions for liabilities and other charges	**7,058**	8,007	**7,058**	7,862
Other	**(284)**	(758)	**(240)**	(519)
	(12,423)	(9,607)	**16,901**	18,291

The movement in deferred tax assets and liabilities during the year is as follows:

	Group			
	At 1 January 2016	*Recognised in profit or loss*	*Recognised in other comprehensive income*	*At 31 December 2016*
	€000	**€000**	**€000**	**€000**
Depreciation of property, plant and equipment	**(1,644)**	**(154)**	**–**	**(1,798)**
Loan impairment allowances	**28,529**	**(3,695)**	**–**	**24,834**
Fair valuation of property	**(4,761)**	**(498)**	**(255)**	**(5,514)**
Fair value movements on available-for-sale investments	**(11,266)**	**(366)**	**3,980**	**(7,652)**
Value of in-force life insurance business	**(21,651)**	**591**	**–**	**(21,060)**
Fair value movement on policyholders' investments	**(6,063)**	**(1,944)**	**–**	**(8,007)**
Provisions for liabilities and other charges	**8,007**	**(949)**	**–**	**7,058**
Other	**(758)**	**474**	**–**	**(284)**
	(9,607)	**(6,541)**	**3,725**	**(12,423)**

35 Deferred tax *(continued)*

	Group			
	At 1 January 2015	*Recognised in profit or loss*	*Recognised in other comprehensive income*	*At 31 December 2015*
	€000	€000	€000	€000
Depreciation of property, plant and equipment	(1,825)	181	–	(1,644)
Loan impairment allowances	30,210	(1,681)	–	28,529
Fair valuation of property	(6,418)	458	1,199	(4,761)
Fair value movements on available-for-sale investments	(10,148)	371	(1,489)	(11,266)
Value of in-force life insurance business	(22,707)	1,056	–	(21,651)
Fair value movement on policyholders' investments	(5,041)	(1,022)	–	(6,063)
Provisions for liabilities and other charges	435	7,572	–	8,007
Other	862	(1,620)	–	(758)
	(14,632)	5,315	(290)	(9,607)

	Bank			
	At 1 January 2016	*Recognised in profit or loss*	*Recognised in other comprehensive income*	*At 31 December 2016*
	€000	**€000**	**€000**	**€000**
Depreciation of property, plant and equipment	**(1,820)**	**30**	**–**	**(1,790)**
Loan impairment allowances	**28,529**	**(3,695)**	**–**	**24,834**
Fair valuation of property	**(4,299)**	**(708)**	**(255)**	**(5,262)**
Fair value movements on available-for-sale investments	**(11,462)**	**(163)**	**3,926**	**(7,699)**
Provisions for liabilities and other charges	**7,862**	**(804)**	**–**	**7,058**
Other	**(519)**	**279**	**–**	**(240)**
	18,291	**(5,061)**	**3,671**	**16,901**

	At 1 January 2015	*Recognised in profit or loss*	*Recognised in other comprehensive income*	*At 31 December 2015*
	€000	€000	€000	€000
Depreciation of property, plant and equipment	(2,125)	305	–	(1,820)
Loan impairment allowances	30,210	(1,681)	–	28,529
Fair valuation of property	(6,025)	525	1,201	(4,299)
Fair value movements on available-for-sale investments	(9,953)	67	(1,576)	(11,462)
Provisions for liabilities and other charges	435	7,427	–	7,862
Other	1,060	(1,579)	–	(519)
	13,602	5,064	(375)	18,291

The recognised deferred tax assets and liabilities are expected to be recovered or settled principally after more than 12 months from the end of the reporting period.

35 Deferred tax *(continued)*

Following changes to the taxation rules on capital gains arising on transfer of immovable property as announced by the Minister for Finance during the Budget Speech for the financial year 2015, and in respect of which a Bill entitled 'An Act to implement Budget measures for the financial year 2015 and other administrative measures' came into effect on 30 April 2015, the final tax on transfers of immovable property acquired after 1 January 2004 was reduced to 8% of the transfer value while the rate in respect of transfers of property acquired before 1 January 2004 was reduced to 10%. The net impact of the application of the changed tax regime on the deferred tax liability attributable to fair valuation of the local group's and the bank's property amounting to €1,199,000 and €1,201,000 respectively was recognised in other comprehensive income during 2015.

36 Other assets

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Committed letters of credit	**8,698**	2,003	**8,698**	2,003
Other	**12,395**	11,956	**7,912**	6,121
	21,093	13,959	**16,610**	8,124

Other assets include €2,008,000 (2015: €4,082,000) related to deferred acquisition costs on investment contracts.

37 Deposits by banks

	Group/Bank	
	2016	2015
	€000	€000
Term deposits	**119**	1,369
Repayable on demand	**10,651**	12,917
	10,770	14,286

38 Customer accounts

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Term deposits	**1,280,325**	1,451,879	**1,280,325**	1,451,879
Repayable on demand	**3,720,511**	3,498,378	**3,780,520**	3,576,439
	5,000,836	4,950,257	**5,060,845**	5,028,318

39 Accruals and deferred income

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Accrued interest	**5,538**	7,718	**5,265**	7,701
Other	**11,633**	22,355	**9,599**	16,197
	17,171	30,073	**14,864**	23,898

40 Liabilities under investment contracts

	Group	
	2016	2015
	€000	€000
At 1 January	**987,008**	1,030,928
Premiums received	**7,946**	54,783
Amounts paid on surrender and other terminations during the year	**(152,217)**	(132,702)
Changes in unit prices and other movements	**88,200**	33,999
At 31 December	**930,937**	987,008

41 Liabilities under insurance contracts

	Group	
	Gross	*Gross*
	2016	2015
	€000	€000
Life insurance (non-linked)		
Provisions for policyholders	**436,897**	419,318
Outstanding claims	**3,074**	6,125
Total non-linked	**439,971**	425,443
Life insurance (linked)		
Provisions for policyholders	**205,140**	190,735
Outstanding claims	**450**	479
Total linked	**205,590**	191,214
Total liabilities under insurance contracts	**645,561**	616,657

	Group			
	Non-linked business	*Linked business*	*All business*	
	Provisions for policy-holders	*Provisions for policy-holders*	*Outstanding claims*	*Total*
	2016	**2016**	**2016**	**2016**
	€000	**€000**	**€000**	**€000**
At 1 January	**419,318**	**190,735**	**6,604**	**616,657**
Premiums received	**–**	**22,248**	**–**	**22,248**
Other movements for the year	**17,579**	**6,832**	**(3,080)**	**21,331**
Account balances paid on surrender and other terminations during the year	**–**	**(14,675)**	**–**	**(14,675)**
At 31 December	**436,897**	**205,140**	**3,524**	**645,561**
	2015	2015	2015	2015
	€000	€000	€000	€000
At 1 January	411,839	175,565	4,974	592,378
Premiums received	–	22,895	–	22,895
Other movements for the year	7,479	(7,725)	1,630	1,384
At 31 December	419,318	190,735	6,604	616,657

42 Provisions for liabilities and other charges

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
At 1 January	**17,133**	2,417	**16,609**	2,417
Additional provisions/increase in provisions	**10,698**	16,414	**10,698**	15,631
Provisions utilised	**(10,129)**	(1,481)	**(10,005)**	(1,132)
Amounts reversed	**(71)**	(217)	**(71)**	(307)
At 31 December	**17,631**	17,133	**17,231**	16,609

At 31 December 2016, a provision of €8,000,000 (2015: nil) was recognised in respect of the estimated cost of brokerage remediation in relation to the 'execution only' trades effected by customers purchasing complex instruments, through the bank, without the bank undertaking an appropriateness test required by MiFID (refer to note 17).

During the year, the bank engaged a 'Group Business Review Team' that has experience in handling similar remediation projects in the UK to investigate the bank's failure, support the design of a remediation programme, carry out detailed estimates of the remediation costs and to eventually execute the programme.

The estimated liability for brokerage remediation was arrived at after taking into consideration transactions made by customers who dealt in complex bonds, equities and funds over the period of time during which the bank has failed to adhere strictly to the requirements stipulated within MiFID. This includes both customers who have purchased and sold such instruments while the bank was still undertaking the brokerage business, as well as customers whose portfolios were transferred to other institutions as a result of the bank's decision to wind down its brokerage business.

Remediation costs for customers that have sold such instruments through the bank's brokerage business were calculated by taking account of the exact amount of units that were purchased and eventually sold by those customers as well as the price at which those units were sold. In respect of instruments that were transferred to other institutions, the estimation for the remediation costs is based on current unit prices, assuming the customer still holds those instruments.

The classification of the instruments between those deemed complex and non-complex was carried out by the bank and was subject to an independent review carried out by third party firms specialised in the subject matter.

The remediation costs also include a provision for income/return that such customers would have received on non-complex instruments had they not dealt in such complex instruments, as well as for operational expenditure that is being incurred to execute the programme.

The liability is expected to be settled in full during 2017.

As at 31 December 2015 a provision amounting to €14,668,000 for the local group and of €14,255,000 for the bank had been recognised in respect of early retirement payments to a number of employees whose employment was to be terminated as part of the early retirement scheme referred in note 18. The provision reflected the full amount of payments agreed with the individual employees affected and this amount is reflected in note 18 'Employee compensation and benefits' presented under termination benefits.

Litigation provision as at 31 December 2016 amounted to €902,000 (2015: €517,000) for the bank and local group. This provision is expected to be settled after more than one year from the reporting date. The impact of discounting is not considered to be significant. The movement in those provisions for 2016 amounting to €385,000 (2015: decrease of €277,000) is recognised in profit or loss under 'General and administrative expenses'.

Based on legal advice, the Board believes that adequate provisions have been recognised, taking into consideration the timing and amount of the probable economic outflows required in respect of the litigation highlighted.

43 Subordinated liabilities

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
4.60% subordinated unsecured loan stock 2017	**58,219**	58,204	**58,219**	58,204
5.90% subordinated unsecured loan stock 2018	**29,199**	29,159	**29,953**	29,942
	87,418	87,363	**88,172**	88,146

These above liabilities will, in the event of the winding up of the bank, be subordinated to the claims of depositors and other creditors. The bank did not have any defaults of interest or other breaches with respect to its subordinated liabilities during the current and comparative periods.

44 Other liabilities

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Bills payable	**29,810**	12,169	**29,810**	12,169
Committed letters of credit	**8,698**	2,003	**8,698**	2,003
Other	**36,245**	15,569	**29,621**	12,187
	74,753	29,741	**68,129**	26,359

45 Called up share capital

	2016	2015
	€000	€000
Group/Bank		
Authorised		
470,000,000 ordinary shares of 30 cent each	**141,000**	141,000
Issued and fully paid up		
360,306,099 ordinary shares of 30 cent each	**108,092**	108,092

During the preceding year, by virtue of a resolution dated 22 April 2015, the shareholders of the bank approved the allotment of 36,034,719 ordinary shares of 30 cent each as a bonus issue of one (1) share for every nine (9) shares held by shareholders on the Company's Register of Shareholders as at close of trading on the Malta Stock Exchange on the 29 April 2015.

This bonus issue was allotted to shareholders on 30 April 2015, and thereby increased the issued and fully paid share capital to 360,306,099 shares of 30 cent each, resulting in a paid up share capital of €108,092,000.

46 Reserves

a *Revaluation reserve*

The revaluation reserve comprises the surplus arising on the revaluation of the local group's freehold and long leasehold properties, net of deferred taxation, and the cumulative net change in the fair value of available-for-sale financial investments held by the local group, net of deferred taxation. The revaluation reserves are not available for distribution.

	Group	*Bank*
	€000	**€000**
On land and buildings:		
1 January 2015	23,675	23,475
– Deferred tax on revaluation surplus determined on the basis applicable to disposals	1,199	1,201
31 December 2015	**24,874**	**24,676**
– Surplus arising on revaluation	**2,554**	**2,554**
– Deferred tax on revaluation surplus	**(255)**	**(255)**
– Transfer to retained earnings upon realisation through disposal	**(77)**	**(77)**
– Deferred tax on transfer upon realisation through disposal	**27**	**27**
31 December 2016	**27,123**	**26,925**
On available-for-sale investments:		
1 January 2015	18,835	18,664
– Fair value adjustments	4,938	5,187
– Deferred tax on fair value adjustments	(1,728)	(1,815)
– Reclassification adjustment to profit or loss upon disposal	(682)	(683)
– Deferred tax on reclassification adjustment	239	239
31 December 2015	**21,602**	**21,592**
– Fair value adjustments	**(585)**	**(432)**
– Deferred tax on fair value adjustments	**205**	**151**
– Reclassification adjustment to profit or loss upon disposal	**(10,787)**	**(10,787)**
– Deferred tax on reclassification adjustment	**3,775**	**3,775**
31 December 2016	**14,210**	**14,299**
Total	**41,333**	**41,224**

b *Retained earnings*

Retained earnings include the Depositor Compensation Scheme reserve which is excluded for the purposes of the Own Funds calculations (refer to note 6) and the General Banking Risk reserve which is held as a capital buffer for regulatory purposes.

Depositor Compensation Scheme reserve

The Depositor Compensation Scheme reserve amounts to €26,932,000 (2015: €30,831,000). As at 31 December 2016, debt securities with a carrying amount of €27,698,000 (2015: €29,981,000) had been pledged in terms of the Depositor Compensation Scheme (refer to note 27a).

General Banking Risk reserve

Banking Rule BR 09 'Measures addressing credit risks arising from the assessment of the quality of asset portfolios of credit institutions authorised under the Banking Act 1994', issued by the MFSA, requires banks in Malta to hold additional reserves for general banking risks in respect of non-performing loans. This reserve is required to be funded from planned dividends. During the year, the bank adhered to the revised Banking Rule BR09 which imposes higher allocations for certain past due exposures. No further allocations to the reserve were necessary as a result of the reduction in non-performing exposures (refer to note 4(b)(iii)). As at the reporting date, this reserve amounted to €8,000,000 (representing 100% of the total estimated amount) (2015: €8,000,000).

47 Contingent liabilities

	Contract amount	
	2016	2015
	€000	€000
Group/Bank		
– Guarantees	**92,971**	108,762
– Standby letters of credit	**23,609**	23,120
– Other contingent liabilities	**1,889**	1,889
	118,469	133,771

The local group provides guarantees and similar undertakings on behalf of third party customers. These guarantees are generally provided in the normal course of the group's banking business. The maximum potential amount of future payments which the local group could be required to make at 31 December is disclosed in the table above. The risks and exposures arising from guarantees are captured and managed in accordance with the local group's overall credit risk management policies and procedures.

The above table discloses the nominal principal amounts, which represents the maximum amounts at risk should the contracts be fully drawn upon and clients default. As a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of the nominal principal amounts is not indicative of future liquidity requirements.

Approximately 50% of the guarantees have a term of less than one year, while guarantees with terms of more than one year are subject to the bank's annual credit review process.

Other contingent liabilities relate to legal claims against the bank. Based on legal advice, it is not considered probable that settlement will require the outflow of economic benefit, in the case of these legal claims, or the amount of the obligation cannot be reliably measured.

48 Commitments

	Group *Contract amount*		*Bank* *Contract amount*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Documentary credits	**25,190**	36,513	**25,190**	36,513
Undrawn formal standby facilities, credit lines and other commitments to lend	**1,200,042**	1,256,092	**1,228,073**	1,256,289
	1,225,232	1,292,605	**1,253,263**	1,292,802

The above commitments exclude commitments in relation to capital expenditure and operating leases which are disclosed in note 49.

49 Capital and lease commitments

a *Capital commitments*

Capital commitments as at 31 December 2016 amounting to €308,000 (2015: €1,154,000) is mainly related to the aquisition of property, plant and equipment.

49 Capital and lease commitments *(continued)*

b *Operating leases*

At 31 December 2016, the local group and the bank were party to non-cancellable operating lease agreements for properties, in respect of which the future minimum lease payments extend over a number of years. The leases run for an initial period of up to one hundred and fifty years. Specific lease arrangements include an option to renew the lease after the original term but the amounts presented in the tables below do not reflect lease charges applicable to the renewal period.

Total future minimum lease net payments under non-cancellable property operating leases:

	2016	2015
	€000	€000
Group/Bank		
Less than one year	**1,232**	1,032
Between one year and five years	**1,077**	673
More than five years	**2,459**	2,535
	4,768	4,240

Lease payments recognised in profit or loss under 'General administrative expenses' amounted to €1,192,000 (2015: €1,263,000). This amount includes a payment of €78,000 (2015: €78,000) in respect of rent paid on one property which is subject to a sub-lease agreement for the same amount.

50 Dividends

	Group			
	2016	2015	**2016**	2015
Gross of income tax	**% per share**	% per share	**€000**	€000
% per 30 cent share				
– prior year's final dividend	**9**	9	**9,368**	8,431
– current year's interim dividend	**24**	17	**25,582**	18,375
	33	26	**34,950**	26,806
Net of income tax	**Cent per share**	Cent per share	**€000**	€000
cent per 30 cent share				
– prior year's final dividend	**1.69**	1.70	**6,089**	5,511
– current year's interim dividend	**4.62**	3.32	**16,628**	11,944
	6.31	5.02	**22,717**	17,455

50 Dividends *(continued)*

The Directors have proposed a final gross ordinary dividend of 4.1 cent (2015: 2.6 cent) per share. The final dividend will be payable to shareholders on the bank's register at 14 March 2017.

	Group	
	2016	2015
	€000	€000
Proposed dividend		
Profit for the year	**40,213**	29,480
Proposed as per dividend policy	**26,138**	19,162
Less: interim dividend paid	**(16,628)**	(11,944)
Available for distribution	**9,510**	7,218
Allocation to General Banking Risk Reserve (note 46)	**–**	(988)
Proposed final dividend	**9,510**	6,230
Issued and fully paid up shares (note 45)	**360,306**	360,306
	Cent per share	Cent per share
Proposed final dividend		
– gross of income tax per share	**4.1**	2.6
– net of income tax per share	**2.7**	1.7

51 Cash and cash equivalents

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Balances of cash and cash equivalents are analysed below:				
Cash	**33,845**	35,307	**33,845**	35,307
Malta Government Treasury Bills of three months or less	**30,999**	50,000	**30,999**	50,000
Balances with Central Bank of Malta (excluding reserve deposit) of three months or less	**255**	–	**255**	–
Items in course of collection from other banks	**16,796**	12,559	**16,796**	12,559
Loans and advances to banks of three months or less	**909,208**	721,715	**827,440**	609,222
Deposits by banks of three months or less	**(10,648)**	(13,354)	**(10,648)**	(13,354)
Items in course of collection to other banks	**(41,599)**	(12,504)	**(41,599)**	(12,504)
Per Statements of Cash Flows	**938,856**	793,723	**857,088**	681,230
Adjustment to reflect balances with contractual maturity of more than three months	**192,694**	203,783	**199,318**	207,165
Per Statements of Financial Position	**1,131,550**	997,506	**1,056,406**	888,395
Analysed as follows:				
Cash and balances with Central Bank of Malta	**82,420**	83,565	**82,420**	83,565
Malta Government Treasury Bills	**39,998**	103,998	**39,998**	103,998
Items in course of collection from other banks	**16,796**	12,559	**16,796**	12,559
Loans and advances to banks	**1,077,859**	841,411	**996,091**	728,918
Deposits by banks	**(10,770)**	(14,286)	**(10,770)**	(14,286)
Other liabilities	**(74,753)**	(29,741)	**(68,129)**	(26,359)
	1,131,550	997,506	**1,056,406**	888,395

52 Segmental information

The local group provides a comprehensive range of banking and related financial services to its customers. The products and services offered to customers are organised by global business.

- Retail Banking and Wealth Management (RBWM) offers a broad range of products and services to meet the personal banking and wealth management needs of individual customers. Typically, customer offerings include personal banking products (current and savings accounts, mortgages and personal loans, credit cards, debit cards and local and international payment services) and wealth management services (insurance and investment products, global asset management services and financial planning services).
- Commercial Banking (CMB) offers a broad range of products and services to serve the needs of our commercial customers, including small and medium sized enterprises, mid-market enterprises and corporates. These include credit and lending and international trade and receivables finance. CMB also offers its customers access to products and services offered by other global businesses, for example Global Banking & Markets (GB&M).
- GB&M provides tailored financial solutions to corporate and institutional clients. The client-focused business line delivers a full range of banking capabilities including assistance with managing risk via interest rate derivatives, the provision of foreign exchange spot and derivative products, and payment services.

The local group's internal reporting to the Board of Directors and Senior Management is analysed according to these business lines. For each of the businesses, the Senior Management, in particular the Chief Executive Officer, as chief operating decision-maker, reviews internal management reports in order to make decisions about allocating resources and assessing performance.

The Board considers that global businesses represent the most appropriate information for the users of the financial statements to best evaluate the nature and financial effects of the business activities in which the local group engages, and the economic environments in which it operates. As a result, the local group's operating segments are considered to be the global businesses.

	Retail Banking and Wealth Management	*Commercial Banking*	*Global Banking and Markets*	*Group Total*
	2016	**2016**	**2016**	**2016**
	€000	**€000**	**€000**	**€000**
Group				
Net interest income				
– External	**60,013**	**56,605**	**9,809**	**126,427**
– Internal	**5,438**	**(8,470)**	**3,032**	**–**
	65,451	**48,135**	**12,841**	**126,427**
Net non-interest income	**36,797**	**14,350**	**3,968**	**55,115**
Net operating income before loan impairment charges	**102,248**	**62,485**	**16,809**	**181,542**
Loan impairment charges	**(2,137)**	**(6,979)**	**86**	**(9,030)**
Provision for brokerage remediation costs	**(8,000)**	**–**	**–**	**(8,000)**
Net operating income	**92,111**	**55,506**	**16,895**	**164,512**
Employee compensation and benefits	**(37,757)**	**(13,016)**	**(1,879)**	**(52,652)**
General and administrative expenses	**(30,223)**	**(11,119)**	**(1,563)**	**(42,905)**
Depreciation of property, plant and equipment	**(2,412)**	**(991)**	**(142)**	**(3,545)**
Amortisation and impairment of intangible assets	**(2,186)**	**(877)**	**(126)**	**(3,189)**
Profit before tax	**19,533**	**29,503**	**13,185**	**62,221**
Assets				
Segment total assets	**3,782,206**	**1,375,745**	**2,148,013**	**7,305,964**
Total equity	**229,582**	**173,062**	**70,880**	**473,524**

52 Segmental information *(continued)*

	Retail Banking and Wealth Management	*Commercial Banking*	*Global Banking and Markets*	*Group Total*
	2015	2015	2015	2015
	€000	€000	€000	€000
Group				
Net interest income				
– External	52,847	60,929	12,760	126,536
– Internal	10,970	(14,917)	4,447	500
	63,817	46,012	17,207	127,036
Net non-interest income	31,686	12,145	5,488	49,319
Net operating income before loan impairment charges	95,503	58,157	22,695	176,355
Loan impairment charges	(4,759)	(6,010)	(57)	(10,826)
Net operating income	90,744	52,147	22,638	165,529
Employee compensation and benefits	(47,734)	(17,742)	(3,009)	(68,485)
General and administrative expenses	(32,122)	(9,930)	(1,502)	(43,554)
Depreciation of property, plant and equipment	(2,433)	(999)	(143)	(3,575)
Amortisation and impairment of intangible assets	(2,110)	(942)	(91)	(3,143)
Profit before tax	6,345	22,534	17,893	46,772
Assets				
Segment total assets	3,691,818	1,439,963	2,109,342	7,241,123
Total equity	218,068	165,120	77,928	461,116

53 Related party transactions

The immediate parent company of the local group and the bank is HSBC Europe BV, a company incorporated in the Netherlands, with its registered address at Karspeldreef 6K, Amsterdam, 1101 CJ Netherlands.

The ultimate parent company of the local group and the bank is HSBC Holdings plc, a company incorporated in England, with its registered address at 8, Canada Square, London E14 5HQ United Kingdom.

Related parties of the local group and the bank include subsidiaries, the ultimate parent, all entities controlled by the ultimate parent, Key Management Personnel, close family members of Key Management Personnel and entities which are controlled or jointly controlled by Key Management Personnel or their close family members.

Key Management Personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of HSBC Bank Malta p.l.c., being the Directors and the bank's Executive Committee members.

53 Related party transactions *(continued)*

a *Transactions, arrangements and agreements involving Directors and other key management personnel*

The table below sets out transactions and arrangements involving key management personnel, close family members and entities controlled or jointly controlled by them:

	Highest balance during the year	*Balance at end of year*	*Highest balance during the year*	*Balance at end of year*
	2016	**2016**	2015	2015
	€000	**€000**	€000	€000
Loans	**661**	**646**	5,350	4,904
Credit card balances	**40**	**32**	22	17
Guarantees issued	**2**	**2**	32	32
Commitments to lend	**561**	**648**	6,250	4,793

The above banking facilities are part of long-term commercial relationships and were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

b *Compensation of Directors and other key management personnel*

The following represents the compensation of Directors and other key management personnel in exchange for services rendered to the bank for the period they served during the year. The increase in salaries and other emoluments of Directors is attributable to an increase in the involvement of Directors in particular as a result of regulatory demands. The increase in salaries and other emoluments of other key management personnel is attributable to the increase in the number of EXCO members during 2016, from 10 to 15.

	2016	2015
	€000	€000
Directors' emoluments (including non-executive Directors)		
Salaries and other emoluments	**739**	636
Benefits	**174**	248
Share-based payments	**80**	123
	993	1,007
Other key management personnel		
Salaries and other emoluments	**2,488**	2,267
Benefits	**525**	640
Share-based payments	**43**	127
	3,056	3,034

53 Related party transactions *(continued)*

c *Transaction with other related parties*

i Transactions with HSBC Bank plc

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Assets				
Derivatives	**1,054**	3,803	**1,054**	3,803
Loans and advances to banks	**599,178**	351,906	**595,666**	351,906
Other assets	**2,329**	994	**2,329**	994
Prepayments and accrued income	**19**	190	**19**	190
Liabilities				
Derivatives	**10,624**	7,818	**10,624**	7,818
Accruals and deferred income	**560**	734	**88**	370
Income statement				
Interest income	**580**	473	**580**	473
Interest expense	**1,995**	38	**1,995**	38
Fee income	**155**	395	**155**	395
Fee expense	**108**	167	**108**	167
Other income	**1,022**	1,011	**1,021**	1,011
Employee compensation and benefits	**388**	518	**335**	430
General and administrative expenses	**6,452**	4,760	**5,270**	4,110

ii Transactions with other subsidiaries of HSBC Holdings plc

	Group		*Bank*	
	2016	2015	**2016**	2015
	€000	€000	**€000**	€000
Assets				
Loans and advances to banks	**405,004**	384,522	**396,598**	370,197
Prepayments and accrued income	**495**	409	**207**	–
Liabilities				
Accruals and deferred income	**1,331**	3,854	**634**	2,920
Income statement				
Interest income	**1,401**	729	**1,401**	729
Interest expense	**30**	26	**30**	26
Fee income	**1,602**	422	**56**	422
Fee expense	**20**	2	**1**	2
Other income	**53**	95	**53**	95
General and administrative expenses	**8,473**	11,490	**7,469**	9,420

53 Related party transactions *(continued)*

c *Transaction with other related parties (continued)*

iii Transactions with local group entities

	Bank	
	2016	2015
	€000	€000
Assets		
Loans and advances to customers	**31**	8,200
Prepayments and accrued income	**288**	122
Liabilities		
Customer accounts	**60,009**	86,066
Subordinated liabilities	**754**	783
Income statement		
Interest income	**117**	324
Interest expense	**38**	104
Fee income	**3,243**	3,172

The above outstanding balances arose from the ordinary course of business and or substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

54 Unconsolidated structured entities

The term 'unconsolidated structured entities' refers to all structured entities that are not controlled by the local group. The local group has established and manages investment funds to provide customers with investment opportunities.

Type of structured entity	Nature and purpose	Interest held by the group
Investment funds	– These vehicles are financed through the issue of units to investors. – To generate fees from managing assets on behalf of third party investors.	– Investments in units issued by the fund – Management fees

As fund manager, the local group may be entitled to receive a management and performance fee based on the assets under management. The total management fees earned during the year were €3,847,000 (2015: €3,874,000).

The table below shows the total assets of unconsolidated structured entities in which the local group has an interest at the reporting date, and the maximum exposure to loss in relation to those interests. The maximum exposure to loss from the local group's interests in unconsolidated structured entities represents the maximum loss that the local group could incur as a result of its involvement with unconsolidated structured entities regardless of the probability of the loss being incurred.

	2016	2015
	€000	€000
Units in HSBC managed investment funds – classified as financial assets at fair value through profit or loss	**72,227**	63,783
Total assets of HSBC managed funds	**443,865**	443,820

The maximum exposure to loss is equivalent to the carrying amount of the assets held at the reporting date.

55 Trust and custody activities

The local group provides custody services to individuals and retirement benefit plans, whereby it holds and manages assets or invests funds received in various financial instruments at the direction of the customer. In line with Group strategy, during 2016, the bank continued the process of exiting from its trust business.

The local group receives fee income for providing these services. Trust assets and assets held in custody are not assets of the group and are not recognised in the statements of financial position. The group is not exposed to any credit risk relating to such placements, as it does not guarantee these investments.

At 31 December 2016, total assets held by the group on behalf of customers amouted to €1,926,804,000 (2015: €2,354,290,000).

56 Registered office and ultimate parent company

The addresses of the registered and principal offices of the bank and its subsidiary companies included in the consolidated financial statements can be found in a separate statement which is filed at the Registrar of Companies in accordance with the provisions of the Third Schedule to the Companies Act, 1995.

The ultimate parent company of HSBC Bank Malta p.l.c. is HSBC Holdings plc, and the immediate parent company is HSBC Europe B.V., which are incorporated and registered in the United Kingdom and the Netherlands respectively. The registered address of HSBC Holdings plc is 8 Canada Square, London E14 5HQ, United Kingdom and the registered address of HSBC Europe B.V. is Karspeldreef 6K, Amsterdam, 1101 CJ, Netherlands. Copies of the HSBC Holdings plc Annual Review 2016, Strategic Report 2016, and Annual Report and Accounts 2016 may be obtained from its registered office or viewed on www.hsbc.com.

57 Investor compensation scheme

In accordance with the provisions of the Investor Compensation Scheme Regulations, 2003 issued under the Investment Services Act, 1994, licence holders are required to transfer a variable contribution to an Investor Compensation Scheme Reserve and place the equivalent amount with a bank, pledged in favour of the Scheme. Alternatively licence holders can elect to pay the amount of variable contribution directly to the Scheme.

58 Critical accounting estimates and judgements

This note contains information about critical judgements, significant assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment and that have the most significant effects on the amounts recognised in the financial statements. Information about assumptions and estimation uncertainties relating to fair valuation of financial instruments is disclosed in note 5. Estimates and judgements are continually evaluated and are based on historical and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

58 Critical accounting estimates and judgements *(continued)*

a *Impairment losses on loans and advances*

Loan impairment allowances represent management's best estimate of losses incurred in the loan portfolios at the balance sheet date. Management is required to exercise judgement in making assumptions and estimates when calculating loan impairment allowances on both individually and collectively assessed loans and advances.

Collective impairment allowances are subject to estimation uncertainty, in part because it is not practicable to identify losses on an individual loan basis due to the large number of individually insignificant loans in the portfolio.

The estimation methods include the use of statistical analyses of historical information, supplemented with significant management judgement, to assess whether current economic and credit conditions are such that the actual level of incurred losses is likely to be greater or less than historical experience.

Where changes in economic, regulatory or behavioural conditions result in the most recent trends in portfolio risk factors being not fully reflected in the statistical models, risk factors are taken into account by adjusting the impairment allowances derived solely from historical loss experience.

Risk factors include loan portfolio growth, product mix, unemployment rates, bankruptcy trends, loan product features, economic conditions such as national and local trends in housing markets, the level of interest rates, portfolio seasoning, account management policies and practices, changes in laws and regulations, and other influences on customer payment patterns. The methodology and the assumptions used in calculating impairment losses are reviewed regularly in the light of differences between loss estimates and actual loss experience. For example, roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

For individually assessed loans, judgement is required in determining whether there is objective evidence that a loss event has occurred and, if so, the measurement of the impairment allowance. In determining whether there is objective evidence that a loss event has occurred, judgement is exercised in evaluating all relevant information on indicators of impairment, including the consideration of whether payments are contractually past-due and the consideration of other factors indicating deterioration in the financial condition and outlook of borrowers affecting their ability to pay. A higher level of judgement is required for loans to borrowers showing signs of financial difficulty in market sectors experiencing economic stress, particularly where the likelihood of repayment is affected by the prospects for refinancing or the sale of a specified asset. For those loans where objective evidence of impairment exists, management determine the size of the allowance required based on a range of factors such as the realisable value of security, the likely dividend available on liquidation or bankruptcy, the viability of the customer's business model and the capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations.

The group might provide loan forbearance to borrowers experiencing financial difficulties by agreeing to modify the contractual payment terms of loans in order to improve the management of customer relationships, maximise collection opportunities or avoid default or repossession. Where forbearance activities are significant, higher levels of judgment and estimation uncertainty are involved in determining their effects on loan impairment allowances. Judgements are involved in differentiating the credit risk characteristics of forbearance cases, including those which return to performing status following renegotiation.

The exercise of judgement requires the use of assumptions which are highly subjective and very sensitive to the risk factors, in particular to changes in economic and credit conditions. Many of the factors have a high degree of interdependency and there is no single factor to which the loan impairment allowances as a whole are sensitive.

58 Critical accounting estimates and judgements *(continued)*

b *Policyholder claims and benefits*

The estimation of future benefit payments and premiums arising from long-term insurance contracts is one of the local group's most critical accounting estimate. The determination of the liabilities under long-term insurance contracts is dependent on estimates made by the local group. Estimates are made as to the expected number of deaths for each of the years in which the local group is exposed to risk. The local group bases these estimates on industry standard mortality tables that reflect recent historical mortality experience, adjusted where appropriate to reflect the local group's own experience. The estimated number of deaths determines the value of the benefit payments and the value of the valuation premiums. The main source of uncertainty is that epidemics such as AIDS, SARS, pandemic flu, swine flu and wide-ranging lifestyle changes, such as in eating, smoking and exercise habits, could result in future mortality being significantly worse than in the past for the age groups in which the local group has significant exposure to mortality risk.

Estimates are also made as to future investment income arising from the assets backing long-term insurance. These estimates are based on current market returns as well as expectations about future economic and financial developments. Interest rate assumptions for the purposes of valuing liabilities as at reporting date are based on the euro swap rates curve. Appropriate margins were taken for bond portfolio and equities/property portfolio.

If the average future investment returns differ by +/-1% from management's estimates, the insurance liability would decrease by €19,316,000 (2015: €17,888,000) or increase by €26,198,000 (2015: €20,779,000). In this case there is no relief arising from reinsurance contracts held.

If the number of deaths in future years differ by +/-10% from management's estimate, the liability would increase by €1,148,000 (2015: €1,169,000) or decrease by €1,193,000 (2015: €1,110,000).

For long-term insurance contracts with fixed and guaranteed term and with DPF, estimates of future deaths, investment returns and administration expenses form the assumptions used for calculating the liabilities during the life of the contract. A margin for risk and uncertainty is added to these assumptions. New estimates are made each subsequent year to reflect the current long-term outlook.

c *Present value of in-force long-term assurance business (PVIF)*

The PVIF measures the shareholder's share of the future profits that are expected to be earned in future years attributable to the long-term life insurance business in force at the valuation date. Policies classified as investment contracts are excluded. The approach is to take a discounted present value of the expected future shareholder cash flows using the risk discount rate.

The risk free rate of return used within the valuation is the Euro swap rate curve as at 30 December 2016 (2015: same approach). The risk discount rate is based on the risk free curve with an additional 0.5% margin (2015: 0.5% margin) to allow for operational risk. The PVIF valuation assumes lapse rates varying by product and duration in-force that range from 0% to 19% pa (2015: from 0% to 19% pa). Expense inflation is calculated as a blend of wage inflation and price inflation, with the latter based on an adjusted French inflation curve. This results in a term dependent expense inflation assumption increasing from 2.0% p.a. to 2.9% p.a. (2015: 1.7% p.a. to 2.7% p.a.).

As the valuation models are based upon assumptions, changing the assumptions will change the resultant estimate of PVIF. The following table shows the effect on the PVIF of reasonably possible changes in the main assumptions across the insurance business:

		2016	2015
Assumptions	**Movement**	**€000**	€000
Risk free rate	+100 basis points	**(2,837)**	(2,232)
Risk free rate	-100 basis points	**7,497**	2,981
Expenses	+10%	**(964)**	(853)
Expenses	-10%	**1,043**	919
Lapse rate	+100 basis points	**1,291**	867
Lapse rate	-100 basis points	**(1,994)**	(1,413)

58 Critical accounting estimates and judgements *(continued)*

d *Provision for brokerage remediation costs*

The estimation of the provision for brokerage remediation costs (refer to note 17) is one of the critical accounting estimates of the local group and the bank. Judgement is particularly involved in estimating the amount of the outflow.

While the remediation programme is considered to have progressed well, which typically makes it easier to make judgements and estimates around a better defined set of possible outcomes, the amount recognised as a provision remains very sensitive to the assumptions used. As a result, and in order to mitigate the risk of estimation uncertainty, the Directors have sought professional expert advice on the assessment as well as on the assumptions underlying the estimated expenditure.

The following assumptions are determined by the Directors to be the most critical:

– The unit market prices of the respective instruments that will be used to carry out the remediation in relation to instruments that were transferred to other institutions as part of the bank's decision to wind down its brokerage business. For the purpose of the provision, current prices were used.

– The benchmark rate used to determine the return that customers would have received on non-complex instruments had they not dealt in such complex instruments via the bank's brokerage business.

Changes to these assumptions will change the resultant estimate of the remediation costs. The following table shows the effect on the amount of the provision of reasonably possible changes in the two assumptions referred to above:

	2016
	Increase/ (decrease)
	€000
Unit market prices increase by 10%	**(500)**
Unit market prices decrease by 10%	**800**
Benchmark rate increases by 100bps	**1,400**

a *Overview*

These Additional Regulatory Disclosures (ARDs) are aimed at providing the local group's stakeholders further insight to the local group's capital structure, adequacy and risk management practices. The disclosures outlined below have been prepared by the local group in accordance with the Pillar 3 quantitative and qualitative disclosure requirements as governed by Banking Rule BR/07: Publication of Annual Report and Audited Financial Statements of Credit Institutions authorised under the Banking Act, 1994, issued by the Malta Financial Services Authority (MFSA). Banking Rule BR/07 follows the disclosure requirements of Directive 2013/36/EU (Capital Requirements Directive) and EU Regulation No 575/2013 (Capital Requirements Regulation) of the European Parliament and of the Council of 26 June 2013.

In light of the fact that the local group is considered a significant subsidiary of HSBC Holdings plc, consolidated supervision at the level of HSBC Holdings plc, the local group is exempt from full disclosure requirements laid down in Part Eight of the CRR. It is however subject to disclosure requirements in terms of article 13 of the CRR.

The basis of consolidation for the purpose of financial reporting under International Financial Reporting Standards (IFRSs), described in note 3 of the Annual Report, differs from that used for regulatory purposes. For regulatory reporting purposes, subsidiaries engaged in insurance activities are excluded from the regulatory consolidation and deducted from regulatory capital subject to thresholds. On the basis of Article 43(a) of the CRR, the investment in HSBC Life Assurance (Malta) Limited is deemed to be significant for the purposes of capital requirements.

The local group publishes these disclosures on an annual basis as part of the Annual Report. As outlined in the requirements of banking regulations, these disclosures are not subject to an external audit, except to the extent that any disclosures are equivalent to those made in the Financial Statements, which have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the EU. The local group, through its internal verification procedures, is satisfied that these ARDs are presented fairly.

b *Capital management*

The local group's approach to capital management is driven by its strategic and organisational requirements, taking into account the regulatory, economic and commercial environment in which it operates. It is the local group's objective is to maintain a strong capital base to support the risks inherent in its business and to meet regulatory capital requirements at all times. To achieve this, the local group manages capital within the context of an annual capital plan which is approved by the Board and which determines the optimal amount and mix of capital required to support planned business growth and meet regulatory capital requirements. Capital generated in excess of planned requirements is returned to shareholders in the form of dividends.

The impact of the local group's capital plan on shareholder returns is therefore recognised by the level of equity capital employed for which the local group seeks to maintain a prudent balance between the advantages and flexibility afforded by a strong capital position and the higher returns on equity from increased leverage.

The local group manages its capital requirements based on internal targets, which are set above the prescribed minimum levels established within the CRR.

i Own funds

For regulatory purposes, the bank's capital base is divided into CET1 capital and Tier 2 capital.

The bank's CET1 capital includes the following items:

– called up share capital;

– retained earnings;

– reserve for general banking risks; and

– other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes, including the treatment of investments in financial sector entities, deferred tax assets, deductions relating to amounts pledged in favour of the Depositor Compensation Scheme and deductions relating to intangible assets.

b *Capital management (continued)*

i *Own funds (continued)*

The bank's Tier 2 capital consists of:

– subordinated liabilities;

– revaluation reserves made up of the surplus on the revaluation of property, net of deferred taxation, and gains on the fair valuation of available-for-sale financial investments, net of deferred taxation; and

– other regulatory adjustments under Article 66(d) and 69 of the CRR.

The following describes the terms and conditions of called up share capital and subordinated liabilities, which are included in the local group's total own funds.

Capital Instruments Main Features	*HSBC Ordinary shares @ par*	*4.6% HSBC Bank Malta p.l.c. Subordinated Bonds 2017 @ par*	*5.9% HSBC Bank Malta p.l.c. Subordinated Bonds 2018 @ par*
Unique identifier	MT0000030107	MT0000031220	MT0000031238
Governing Law(s) of the instrument	Maltese Law	Maltese Law	Maltese Law
Regulatory Treatment			
Transitional CRR rules	Common Equity Tier 1	Tier 2	Tier 2
Post-transitional CRR rules	Common Equity Tier 1	Tier 2	Tier 2
Eligible at solo/(sub)consolidated /solo & (sub)consolidated	Solo & (Sub) consolidated	Solo & (Sub) consolidated	Solo & (Sub) consolidated
Amount recognised in regulatory capital	108,091,800	57,468	10,854,533
Nominal amount of instrument	108,091,800	58,234,390	30,000,000
Issue Price	N/A	At par (€100 per bond)	At par (€100 per bond)
Redemption Price	N/A	At €100	At €100
Accounting classification	Share Equity	Liability – amortised cost	Liability – amortised cost
Original date of issuance	27 January 1993*	12 February 2007	16 October 2008
Perpetual or dated	N/A	Dated	Dated
Original maturity date	No	1 February 2017	7 August 2018
Issuer call subject to prior supervisory approval	No	No	Yes
Coupons/dividends			
Fixed or floating dividend coupon	Floating	Fixed	Fixed
Coupon rate and any related index	N/A	4.60%	5.90%
Existence of dividend stopper	No	No	No
Fully discretionary, partially discretionary or mandatory (in terms of timing)	Fully discretionary	Mandatory	Mandatory
Fully discretionary, partially discretionary or mandatory (in terms of amount)	Partially discretionary	Mandatory	Mandatory
Existence of step up or other incentive to redeem	N/A	No	No
Non-cumulative or cumulative	Non-cumulative	Non-cumulative	Non-cumulative
Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible
Write-down features	No	No	No
Position in subordination hierarchy in liquidation	Subordinated to HSBC Subordinated Bonds	Subordinated to senior creditors and depositors	Subordinated to senior creditors and depositors
Non-compliant transitional features	No	No	No

* Date when the bank was initially listed on the Malta Stock Exchange

b *Capital management (continued)*

i Own funds (continued)

Further to the above, the local group's total own funds include other items the terms of which are described below.

a Retained earnings

The retained earnings represent earnings not paid out as dividends. Interim profits form part of Own funds only if those profits have been verified by the local group's independent external auditor. The local group may only make distributions out of profits available for this purpose.

Retained earnings includes an amount of €26,932,000 pledged in favour of the Depositor Compensation Scheme as at 31 December 2016, that are not available to the local group for unrestricted and immediate use to cover risk of losses as soon as they occur. The Depositor Compensation Scheme reserve is excluded for the purposes of the Own Funds calculation.

Moreover, an amount of €8,000,000 is also included in retained earnings relating to the reserve for general banking risks, since the local group is required to allocate funds to this reserve in accordance with the revised Banking Rule BR/09: 'Measures Addressing Credit Risks Arising from the Assessment of the Quality of Asset Portfolios of Credit Institutions authorised under the Banking Act, 1994'. This reserve refers to the amount allocated by the bank from its retained earnings, to a non-distributable reserve against potential risks linked to the local group's non-performing loans and advances. No further allocations to the reserve were necessary as a result of a reduction in non-performing exposures.

b Revaluation reserves

Property revaluation reserve

This represents the surplus arising on the revaluation of the local group's property net of related deferred tax effects. This reserve is not available for distribution.

Available-for sale financial investments reserve

This represents the cumulative net change in fair values of available-for-sale financial investments held by the local group, net of related deferred tax effects.

In accordance with article 492 of the CRR, the local group is required to complete a transitional disclosure template during the phasing in of regulatory adjustments from 1 January 2014 to 31 December 2017. The transitional disclosure template is set out below.

	As at 31 December 2016
	€000
Common Equity Tier 1 (CET1) capital	
Common Equity Tier 1 (CET1) capital: instruments and reserves	
Capital instruments and the related share premium accounts	108,092
Retained earnings	223,066
Accumulated other comprehensive income (and other reserves)	41,226
Funds for general banking risk	8,000
Independently reviewed profits net of any foreseeable dividend	30,703
CET1 capital before regulatory adjustments	411,087
Common Equity Tier 1 (CET1) capital: regulatory adjustments	
Intangible assets	(5,424)
Depositor Compensation Scheme reserve	(26,932)
Regulatory adjustments relating to investment property	(10,849)
Regulatory adjustments relating to unrealised gains and losses pursuant to Articles 467 and 468	(5,641)
Other	(36)
Total regulatory adjustments to CET1	**(48,882)**
CET1 capital	**362,205**

b *Capital management (continued)*

i Own funds (continued)

b Revaluation reserves (continued)

	As at 31 December 2016
	€000
Tier 2 capital	
Capital instruments and subordinated liabilities	128,644
Tier 2 capital: regulatory adjustments	
Amount to be deducted from or added to Tier 2 capital with regard to additional filters and deductions required pre CRR	(101,242)
Total Tier 2 capital	**27,402**
Total own funds	**389,607**
Total risk-weighted assets	**2,748,282**
Capital ratios	
CET1 capital	**13.2%**
Total capital	**14.2%**

The retained earnings in the disclosure template above does not agree with the retained earnings in the consolidated results reported by the local group under IFRS due to the exclusion of the subsidiary engaged in insurance activities from the regulatory consolidation.

The table below provides a full reconciliation of the local group's total own funds to the Statement of financial position within the audited financial statements for the year ended 31 December 2016, as required by article 437(1)(a) of the CRR.

	Group	*Bank*
	2016	**2016**
	€000	**€000**
Common Equity Tier 1		
As per statement of Financial Position		
– Called up share capital	108,092	108,092
– Retained earnings	324,099	271,078
	432,191	379,170
Less: Own Funds adjustments		
– Expected final dividend	(9,510)	(9,510)
– Retained earnings – HSBC Life Assurance (Malta) Limited	(52,820)	–
– Depositor Compensation Scheme reserve	(26,932)	(26,932)
– Intangible assets	(5,424)	(5,424)
– Revaluation reserve	24,736	24,734
– Other	(36)	5
Sub-total Tier 1	**362,205**	**362,043**

b *Capital management (continued)*

i Own funds (continued)

b Revaluation reserves (continued)

	Group **2016** **€000**	*Bank* **2016** **€000**
Tier 2		
As per statement of Financial Position		
Revaluation reserve	41,226	41,224
Less: Own Funds adjustments		
– Property revaluation reserve	(16,274)	(16,274)
– Unrealised gains and losses	(8,462)	(8,462)
	16,490	16,488
As per statement of Financial Position		
Subordinated liabilities	87,418	88,172
Less: Own Funds adjustments		
– HSBC Life Assurance (Malta) Limited – holding in banks subordinated loan capital	754	–
– Amortisation of subordinated loan capital	(77,260)	(77,260)
Subtotal of subordinated liabilities	10,912	10,912
Subtotal Tier 2	**27,402**	**27,400**
Total Own Funds	**389,607**	**389,443**

ii Capital requirements

The local group is required to maintain a ratio of total regulatory capital to risk-weighted assets (Total capital ratio) above the prescribed minimum level of 8%.

Pillar 1 capital requirements are based on standard rules and set the minimum own funds requirements to cover credit risk, market risk and operational risk of credit institutions. The local group uses the Standardised Approach for credit risk and operational risk and the Basic Method with respect to market risk in relation to the local group's foreign exchange risk. Under the Standardised Approach, the local group utilises risk weights determined by exposure class, credit risk mitigation and credit ratings as outlined in the CRR. Capital charge for foreign exchange risk using the Basic Method is calculated at 8% of the higher of the sum of all the net short positions and the sum of all the net long positions in each foreign currency. The Standardised Approach for operational risk, requires the group to divide its activities into the business lines prescribed in Article 317 of the CRR. The risk-weighted assets are derived by apply 12.5% to the capital requirements from each business line.

The local group will be fully implementing the CRD IV capital requirements with effect from January 2019. In respect of the local group, Banking Rule BR/15: 'Capital Buffers of Credit Institutions authorised under the Banking Act, 1994', will require additional buffers, namely the 'capital conservation buffer', the 'countercyclical buffer', 'other systemically important institutions (O-SII) buffer' and the 'systemic risk buffer'. Automatic restrictions on capital distributions apply if the local group's CET1 capital falls below the level of its CRD IV combined buffer.

The local group will be required to maintain a capital conservation buffer of 2.5% and O-SII buffer of 1.5%, made up of CET1 capital, on the risk weighted exposures of the bank as from 1 January 2019. These buffers are being phased in over the period from 1 January 2016 to 31 December 2018.

CRD IV contemplates a countercyclical buffer in line with Basel III, in the form of an institution-specific countercyclical buffer and the application of increased requirements to address macro-prudential or systemic risk. This is expected to be set in the range of 0 – 2.5% of relevant credit exposure RWAs, whereby the rate shall consist of the weighted average of the 'countercyclical buffer' rates that apply in the jurisdiction where the relevant exposures are located. Given that the local group's exposures are contained within Malta, this buffer is expected to be marginal, since the deviation of Malta's credit-to-GDP ratio is not expected to be significant taking cognisance of its long-term trend.

b *Capital management (continued)*

ii Capital requirements (continued)

Given the local group's position and its systematic relevance to the financial system in Malta, the local group is also required to maintain a 1.5% O-SII buffer also made up of CET1 capital. This buffer is also institution specific and may be set at a maximum of 2% of a systemically important institution's total risk exposure amount. In addition to the measures above, CRD IV sets out a 'systemic risk buffer' for the financial sector as a whole, or one or more sub-sectors, to be deployed as necessary by each EU member state with a view to mitigating structural macro-prudential risk. The 'systemic risk buffer' may range between 0% and 5%. In the case of the local group, the higher of the O-SII buffer and the systemic risk buffer applies.

	Group		
	Exposure value	*Risk weighted assets*	*Capital Required*
At 31 December 2016			
Central governments or Central banks	975,392	–	–
Public sector entities	27,692	25,967	2,077
Multilateral development banks	164,811	–	–
Institutions	992,264	217,679	17,414
Corporates	190,457	177,927	14,234
Retail exposures	166,651	113,259	9,061
Secured by mortgages on immovable property	2,610,140	1,397,838	111,827
Exposures in default	188,565	235,998	18,880
Items associated with particularly high risk	59,801	75,958	6,077
Equity exposures	25	25	2
Other items	216,600	225,392	18,031
Credit risk	5,592,398	2,470,043	197,603
Operational risk		272,858	21,829
Market risk		5,381	430
Total capital required		**2,748,282**	**219,862**
Own funds			
Common Equity Tier 1			362,205
Tier 2			27,402
Total own funds			**389,607**
Total capital ratio			**14.2%**

iii Pillar 2 and Internal Capital Adequacy Assessment Process (ICAAP)

As stipulated in Section 1 of Chapter 2 of CRD IV, the local group is required to have in place an internal process to assess the adequacy of capital levels in relation to its overall risk profile. The outcome of this process is enshrined in a document known as the Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP encompasses the adequacy of capital requirements for Pillar 1 risks, namely credit, market and operational, and other material residual risks not fully captured under Pillar 1, including concentration, liquidity, reputational and strategic risks, and interest rate risk in the banking book and risks arising from the macroeconomic environment.

Through the ICAAP, the local group examines its risk profile from a capital viewpoint, aiming to ensure that capital resources:

– remain sufficient to support the risk profile and outstanding commitments of the local group;

– exceed current regulatory requirements, and ensures that the local group is well placed to meet those expected in the future;

– allow the local group to remain adequately capitalised in the event of a severe economic downturn stress scenario; and

– remain consistent with the strategic and operational goals and investor expectations.

The minimum regulatory capital that the local group is required to hold is determined by the rules and guidance established by the ECB, through the CRD IV and the CRR. These capital requirements are a primary influence shaping the business planning process, in which RWA targets are established in accordance with the local group's strategic direction and risk appetite.

b *Capital management (continued)*

iii Pillar 2 and Internal Capital Adequacy Assessment Process (ICAAP) (continued)

The ICAAP and its constituent capital calculations are examined by the joint supervisory team, as part of its supervisory review and evaluation process. This examination informs the regulator's view of the local group's Pillar 2 capital requirements.

Preserving the local group's strong capital position remains a priority, and the level of integration of risk and capital management helps to optimise the local group's response to business demand for capital. Risks that are explicitly assessed through capital are credit risk including counterparty credit risk, market and operational risk, interest rate risk in the banking book, insurance risk, pension risk, residual risk and structural foreign exchange risk.

Furthermore, stress testing forms an integral part of the risk and capital management framework and is an important component of ICAAP. Its main purpose is to highlight to senior management potential adverse unexpected outcomes that could arise under hypothetical scenarios, and provides a quantitative indication of how much capital might be required to absorb the losses, should such adverse scenarios occur. Stress testing is used to assess risk concentrations, estimate the impact on revenue, impairments, write-downs and the resultant capital adequacy under a variety of adverse scenarios.

Macroeconomic stress testing considers the impact on both revenue and capital under a range of scenarios. It entails multi-year systemic shocks to assess the local group's ability to meet its capital requirement and liabilities as they fall due under a downturn in the business cycle and/or macroeconomic environment.

The stress testing framework brings multiple benefits to risk management, including: understanding the impact of recessionary scenarios; assessing material risk concentrations; impact of market price movements; and, forecasting of the balance sheet management and liquidity.

A series of stress events are run on a regular basis to assess the potential impact of an extreme yet plausible event on the local group. In an adverse scenario, a range of mitigating actions is ready to be implemented whenever the need arises. The latter also forms part of the ICAAP document.

From the local group's 2016 ICAAP, prior to applying stress testing scenarios, the local group maintained a strong capital position throughout the period reviewed. CET1 capital remained robust and comfortably above the risk appetite limit as well as the regulatory requirements, adjusted for the applicable capital buffers. With the application of severe stress scenarios, the local group maintained its strong CET1 capital base for absorbing the impact of the stress whilst continuing to meet its regulatory capital requirements.

c *Credit risk*

i Introduction to credit risk

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from lending, trade finance and treasury business, principally from the holdings of debt securities but also from off-balance sheet products such as guarantees. The local group has standards, policies and procedures dedicated to control and monitor the risk arising from all such activities.

ii Credit risk management

Within the overall framework of the local group policy, the local group has an established risk management process encompassing credit approvals, the control of exposures, credit policy direction to business units and the monitoring and reporting of exposures both on an individual and a portfolio basis which includes the management of adverse trends. Management is responsible for the quality of its credit portfolios and follows a credit process involving delegated approval authorities and credit procedures, the objective of which is to build and maintain risk assets of high quality. Regular reviews are undertaken to assess and evaluate levels of risk concentrations by market sector and product.

The bank's credit risk rating systems and processes differentiate exposures in order to highlight those with greater risk factors and higher potential severity of loss. In the case of individually significant accounts, risk ratings are reviewed regularly and any amendments are implemented promptly.

c *Credit risk (continued)*

ii Credit risk management (continued)

The principal objectives of the local group's credit risk management are:

– to maintain a strong culture of responsible lending and a robust risk policy and control framework;

– to both partner and challenge global businesses in defining, implementing, and continually re-evaluating risk appetite under actual and scenario conditions; and

– to ensure there is independent, expert scrutiny of credit risks.

Within the bank, the credit risk function's responsibilities include:

– formulating credit policy;

– guiding business on appetite for credit risk exposure to specified market sectors, activities and banking products and controlling exposures to certain higher-risk sectors;

– undertaking an independent review and objective assessment of risk and exposures over designated limits, prior to the facilities being committed to customers or transactions being undertaken;

– monitoring the performance and management of portfolios;

– controlling exposure to sovereign entities, banks and other financial institutions, as well as debt securities;

– setting policy on large credit exposures, ensuring that concentrations of exposure by counterparty, sector or geography do not become excessive in relation to the capital base, and remain within internal and regulatory limits;

– maintaining and developing the risk rating framework and systems and overseeing risk rating system governance for both wholesale and retail businesses; and

– reporting on retail portfolio performance, high risk portfolios, risk concentrations, large impaired accounts, impairment allowances and stress testing results.

Special attention is paid to problem exposures in order to accelerate remedial action. The local group uses specialist units to provide customers with support in order to help them avoid default wherever possible.

The table below reflects the local group's maximum exposure to credit risk before collateral held or other credit enhancements in accordance with the regulatory information submitted to the MFSA, as follows:

	Average exposure	*Year end exposure value*
	2016	**2016**
	€000	**€000**
Central Government or central banks	1,061,613	975,392
Public sector entities	82,370	27,692
Multilateral development banks	82,406	164,811
Institutions	966,206	992,264
Corporates	248,438	190,457
Retail exposures	167,086	166,651
Secured by mortgages on immovable property	2,552,352	2,610,140
Exposures in default	231,372	188,565
Items associated with particular high risk	62,016	59,801
Equity exposures	109,282	25
Other items	217,569	216,600
Total	**5,780,710**	**5,592,398**

c *Credit risk (continued)*

ii Credit risk management (continued)

The residual maturity breakdown by exposure class at year-end was as follows:

	Total	*Less than one year*	*Over one but less than five years*	*Over five years*	*No maturity*
	€000	**€000**	**€000**	**€000**	**€000**
At 31 December 2016					
Central government or central banks	975,392	277,359	654,067	43,966	–
Public sector entities	27,692	3,554	6,468	16,110	1,560
Multilateral development banks	164,811	41,528	104,891	18,392	–
Institutions	992,264	824,819	137,445	30,000	–
Corporates	190,457	119,470	19,630	35,754	15,603
Retail Exposures	166,651	44,284	57,796	39,838	24,733
Secured by mortgages on immovable property	2,610,140	42,364	254,480	2,120,889	192,407
Exposures in default	188,565	188,565	–	–	–
Items associated with particular high risk	59,801	9,600	40,851	3,141	6,209
Equity exposures	25	–	–	–	25
Other items	216,600	–	–	–	216,600
Total	**5,592,398**	**1,551,543**	**1,275,628**	**2,308,090**	**457,137**

iii Credit concentration risk

Concentrations of credit risk arise when a number of counterparties or exposures have comparable economic characteristics, or such counterparties are engaged in similar activities, or operate in the same geographical areas or industry sectors, so that their collective ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions. The local group uses a number of controls and measures to minimise undue concentration of exposure in its portfolios across industry, country and customer groups. These include portfolio and counterparty limits, approval and review controls, and stress testing.

Credit concentration risk analysed by counterparty

In terms of Part Four of the CRR 'Large Exposures', the total amount of exposures which exceeded 10% of eligible capital represented 20.2% of the total loan portfolio as at end of 2016. These exposures are strictly monitored by management and every reasonable step is taken to reduce this concentration and spread risk over a wider customer base with further growth in the loan portfolio.

The maximum on-balance sheet credit exposure to any client, group of connected clients or counterparty as at 31 December 2016 amounted to €145,232,000 before taking account of collateral or other credit enhancements.

Within its daily operations, the local group transacts with counterparty banks and other financial institutions. By conducting these transactions, the local group is running the risk of losing funds due to the possible delays in the repayment of existing and future obligations by counterparty banks. To mitigate this risk, the local group places short-term funds solely with pre-approved counterparties subject to pre-established limits determined on the basis of the respective institution's credit rating as well as with its parent. The positions are checked against the limits on a daily basis and in real time.

As prescribed in article 400(2)(c), in light of the fact that the local group is subject to prudential supervision on a consolidated basis, the local group's exposure with its parent is exempt from limits to large exposures outlined in article 395(1) of the CRR. Similarly, the local group invests in debt securities issued by Maltese government, and given that these exposures attract a 0% risk weight, they are also exempt from large exposure limits.

c *Credit risk (continued)*

iii Credit concentration risk (continued)

Credit concentration risk analysed by industry sector

An industry sector analysis of the local group's exposure amounts split by exposure class is shown in the following table:

			Corporate and commercial				
	Total	*Personal*	*Property*	*Manu-facturing*	*Govern-ment*	*Other commercial*	*Financial*
	€000	**€000**	**€000**	**€000**	**€000**	**€000**	**€000**
At 31 December 2016							
Central government or central banks	975,392	–	–	–	975,392	–	–
Public sector entities	27,692	–	–	–	–	27,692	–
Multilateral development banks	164,811	–	–	–	–	–	164,811
Institutions	992,264	–	–	–	–	–	992,264
Corporates	190,457	1,312	9,764	9,532	–	169,849	–
Retail exposures	166,651	133,429	5,580	1,230	–	26,412	–
of which: SME	*32,567*	*2,476*	*5,304*	*1,049*	–	*23,738*	–
Secured by mortgages on immovable property	2,610,140	1,913,149	59,795	60,633	–	576,563	–
of which: SME	*519,438*	–	*55,996*	*27,971*	–	*435,471*	–
Exposures in default	188,565	87,068	45,304	15,945	–	40,248	–
Items associated with particular high risk	59,801	–	8	–	–	59,793	–
Equity exposures	25	–	–	–	–	25	–
Other items	216,600	–	–	–	–	216,600	–
Total assets	**5,592,398**	**2,134,958**	**120,451**	**87,340**	**975,392**	**1,117,182**	**1,157,075**

Credit concentration risk analysed by geographical distribution

The geographical concentration of the local group's exposure classes as at the end of the reporting period are analysed in the following table.

	Total	*Malta*	*Europe*	*Other*
	€000	**€000**	**€000**	**€000**
At 31 December 2016				
Central government or central banks	975,392	675,325	294,865	5,202
Public sector entities	27,692	27,692	–	–
Multilateral development banks	164,811	–	83,299	81,512
Institutions	992,264	21,715	966,786	3,763
Corporates	190,457	190,457	–	–
Retail exposures	166,651	166,651	–	–
Secured by mortgages on immovable property	2,610,140	2,610,140	–	–
Exposures in default	188,565	188,565	–	–
Items associated with particular high risk	59,801	59,801	–	–
Equity exposures	25	25	–	–
Other items	216,600	216,600	–	–
Total	**5,592,398**	**4,156,971**	**1,344,950**	**90,477**

c *Credit risk (continued)*

iv Credit quality

The local group's credit risk rating processes are designed to highlight exposures which require closer management attention because of their greater probability of default and potential loss. The credit quality of unimpaired loans is assessed by reference to the local group's standard credit rating system.

The four classifications below describe the credit quality of the local group's lending, debt securities and derivatives.

– Strong: exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss. Personal accounts operate within product parameters and only exceptionally show any period of delinquency.

– Medium: exposures require closer monitoring and demonstrate an average to good capacity to meet financial commitments, with low to moderate default risk. Personal accounts typically show only short periods of delinquency, with any losses expected to be minimal following the adoption of recovery processes.

– Sub-standard: exposures require varying degrees of special attention and default risk is of greater concern. Personal portfolio segments show longer delinquency periods of generally up to 90 days past due and/or expected losses are higher due to a reduced ability to mitigate these through security realisation or other recovery processes.

– Impaired: exposures have been assessed, individually or collectively as impaired.

As illustrated in the table below, these classifications each encompass a range of more granular, internal credit rating grades assigned to corporate and personal lending business as well as external rating grades, attributed by external agencies to debt securities. There is no direct correlation between the internal and external ratings at granular level, except to the extent each falls within a single quality.

Quality classification	*Debt securities and other bills – External credit rating*	*Wholesale and retail lending – Internal credit rating*
Strong	A- and above	CRR 1 to CRR 2
Good	BBB+ to BBB-	CRR 3
Satisfactory	BB+ to B and unrated	CRR 4 to CRR 5
Sub-standard	B- and below	CRR 6 to CRR 8
Impaired	Impaired	CRR 9 to CRR 10

The Customer Risk Rating (CRR) 10-grade scale assigned to corporate and personal lending business summarises a more granular underlying CRR scale for these customer segments; this combines obligor and facility/product risk factors in a composite measure.

For debt securities and certain other financial instruments, external ratings have been aligned to the four quality classifications.

c *Credit risk (continued)*

iv Credit quality (continued)

Distribution of financial instruments by credit quality

	Performing				*Past due not impaired*	*Non-performing*		
	Strong	*Good*	*Satisfactory*	*Sub-Standard*		*Impaired*	*Impairment Allowances*	*Total*
	€000	**€000**	**€000**	**€000**	**€000**	**€000**	**€000**	**€000**
As at 31 December 2016								
Balances with Central Bank of Malta and Treasury Bills	88,573	–	–	–	–	–	–	88,573
Items in the course of collection from other banks	16,796	–	–	–	–	–	–	16,796
Held for trading derivatives	1,054	–	10,281	–	–	–	–	11,335
Loans and advances to banks	996,091	–	–	–	–	–	–	996,091
Loans and advances to customers								
– Personal	844,504	326,519	718,175	7,053	38,197	74,501	(14,750)	1,994,199
– Corporate and Commercial	226,265	113,883	720,691	104,090	58,292	139,554	(36,611)	1,326,164
Available-for-sale financial investments	1,047,802	747	–	–	–	–	–	1,048,549
Accrued income	10,367	974	5,299	682	421	1,635	–	19,378
Other assets	4,202	–	4,470	26	–	–	–	8,698
	3,242,454	**442,123**	**1,459,982**	**111,854**	**96,910**	**215,733**	**(51,361)**	**5,517,695**

Past due but not impaired gross loans and advances to customers

Past due but not impaired are those loans where although customers have failed to make payments in accordance with the contractual terms of their facilities, they have not met the impaired loan criteria described below.

The following table analyses the local group's past due but not impaired gross loans and advances to customers.

	Total
	2016
	€000
Personal	
Past due by up to 29 days	29,084
Past due by up to 59 days	5,547
Past due by up to 89 days	3,567
Corporate and commercial	
Past due by up to 29 days	48,596
Past due by up to 59 days	9,505
Past due by up to 89 days	190
	96,489

c *Credit risk (continued)*

iv Credit quality (continued)

Impaired loans and advances

Impaired loans and advances are those that are classified as Customer Risk Rating (CRR) 9 or CRR 10. These grades are assigned when the local group considers that either the customer is unlikely to pay its credit obligations in full, without recourse to security, or when the customer is more than 90 days on any material credit obligation to the local group.

Impaired loans and advances also include renegotiated loans and advances that have been subject to a change in contractual cash flows as a result of a concession which the local group would not otherwise consider, and where it is probable that without the concession the borrower would be unable to meet the contractual payment obligations in full, unless the concession is insignificant and there are no other indicators of impairment.

The table below analyses the loan impairment charges for the year and the impairment allowances recognised for impaired loans and advances that are either individually assessed or collectively assessed, and collectively impairment allowances on loans and advances classified as not impaired.

	Individually assessed	*Collectively assessed*
	2016	**2016**
	€000	**€000**
At 1 January	39,505	7,187
Amounts written off	(3,328)	–
Recoveries of amounts written off in previous years	1,291	–
Discount unwind	(2,465)	–
Exchange	89	–
Loan impairment charge	8,874	208
At 31 December	**43,966**	**7,395**
Personal	11,784	2,966
Corporate and commercial	32,182	4,429
At 31 December	**43,966**	**7,395**

In 2016, interest of €1,471,000 was accrued on loans for which individually assessed impairment provisions existed. This represents the unwinding of discounting in accordance with IAS 39.

The local group's impaired and past due but not impaired loans and advances to customers are all concentrated in Malta.

	Individually assessed	*Collectively assessed*
	2016	**2016**
	€000	**€000**
New allowance	14,461	5,080
Release of allowance no longer required	(4,296)	(4,872)
Recoveries of amounts previously written off	(1,291)	–
Total loan impairment charge at 31 December	**8,874**	**208**
Personal		
– residential mortgages	4,078	(325)
– other personal lending	78	861
Corporate and commercial		
– commercial real estate	2,606	288
– other corporate lending	2,112	(616)
Total loan impairment charge at 31 December	**8,874**	**208**

c *Credit risk (continued)*

iv Credit quality (continued)

Impaired loans and advances (continued)

Losses for impaired loans are recognised promptly when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Impairment allowances are calculated on individual loans and on groups of loans assessed collectively, are recorded as charges in profit or loss, and are recorded against the carrying amount of impaired loans through the use of impairment allowance accounts. Losses which may arise from future events are not recognised.

Individually assessed loans and advances

The factors considered in determining whether a loan is individually significant for the purposes of assessing impairment include:

- the size of the loan;
- the number of loans in the portfolio; and
- the importance of the individual loan relationship, and how this is managed.

Loans that meet the above criteria will be individually assessed for impairment, except when volumes of defaults and losses are sufficient to justify treatment under a collective assessment methodology.

For all loans that are considered individually significant, the local group considers on a case-by-case basis at each reporting date whether there is any objective evidence that a loan is impaired. The criteria used by the local group to make this assessment include:

- known cash flow difficulties experienced by the borrower;
- contractual payments of either principal or interest being past due for more than 90 days;
- the probability that the borrower will enter bankruptcy or other financial realisation;
- a concession granted to the borrower for economic or legal reasons relating to the borrower's financial difficulty that results in forgiveness or postponement of principal, interest or fees, where the concession is not insignificant; and
- there has been deterioration in the financial condition or outlook of the borrower such that its ability to repay is considered doubtful.

For loans where objective evidence of impairment exists, impaired losses are determined considering the following factors:

- the local group's aggregate exposure to the customer;
- the viability of the customer's business model and their capability to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;
- the amount and timing of expected receipts and recoveries;
- the likely dividend available on liquidation or bankruptcy;
- the extent of other creditors' commitments ranking ahead of, or pari passu with, the local group and the likelihood of other creditors continuing to support the customer;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realisable value of security (or other credit risk mitigants) and likelihood of successful repossession; and
- the likely costs of obtaining and selling collateral as part of foreclosure.

Determination of the realisable value of security is based on the current market value when the impairment assessment is performed. The value is not adjusted for expected future changes in market prices, though adjustments are made to reflect local conditions, such as forced sale discounts.

c *Credit risk (continued)*

iv Credit quality (continued)

Impaired loans and advances (continued)

Impairment losses are calculated by discounting the expected future cash flows of a loan, which includes expected future receipts of contractual interest, at the loan's original effective interest rate and comparing the resultant present value with the loan's current carrying amount. The impairment allowances on individually significant accounts are reviewed at least annually and more regularly when circumstances necessitate review. This normally encompasses re-assessment of the enforceability of any collateral held and the timing and amount of actual and anticipated receipts. Individually assessed impairment allowances are only released when there is reasonable and objective evidence of a reduction in the established loss estimate.

Collectively assessed loans and advances

Impairment is assessed on a collective basis:

– to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment; and

– for homogeneous groups of loans that are not considered individually significant.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for a collective impairment assessment. These credit risk characteristics may include type of business involved, type of products offered, security obtained or other relevant factors. This assessment captures impairment losses that the local group has incurred as a result of events occurring before the reporting date, which the local group is not able to identify on an individual loan basis, and that can be reliably estimated. These losses would only be identified individually in the future. When information becomes available which identifies losses on individual loans within the group, those loans are removed from the group and assessed on an individual basis.

The collective impairment allowance is determined after taking into account:

– historical loss experience in portfolios of similar risk characteristics (for example, by industry sector, loan grade or product);

– the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against the individual loan; and

– management's judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses at the reporting date is likely to be greater or less than that suggested by historical experience.

The period between a loss occurring and its identification is estimated by local management for each identified portfolio based on economic and market conditions, customer behaviour, portfolio management information, credit management techniques and collection and recovery experiences in the market. As it is assessed empirically on a periodic basis the estimated period between a loss occurring and its identification may vary over time as these factors change.

Homogeneous groups of loans and advances

For homogeneous groups of loans that are not considered individually significant, two alternative methods are used to calculate allowances on a portfolio basis:

– When appropriate empirical information is available, the local group utilises roll rate methodology. This methodology employs statistical analyses of historical data and experience of delinquency and default to estimate the loans that will eventually be written off as a result of the events occurring before the balance sheet date but which the group is not able to identify individually. Individual loans are grouped using ranges of past due days; statistical analysis is then used to estimate the likelihood that loans in each range will progress through the various stages of delinquency and become irrecoverable. In applying this methodology, adjustments are made to estimate the periods of time between a loss event occurring and its discovery, for example through a missed payment, (known as the emergence period) and the period of time between discovery and write-off (known as the outcome period). Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss.

c *Credit risk (continued)*

iv Credit quality (continued)

Impaired loans and advances (continued)

– When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll rate methodology, the local group adopts a formulaic approach based on historical loss rate experience. Where a basic formulaic approach is undertaken, the period between a loss event occurring and its identification is explicitly estimated by local management.

The inherent loss within each portfolio is assessed on the basis of statistical models using historical data observations, which are updated periodically to reflect recent portfolio and economic trends. When the most recent trends arising from changes in economic, regulatory or behavioural conditions are not fully reflected in the statistical models, they are taken into account by adjusting the impairment allowances derived from the statistical models to reflect these changes as at the reporting date.

Reversals of impairment

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. The reversal is recognised in profit or loss.

Loan write-offs

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realisation of security. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write-off may be earlier.

v Collateral and other credit enhancements

It is the local group's practice to lend on the basis of the customer's ability to meet their obligations out of their cash flow resources rather than rely on the value of security offered. Depending on the customer's standing and the type of product, facilities may be provided unsecured. For other lending a charge over collateral is obtained and considered in determining the credit decision and pricing. In the event of a default, the group may utilise the collateral as a source of repayment. Depending on its form, collateral can have a significant financial effect in mitigating exposure to credit risk.

The principal collateral types are as follows:

– In the personal sector, mortgages over residential properties, cash and securities; and

– In the commercial real estate sector, charges over the properties being financed;

The table below represents for each exposure class, the total exposure value that is covered by eligible collateral, analysed into residential immovable property, commercial immovable property and other eligible collateral. In the case of exposures secured by mortgage on immovable property, the value is limited to 70% of the market value of the property or the mortgage lending value of the property in the case of residential property, and 50% of the market value of the property or 60% of the mortgage lending value of the property in the case of commercial property. The local group also holds other eligible collateral classified as funded credit protection, such as cash and life insurance policies, as well as liquid sovereign debt securities. The local group does not use any guarantees or credit derivatives as referred to in Article 453(g) of the CRR as a credit risk mitigant to cover credit exposures.

c *Credit risk (continued)*

v Collateral and other credit enhancements (continued)

	Exposure value covered by				
	Residential immovable property	*Commercial immovable property*	*Other eligible collateral*	*Exposure value not covered by eligible collateral*	*Total*
	€000	**€000**	**€000**	**€000**	**€000**
As at 31 December 2016					
Central government or central banks	–	–	–	975,392	975,392
Public sector entities	–	–	1,725	25,967	27,692
Multilateral development banks	–	–	–	164,811	164,811
Institutions	–	–	–	992,264	992,264
Corporates	–	–	8,761	181,696	190,457
Retail Exposures	–	–	9,255	157,396	166,651
Secured by mortgages on immovable property	1,969,304	621,105	19,731	–	2,610,140
Exposures in default	175	41	1,208	187,141	188,565
Items associated with particular high risk equity	6,938	29,163	9,162	14,538	59,801
Equity exposures	–	–	–	25	25
Other items	–	–	–	216,600	216,600
Total	**1,976,417**	**650,309**	**49,842**	**2,915,830**	**5,592,398**

vi Asset encumbrance

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

The objective of this disclosure is to facilitate an understanding of available and unrestricted assets that could be used to support potential future funding and collateral needs. An asset is defined as encumbered if it has been pledged as collateral against an existing liability, and as a result is no longer available to the group to secure funding, satisfy collateral needs or be sold to reduce the funding requirement.

The disclosure is not designed to identify assets which would be available to meet the claims of creditors or to predict assets that would be available to creditors in the event of a resolution or bankruptcy.

Encumbered and unencumbered assets

	Carrying amount of encumbered gross assets	*Fair value of encumbered gross assets*	*Carrying amount of unencumbered gross assets*	*Fair value of unencumbered gross assets*
	€000	**€000**	**€000**	**€000**
Group				
At 31 December 2016				
Equity instruments	–	–	749	749
Debt securities	92,483	92,483	959,968	959,968
Loan and advances to customers	11,637	11,637	3,308,695	3,308,695
Other assets	–	–	3,036,552	3,036,552
	104,120	**104,120**	**7,305,964**	**7,305,964**
Bank				
At 31 December 2016				
Equity instruments	–	–	747	747
Debt securities	92,483	92,483	955,319	955,319
Loan and advances to customers	11,637	11,637	3,308,726	3,308,726
Other assets	–	–	1,354,160	1,354,160
	104,120	**104,120**	**5,618,952**	**5,618,952**

c *Credit risk (continued)*

vi Asset encumbrance (continued)

The local group does not encumber any of the collateral received or any of its own debt securities issued.

As at 31 December 2016, the local group did not have any outstanding liabilities associated with encumbered assets and collateral received.

The bank undertakes the following types of encumbrance:

i Pledging of loans and advances to customers and debt securities against the provision of credit lines by the Central Bank of Malta.

ii Pledging of balances held with the Central Bank of Malta and debt securities in favour of the Depositor Compensation Scheme.

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d *Remuneration policy*

Information on the local group's remuneration policy and practices is disclosed in the Remuneration Report within the Annual Report located on page 43.

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e *Leverage*

The leverage ratio is a regulatory and supervisory tool intended to provide a transparent and non-risk based measurement of an institution to supplement the risk-based capital requirements.

The leverage ratio is calculated on a three-month average of capital as a proportion of total exposures. Capital is defined as Tier 1 capital in line with article 25 of the CRR, whilst total exposure relates to the total on and off-balance sheet exposures, less deductions applied to Tier 1 capital.

During 2016, the European Commission published a Proposal to amend Regulation 575/2013 (CRR), which included the introduction of a 3% leverage ratio as a binding Pillar I requirements. Although this proposal is still in draft and further discussions are expected, the local group complies with the 3% leverage ratio based on fully-transitioned Basel III standards.

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

	2016
	€000
Tier 1 capital	362,205
Total exposure measure for the purposes of the leverage ratio	6,013,143
Leverage ratio	**6.0%**

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

	2016
	€000
On-balance sheet exposures (excluding derivatives and SFTs)	
On-balance sheet items (excluding derivatives and SFTs)	5,676,664
Asset amounts deducted in determining Tier 1 capital	(5,424)
On-balance sheet exposures (excluding derivatives and SFTs)	**5,671,240**
Derivative exposures	
Replacement cost associated with all derivatives transactions	11,549
Add-on amounts for PFE associated with all derivatives transactions	5,494
Total derivative exposures	**17,043**
Other off-balance sheet exposures	
Off-balance sheet exposures at gross notional amount	1,067,556
Adjustments for conversion to credit equivalent amounts	(742,696)
Other off-balance sheet exposures	**324,860**

e *Leverage (continued)*

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

	2016
	€000
Total on-balance sheet exposures (excluding derivatives, SFTs and exempted exposures), of which:	
Exposures treated as sovereigns	975,392
Institutions	988,626
Secured by mortgages of immovable properties	2,478,007
Retail exposures	158,533
Corporate	145,118
Exposures in default	187,454
Other exposures	743,534
	5,676,664

Income Statements and Statements of Comprehensive Income: Five-Year Comparison

Group Income Statements

	2016	2015	2014	2013	2012
	€000	€000	€000	€000	€000
Interest receivable and similar income	**142,062**	150,567	155,789	162,106	174,637
Interest expense	**(15,635)**	(23,531)	(33,227)	(37,395)	(41,537)
Net interest income	**126,427**	127,036	122,562	124,711	133,100
Net non-interest income	**47,115**	49,319	50,698	62,301	64,576
Loan impairment charges	**(9,030)**	(10,826)	(22,545)	(3,272)	(5,115)
Operating expenses	**(102,291)**	(118,757)	(98,594)	(93,263)	(97,226)
Profit before tax	**62,221**	46,772	52,121	90,477	95,335
Tax expense	**(22,008)**	(17,292)	(18,504)	(31,760)	(33,733)
Profit for the year	**40,213**	29,480	33,617	58,717	61,602
Earnings per share	**11.2c**	8.5c	9.7c	18.1c	19.0c

Group Statements of Comprehensive Income

	2016	2015	2014	2013	2012
	€000	€000	€000	€000	€000
Profit for the year	**40,213**	29,480	33,617	58,717	61,602
Other comprehensive income					
Items that will be reclassified to profit or loss when specific conditions are met					
Available-for-sale investments:					
– fair value gains	**(585)**	4,938	13,656	305	16,671
– fair value (gains)/losses reclassified to profit or loss on disposal	**(10,787)**	(682)	(1,719)	(4,295)	(4,049)
– income taxes	**3,980**	(1,489)	(4,178)	1,396	(4,418)
	(7,392)	2,767	7,759	(2,594)	8,204
Items that will not be reclassified subsequently to profit or loss:					
Properties:					
– surplus arising on revaluation net of income taxes	**2,299**	–	(28)	84	(4,022)
– income taxes determined on the basis applicable to disposals	**–**	1,199	3	(20)	583
	2,299	1,199	(25)	64	(3,439)
Other comprehensive income for the year, net of tax	**(5,093)**	3,966	7,734	(2,530)	4,765
Total comprehensive income	**35,120**	33,446	41,351	56,187	66,367

Statements of Financial Position: Five-Year Comparison

	2016	2015	2014	2013	2012
	€000	€000	€000	€000	€000
Assets					
Balances with Central Bank of Malta, Treasury Bills and cash	**122,418**	187,563	118,033	151,458	106,991
Cheques in course of collection from other banks	**16,796**	12,559	10,990	9,703	7,211
Financial assets designated at fair value attributable to insurance operations	**1,383,606**	1,372,484	1,421,580	477,345	454,591
Held for trading derivatives	**11,440**	11,492	13,170	12,666	17,615
Loans and advances to banks	**1,077,859**	841,411	875,095	564,790	681,352
Loans and advances to customers	**3,320,332**	3,284,615	3,273,381	3,300,982	3,354,413
Available-for-sale financial investments	**1,053,200**	1,203,638	1,153,884	918,292	987,471
Prepayments and accrued income	**31,178**	40,863	44,730	38,677	41,121
Current tax assets	**12,963**	11,792	8,833	7,939	6,134
Reinsurance assets	**85,228**	83,088	85,337	37,424	–
Non-current assets held for sale	**9,750**	11,347	9,297	11,783	11,240
Investment property	**13,026**	15,458	16,326	14,529	14,471
Property, plant and equipment	**59,147**	58,559	59,481	61,491	54,872
Intangible assets	**65,765**	69,653	73,971	86,618	91,210
Deferred tax assets	**22,163**	22,642	13,612	12,522	11,273
Other assets	**21,093**	13,959	21,267	15,311	46,509
Total assets	**7,305,964**	7,241,123	7,198,987	5,721,530	5,886,474
Liabilities					
Deposits by banks	**10,770**	14,286	59,848	41,794	258,611
Customer accounts	**5,000,836**	4,950,257	4,867,124	4,517,862	4,516,999
Held for trading derivatives	**12,600**	11,732	13,870	12,929	17,857
Accruals and deferred income	**17,171**	30,073	27,514	30,230	33,559
Current tax liabilities	**177**	3,508	172	16	24
Liabilities under investment contracts	**930,937**	987,008	1,030,928	16,763	17,254
Liabilities under insurance contracts	**645,561**	616,657	592,378	524,999	493,254
Provisions for liabilities and other charges	**17,631**	17,133	2,417	3,211	7,493
Deferred tax liabilities	**34,586**	32,249	28,244	25,195	24,363
Subordinated liabilities	**87,418**	87,363	87,284	87,273	87,240
Other liabilities	**74,753**	29,741	44,103	38,274	29,222
Total liabilities	**6,832,440**	6,780,007	6,753,882	5,298,546	5,485,876
Total equity	**473,524**	461,116	445,105	422,984	400,598
Total liabilities and equity	**7,305,964**	7,241,123	7,198,987	5,721,530	5,886,474
Memorandum items					
Contingent liabilities	**118,469**	133,771	133,448	111,852	104,569
Commitments	**1,225,232**	1,292,605	1,291,225	1,269,222	1,073,831

Statements of Cash Flows: Five-Year Comparison

	2016	2015	2014	2013	2012
	€000	€000	€000	€000	€000
Net cash (used in)/from operating activities	**5,457**	(54,019)	448,298	51,339	258,354
Cash flows from investing activities					
Dividends received	**–**	–	–	21	26
Interest received from financial investments	**33,435**	54,037	39,435	30,255	41,356
Purchase of other available-for-sale financial investments	**(100,609)**	(312,346)	(413,566)	(277,694)	(375,638)
Proceeds from sale and maturity of financial investments	**227,414**	323,562	217,133	334,396	335,059
Purchase of property, plant and equipment, investment property and intangible assets	**(990)**	(4,640)	(5,264)	(12,087)	(6,133)
Proceeds on sale of property, plant and equipment, intangible assets and liquidation of subsidiary company	**2,639**	3	81	476	502
Proceeds on disposal of card acquiring business	**–**	–	–	–	–
Net cash flows from/(used in) investing activities	**161,889**	60,616	(162,181)	75,367	(4,828)
Cash flows from financing activities					
Dividends paid	**(22,717)**	(17,455)	(19,349)	(33,956)	(32,628)
Net cash used in financing activities	**(22,717)**	(17,455)	(19,349)	(33,956)	(32,628)
(Decrease)/increase in cash and cash equivalents	**144,629**	(10,858)	266,768	92,750	220,898

Accounting Ratios: Five-Year Comparison

	2016	2015	2014	2013	2012
	%	%	%	%	%
Net operating income before loan impairment charges to total assets	**2.5**	2.4	2.4	3.3	3.4
Operating expenses to total assets	**1.4**	1.6	1.4	1.6	1.6
Cost efficiency ratio	**60.0**	59.0	56.8	49.9	49.0
Profit before tax to total assets	**0.9**	0.6	0.7	1.6	1.6
Profit before tax to equity	**13.1**	10.1	11.7	21.4	23.8
Profit after tax to equity	**8.5**	6.4	7.6	13.9	15.4

	2016	2015	2014	2013	2012
Shares in issue (millions)	**360.3**	360.3	324.3	291.8	291.8
Net assets per 30 cent share (cent)	**131.4**	128.0	137.3	130.4	123.5
Earnings per 30 cent share (cent)	**11.2**	8.5	9.7	18.1	19.0
Dividend per 30 cent share (cent)					
– gross	**11.2**	7.7	9.7	17.8	17.2
– net	**7.3**	5.0	6.3	11.6	11.2
Dividend cover	**1.5**	1.5	1.5	1.7	1.9

Financial Highlights in US dollars

	2016	2015
	US$000	US$000
Income Statements		
Net operating income	**199,206**	191,927
Operating expenses	**(112,245)**	(129,243)
Net impairment	**(18,687)**	(11,782)
Profit before tax	**68,274**	50,902
Tax expense	**(24,149)**	(18,819)
Profit for the year	**44,125**	32,083
Profit attributable to shareholders	**44,125**	32,083
Statements of Financial Position		
Assets		
Balances with Central Bank of Malta, Treasury Bills and cash	**134,329**	204,125
Cheques in course of collection from other banks	**18,430**	13,668
Financial assets designated at fair value attributable to insurance operations	**1,518,231**	1,493,674
Held for trading derivatives	**12,553**	12,507
Loans and advances to banks	**1,182,735**	915,708
Loans and advances to customers	**3,643,400**	3,574,647
Available-for-sale financial investments	**1,155,676**	1,309,919
Prepayments and accrued income	**34,212**	44,471
Current tax assets	**14,224**	12,833
Reinsurance assets	**93,521**	90,425
Non-current assets held for sale	**10,699**	12,349
Investment property	**14,293**	16,823
Property, plant and equipment	**64,902**	63,730
Intangible assets	**72,164**	75,803
Deferred tax assets	**24,319**	24,641
Other assets	**23,145**	15,192
Total assets	**8,016,833**	7,880,515
Liabilities and equity		
Deposits by banks	**11,818**	15,547
Customer accounts	**5,487,417**	5,387,365
Held for trading derivatives	**13,826**	12,768
Accruals and deferred income	**18,842**	32,728
Current tax liabilities	**194**	3,818
Liabilities under investment contracts	**1,021,517**	1,074,161
Liabilities under insurance contracts	**708,374**	671,108
Provisions for liabilities and other charges	**19,346**	18,646
Deferred tax liabilities	**37,951**	35,096
Subordinated liabilities	**95,924**	95,077
Other liabilities	**82,026**	32,367
Called up share capital	**118,609**	117,637
Revaluation reserve	**45,355**	50,581
Retained earnings	**355,634**	333,616
Total liabilities and equity	**8,016,833**	7,880,515

The US Dollar Exchange as at 31 December 2016 was €1=US$1.0973 (2015: €1=US$1.0883).

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