



# Under the Microscope

**A Review of the Maltese Banking Sector  
for Financial Year 2017/2018**

December 2018

[kpmg.com.mt](http://kpmg.com.mt)





# Welcome to the **fourth edition**

*of Under the Microscope.*

Under the Microscope remains a one of a kind publication, dedicated towards providing an analysis of the performance of local banks over the last financial period together with a range of insightful articles developed in-house by local KPMG thought leaders.

In fact, in this year's publication one will find an array of thought leadership pieces, aimed at stimulating one's mind with a view to generating an element of thought and consideration to an ever evolving financial services industry which is now, more than ever, driven by regulatory and technological innovation.

FinTech and Regtech today are still in their infancy, despite these buzzwords thrown left, right and centre. In this publication we really seek to explore how the financial services industry has shifted, and how we can expect to be able to change in line with the new landscape we are all currently living.

Across the publication, readers will also find a number of QR codes which will provide the user with a visual explanation and representation of the content of the respective article, provided directly by the thought leaders themselves. We encourage readers to make use of this functionality.

We trust you find this edition as interesting and of value to read as it was for us to prepare.

Sincerely,  
Mark, Tonio and Noel



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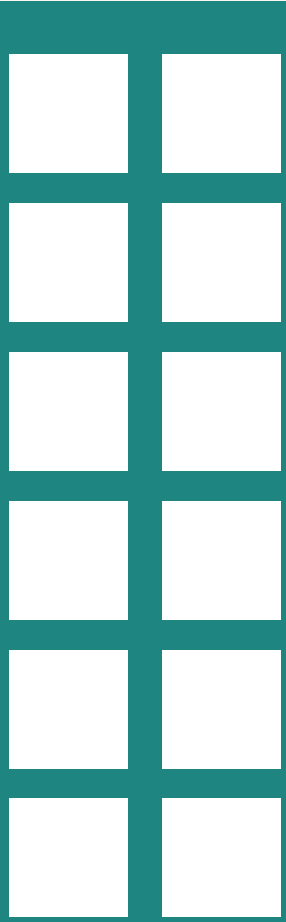
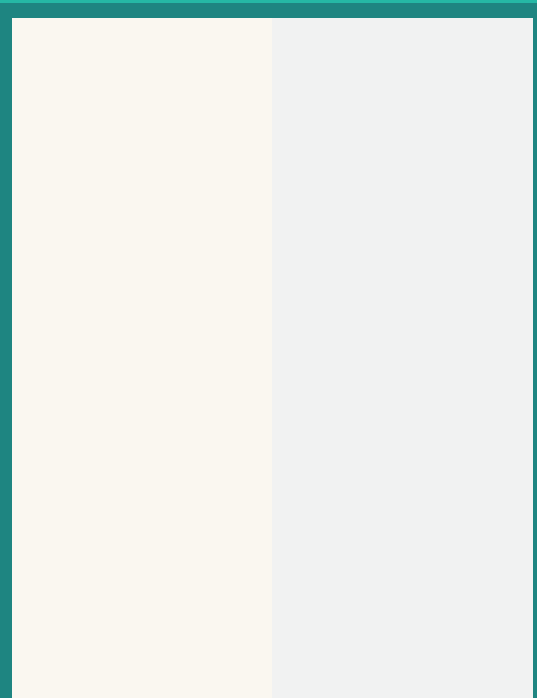


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**BANK**



# Approach

This Report is primarily based on the 2017/2018 Annual Group/Solo financial results and preceding period comparatives of 20 banks:

- AgriBank plc
- APS Bank Ltd
- Bank of Valletta plc
- BNF Bank plc
- CommBank Europe Ltd
- Credorax Bank Ltd
- ECCM Bank plc
- FCM Bank Limited
- Ferratum Bank plc
- FIMBank plc
- HSBC Bank Malta plc
- IIG Bank (Malta) Ltd
- Izola Bank plc
- Lombard Bank Malta plc
- MeDirect Bank (Malta) plc
- MFC Merchant Bank Ltd
- NBG Bank Malta Ltd
- Novum Bank Ltd
- Sparkasse Bank Malta Plc
- Yapi Kredi Bank Malta Ltd

Akbank T.A.S. and Garanti Bankasi A.S., being branches of Turkish banks operating in Malta, have been excluded from the analysis. Credit Europe Bank NV Malta, a Dutch branch operating in Malta has also been excluded from the analysis. Satabank plc has been omitted from this year's publication in view of the fact that the latest financial statements available are those for year ended December 2016.

In the assessments of AgriBank plc, Commbank Europe Ltd and MeDirect Bank (Malta) plc we used the financial statements for the year ended 2018, given that their financial year ends during the current calendar year.

In the case of Bank of Valletta plc, HSBC Bank Malta plc, and MeDirect Bank (Malta) plc, we also used the latest interim financial statements to support our analysis.

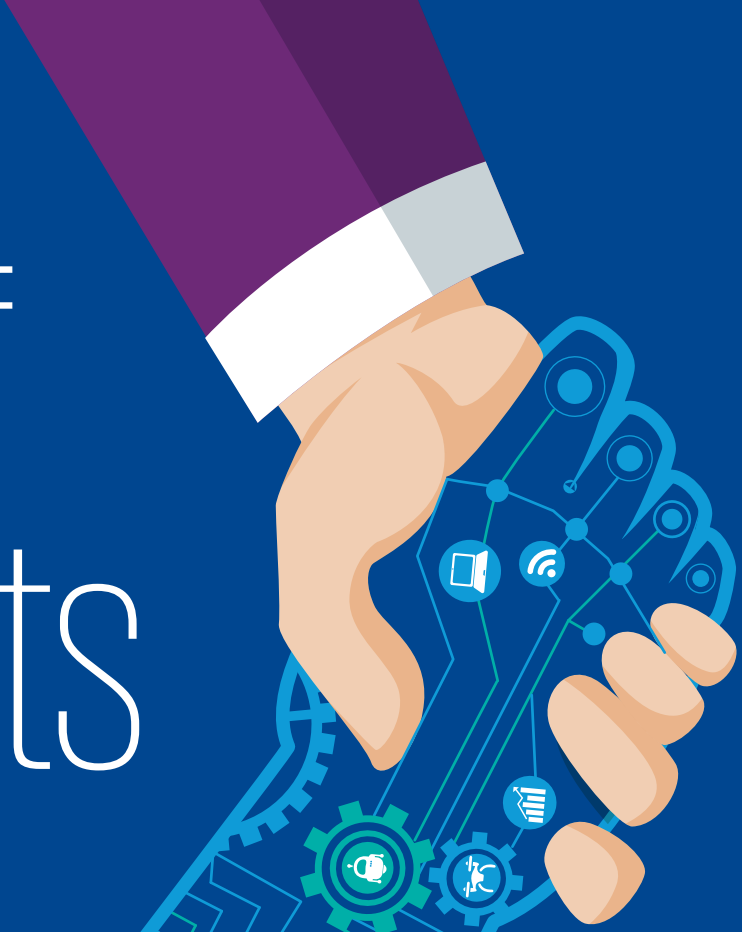
Furthermore, Lombard Bank Malta plc's assessment does not include the results of Redbox Limited.

All the data related to the analysis of the Bank's financial statements has been obtained solely from publicly available sources. This analysis has, in most cases and as much as possible, utilised comparable data to provide meaningful results.

In undertaking our analysis, in certain cases we were required to calculate certain regulatory or financial ratios from the public information available. The ratios which were calculated in-house have been clearly identified in the respective analysis. The formulas utilised in the ratio calculations were as follows:

- $ROE = \text{Profit before tax} / \text{Shareholder's equity}$
- $ROA = \text{Profit before tax} / \text{Total Assets}$
- $\text{Cost-to-income} = \text{Operating Costs} / \text{Operating Expenses}$
- $\text{NII to Total Income} = \text{NI Income} / \text{Total Income}$
- $\text{NPL ratio} = \text{Gross Non-performing Loans and Advances} / \text{Gross Loans and Advances}$

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# Glossary



# Glossary

- AC- Amortised Cost
- AFS - Available-for-Sale
- AI - Artificial Intelligence
- AISP - Account Information Service Providers
- AUD - Australian Dollar
- BPS - Basis Points
- CAR - Capital Adequacy Ratio
- CBM - Central Bank of Malta
- CEO - Chief Executive Officer
- CET1 - Common Equity Tier 1
- CI - Cost-to-Income
- CRDIV - Capital Requirements Directive
- DAO - Decentralized Autonomous Organization
- DLT - Digital Ledger Technology
- EBA - European Banking Authority
- ECL - Expected Credit Losses
- EEC - European Economic Community
- eIDAS - electronic IDentification, Authentication and trust Services
- EU - European Union
- EUR - Euro
- FinTech - Financial Technology
- FS - Financial Services
- FVOCI - Fair Value through Other Comprehensive Income
- FVTPL - Fair Value through Profit and Loss
- GBP - Great Britain Pound
- HTC - Hold-to-Collect
- IAS - International Accounting Standards
- ICT - Information Communication Technology
- IFRS - International Financial Reporting Standards
- IT - Information Technology
- KYC - Know Your Customer
- LCR - Liquidity Coverage Ratio
- M&A - Mergers and Acquisitions
- MOU - Memorandum of Understanding
- N/A - Not Available
- NII - Net Interest Income
- NPL - Non-Performing Loans
- PBT - Profit Before Tax
- PISP - Payment Initiation Service Provider
- PSD - Payment Services Directive
- R&D - Research and Development
- RegTech - Regulatory Technology
- ROA - Return on Assets
- ROE - Return on Equity
- SMEs - Small and Medium Enterprises
- SPPI - Solely Payments of Principal and Interest
- SSM - Single Supervisory Mechanism
- T-Bill - Treasury Bill
- TMT - Technology, Media, Telecommunications
- USD - United States Dollar
- VFA - Virtual Financial Asset
- VFAOs - Virtual Financial Asset Offerings

	- Number of employees		- Date of establishment		- Licences
	- Number of branches		- Main activities		- Group Composition
	- Personal Lending*		- Information and communication and Administrative and support service		- Significant Institutions
	- Commercial Lending*		- Manufacturing Sector		

\* Ratio calculated as a percentage of of Total Gross Loans and Advances to Customers, unless stated otherwise.

# The Banking Hub



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Banks have for centuries performed an indispensable role in the development of economies both on micro and macro levels. Whilst other forms of investment vehicles and finance companies have taken shape, banks still remain [and will remain] a predominant force in the financial ecosystem in view of the very nature of their business - the acceptance of deposits and the provision of credit - which is core to economical mechanics. Undisputedly, banks will change and adapt in response to changes in technology, customer trends, and regulation yet the traditional role will have to remain if these are to be called banks.

Tiny Malta boasts of 24 active credit institutions which are different in size, objectives, business models and the markets they seek to serve. It has often been cited that our banking industry remained resilient in the face of financial crises in the past and perhaps this was principally due to the conservative nature of banking practices on the Island – at least to the extent of our core domestic banks operating in the retail market.

Over the last 30 years or so, since parliament had taken the bold step of embarking on making the island a financial centre, licenced banks grew exponentially, both in number, type and size. Banks were attracted to the island as a result of the promulgation of a suite of financial services laws that was conducive towards effective regulation, a relatively low cost of operation and an advantageous fiscal regulation. The growth of the core retail banks was on the other hand testament of the values and character of the indigenous population with a disposition to save for a rainy day whilst trusting and remaining loyal to the banks on the Island which did not let it down.

As a result of multiple financial crises, banking regulation internationally was forced to become more stringent and onerous on operators in response to public outcry that banks were not being properly regulated to safeguard the interest of investors but more importantly of depositors. And, notwithstanding the performance of the Maltese banking market, increased regulation was inevitable for an Island that was both a member of the European Union and a Eurozone country.

Perhaps it is not surprising that our banks did well for most of the time – the size and the business model of licenced banks in Malta must have surely facilitated the execution of more effective corporate governance, which over time has evolved very much in substance as the process of constituting boards and board committees became a serious affair. It is true, that the Island has limiting factors when it comes to people specialisation and although we have improved tremendously, particularly as professionals across all industries return to our shores from abroad having experienced working in international financial centres, the industry is often forced to revert to overseas recruitment and outsourcing as availability of specialists in the different areas of banking remain scarce. Having said that, the experience working with a large number of banks in Malta has shown a high level of professionalism, integrity and commitment towards serving the right customers. Undoubtedly, banks have not always had the same levels of customer on-boarding sophistication and it is likely that with the influx of investment into the jurisdiction that has also fuelled the economy, some unwanted business may have slipped through the net. This is not to say, however, that Malta's banking sector has become rogue – Malta, like all the other jurisdictions in Europe has had to deal with actual and suspicion of money laundering activities and that is exactly the reason why anti-money laundering laws and regulation continue to become tighter in the European Union. Laws are not being changed because of Malta.

It is thus frustrating and upsetting to note that Malta's banking industry is under attack both in the local public arena as well as by international institutions that have cast, intentionally or unintentionally, a significant stain on the industry in general. Unfortunately, in a country that is subject to acute political polarisation, self-interest emerges in its most dangerous form, driving anti-competitiveness, a deterioration of trust and media frenzies engineered to catapult and promulgate [un]worthy allegations across the digital world. This behaviour can be defined and perhaps still is, grossly irresponsible and loaded with protecting or promoting self-interest at the expense of the industry and Malta in general. The political landscape over the last 18 months arguably accentuated issues that – directly or indirectly – contributed to the denting of Malta's reputation as an Island of repute.

Government, Opposition, bank boards, professional service providers and the regulators on the Island, must endeavour to assist in the continuous improvement of the governance structures in place as should other jurisdictions; should provide robust and credible supervision and oversight in line with the more involved approach of the European regulator; should ensure as much as is possible to protect our institutions from unethical or criminal behaviour, the existence of which is costing the industry its whole reputation globally.

All stakeholders must focus on the issues at hand and deal with them in a proportionate manner. To date, were it not for the very integrity of the industry itself, Malta would have already had a failed industry – we are not, however, out of the woods. Issues are still being manifested in operational issues being faced by credit institutions in Malta such as the availability of correspondent banking relationships for specific currencies that are indispensable for the effective operation of a bank's international business as well as an apparent focus on the oversight of our banks by European and other international supervisors that is clearly the result of discomfort and suspicion.

This should not be taken lightly – rather, it should be on everyone's agenda and the more we talk about it, the more everyone will hopefully become aware of what we risk losing. We must debate, reflect and act! Our banking industry is a gem which we must continue to protect and drive for the growth we have successfully experienced over the years - and like a gem, polish and let shine.



**The growth of the core retail banks was on the other hand testament of the values and character of the indigenous population with a disposition to save for a rainy day whilst trusting and remaining loyal to the banks on the Island which did not let it down.”**



# Key Sector Information

21 credit institutions and 3 branches of foreign credit institutions

Malta ranked 41<sup>st</sup> out of 140 economies for Soundness of Banks in 2018



Credit Institutions

Total GDP 2018Q3: €3,252.6 million (2017Q3: €2,971.6 million)

Real Expenditure per Capita (PPS EU28) (2017): €28,900 (2016: €27,400)

Unemployment Rate for 2018Q3: 3.8% (2017Q3: 4.0%)

Inflation Rate for 2017: 1.3% (2016: 0.9%)



Economy

Total new funds licensed (incl. sub-funds) (2004 – Q2 2018): 1,488

Total funds surrendered (incl. sub-funds) (2004 – Q2 2018): 833

Net Asset Value of Malta-domiciled funds: €11.88 billion as at end September 2018

Funds administered in Malta (incl. sub-funds):

- Malta-domiciled funds administered in Malta: 573 as at end September 2018
- Non-Malta-domiciled funds administered in Malta: 171 as at end June 2018

Net Asset Value of funds administered in Malta (domiciled and non-domiciled in Malta): €12.1 billion as at end June 2018



Trust and Funds

Global Competitiveness Report 2018 World Economic Forum ranks Malta:

- 36<sup>th</sup> out of 140 economies in terms of National Competitiveness
- 22<sup>nd</sup> out of 140 economies for the strength of Auditing and Reporting Standards
- 37<sup>th</sup> out of 140 economies for the Financing of SMEs
- 48<sup>th</sup> out of 140 economies for Companies Embracing Disruptive Ideas
- 34<sup>th</sup> out of 140 economies for Innovation Capabilities



International Financial Centre

[https://www.mfsa.com.mt/pages/readfile.aspx?f=/files/Publications/Statistics/Licences\\_Statistics/01.%20Statistical%20Tables%20-%203rd%20Quarter%202018.pdf](https://www.mfsa.com.mt/pages/readfile.aspx?f=/files/Publications/Statistics/Licences_Statistics/01.%20Statistical%20Tables%20-%203rd%20Quarter%202018.pdf)

<http://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf>

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<https://tradingeconomics.com/malta/rating>

<https://www.timesofmalta.com/articles/view/20160909/local/trade-deficit-narrows-to-149m-in-july-nso.624521>

<https://tradingeconomics.com/malta/government-debt>

[https://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=tepsr\\_wc170&plugin=1](https://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=tepsr_wc170&plugin=1)

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[https://nso.gov.mt/en/News\\_Releases/View\\_by\\_Unit/Unit\\_A1/National\\_Accounts/Documents/2018/News2018\\_193.pdf](https://nso.gov.mt/en/News_Releases/View_by_Unit/Unit_A1/National_Accounts/Documents/2018/News2018_193.pdf)



## Financial Institutions

48 financial institutions licenses, of which:

- 37 are authorised to provide payment services
- 15 are authorised to issue electronic money



## Insurance

66 licensed insurance undertakings (September 2018)

- 49 Non-life
- 8 Life
- 2 Composite
- 7 Re-insurance enterprises

The current Labour Government came into power in 2013 and was re-elected 2017. The next elections are due in 2022.

Malta's Sovereign rating:

- Fitch: **A+**
- S&P: **A-/A-2**
- Moody's: **A3**

Government's Deficit for first half of 2018: €141.9 million in deficit (compared to the same period in 2017: €92.0 million)

Total Government debt end of 2017: 50.8% of GDP



## Government

Double taxation treaties exist with more than 75 countries

Corporation tax of 35% but with a full imputation tax system which completely eliminates the economic double taxation of company profits

Apart from operating a full imputation system, Malta operates a tax refund system reducing this effective tax rate to between nil and 6.25%. In addition, recent introduction of tax rules in Malta provide for the possibility for Maltese registered companies to avail of a Notional Interest Deduction. This may further reduce the tax liability at the level of a Maltese registered company by allowing it to claim, against its chargeable income, a notional deduction for the cost of capital. The deduction is computed as a percentage of risk capital as at year end- this currently stands at 7% (2% risk free rate plus 5% premium)

The maximum personal taxation rate is 35% for those earning €60,001 upwards. No tax is payable on income up to €9,001 for those paying at single rates.

Highly qualified foreign executives can benefit from a flat rate of 15% tax on income up to €5m – any income over and above this is tax free.



## Taxation

# Open Banking: Are SMEs Open for business?




In August 2018, KPMG in the UK asked 1,000 SMEs for their views on Open Banking, testing their willingness to share data with a third-party under 13 different scenarios. It was found that the opinion is polarised and UK SMEs fall under three distinct types of customers, each with different appetites for Open Banking. A synopsis of the result from this survey is found below:

## 1000

Small to Medium Enterprises (SMEs) in the UK about Open Banking

Not all the SMEs are the same

- 1 What is their awareness of Opening Banking
- 2 What is their attitude towards open systems and data sharing in relation to financial data
- 3 How do they feel about trusting financial and other associated brands with this data
- 4 What are their attitudes towards future open banking models, apps and products

 Steady Conservatives	 Moderate Maybes	 Open for Business
42% of the market and are low growth, small and simple businesses with a limited appetite for Open Banking	28% of the sample and are a relatively low-growth mid-sized businesses, with some appetite for Open Banking	30% are high-growth sophisticated and larger businesses, typically in manufacturing, TMT or financial services
<b>Low financial complexity</b> with 52% not even having considered accountancy software	<b>More sophisticated finance</b> product users with up to 11 financial products	<b>Greatest financial complexity</b> 92% using more than 9 financial products and have a relationship with on average 3.5 financial providers
<b>Not excited by many Open Banking services</b> Most inclined towards services that will make their lives easier in terms of reporting obligations	<b>Need some convincing</b> But have a strong interest in services that save time or money such e.g. managing payments to/from customers and supplies	<b>Most likely to adopt and pay for Open Banking services</b> Willing to consider an average of 10 of 13 Open Banking products put to them
Help me save money	Make my life easier	Don't sell to me

The overarching themes are clear

Open Banking isn't for everyone (yet)



Almost half of SMEs will not engage in Open Banking services



25% of respondents unlikely to share any data with third party financial providers under any circumstance



In return for access to their data, SMEs want financial savings in the region of 10 to 24 percent

Trust Matters



High street banks, followed by building societies, are most trusted by SMEs and best placed to deliver Open Banking



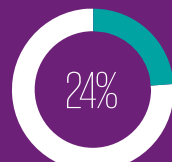
New entrants and start ups are least trusted, especially by more conservative businesses (43% of the sample)

**We've found that a similar distribution applies to the likelihood of SMEs switching for Open Banking Services.**

Of the SMEs that would opt into Open Banking



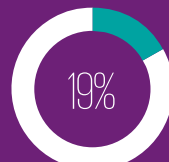
44% would not pay for any Open Banking services



The ones who would pay, would want 24% A dashboard of all their business financial accounts, loans, savings, assets etc.



22% For the ability to make and receive payments to/ from suppliers and customers easily and quickly



19% Financial software to automatically and efficiently manage regular payments on behalf of the SME



## Steady conservative

Low growth, smaller, simpler SMEs (42%) – very limited appetite for 'open banking' type propositions

Likely propositions would be:

- 'Keep me safe' (e.g. tax return)
- Payments (to avoid merchant fees) possibly using either 'closed' PISP (e.g. Tesco Payplus), trade solution (e.g. British Retail Council)

A difficult segment for banks as incumbents since nobody is likely to target this cluster (and even if they do they won't move) hence they may become "the rump" for the High Street Banks

Low interest in Open Banking and probably not profitable



Very conservative but not entirely closed. Useful models to address this sector would be:

- A RM/business bank lite
- Natural franchises/trade bodies – e.g. the add on to Llonidis or Bunzl

Inherently more loyal to their High Street Bank



## Moderate may-be

'The rest' – some appetite and typically lower growth/slightly smaller organizations

Somewhere between steady conservatives and open for business – showing interest but not convinced. Some will follow the behaviours of open for business



Banks should seek to own this cluster as their heartland – BUT they have to move the model or they will move to open for business behaviours over time

Likely strategies to include:

- Evolutionary play – i.e. introduce on a targeted basis incremental open banking propositions to take existing customer base on a journey as customers likely to be comfortable experimenting with existing providers
- 'Fight for open for business and ripple down to moderate may-be'

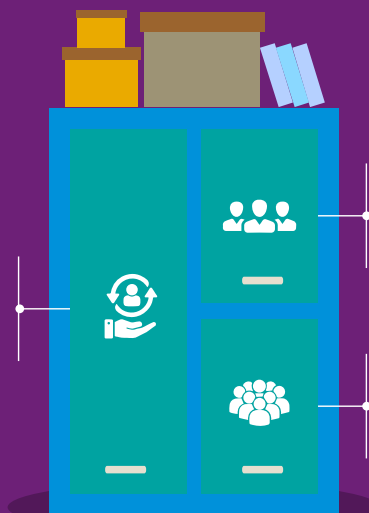


## Open for business

High growth, larger, more sophisticated SMEs (30%) – typically TMT, Manufacturing or FS. This cluster is 'open for business' both in terms of the services that might be consumed (and indeed paid for), and who provides them

Propositions to appeal to this sector likely to be:

- sophisticated AISP + intelligence play – i.e. data powered financial decisions (Tom's smartcash option)
- Ecosystem play maximizing across 'whole of market'
- Sector specialist – 'The Manufacturers Bank'
- Entrepreneur oriented – i.e. whole view of the individual and the business



Wide open as a market both in terms of:

- Propensity to buy
- Who they would consider buying from

Given high growth nature they are likely to be one or all of:

- Participants in high growth sectors e.g. Tech
- Entrepreneur led and owned
- New business model

# Challenges to Innovation in Banking



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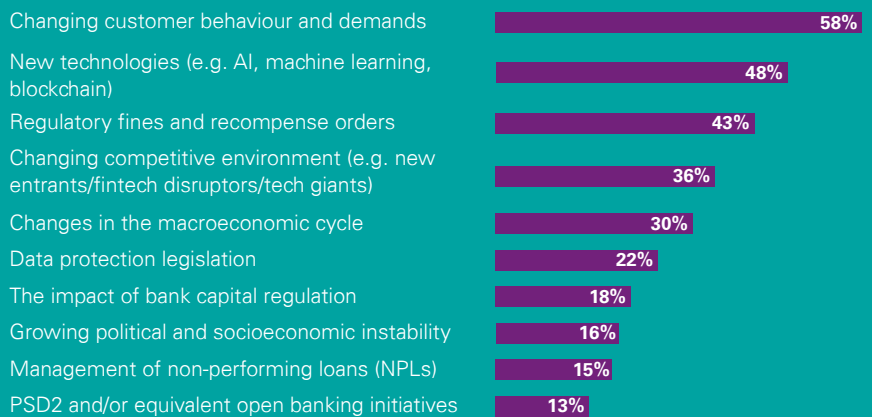
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**The past few years have seen banks shift their focus towards looking for ways to improve their operations' effectivity through technology, update their legacy systems, and improve their customer experience. There seems to be a sense of urgency driving traditional banks to become more innovative. What should banks really be looking at in order to truly become more innovative?** ”

As digital innovation and disruption has caused customers to lean towards digital services and tools for their financial management requirements, traditional banks are becoming increasingly vulnerable. Recent research on trends that will have the biggest impact on banking in the next few years, suggests that there will be significant change in customer behaviour and demands, a change brought about by the introduction of new technologies and a more competitive environment.

## Trends that will have the biggest Impact on Retail Banks Through 2020



Source: Temenos and the Economist Intelligence Unit, n=400, 2018

Put simply, in order to survive, it has now become mission critical for banks to become more innovative and prepare themselves for a future that is already shaping itself today. That said, aside from new and emerging technologies, what should banks be doing to become innovative?

In order to truly succeed in this new and disruptive environment, banks must equip themselves to overcoming three main barriers to innovation:



## Organisational Structure



**A hierarchical management structure hinders creativity, agility, and flexibility, all drivers of innovation. ”**

The rigidity of hierarchical organisations is one of the largest barriers to innovation. Traditional banks are built with a strict management hierarchy in place; they possess an efficient chain of command, with managers running their departments and reporting upward to more senior decision makers.

However, in terms of innovation, this structure only caters for the utilisation of creative ideas that come from the top and are shared downwards. Creative ideas coming from the middle or lower levels of a hierarchy have to work their way up through a series of managers, each with the power to approve or reject but each lacking the power to implement. With this structure ideas are easily lost or forgotten.

Banks are now operating in a dynamic and ever changing environment where it is a necessity to quickly pursue new strategies and implement change. They must implement strategies that allow employees the opportunity to share ideas and be creative, regardless of rank or position within the organisation. Organisations should strive to be open to collaborative brainstorming, where flat organisational structures allow for faster, actionable, and two way communication between junior members and senior members of the bank.

Achieving the right organisational structure starts with leadership reflecting on a critical question “Does our organisational chart stifle innovation?” A recent research study, highlights that 72% of bankers believe that traditional corporate structures and chains of command are inhibiting innovation. Boardroom and strategy discussions must shift their focus to understanding industry trends, forecasting future customer needs, preparing for talent challenges and ensuring that their organisational structure allows for innovation to thrive within the company.

## Organisational Culture



**A culture that sustains and supports innovation is one that encourages its employees to envision without fear. ”**

Corporate culture is the most powerful and most intangible barrier to innovation. Recent research claims that 9 out of 10 banks believe that their organisation must innovate at an increasingly rapid rate in order to stay competitive. As a result, a refined and flat organisational structure means little, if the culture of the organisation does not support innovation. True innovation requires a culture of “short cycle attempts to turn an envisioning process into operational realities”. This philosophy goes against the typical culture of long term planning found in a traditional bank. In order to support innovation, banks must create and drive a culture that is based on experimentation and discovery.

Developing a culture that supports innovation starts at the top. Leaders within an organisation must understand and believe that generating and developing new ideas is an ongoing discovery process which does not always immediately create the product or service that customers want. They must also understand that when a project does not reach its macro objectives, it is essential to extract learning and new insights so that the “failure” eventually leads to a new success.

Once leaders believe this, they must work on encouraging talent within the organisation to work on their ideas and to stay involved and engaged. The best way to accomplish this is to translate the organisation’s cultural foundations into tangible values and these values into behaviours and competencies. These competencies and behaviours will then feed in to a series of initiatives, such as, performance management initiatives, that seek to guide the behaviour of employees. Innovation should become one of the organisation’s core values. In this manner, banks will make innovation part of the agenda for all, ensuring that innovation becomes an operational norm, rather than an occasional, sporadic process.



## Organisational Talent



**Banks must ensure that they have the right people, with the right skills, in the right place, at the right time. ”**

Talent is the epicentre of innovation. All of the above means little if an organisation does not possess Talent that is capable of driving innovation. Banks must look at organisational talent from two perspectives; leadership talent and employee talent. On one hand organisations must invest in ensuring they possess leaders who are capable of driving and encouraging innovation, and on the other hand they must ensure that employees are receptive to change and capable of being innovative.

The importance of banks giving talent its due attention is made stronger by the strong competition for talent. Due to the growing skills shortage, advancing technologies, generational shifts, and evolving dynamics around the nature of work, today's pursuit for talent is as competitive as ever. This reality demands that organisations take charge of how they attract, develop and retain their organisation's talent.

Banks must remember that they are not just competing amongst themselves for employees who have the drive and skills essential for innovation; they are also competing against flashy tech start-ups and fintech firms, which offer flatter structures, a lot of room for career growth, an innovative culture, and the space to work in an autonomous manner. Including innovation as a core value will ensure this permeates into the employer brand, thus working to also attract the younger talent of today, the digital natives and millennials.

### Measure.Define.Action

Banks must work towards creating customised, contextual, and strategic talent management initiatives that are aligned with the organisation's business strategy, and focused upon driving innovation and maximising organisational performance through its talent.

The strategies that drive innovation cannot be introduced overnight. Rather, banks must commit their time and financial resources to taking stock of their current realities, both internally (in terms of talent) and externally (in terms of their customers and industry trends), defining their future state, and implementing a strong talent management plan to get them there. Without this, banks will not be able to survive within the industry in the future, a future that has already begun to take shape.





# KPMG Suite of Services: Distributed Ledger Technology

KPMG offers a suite of DLT services that addresses all stages of advisory and assists with abiding to regulation. No matter at what stage of development your product is in, we can help you structure the business around it and regulate it accordingly.

## Regulatory assistance with Initial VFA Offerings and to VFA Services providers

- Assistance with and reviews of licensing required under the Virtual Financial Assets (VFA) Act
- Evaluation workshops aimed at assessing business models and related regulatory implications
- Reviews of business plans, financial models, white papers and related funding requirements
- Assistance with complying with regulatory requirements
- Assistance with ensuring a good corporate governance, risk management and internal controls infrastructure
- Reviews of the Financial Instrument Tests
- Training to Board of Directors and C-Suite cohort
- Assessment of regulatory implications emanating from other jurisdictions in connection with initial VFA offerings



## Corporate assistance and Tax services for Promoters, Issuers, Crypto Exchanges, Crypto funds and Investors

- Advice on the characterisation for tax purposes of a coin or token issue
- Advice on the tax treatment of revenues derived from ICOs, STOs, TGEs and crypto exchanges
- Guidance on tax and corporate structuring to ensure compliance and efficiency
- Assistance with obtaining tax incentives, exemptions and rebates
- Assistance with assessing attendant tax reporting obligations
- Assistance with set up, including registration, preparation of the white paper, token purchase agreements, best practice terms etc
- Advice on taxation of returns from digital assets, available exemptions and tax treaty application
- Review of offering and subscription materials from a tax perspective
- Global support through the KPMG network



## Audit and assurance

- Audit of financial statements
- Review engagements in relation to ICOs
- Report on IT systems and security access protocols



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# The profile of Maltese Banks

The Central Bank of Malta splits the 21 local banks into three categories:

- **Core Domestic Banks:** these can be loosely defined as those credit institutions which provide an array of banking services and are core providers of credit and deposit services in Malta. Typically, these banks operate through a branch network.
- **Non-Core Domestic Banks:** these play a more restricted role in the Maltese economy, since the suite of banking services they offer to Maltese residents are somewhat limited and usually restricted to deposit taking.
- **International Banks:** these banks are those which predominantly offer their services to persons residing outside Malta.

Malta also hosts three branches, namely two Turkish and one of Dutch origin.

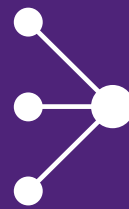


## Core Domestic Banks

APS Bank Limited  
Bank of Valletta plc  
BNF Bank plc  
HSBC Bank Malta plc  
Lombard Bank Malta plc  
MeDirect Bank (Malta) plc

**Total number of  
Core domestic Banks: 6**





## Non-Core Domestic Banks

FCM Bank Limited  
FIMBank plc  
IIG Bank (Malta) Limited  
Izola Bank plc  
Sparkasse Bank Malta plc

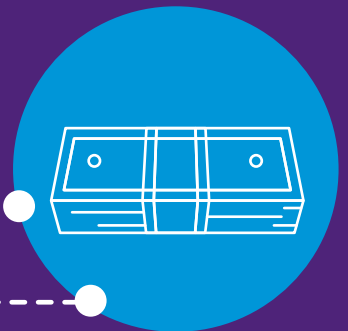
**Total number of  
Non-core domestic Banks: 5**



## International Banks

AgriBank plc  
CommBank Europe Limited  
Credorax Bank Limited  
ECCM Bank plc  
Ferratum Bank plc  
MFC Merchant Bank Limited  
NBG Bank Malta Limited  
Novum Bank Limited  
Satabank plc  
Yapi Kredi Bank Malta Ltd

**Total number of  
International Banks: 10**



## Branches

Akbank T.A.S.  
Türkiye Garanti Bankasi Anonim Sirketi  
Credit Europe Bank NV

**Total number of  
Branches: 3**

# Key Figures

## Core Banks

		Total Assets		Amounts Owed to Customers		NII		Net fee and commission income/ (expense)		PBT	
		€ million		€ million		€ million		€ million		€ million	
		2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
1	APS Bank Limited	1,496	1,285	1,226	1,099	33	28	4	4	18	16
2	BNF Bank plc	568	523	514	483	10	10	2	2	1	2
3	Bank of Valletta plc	11,821	10,723	10,101	9,185	183*	149	86*	66	175*	146
4	HSBC Bank Malta plc	6,798	7,306	4,766	5,001	121	126	23	24	50	62
5	Lombard Bank Malta plc***	860	844	737	725	15	14	3	3	7	7
6	MeDirect Bank (Malta) plc**	2,546	2,571	1,979	1,902	63	58	4	3	14	19

## Non-Core Banks

7	FCM Bank Limited	70	66	61	57	0	0	0	0	(1)	(1)
8	FIMBank plc****	1,370	1,655	706	900	22	20	16	13	10	5
9	IIG Bank (Malta) Ltd*****	160	146	133	114	4	5	1	1	2	4
10	Izola Bank plc	207	197	146	132	2	2	3	2	4	4
11	Sparkasse Bank Malta plc	520	485	482	454	2	2	6	5	5	4

## International Banks

12	AgriBank plc**/****	35	28	25	19	1	1	0	0	0	0
13	CommBank Europe Limited**/****	660	618	0	0	15	15	1	1	(4)	14
14	Credorax Bank Limited	136	100	5	5	0	0	12	9	3	19
15	ECCM Bank plc	445	355	181	97	10	6	2	1	10	7
16	Ferratum Bank plc	261	169	171	98	87	60	(5)	(5)	11	3
17	MFC Merchant Bank Limited	15	53	2	0	0	1	2	1	1	1
18	NBG Bank Malta Limited	645	585	237	235	10	15	0	0	7	8
19	Novum Bank Limited	89	59	62	34	2	0	19	14	2	(1)
20	Yapi Kredi Bank Malta Ltd	158	149	0	0	3	2	0	0	1	1

For ease of perusal, all figures in the above table exceeding €0.5million were rounded up to the nearest € million.

\*These figures have been calculated for 15 months to December 2017, due to the change in financial year end.

\*\*The figures for MeDirect Bank (Malta) plc, AgriBank plc, and CommBank Europe Limited are for the financial years ended 2017/2018.

\*\*\*The figures for Lombard Bank Malta plc were based on a solo basis.

\*\*\*\*For these banks, the above figures were converted to Euro using the applicable ECB AUD/GBP/USD to EUR financial year end exchange rates (for Balance Sheet items) and average currency exchange rates (for Income Statement items).

### Core Banks

		CET1 Ratio		CAR		Own Funds	
		%		%		€ million	
		2017	2016	2017	2016	2017	2016
1	APS Bank Limited	14	16	15	17	113	110
2	BNF Bank plc	12	8	14	11	42	25
3	Bank of Valletta plc	16	13	19	17	931	775
4	HSBC Bank Malta plc	14	13	14	14	366	390
5	Lombard Bank Malta plc***	14	16	14	17	89	86
6	MeDirect Bank (Malta) plc**	14	12	17	14	357	253

### Non-Core Banks

7	FCM Bank Limited	N/A	N/A	243	16	7	7
8	FIMBank plc****	11	10	16	13	157	176
9	IIG Bank (Malta) Ltd*****	14	16	14	16	22	24
10	Izola Bank plc	N/A	N/A	26	33	27	25
11	Sparkasse Bank Malta plc	25	22	25	22	23	21

### International Banks

12	AgriBank plc**/****	N/A	N/A	25	24	7	6
13	CommBank Europe Limited**/****	44	51	44	51	310	338
14	Credorax Bank Limited	18	25	18	N/A	23	25
15	ECCM Bank plc	41	38	95	90	262	257
16	Ferratum Bank plc	17	16	17	16	40	25
17	MFC Merchant Bank Limited	83	89	83	89	12	51
18	NBG Bank Malta Limited	48	N/A	48	48	223	223
19	Novum Bank Limited	N/A	N/A	26	26	12	10
20	Yapi Kredi Bank Malta Ltd	41	40	41	40	61	60

For ease of perusal, all figures in the above table exceeding €0.5million were rounded up to the nearest € million.

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# #BlockchainIsland



**Steve Stivala**

Senior Manager  
Management Consulting Services  
Economics Team - Subject Matter Experts

It is truly amazing how fast technology accelerates into the future. Relentless, oftentimes pervasively spreading without clear direction into a digital unknown. It is easy to have a blurry vision when on a speeding proverbial hype train. So when things get too fast too quickly, one needs to stop and think.

Last year, we argued that Malta and Fintech are a match made in heaven (or in the 'cloud' if you are more scientifically-inclined). We still think that, but a few caveats are in order.

We can learn a lot from history. The winning technology is not always the best (think Betamax); and what we think is going to revolutionise the way we do things, usually stalls in the face of tepid demand – Google Glass for instance was a miserable failure simply because the benefit of wearing a pair did not outweigh the cost of looking like a complete nerd.

So why should we be excited about fintech, blockchain and cryptos<sup>1</sup>? For starters, unlike Google Glass, demand is not tepid. On the contrary, demand is so strong that even 'joke currencies' like Doge Coin (named after an internet meme featuring a Shiba Inu) managed to raise a substantial capitalisation of US60 million in 2014 and become the 20th largest cryptocurrency worldwide. But is such demand shrouded in fervour and exuberance, and if so, are we heading in uncharted and dangerous territory?

Up until a few years ago, discussions on cryptos and blockchain (the underlying technology powering it) were the exclusive domain of your stereotypical basement dweller or "techie". Now, even the local barber across the street is talking about (and investing in) cryptos. Wearing the 'economist hat', that is a concern - not so much because this may be a pre-cursor to a festering of speculative mania, but because cryptos combine everything we don't know about money with everything we don't know about computers. And by 'we', we mean the average lay person on the street. The last time we had something similar, was way back in 2008 when complex derivatives were being traded along a so called 'securitisation food chain'.

Psychology plays a pivotal role here. A recent survey carried out in 2018<sup>2</sup> has shown that the majority of respondents think that crowd psychology (or herd behaviour) has been behind the recent surge in the price of the world's largest digital currency. And that is hard not to believe, when we know for a fact that Bitcoin (and other digital currencies) derive its intrinsic value purely from a willingness to accept the currency as payment. But unlike FIAT currency, the decentralised counterpart has failed to keep a steady footing.

Earlier this year in January, a major Bitcoin conference held in Miami stopped accepting Bitcoin as payment, with organisers claiming that high network fees and manual processing issues led them to close ticket payments using cryptocurrencies. A true story so steeped in irony that it isn't even funny, especially when Malta is being widely touted as the global frontrunner and trail blazer in crypto technologies.

Ultimately, the value of a commodity is a function of desirability (whether that desirability emanates from usage or vanity is irrelevant). Take the famous story of the black pearl. When they were first introduced in the market, no one had any idea whether they were more precious than white pearls. But then, a famous jeweller called Harry Winston decided to exhibit the black pearls next to expensive and desirable gems – rubies, sapphires, diamonds. The rest is history – black pearls are now worth more than white pearls.

<sup>1</sup>Clearly, these terms are not the same but we will spare you the definitions, as these have been repeated *ad nauseum*

<sup>2</sup>DataTrek Research

And herein lies the lesson. As a country, we are venturing into a brand new digital space, and one must tread carefully. Whilst we wholeheartedly believe that blockchain has immense potential (decentralisation, security, and speed, to name a few) – we must also echo Voltaire’s adage (also popularised by Spiderman’s Uncle Ben) - with great power comes great responsibility.

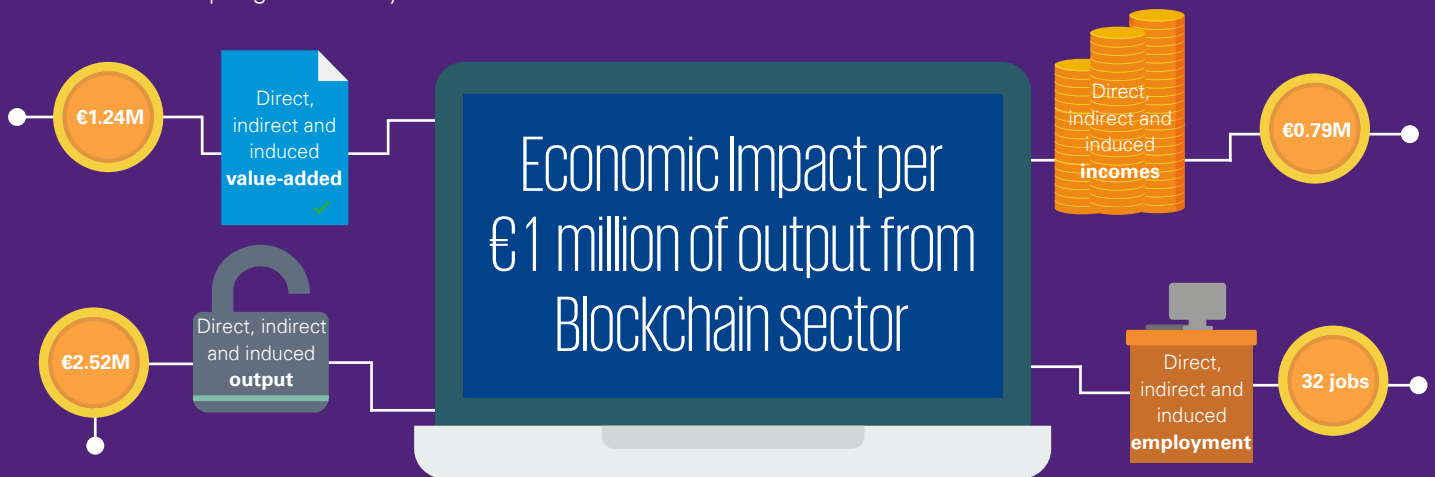
From an economic standpoint, Malta stands to gain. Malta has taken steps to establish a robust regulatory framework to enable the development of strong and reputable industries based around blockchain and similar innovative technologies. And just like Gaming, Financial Services, ICT, and Pharmaceuticals, industries revolving around Blockchain are a nice and desirable addition to Malta’s repertoire. Economic diversification is the name of the game here, such that a potential negative shock in one of the industries would not have systemic effects across the island.

All this neatly ties together in the various potential benefits to the Maltese economy which may emanate from the growth of the blockchain and its promulgation across various industries and sectors in Malta – first port of call, the Financial Services industry. In order to remain competitive and ahead of the curve, an economy must constantly strive to re-invent itself. The growth of industries such as financial services, ICT, and iGaming have driven home the message that the knowledge economy has enormous economic potential for a nation such as Malta.

### Labour market efficiencies and potential economic impacts

Blockchain may be a new technology, but the work it will create will require the same sort of talent as Malta’s other booming industries. The nation will need more people skilled in finance, ICT, mathematics, cyber security and data analytics. The creation of a robust regulatory environment will drive more business for professional service providers, including those in the accounting, legal and IT support spaces. There is definitely scope for synergies between industries, and new entrants into the blockchain sector will benefit from the labour forces mobility between roles.

Based on estimates of the economic multipliers for the Maltese economy<sup>3</sup>, if businesses operating in the blockchain sector end up having a similar impact on the local economy as the financial services sector, the total economic impact<sup>4</sup>, per €1 million of output generated by the sector could be as follows:



The arrival of the blockchain industry will not be without its challenges. Malta’s strong economic performance has driven the country to a state of near-full employment, and sourcing the required skilled staff will prove to be a challenge for any new industry. The same can be said regarding the shortage of office space, particularly in the more prestigious regions of the island. Such challenges can be overcome; however they will place additional inflationary pressures on the local economy, as skilled labour demand higher wages, and property prices continue to be pushed upwards.

Ultimately however, it comes back to prudence - cautious and sensible investment, both from an individual and a macro standpoint. A thriving blockchain capability will likely create wealth across a number of other industries, which will in turn continue to feed into the economy as a whole, but the risk needs to be accounted for, especially when dealing with complex technology which is not immediately intuitive.

These are exciting times indeed, and as KPMG we are very much invested in this area through our active involvement together with our clients. Exhibiting a sense of caution should not be construed as technology aversion or scepticism, but rather as recognition of the challenges being faced by emerging technologies, and the principle of prudence one should adopt in such circumstances.



**The arrival of the blockchain industry will not be without its challenges. Malta’s strong economic performance has driven the country to a state of near-full employment, and sourcing the required skilled staff will prove to be a challenge for any new industry.**

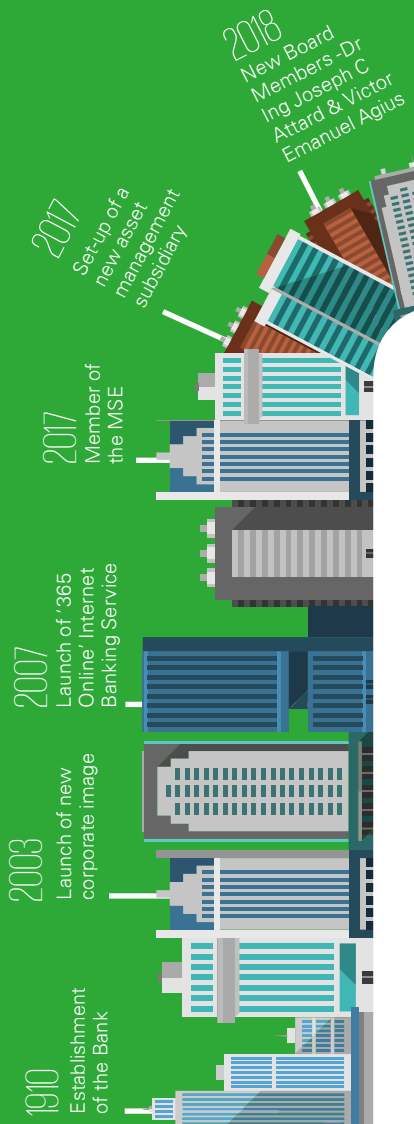


<sup>3</sup>I. Cassar, “Estimates of Output, Income, Value Added and Employment Multipliers for the Maltese Economy”, 2015, Central Bank of Malta  
<sup>4</sup>Direct impacts represent the first round of transactions between producers and consumers. Indirect impacts represent upstream effects and demand for goods and services sourced from intermediate suppliers. Induced effects represent subsequent rounds of spending by the actors involved in a transaction, such as the subsequent spending of wages paid to a supplier’s employees. The sum of these three impacts is the total economic impact of an industry.



# Core Domestic Banks





2018  
New Board Members - Dr Ing Joseph C Attard & Victor Emanuel Agius

2018  
Appointment of new CRO - Mr. Giovanni Bartolotta



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## Profitability

The Group reported a Profit Before Tax of €18.36 million for the year ended 2017, which represents a strong growth of 16.5% over the 2016 financial period. This growth was attributed to a number of factors, including a significant increase in Interest Receivable on Loans and Advances, Balances held with the Central Bank of Malta, and investments in treasury bills, which increased by €4.57 million (or 17%) over 2016. This increase is reflective of a significant 27% increase in Loans and Advances to Customers over the previous year, which totalled at €1,024.59 million as at December 2017. The increase in Interest Income from Loans and Advances to Customers was negatively impacted by a slight decrease of 9% (or €1.04 million) in Interest Income generated from Debt Securities. Nonetheless, the shift in the Bank's deposit mix favouring demand deposits over term deposits also had a positive impact on the Group's Interest Payable for the year ended 2017. This declined by €1.27 million (or 12%) during the year under review. In fact, the Group's Net Interest Income to Total Income ratio stood at 76.7% as at 2017, as opposed to 80.2% in 2016.



Furthermore, the increase in the Net Gains on Financial Instruments by €1.94 million (or 137%) over the previous year also contributed to the strong growth in the Group's Profit Before Tax. This was mainly a result of the realised gains reported on available-for-sale investments which have been sold during 2017. Additionally, and as a testament to the Bank's focus on lending and investment services, there has been a year-on-year increase in Fees and Commission Income of €0.56 million (or 13%). Moreover, the Group's Net Impairment Losses increased by 150% (or €1.48 million) in 2017, due to an increase in impairments on Loans and Advances to Customers. This increase in impairments was softened by a reduction in the level of bad debts written off which amounted to €1.26 million in 2017, as opposed to €1.52 million which had been reported in 2016.



It is also interesting to mention that the increase in the Group's Profit Before Tax was also challenged by an increase of 24% (or €2.19 million) in personnel expenses which was mainly encountered due to the increase in the Bank's staff complement from 300 to 361 individuals during the year ended 2017. Furthermore, Other Administrative Expenses also increased by €0.87 million (or 11%) while Fees and Commission Expenses increased by €0.20 million (or €57%). As highlighted by the Group's Directors, the higher expenses were a reflection of the Group's increased activities and continuous developments to attain long-term growth.

\*NII to Total Income ratio calculated in line with stated formula

66.7%



23.1%



- > Credit Institution
- > Intermediaries – Tied Insurance Intermediaries
- > Investment Services, Category 2 licence
- > Alternative Investment Fund Manager

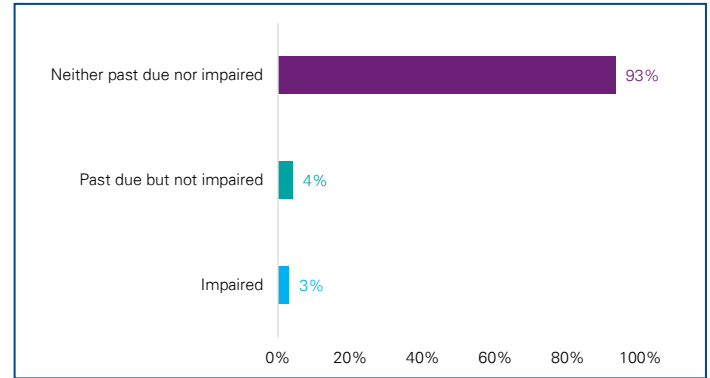


- > ReAPS Asset Management Limited
- > APS Funds Sicav p.l.c



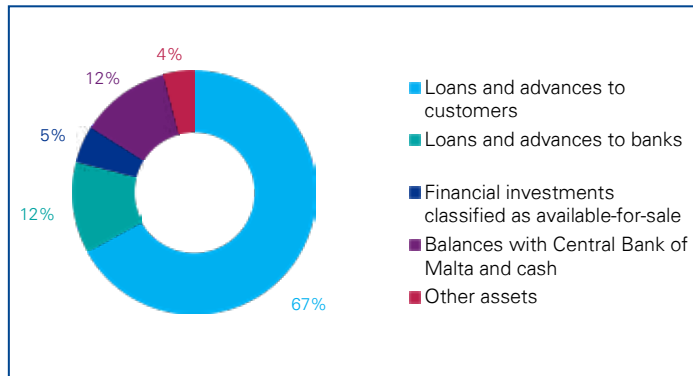
## Assets and Liabilities

During the financial year under review, the Group's asset base grew by 16.5% (or €211.89 million) over 2016. This growth was largely due to the aforementioned increase in Loans and Advances to Customers and also an increase in Financial Assets at Fair value through Profit and Loss of €33.72 million (or 1015%). The latter increase was a result of the Group's increased investment in fixed income instruments and collective investment schemes. Despite the increase in the loans portfolio and other investments, the Group continued to enjoy a strong capital base as represented through its CAR ratio of 14.82% and CET1 ratio of 14.44%, as at December 2017. The Group has, in this regard, experienced a slight decrease of 2.13% in its CAR ratio and 1.2% in its CET1 ratio, year-on-year; thus still remaining solidly above the statutory minima. Additionally, while the Net Impairment Losses experienced a growth over the



Credit Quality

previous year, the credit quality of the loan portfolio remained of a high standard, with the non-performing loans ratio decreasing from 6.5% to 4.2%



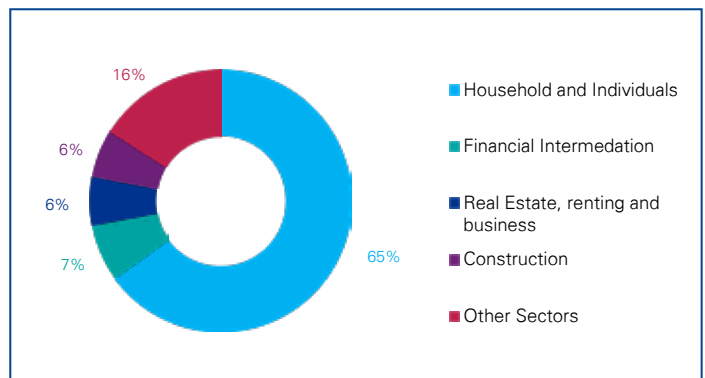
Furthermore, Debt and Other Fixed Income Instruments decreased by 21.8% (or €70.52 million) from the previous year as a result of a reallocation to the APS Diversified Bond Fund\*. Interestingly, as seen in the Total Assets graph, the substantial increase in Loans and Advances to Customers was mainly driven by the increase in Loans and Advances to households and individuals. In 2017, €672.37 million out of €1,040.99 million Loans (i.e. 65%) were classified as Loans to households and individuals, which portrays an increase of 24% over the previous year.

### Total Assets

€204.88 million (or 18%) was experienced during the year ended 2017. This increase was principally driven by the substantial growth of 12% (or €126.46 million) in its Amount Owed to Customers over 2016, mainly due to a growth in customer deposits repayable on demand of €127.40 million (or 23%). This increase continued to strengthen the Group's funding position which ultimately improved its liquidity position.

Furthermore, the Group also experienced an increase of 207% (or €74.93 million) in the Amounts Owed to Banks. This growth was largely determined by the introduction of Amounts Owed to Banks with contractual re-pricing dates of over 3 months. The Group remained well-capitalised with a CAR of 14.82% of which 14.44% is CET1, which is well above the statutory minima. The amount of profit carried to reserves for the Group and the Bank at 31 December 2017 amounted to €13.1 million.

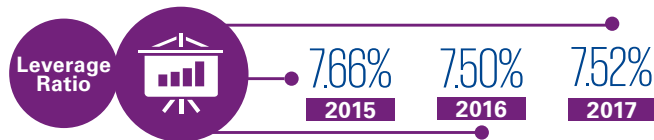
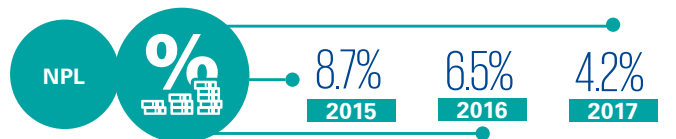
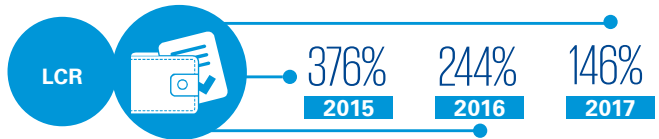
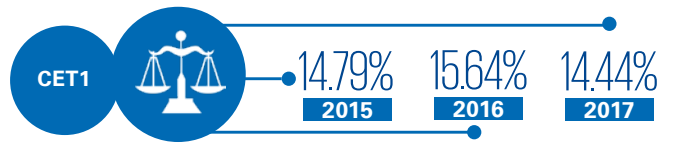
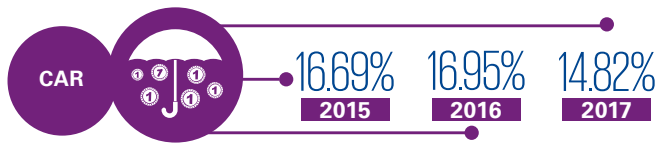
In terms of the Group's liability base, an increase of



Concentration of Loans and Advances to Customers

\*A fund designed for investors who can accept moderate to high risk levels and are ready to invest for the medium to long-term.

# Core Regulatory Ratios



## BRANCHES IN MALTA





# Helping you cope with Regulatory Change

**Complexity and change are driven by numerous forces, both external (regulations, marketplace events) and internal (new products, business models), all of which impact your organisation. KPMG's Risk Consulting Team can shape the thinking of Boards and Management regarding complex business issues. The team is composed of dedicated specialists who are well-placed to assist you with your efforts towards regulatory compliance and beyond.**

**Our expertise has been gained through working with various clients across different industries and sectors. We work with Banks and Financial Institutions and we are also active in the VFA space.**

**The team, which is supported by a wider global network, is experienced in assisting through the provision of a full suite of risk consulting services including, but not limited to, regulatory compliance, financial risk management, actuarial, internal audit and anti-money laundering services.**

**We welcome the opportunity to discuss what KPMG's Risk Consulting Team can offer to you.**



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**2018**  
Appointment of new Board Members - Sheikh Turki Faisal Q.F. Al-Thani & Juanita Bencini

**2017**  
Name changed to BNF Bank plc

**2016**  
Al Faisal Group acquires majority shareholding in Banif Bank (Malta) plc

**2011**  
Launch of the Online Payment Facility

**2010**  
Introduction of the first cash recycler ATM in Malta

**2008**  
Establishment of the Bank

**2018**  
Appointment of new CFO: Mark Micallef



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### Profitability

For the financial year ended 31<sup>st</sup> December 2017, the Bank registered a profit for the year of €0.87 million, representing a decline of €1.23 million (or 58.7%), with a comparable decline of €1.20 million (or 7.8%) in Net Operating Income over the one-year period, from €15.35 million in 2016 to €14.15 million in 2017. Net Operating Income covered 108.4% of the Operating Expenses of the Bank, including Net Impairment Provision. The decline in the aforementioned financial indicators is attributable entirely to the one-off gain on disposal of investment in VISA made by the Bank in 2016, amounting to €3.11 million. Excluding the impact of the VISA gain, Net Operating Income would have increased by €1.91 million year-on-year, signifying that the underlying financial results of the Bank portray a positive upward trend.



Net Interest Income from business carried out with customers and other banks amounted to €10.40 million, representing an increase of 8.0% (or €769.00 million). The main driver to this positive movement is the decrease noted in Interest Payable of €1.22 million (or 19.0%), slightly offset by a decline in Interest Income on Loans and Advances to Customers of €0.61 million (or 4.3%). The decline in Interest Payable is mainly due to the shift in customer deposits from term to on-demand deposits.

Net Fee and Commission Income amounted to €2.33 million, representing an increase of €0.45 million (or 24.2%) year-on-year. The increase in Net Fee and Commission Income was driven by an increase in credit related fees together with an improvement in payments and cards business lines, and other banking services.



Operating Expenses, excluding impairment, increased by 11.3% (or €1.27 million) from €11.26 million in 2016 to €12.53 million in 2017. This increase is mainly due to an increase in Employee Compensation and Benefits for 2017 of €1.22 million which is mainly driven by the increase in the average number of persons employed from 161 in 2016 to 201 in 2017.

During 2017, Impairment Provisions increased by a net amount of €0.52 million to a Total Impairment Provision of €9.09 million (2016: €8.77 million) as at year-end. The gross increase in Impairment Provisions amounted to €2.48 million whilst reversals of write-downs in prior years amounted to €1.96 million. Provisions for Impairment as a Percentage of Gross Loans and Advances to Customers stood at 2.3% as at year-end.

70.4%



17.8%



> Credit Institution



> BNF Bank plc

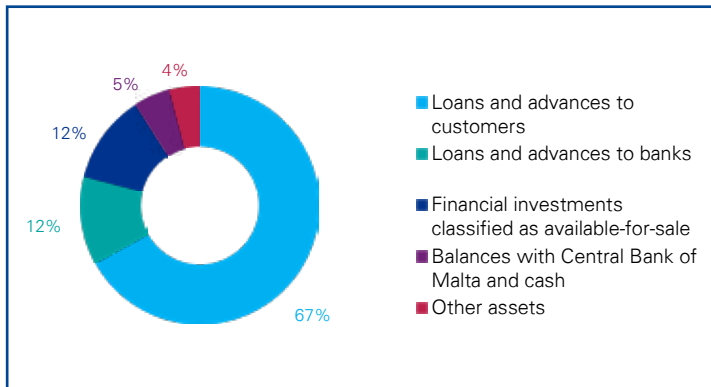


## Assets and Liabilities

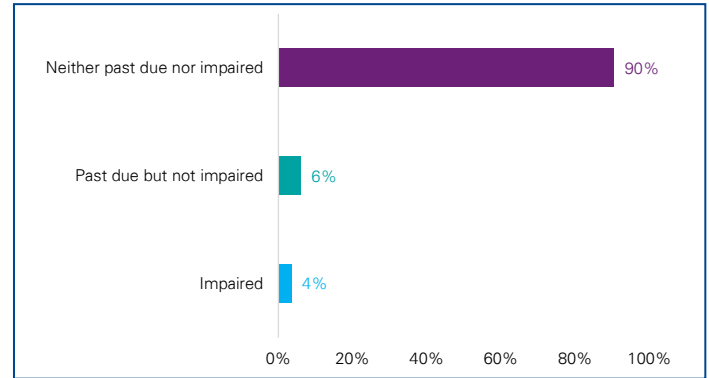
The Bank's asset base increased to €567.74 million as at 31<sup>st</sup> December 2017. The Bank has allocated excess liquidity which was not utilised in the credit granting process to its investment portfolio.

The largest component of the Bank's total assets is by far Loans and Advances to Customers, which amounted, as at year end, to €382.31 million net of Impairment Allowances. Gross Loans and Advances to Customers increased by €41.03 million (or 11.7%), reaching €391.40 million by year-end.

The Bank's investment portfolio increased significantly, from €17.76 million as at end of 2016 to €67.66 million as at the end of 2017, representing an increase of 281.0% (or €49.91 million). The main increase was noted in foreign government



Total Assets

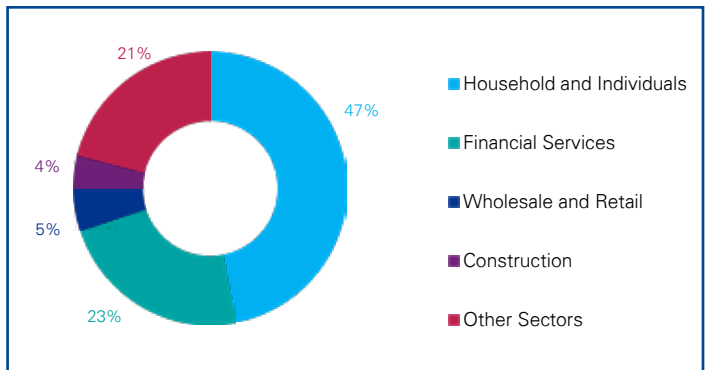


Credit Quality

and other debt securities. The portfolio includes €3.77 million worth of investments which are pledged in favour of the Depositor Compensation Scheme as well as the Bank's investment in VISA.

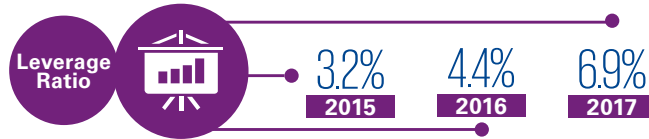
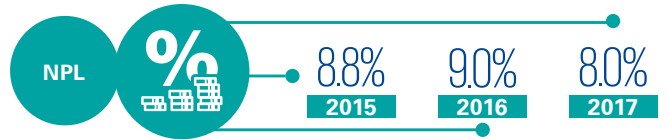
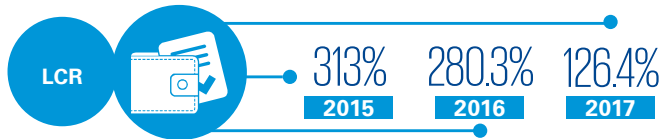
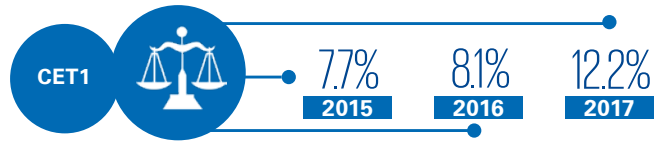
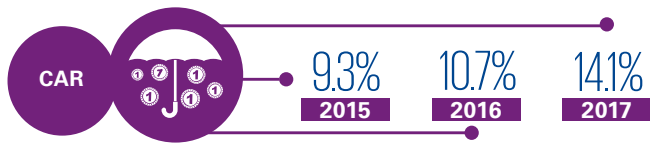
Customer Deposits increased by €30.89 million (or 6.4%), amounting to €513.85 million by year-end. Gross Loans to Customer Deposits ratio as at end of 2017 stood at 76.2% compared to 72.5% as at the end of 2016.

In January 2017, the Bank increased its Share Capital by €15.00 million through a Rights Issue, strengthening further the Bank's capital regulatory position, reflected by the Bank's strong CAR of 14.1% as at end 2017.



Concentration of Loans and Advances to Customers

# Core Regulatory Ratios



## BRANCHES IN MALTA





# Make People Decisions that Make Business Sense

Ensure you have the right people, with the right skills, in the right place, at the right time

## Measure



Collect data, assess, and take stock of the current state of your organisation. Set baselines and understand the People Journey you must take in order to achieve your Business Objectives and increase your Return on Investment

## Define



Create a clear Mission, Vision, and Set of Values that define your organisation. Translate these values into core competencies that will support and guide your People in achieving your business objectives

## Action



Develop and implement an action plan that ensures you effectively and strategically manage your talent

## Make It Stick



Drive incremental, long-term, and strategic change that truly helps you achieve your business objectives

[www.kpmg.com/mt/peopleandchange](http://www.kpmg.com/mt/peopleandchange)

Malcolm Pace Debono

**Director, People and Change  
Advisory Services**

[mpacedebono@kpmg.com.mt](mailto:mpacedebono@kpmg.com.mt)

Petra Sant

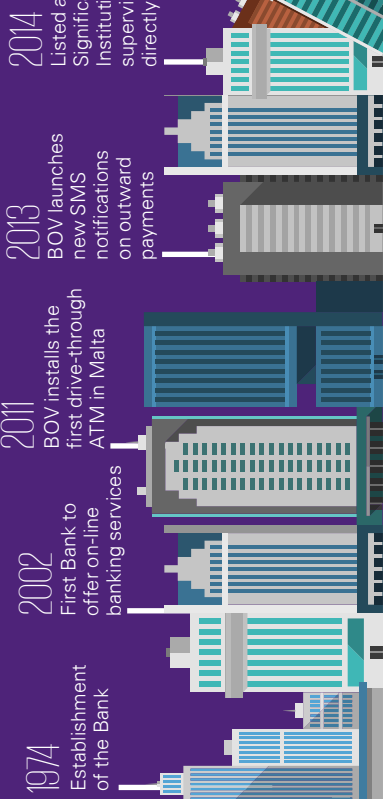
**Senior Manager, People and Change  
Advisory Services**

[petrasant@kpmg.com.mt](mailto:petrasant@kpmg.com.mt)



# Bank of Valletta p.l.c.

Financial year ended 31<sup>st</sup> December 2017



2017  
Increase in share capital through a rights issue  
Launch of contactless cards

2018  
Licensed as a Higher Education Institution  
2018  
Inaugurated new representative office in London



1,613



36

## Profitability

During financial period 2017, the Bank's Board of Directors resolved to change the financial reporting date of the Bank from 30<sup>th</sup> September to 31<sup>st</sup> December. The objective was to align the Bank's financial year-end with that of the vast majority of its European counterparts. The financial period which started on 1<sup>st</sup> October 2016 had a duration of 15 months and ended on 31<sup>st</sup> December 2017. Prior financial periods started on 1<sup>st</sup> October had a duration of 12 months and ended on 30<sup>th</sup> September.

The Group recorded a profit before tax of €174.74 million for the 15 month period ended 31<sup>st</sup> December 2017 compared to €145.91 million for the 12 month period ended 31<sup>st</sup> December 2016 or €118.40 million as adjusted for the one-off gain on the VISA transaction. The gain on the VISA transaction was brought about by the disposal of the Bank's membership interest in Visa Europe.

Net interest income rose by €34.12 million (22.9%), (declined by €2.47 million (1.7%) if annualised) from €148.83 million for financial year 2016 to €182.95 million for financial year 2017. The annualised decline in net interest income is mainly due to a decline in interest income on debt and other fixed income instruments.



The Group continued to focus on its strategy to explore and tap into new sources of income, this being mainly non-interest income, in an effort to balance the impact of low interest margins coupled with high levels of liquidity and negative interest rates on deposits held with the Central Bank of Malta and the European Central Bank. In view of the foregoing, net fee and commission income increased by €20.20 million (30.6%) or €2.95 million (4.5%) if annualised, from €66.09 million for financial year ended 30<sup>th</sup> September 2016 to €86.29 million for financial period ended 31<sup>st</sup> December 2017. Most of the increase arises from investment services and credit card fees.

Overhead costs rose by €38.47 million (34.1%) or €8.22 million (7.3%) if annualised, from €112.78 million for financial year 2016 to €151.25 million for financial year 2017. The main drivers to the aforementioned cost increases were the Group's initiatives to strengthen its anti-money laundering and anti-financial crime defences as well as the Core Banking Transformation programme which entailed considerable recruitment of personnel and the procurement of consultancy services.



The Group's profit for financial period 2017 includes a net impairment reversal of €6.23 million compared to an impairment charge of €23.14 million for financial year 2016. This reversal reflects the Group's steady focus on debt recovery and the management of non-performing loans, both of which are core to Group's operating strategy.

The Group's income from its share of ownership of the insurance companies increased remarkably, with profit recognised for financial period 2017 amounting to €19.29 million, compared to €3.73 million for financial year 2016. This remarkable increase is attributable to a number of factors, mainly a stronger performance in both life insurance and non-life insurance business, as well as the consolidation of eighteen months' profit (instead of the twelve months norm) in order to align the reporting dates of the companies.

25.7%\*



12.1%



- > Credit Institution
- > Investment Services (Category 3 and 4A licences)
- > Trustee or Co-Trustee to provide Fiduciary Services in terms of the Trusts and Trustees Act
- > Intermediaries – Tied Insurance Intermediaries (Companies)



- > BOV Asset Management Limited
- > BOV Fund Services Limited

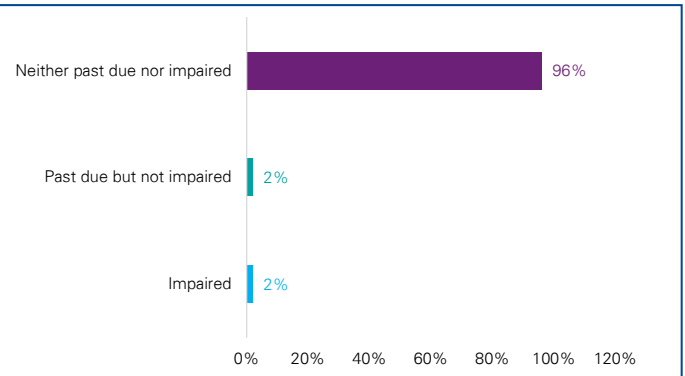


## Assets and Liabilities

The Group's total liabilities increased by €864.85 million (8.7%), with the most notable increase being in short-term retail deposits. Customer deposits increased by €916.11 million (10.0%) from 30<sup>th</sup> September 2016 to 31<sup>st</sup> December 2017 to reach €10.10 billion. This increase is mainly driven by an increase in repayable on demand deposits. The increase in customer deposits, and therefore liquidity, was the main driver behind the increase in the Group's asset base from €10.72 billion as at 30<sup>th</sup> September 2016 to €11.82 billion at the reporting date. As at 31<sup>st</sup> December 2017, customer deposits financed 85.5% of the Bank's asset base.

Gross loans to deposit ratio continued to decrease, from 46.9% as at 30<sup>th</sup> September 2016 to 44.3% as at 31<sup>st</sup>

December 2017, reflecting the increase in customer deposits and the Bank's highly liquid position. Despite the decline in the Gross loans to deposit ratio, the Bank increased its lending activity in 2017. The loan book gross of impairment losses as at

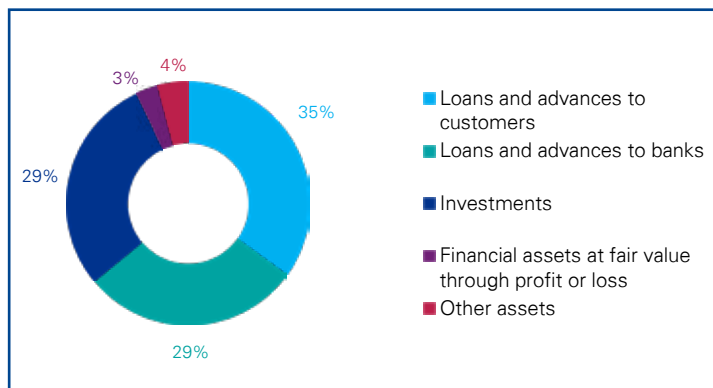


Credit Quality

31<sup>st</sup> December 2017 stood at €4.47 billion (September 2016: €4.31 billion), representing an increase of €162.12 million (3.8%) in total loans. The increase is partially attributable to a 4% annualised increase in home loans. Net loans as at 31<sup>st</sup> December 2017 amount to 36.4% (September 2016: 38.5%) of the Group's assets.

Debt and equity holdings decreased by €427.87 million (10.4%) and stand at €3.70 billion (September 2016: €4.13 billion), while short term funds increased by €1.32 billion (56.9%) to reach €3.59 billion (September 2016: €2.27 billion).

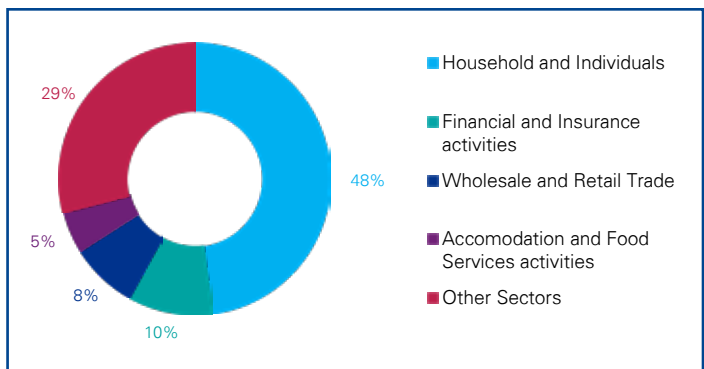
The shift away from debt and equity investments with longer maturities towards advances to other banks with shorter maturities led to a higher mismatch between assets and liabilities.



Total Assets

Shareholders' funds have increased by €232.93 million (31.9%) over the financial period and as at 31<sup>st</sup> December 2017 amount to €962.09 million. The increase is mainly attributable to a bonus issue of 30 million fully paid ordinary shares of a nominal value of €1.00 per share and a rights issue of 105 million ordinary shares of a nominal value of €1.00 per share. The aforementioned rights issue generated an increase in the share premium account equivalent to €0.43c per share, net of share issue expenses.

The Common Equity Tier 1 capital ratio increased from 12.8% in 2016 to 16.1% as at 31<sup>st</sup> December 2017, providing for adequate capital buffers to sustain business growth in line with the Bank's strategy. The Bank's Capital adequacy ratio stood at 19.4% (2016: 16.8%).



Concentration of Loans and Advances to Customers

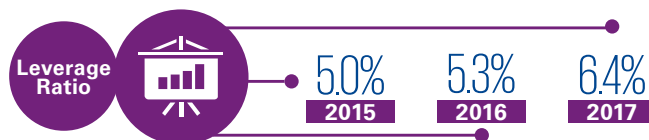
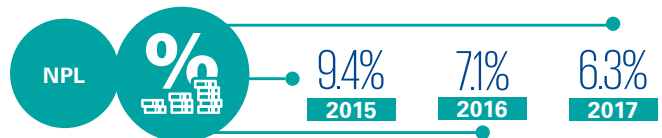
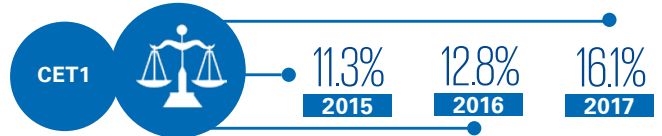
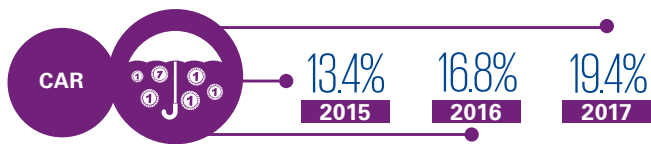
\*The ROA and CI Ratio for 2017 was calculated in line with stated formula.

\*The NII to Total Income Ratio was calculated in line with stated formula.

\*The Personal Lending percentage was calculated calculated on Total Assets.

In view of the highly competitive and complex current financial services environment, together with the digital revolution, the Board has identified the need to rapidly embrace the disruptive nature of Fintech. A Fintech Initiation Plan has been put into action with two operational streams. The first stream will tie up with the Core Banking Transformation plans currently in place to ensure that the Bank has the right resources in place to meet the evolving needs of customers in a digitised world. The second stream will be scanning the market with the assistance of industry experts with the ultimate aim of identifying Fintech start-ups that can provide synergies and potential for partnerships or buy-outs.

## Core Regulatory Ratios



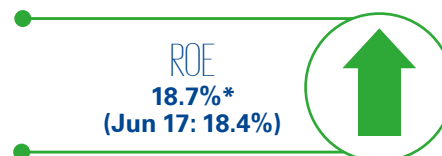
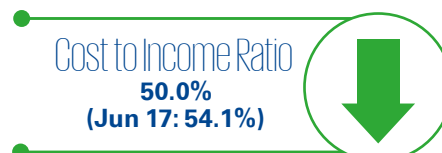
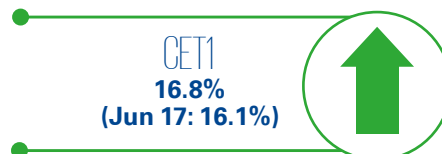
## BRANCHES IN MALTA



# Bank of Valletta p.l.c.

## Additional Analysis on Interim Financial Statements for the period ended 30<sup>th</sup> June 2018

(P&L compared to June 2017 and BS compared to December 2017)



\*Annualised ROE is before litigation provision for the period ended 30 June 2018. Annualised ROE post-litigation stands at 2.8%.

# The Banking Industry and Fintech



**David Pace**  
Partner  
Deals Advisory



**Roberto Vitale**  
Senior Manager  
Deals Advisory

The banking industry may have well initially considered Fintech companies a threat, but are now seeing these more as collaborators with partnerships between the two becoming increasingly common. Whilst many Fintech entities were able to scale as stand-alone entities, others quickly realised that acquiring customers while navigating around a highly regulated environment is complex and a costly task. Banks, on the other hand, are starting to understand that being unreceptive to Fintech, which is gaining momentum rapidly, can prove detrimental to their sustainability. Accordingly, banks are appreciating the increase in revenue and efficiency that may be reaped by leveraging the superior technology that Fintech companies offer.

Research shows that from 2013 till April 2018 only 20% of the top 50 banks in the US have engaged in M&A activities in Fintech, with a total of only 20 completed transactions. This can be attributed to the challenges that banks may face, such as integration, resulting from significant cultural differences between the two types of companies.

Notwithstanding this low volume of activity, the trend is recently changing and activity in this space surged during the last 7 months, with 40% of the 20 transactions closing during this period.

The range of Fintech transactions is also indicative of how the appeal spans across a bank's value chain. JP Morgan Chase acquired two Fintech companies during 2017, one of which is WePay, a payments platform. This acquisition appears to align with the bank's organisational strategy to focus on the bank's payment solution – Chase Pay, highlighting that the acquisition will allow the bank to faster and efficiently get to market. Goldman Sachs has also been active, acquiring Final a credit card start-up and Finacelt, a lending start-up that allows contractors to offer financing to customers.

## The Local scene – M&A interest on the rise

Malta is positioning itself at the forefront in the Fintech space – from being the first country to innovatively aim to regulate the digital economy to the manner in which a whole ecosystem is rapidly developing locally. The latter was evidenced at the recent DELTA and Malta Blockchain events – both international blockchain and cryptocurrency technology summits, that brought together an impressive Fintech and crypto currency gathering. Government's pro-active stance at creating the climate coupled with the infrastructure to support the manner in which technologies stretch the boundaries of legacy regulation and practices has enabled significant interest from foreign investors in this space. Notable players in the industry such as Binance, one of the largest Crypto-exchanges in the world, are openly advocating the benefits of its move to the Island.

Revolut, the digital bank, officially launching its courting of the Malta market at the DELTA summit, claimed that over 30,000 registered customers, had signed-up throughout the 'soft-launch' month of September. Revolut's country manager announced on LinkedIn that they've reached 50,000 users in Malta to-date, which is 15% penetration of the addressable adult market (18+ year old).

Joshua Greenwald, former Space X engineer, also favoured Malta for launching a cryptocurrency exchange, due to the certainty and stability that the island provides in this sector.

**SELL!**

**BUY!**



SCAN ME



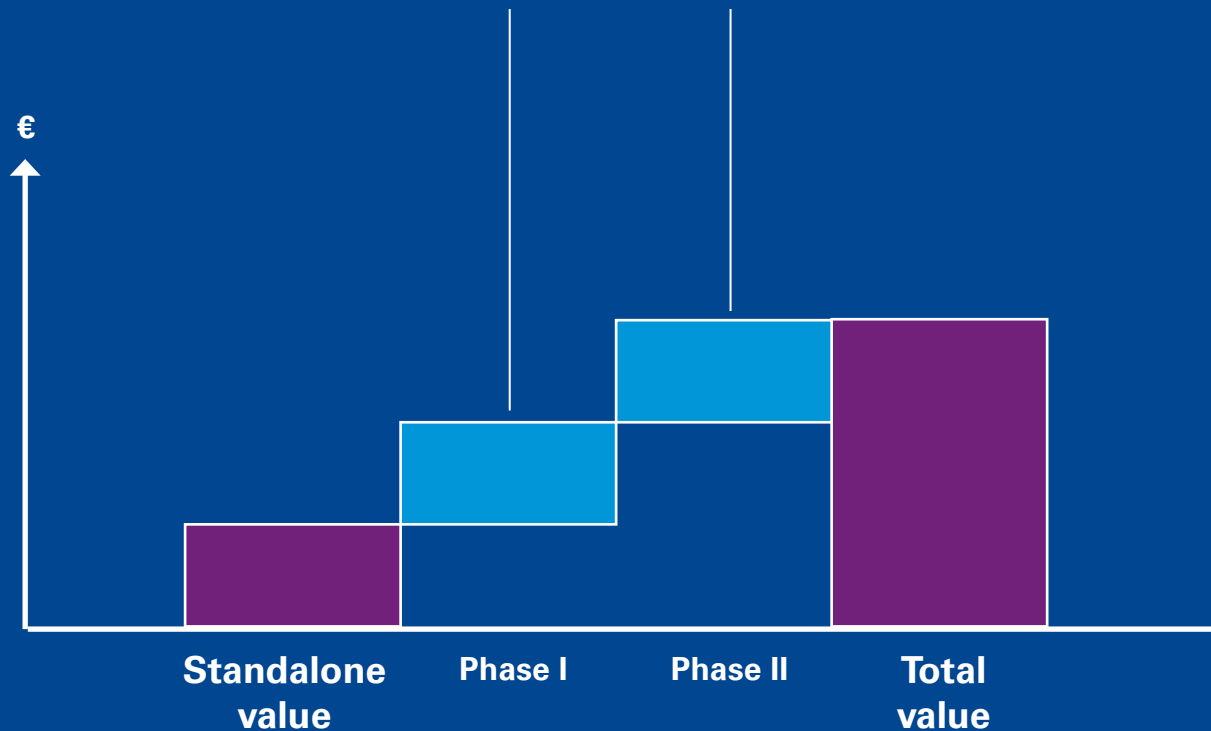
# M&A: driven by the gap between today's value and the potential that could be unleashed

## Phase I – Making the most of the target

- Remove overlapping costs/assets
- Exploit cross-selling opportunities
- Protect key customers and top talent
- Defend market share
- Optimize cost of capital
- Combined management talent and skills

## Phase II – Overall uplift for combined entity

- Leverage capabilities and best practices (new hires, new processes, shared services)
- Combined innovation pipeline and capital investment
- Joint performance for step-change improvements
- Exploit joint platforms & invest in new business opportunities such as new products and geographies



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# HSBC Bank Malta p.l.c.

Financial year ended 31<sup>st</sup> December 2017

1999

HSBC Bank Malta PLC acquired Mid-Mod Bank LTD

2014

Listed as Significant Institution and supervised directly

2014

Launch of Mobile Banking App

2017

First Major bank to launch contactless payments

2018

First bank in Malta to launch fingerprint and Face ID recognition

2018

Appointment of new Chief Financial Officer - Mrs Emma Nuttall



1,378

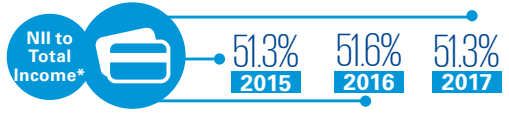


28

## Profitability

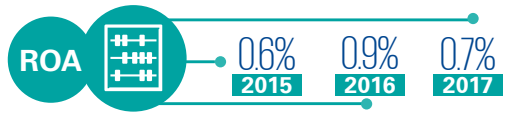
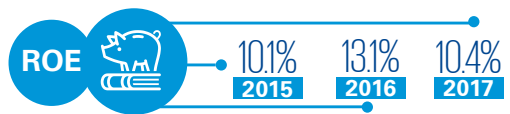
During the financial year ended 2017, the Group reported a Profit Before Tax of €49.82 million, a decrease of 19.9% (or €12.40 million) from the previous year. However, it is pertinent to note that this reported PBT incorporates two items which the management believe should be excluded in order to better reflect the Group's management performance. These two items comprise; the reversal of a provision raised during the previous year in connection with a redemption programme, which provision was not fully required, and an additional charge with respect to the provision for collective agreement clauses relating to future employee benefits. When taking into account these adjustments, the Group's Profit Before Tax would be increased to €55.62 million; that being €5.80 million more than the reported PBT for 2017.

Net Interest Income decreased by 4.6% (or €5.77 million) over the previous year. This was primarily due to a contraction in the corporate lending book and the bonds portfolio. Whilst lending margins did not experience any significant changes, the average yield of the investment book deteriorated as a result of the amortisation of high-yield bonds. However, this decline in Interest Income is partially mitigated by the reduction in Interest Expenses of 22.0% (or €3.45 million), which resulted mainly due to the maturity of the Bank's subordinated liabilities.



The Group's Net Fee Income also declined during the financial year ended 2017 to €22.74 million from €23.75 million reported in the previous year. The contraction in the lending book outlined above contributed to this decline. In the CEO's report it is further explained that this decline was a result of "a lower level of credit activity and the ongoing review of the bank's risk appetite". These activities also affected the Group's Net Trading Income which decreased by 27.5% (or €2.00 million) from the previous year.

Other contributors to the decrease in PBT include General and Administrative Expenses which increased by €9.37 million (or 21.8%) and Employee Compensation and Benefits which grew by €3.54 million (or 6.7%) over the previous year. The main reason for the increase in Administrative Expenses was the exercise undertaken by the Group to strengthen its risk and compliance standards. On the other hand, Termination and Long-term Employee Benefits were the main contributors to the increase in Employee Compensation and Benefits, driven by the early voluntary retirement programme which the Bank introduced in 2016. It is also pertinent to note that the increased level of expenditure was partly counteracted by the Net Reversal of Loan Impairment Charges which amount to €1.17 million in 2017, as opposed to the Net Impairment Charges of €9.03 million reported during the financial year ended 2016.



\*NII to Total Income ratio calculated in line with stated formula

66.2%



33.8%



- > Credit Institution
- > Investment Services (Category 3 and 4A)
- > Intermediaries – Tied Insurance Intermediaries (Companies & Individuals)
- > Trustee / Fiduciary Services



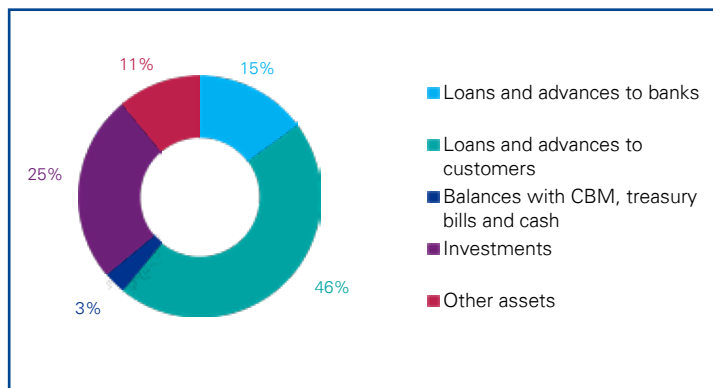
- > HSBC Life Assurance (Malta) Limited
- > HSBC Global Asset Management (Malta) Limited



## Assets and Liabilities

As at the financial year ending 31<sup>st</sup> December 2017, the Group's asset base amounted to €6,797.98 million, decreasing by 7.0% (or €507.98 million) from the previous year. This decrease was principally driven by a reduction in Financial Assets both the ones classified as Financial Assets Designated at Fair Value Attributable to Insurance Operations and also those classified as Held for Trading Derivatives. The former set of Financial Assets is made up of Debt, Treasury Bills, Equity and other fixed and non-fixed income instrument, and during the year under review this portfolio experienced a decrease of 47.4% (or €656.34 million). Additionally, Derivatives Held for Trading amounted to €5.18 million, reporting a decrease of 54.8% (or €6.27 million) over the previous year. The Group's asset base was further eroded

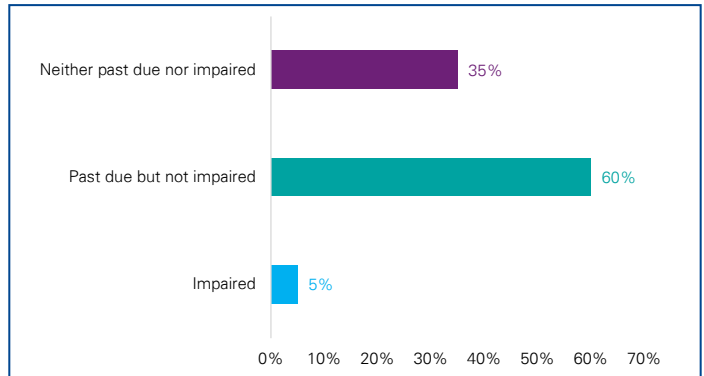
by the decrease in Loans and Advances both to Banks and also to Customers. The latter decrease by 5.8% (or €191.50 million) while Loans and Advances to Banks shrank by €18.55 million (or 1.7%) over 2016. This decline in net Loans and Advances was



Total Assets

base. This change mainly resulted as a consequence of the transfers to Liabilities Attributable to Disposal Group Held for Sale.

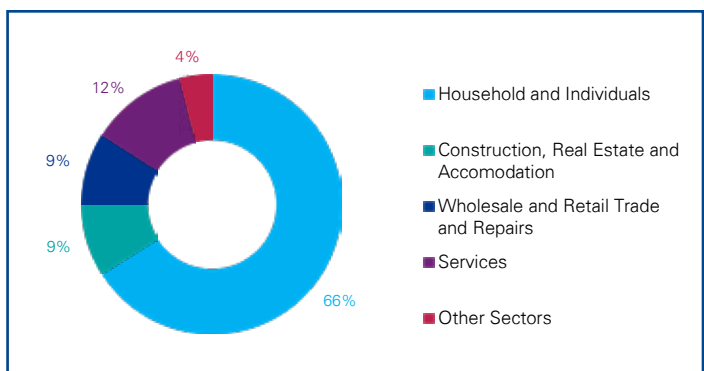
The Group's capital ratios continued to improve as the Bank's risk weighted assets decreased year-on-year. Common Equity Tier 1 capital increased to 13.9% from 13.2% and the total capital ratio was 14.4%, up from 14.2% at the end of 2016.



Credit Quality

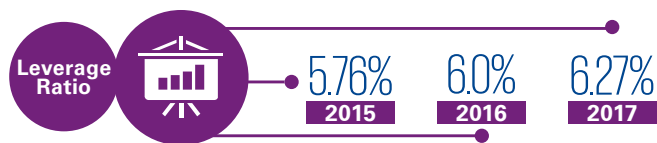
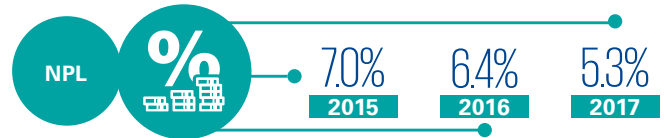
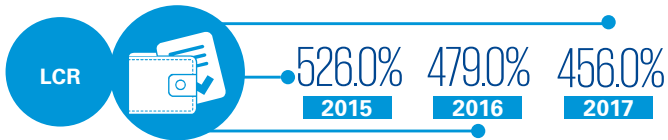
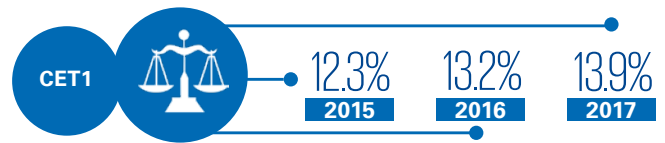
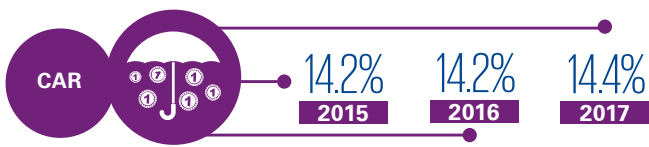
a result of the lessened business activity in the corporate loan book, mainly due to the Group's focus on its compliance programme. Conversely, the Group experienced a growth of 17.2% in its retail lending book.

In terms of liabilities, during 2017 the Group reported a total liability base of €6,318.95 million, representing a decrease of €513.50 million (or 7.5%) over the previous year. This decrease is partially due to the reduction in customer deposits of 4.7% (or €234.84 million) driven by the reduction in corporate deposits. However, this decrease was mitigated by the increase in Deposits by Banks of €43.93 million (or 407.9%). Liabilities under Investment Contracts also experienced a decrease in the year under review of 78.2% (or €507.98 million), which contributed to the lessened liability



Concentration of Loans and Advances to Customers

# Core Regulatory Ratios



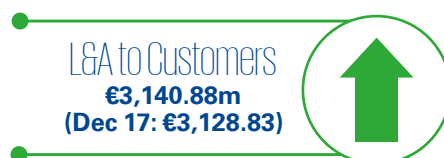
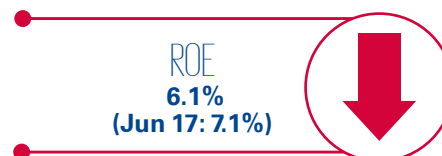
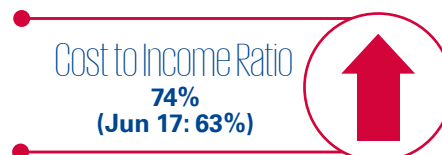
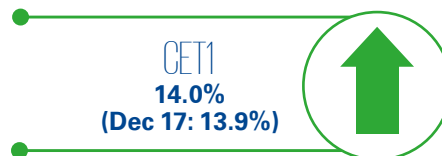
## BRANCHES IN MALTA



# HSBC Bank Malta p.l.c.

## Additional Analysis on Interim Financial Statements for the period ended 30<sup>th</sup> June 2018

(P&L compared to June 2017 and BS compared to December 2017)



**2012** Lombard announces increase in shareholding in Maltapost from 67.72% to 74.5%

**2002** Lombard Bank Malta plc agrees to acquire 75% participation in Gasan Fund Management Limited

**1994** Listed on the MSE

**1990** Became a Public Limited Company

**1969** Establishment of the Bank

**2018**  
49.01% of the Bank's shares purchased by the National Development and Social Fund



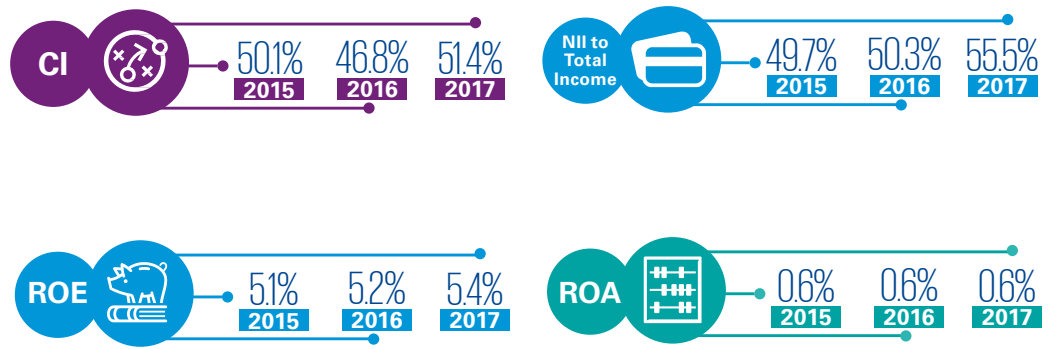
809



7

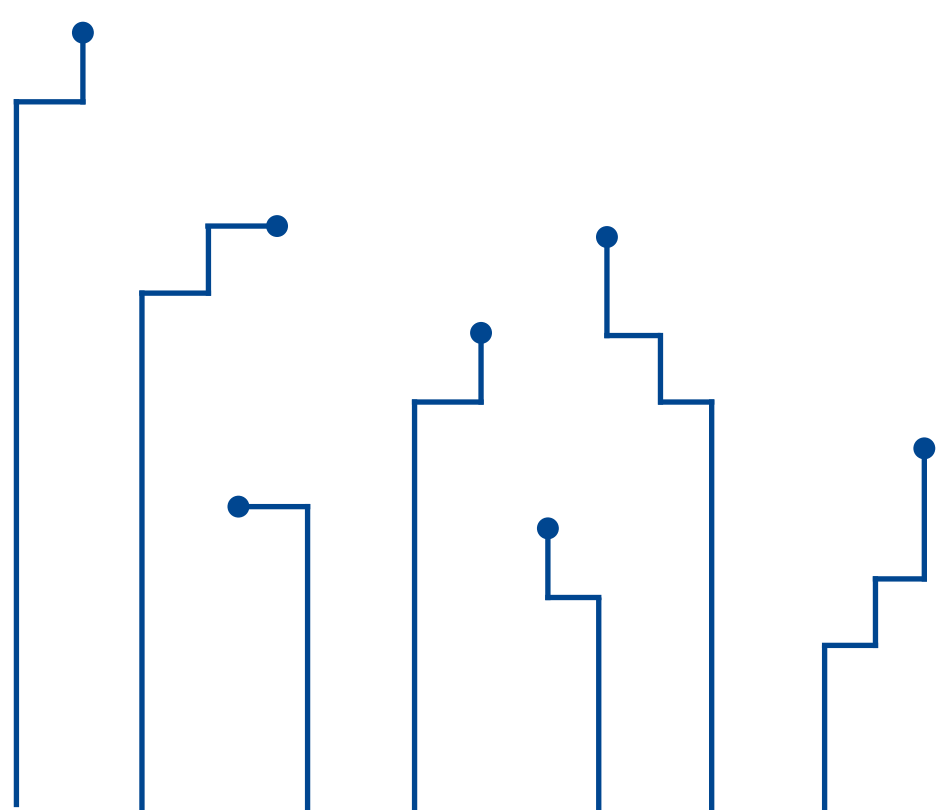
## Profitability

The Bank recorded a profit before tax of €7.47 million for the year ended 31<sup>st</sup> December 2017 compared to €6.65 million for the year ended 31<sup>st</sup> December 2016. As a result of increased customer lending and lower cost of deposits, net interest income increased by €1.26 million (8.8%) to €15.29 million. The Bank's net fee and commission income also increased by €0.35 million (9.2%) to €3.06 million for the year ended 31<sup>st</sup> December 2017 as a result of transaction banking activity.



Operating costs of the Bank increased by €1.15 million (11.7%). This increase mainly relates to costs incurred in relation to Risk Management and Compliance activities. Employee compensation and Benefits increased by €0.54 million (3.1%) mainly as a result of an increase in the Bank's workforce of 157 to 166 personnel.

The Bank's net impairment losses for 2017 amounted to €2.83 million compared to €4.03 million for 2016. Specific allowances on loans and advances to customers of €9.09 million were offset by reversals of write-downs on specific allowances on loans and advances to customers of €9.70 million. Impairment allowances for the year declined in line with the improvement in the quality of the loan portfolio in 2017.



29%



42%



- > Credit Institution
- > Investment Services (Category 2 licence)
- > Investment Managers



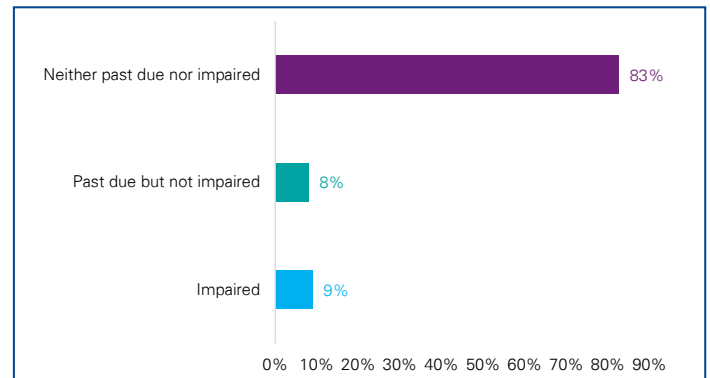
- > Redbox Limited
- > Malta Post plc



## Assets and Liabilities

The Bank's Total Asset base for the year ended 31<sup>st</sup> December 2017 stood at €859.84 million, representing an increase of €16.15 million (1.9%) when compared to the asset base as at 31<sup>st</sup> December 2016 of €843.69 million. This increase was mainly driven by an increase in Loans and advances to customers of €84.16 million (24.4%) to €428.61 million as a result of the Bank's efforts to diversify the loan portfolio and also by focusing on servicing further retail lending predominantly, the Home loan sector. On the other hand, Loans and Advances to Banks declined by €65.71 million (42.1%). This decline is mainly noted in Term loans and advances to banks.

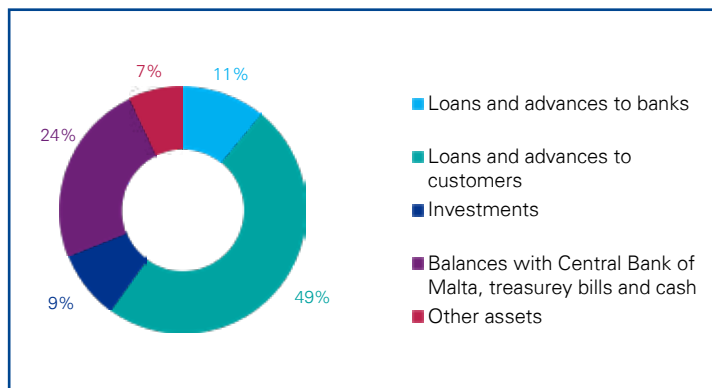
The Bank's Total Liability base for the year ended 31<sup>st</sup> December 2017 stood at €765.75 million representing an increase of €13.46 million (1.8%) year-on-year. This increase was



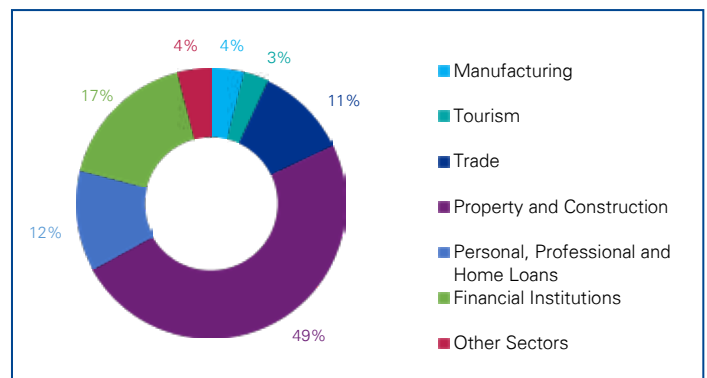
Credit Quality

principally driven by an increase of €11.31 million (1.6%) in Amounts owed to Customers which are repayable on demand. Furthermore, Other Liabilities, consisting mainly of Other Payables, also increased by €6.25 million to €15.08 million. On the other hand, Amounts owed to Banks which are repayable on demand declined by €3.67 million (40.7%) to €5.36 million.

The Bank's CAR and CET1 ratios as at end of financial year 2017 have decreased slightly. The drop in capital adequacy was mainly driven by an increase of RWAs, year-on-year by c. €100 million, which despite an increase in available regulatory CET1 Capital from 2016 to 2017, impacted the Bank's regulatory capital ratios.

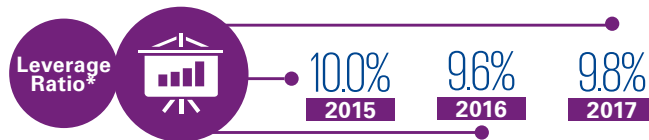
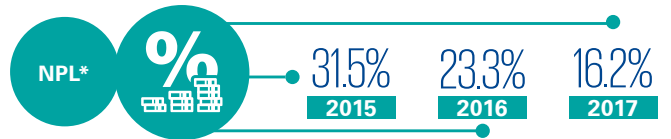
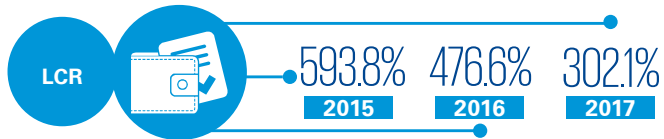
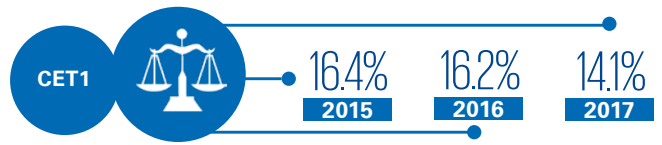
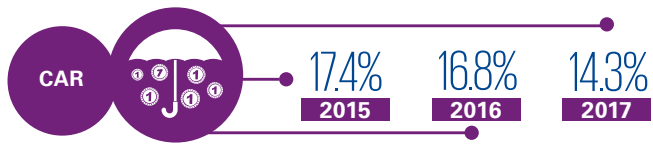


Total Assets



Concentration of Loans and Advances to Customers

# Core Regulatory Ratios



\*NPL Ratio calculated in line with stated formula.

\*Leverage Ratio for 2015 calculated as Capital/Total Assets.

## BRANCHES IN MALTA





# Key Strategic Priorities for Internal Audit in the Banking Sector

To better understand how banks are responding to developments that impact Internal Audit, KPMG professionals conducted a survey of 22 Heads of Internal Audit from banks in 11 European Union states. Most of the banks in the sample identified the following key strategic priorities, over the next three years. Through our reach in the market we know that these are also key challenges for the local banking industry participants.

## Key strategic priorities for the next three years



## How can we help you?

KPMG's Internal Audit team is equipped with the proper skills and industry experience to deal with these areas through our varied services including Internal Audit Outsourcing, Internal Audit Co-sourcing or even Quality Assurance Reviews of the Internal Audit Function. The delivery of these services are carefully tailored to consider our clients' own strategic priorities through the introduction of methods such as the following:



### Technology-enabled Internal Audit

We deliver our services through the use of technologies aimed at improving audit quality and driving value while keeping costs at efficient levels throughout all phases of the internal audit process.



### Advancing Regulatory Technology Solutions

We combine our risk and regulatory expertise with the technology capabilities of our IT and Software Development team to give a full life-cycle support to our clients' RegTech transformation journey.



### Involving IT Subject Matter Experts

We work together with our IT Advisory team in order to ensure that the risks and opportunities that our clients face are properly assessed and strengthened.



### Developing a Culture Audit Approach

With the right emotional intelligence, deep business acumen and strategic thinking, we go beyond the traditional check-the-box audit methodologies to help sensitise the criticality of culture to the organisation.

To learn more about how our Internal Audit team can help you tackle your key strategic priorities, you can send an email with your enquiries to:

### Alex Azzopardi

Director

Risk Consulting Advisory and Internal Audit Services

(+356) 2563 1102

[alexazzopardi@kpmg.com.mt](mailto:alexazzopardi@kpmg.com.mt)



# Medirect Bank (Malta) PLC

Financial year ended 31<sup>st</sup> March 2018

2004

Establishment of the Bank

2009

AnaCap Acquires Malta-based Mediterranean Bank

2010

Acquired majority shareholding in Charts Investment

2014

Mediterranean Bank acquires Volksbank Malta and rebrands to Mediterranean Corporate Bank Ltd

2015

Mediterranean Bank reclassified as a core domestic bank

2015

Established a Branch in Belgium

2018

Listed as Significant Institution and supervised directly by ECB

2018

Name change to MeDirect



# 310



# 4

## Profitability

For the financial year ending 31<sup>st</sup> March 2018, the Group has reported a decrease of 23.9% (or €4.43 million) in its Profit Before Tax, thus amounting to €14.01 million. This decrease is mainly attributed to an increase in Total Operating Expenses of 11.9% (or €5.08 million) from 2017, which included an increase in Legal and Professional charges. Net Impairment Charges as at March 2018 amounted to €8.30 million representing an increase of 48.1% (or €2.70 million) over the previous year. This increase in expenses was partly off-set by the growth in the Group's Net Interest Income of €5.37 million (or 9.3%). This was mainly due to the increase in interest income on Loans and Advances to Customers and decrease in Interest Expense on Amounts Owed to Customer. Furthermore, during the year under review, the Group also experienced an increase in its Net Fee and Commission Income and Net Trading Income of 54.1% (or €1.49 million) and 80.4% (or €1.75 million) respectively, when compared to the previous year. Net Trading Income originated from foreign exchange activities while Net Fee and Commission income was mainly generated from fees on banking transactions and investment services.



That being said, this increase in income was further counteracted by the major shift from Realised Gains on the disposal of Loans and Advances of € 3.59 million, reported in 2017, to Realised Losses of € 1.03 million reported during this year.



\*NII ratio calculated in line with stated formula

15.6%\*



32.3%\*



- > Credit Institution
- > Investment Services (Category 2 and 4 licence)

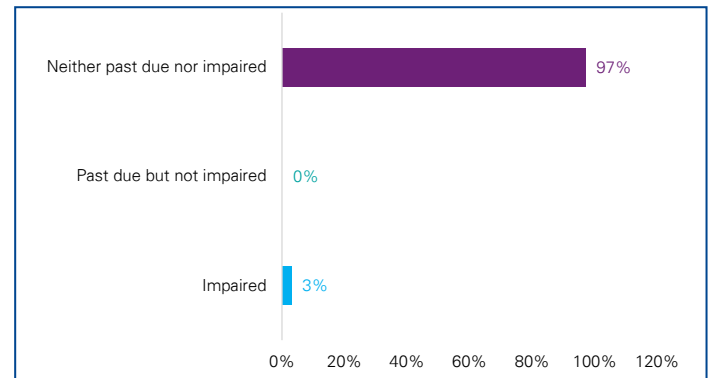


- > MeDirect Bank SA
- > Grand Harbour I B.V.
- > Medifin Estates



## Assets and Liabilities

As at 31<sup>st</sup> March 2018, the asset base of the Group amounted to €2,545.61 million, portraying a decrease of 1.0% (or €25.69 million) over the previous financial year. The main reason for this minor decrease in Total Assets was the decline in the Group's Balances with the Central Bank and Cash, and Treasury investments of €141.46 million (or 57.7%) and €138.23 million (or 19.8%) respectively. The main reason behind the decline in Treasury investments, comprising of covered bonds, bonds issued by supranational organisations and sovereign bonds, was due to the decrease in Debt securities and other fixed income securities issued by foreign banks by 46.7% (or €208.34 million). Conversely the Bank's Loans and Advances to Customers, and, to Financial Institutions increased by 17.4% (or €251.75 million) and 6.3% (or €6.73 million) respectively. The main driver in the increase in Loans and Advances was, in both cases, increases

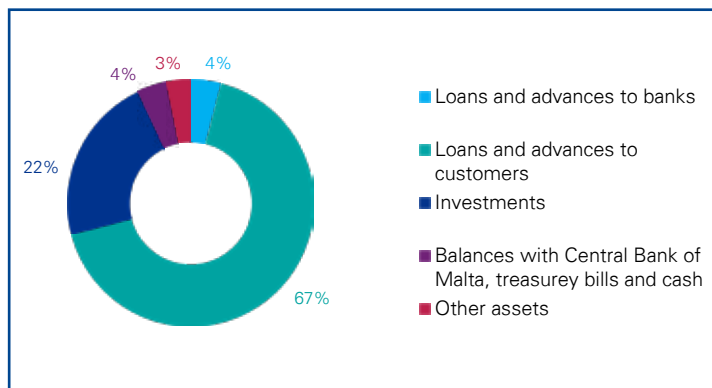


Credit Quality

in Term based products. In the case of Loans and Advances to Customers, there has been an increase in Term Loans and Advances to Corporates of €252.82 million (or 17%) while Term Loans and Advances to Retail Customers decreased by €2.93 (or 39%). Further to this, Intangible Assets increased by €2.50 million mainly as a result of the Group continuous investment in technology in order to enhance its online banking and investment services lines for its customers.

The Group's total liability base amounted to €2,224.91 million, representing a decrease of 5.2% (or €122.56 million) over the previous year. This decline is mainly attributed to a reduction in the Amounts Owed to Financial Institutions of 64.8% (€323.76 million) as a result of a decrease in Term Deposits. However, this was partially off-set by an increase in Amounts Owed

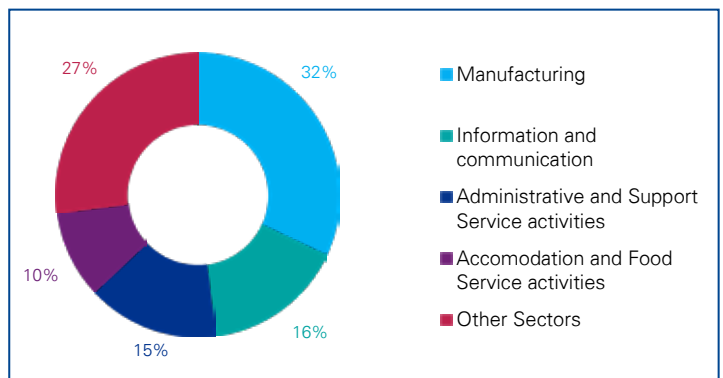
to Customers of 4.1% (or €77.65 million) which was mainly due to an increase in customer Term Deposits emanating from the Belgian market through MeDirect SA.



Total Assets

The Group also experienced an increase in Subordinated Liabilities of 42.3% (or €19.91 million). These comprise of unsecured debt securities maturing in 2019 which are also listed on the Malta Stock Exchange.

The Group remains committed to operating with strong regulatory ratios and a robust liquidity position. At 31<sup>st</sup> March 2018, the Regulatory Group's Capital Adequacy Ratio stood at 16.6% (2017: 13.7%). The improved capital adequacy is pursuant to increased level of regulatory capital, despite an increase in Risk-Weighted Assets.

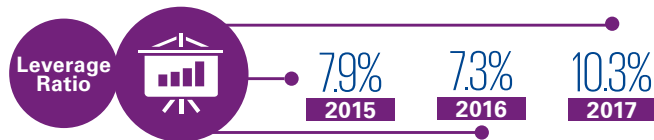
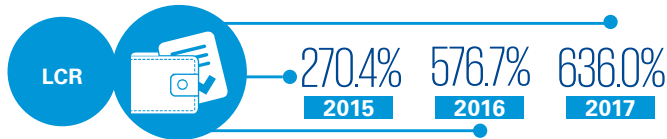
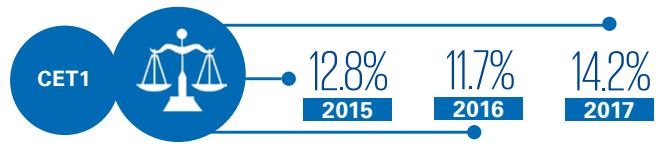
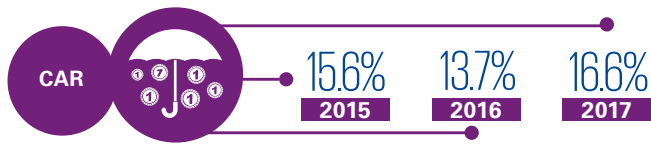


Concentration of Loans and Advances to Customers

\*ROE refers to profit before tax to equity.

\*Calculated as a percentage of Total Local Lending Portfolio.

# Core Regulatory Ratios



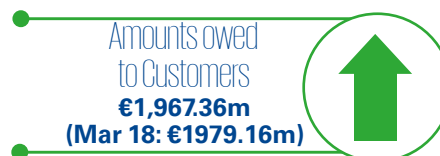
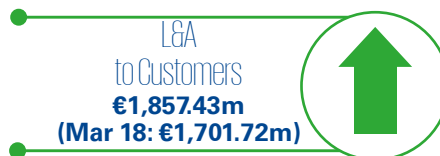
## BRANCHES IN MALTA



# MeDirect Bank (Malta) plc

## Additional Analysis on Interim Financial Statements for the period ended 30<sup>th</sup> September 2018

(P&L compared to a six-month period April to September 2017 and Balance Sheet compared to March 2018)



# DLT & Financial Inclusion



**Juanita Brockdorff**  
Partner  
Tax Services



**Aiste Gerybaite**  
Assistant Manager  
Tax Services

Global banking industry is valued at \$134.1 trillion<sup>1</sup> and the industry's growth will be affected by DLT, which will revolutionise the way we transact today by eliminating intermediaries, reducing operational costs and by bringing us closer to real-time transaction between banks. DLT is here to shake banking industry's inefficiencies to service its customers effectively and ironically it seems DLT was brought down onto the banks by customers themselves who craved for a change. It is easy to get lost in all this DLT hype, however finding a bank's way forward in the industry can be simply put to be as the survival of the fittest.

Banks are being shaken by their core and are challenged to adapt, and ultimately, to survive. The EBA and World Bank Group note the application of DLT in the financial sector will primarily focus on the areas where there is little automatization and heavy use of manual processes, in areas such as payment authorisation, clearance and settlement, trade finance, capital markets and KYC processes<sup>2</sup>.

## Simplifying cross border trade finance and transaction processing

R3 consortium of the world's largest financial institutions in R&D of DLT in the financial services industry together with 11 banks, including HSBC, SEB and Mizuho, are testing an application designed to cut costs and finance trade inefficiencies. Similarly, smart contracts can reduce costs, increase efficiency and lower risk of duplication of documentation. Use of smart contracts in transaction processing through the integration of self-enforcing contracts, which monitor external inputs from trusted sources, such as a financial exchanges, in order to settle according to the contract's stipulations, would lead to cost effectiveness and trade inefficiencies. In fact, Mitsubishi UFJ Financial Group, Michinoku Bank, Shanghai Huarui Bank and a number of other players are partnering and experimenting with Ripple based smart contract system which allows to simplify the exchange process by creating point-to-point and transparent transfers in which banks do not have to pay corresponding bank fees.

KPMG is in the game too. KPMG has advised HSBC on their Blockchain strategy and has collaborated with alliance partner ServiceNow to deliver work to such banks as RBS and Santander on their Fintech projects.

New technology brings new challenges. Smart contracts are questioned on their legality however initiatives such as CommonAccord are addressing such issues by attempting create contracts in a modular fashion with the objective to remove ambiguity as much as possible so that smart contract accurately reflects written legal text and is enforceable in the "real world".

## KYC and data privacy

In June 2018 R3 announced that it completed the testing stage of a blockchain app for the access to KYC for transaction processing in collaboration with participating banks. App allows corporate customers to create and manage their own identities including KYC documentation and grant permission to multiple banks to access this data. Thus eliminating the need for each bank to individually request and update KYC records. Also, the EU is taking forward strides towards full recognition of digital identity and with introduction of new legislation for mutual recognition of digital certificates like eIDAS<sup>3</sup>, where a state would issue a unique digital identity to each person identity verification could become effortless.

<sup>1</sup>According to <http://www.cpifinancial.net/news/post/40753/global-banking-industry-value-hit-134-1-trillion-in-2016-and-will-see-growth-to-2021>

<sup>2</sup>World Bank Group, Public Distributed Ledger Technology and Blockchain Fintech Notes, <http://documents.worldbank.org/curated/en/177911513714062215/pdf/122140-WP-PUBLIC-Distributed-Ledger-Technology-and-Blockchain-Fintech-Notes.pdf>

<sup>3</sup>Regulation (EU) No 910/2014, <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32014R0910>



**KPMG is in the game too: it has advised HSBC on its Blockchain strategy and we have collaborated with alliance partner ServiceNow to deliver work to such banks as RBS and Santander on their Fintech projects.** ”

It is no secret blockchains such as Ethereum are bases which can broadcast private data to all participants of the network and thus are not suitable for financial services industry. DLTs however, can be developed in such way that any private or personal data is shared only with authorised participants such as the risk management departments of banks. Baker Mackenzie notes that DLT “can bridge the gap between these data silos to create a system of shared facts that evolve as commerce happens. These ledgers can be trusted to be accurate from the beginning, reconciling as they go, without the need for multiple reconciliation handshake after every calculation.”

Article 17 of the General Data Protection Regulations provides for the right to be forgotten. In a public blockchain all data is shared with all nodes in the system implementing such rights seems highly impossible. However, because permissioned DLT systems involve known and trusted parties, historical entries can be amended provided the required number of parties agrees to an erasure. For example, a similar process has been carried out by participants of the Ethereum network to reinstate the funds lost in the infamous “DAO hack”. Accordingly, DLT systems may be designed to allow personal data to be deleted if a sufficient majority of parties to the system agree.

#### Catalyst for change

DLT may not yet be sufficiently mature to provide all solutions for the financial services industry but one thing is clear, DLT is here to stay and so are financial institutions which embrace the change. Banks are to reconsider the domains they are set up in, the way they function and the way they are going to adopt DLT and blockchain technology in order to remain on board and relevant.

Time to act is now. Therefore if you are in the financial services industry and would like to discuss your plans- speak to us. KPMG in Malta has a specialised team across all our functions and with the help of our worldwide network we are in a position to be your one-stop-shop for all your DLT needs.





# Non-Core Domestic Banks



# FCM Bank Limited

Financial Year ended 31<sup>st</sup> December 2017



1



2010



11

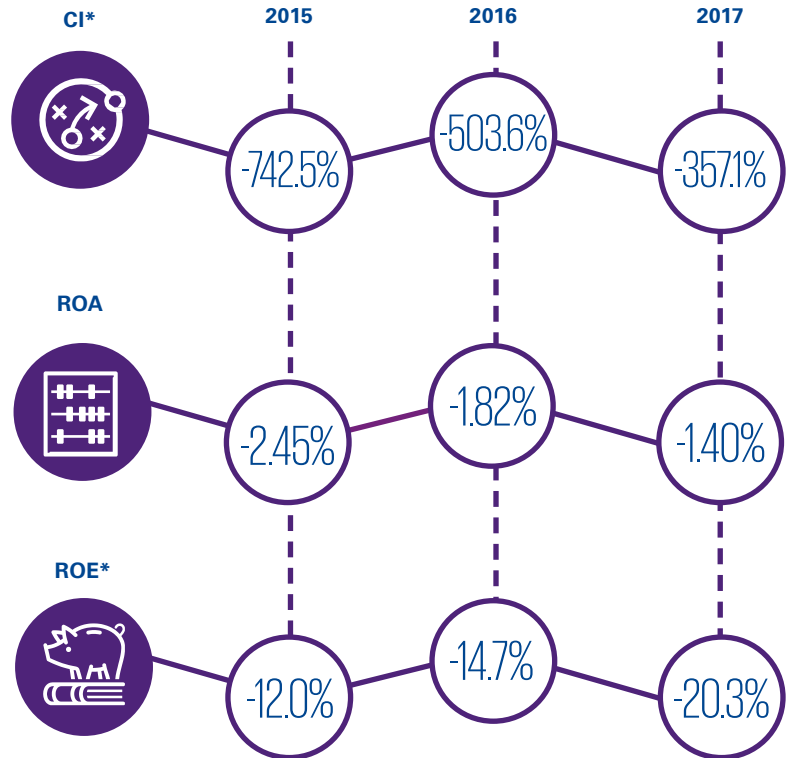


- > Corporate and real estate lending
- > FX spot business



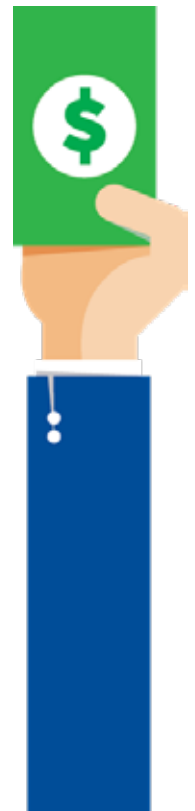
Credit Institution

## Core Financial Ratios



### Profitability

As at 31<sup>st</sup> December 2017, the Bank reported a Loss Before Tax of €0.98 million. An increase in Dividend Income, generated from exchange traded debt funds, of 561.5% (or €0.72 million), provided for increased revenue generation although this was counteracted by a decline in Interest Income of 52.4% (or €0.85 million) from the previous year as a result of the low interest rate environment for debt and other fixed income instruments. Increases in Interest Expenses provided for a Net Interest and Dividend expense, rather than a Net income. It is fair to say that, this is a reflection of the Bank's purposeful refrainment in investment of available funds in lieu of the change in shareholding process which it was going through during 2017. During the year under review, the Bank also experienced a decrease in its total Administrative Expenses by 9% (or €0.14 million) over 2016. This was mainly contributed to a reduction in its staff complement which reflected a drop of 11.7% (or €0.07 million) in the Employee and Compensation Benefits between the financial year ending 2016 and that ending in 2017. This decrease in Administrative Expenses was however partially offset by the shift from Foreign Exchange Gains, which had been reported during the period ending 31<sup>st</sup> December 2016 (€0.13 million), into Foreign Exchange Losses reported during the financial year ended 2017 (€0.004 million). Nevertheless, the Bank also reported a net increase in Gains on Financial Assets of €0.37 million (134.9%) when compared to the previous reporting year.



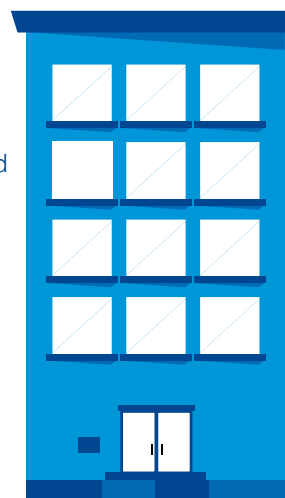
\*CI ratio calculated in line with stated formula

\*RoE ratio calculated in line with stated formula

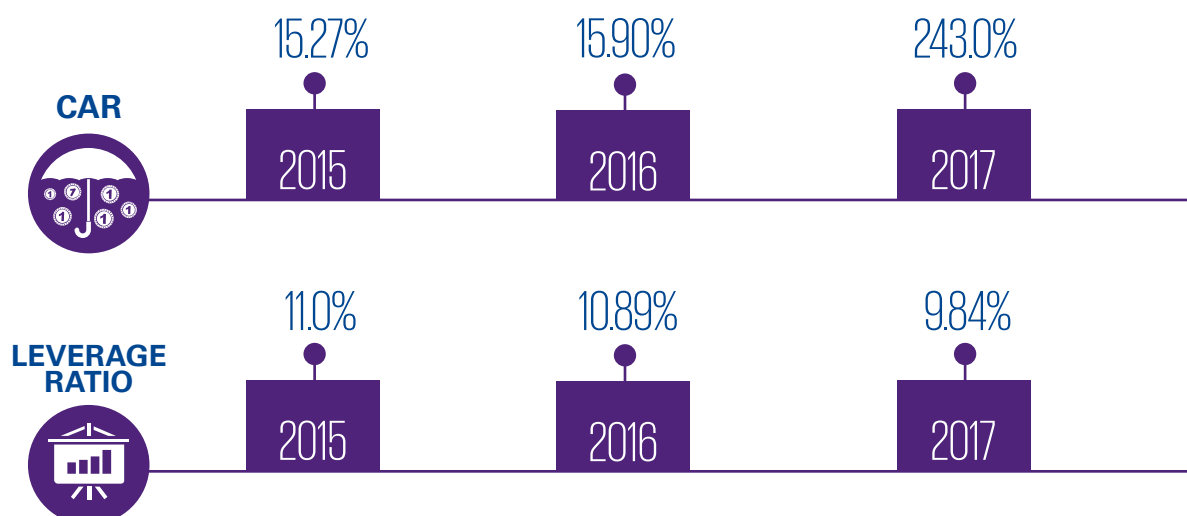
## Assets and Liabilities

The Bank's total asset base stood at €69.86 million as at 31<sup>st</sup> December 2017, reflecting an increase of 6.3% (or €4.11 million) over 2016. This is highly attributed to a significant growth in the Bank's Cash and Cash Equivalents of 628.1% (or €56.79 million) over the previous year. This increase in the Bank's Cash and Cash Equivalents was mainly due to the fact that the Bank, upon completion of its change in shareholding process, disposed of the majority of its Investment Portfolio as one of the first steps in the implementation of its new strategic direction under new management. In fact, the Bank disposed of all its investments which were classified as Held-to-Maturity and also those financial assets classified as Loans and Receivables. Additionally, the Available-for-Sale Investments and the Financial Assets classified at FVTPL also decreased by 99.6% (or €34.56 million) and 6.2% (or €0.14 million) respectively. (This resulted in an investment portfolio of €2.27 million, as at 31<sup>st</sup> December 2017 (2016: €54.64 million).

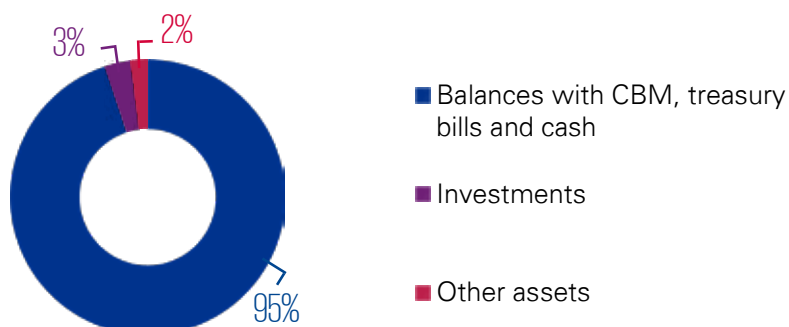
As at 31<sup>st</sup> December 2017, the Bank's liability base amounted to €60.96 million, representing a year-on-year increase of 7.2% (or €4.16 million). This was mainly driven by an increase of 7.2% (or €4.11 million) in Amounts Owed to Customers. Further to this, the Bank also increased its share capital by €1 million during the financial year ended 2017, implying a substantial increase in its CAR which resulted in 243.0% as at end 2017.



## Core Regulatory Ratios



### Total Assets



# FIMBank p.l.c.

Financial Year ended 31<sup>st</sup> December 2017



1



1994\*

\*Banking licence issued in 2005



417

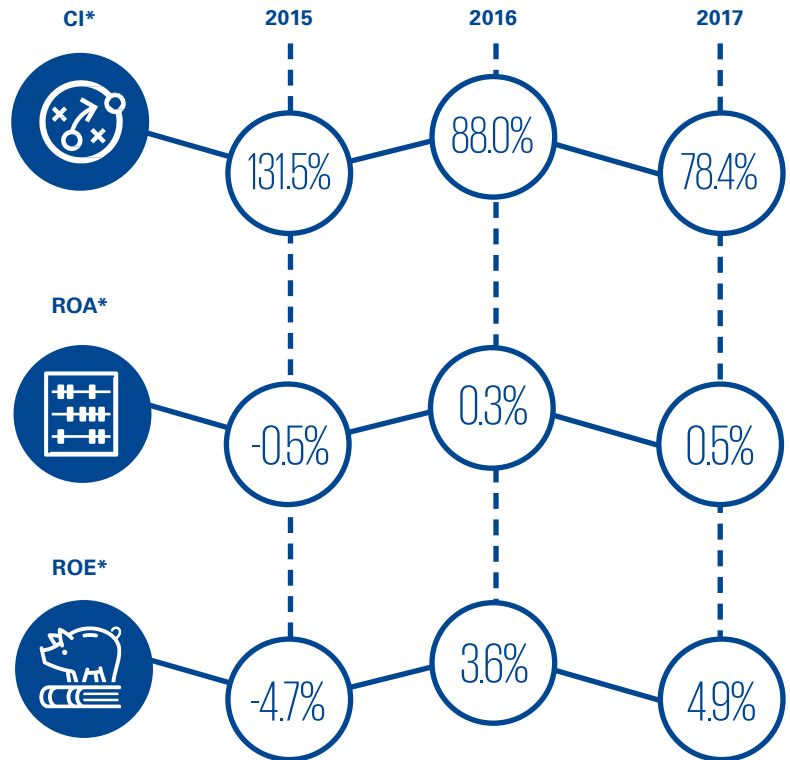


- > Short-term international trade finance to corporates
- > Intermediary to other financial institutions for international settlements, forfaiting and loan syndications



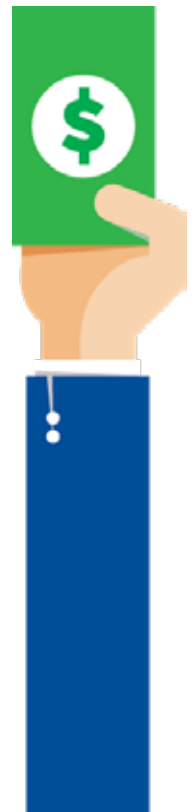
Credit Institution

## Core Financial Ratios



### Profitability

The Group registered a Profit before Tax of \$11.68 million for the year ended 31<sup>st</sup> December 2017, representing a remarkable increase of \$6.46 million (or 123.7%) when compared to the previous year. The increase is mainly attributable to the positive increase in net interest income of \$2.97 million (or 13.5%) and in net fee and commission income of \$3.68 million (or 24.8%). Net interest income increased as a result of overall improved interest yields and more efficiency in funding volumes and cost of funds. Fee and commission income also mirrored such increase as a result of improved fees on documentary credits and forfaiting. On the other hand, a significant decline was noted in the net gains from other financial instruments carried at fair value. These declined from \$3.37 million in 2016 to \$0.11 million in 2017 in view of the fact that the realised profits of \$3.4 million generated in 2016 from the trading of investment securities were not repeated in 2017. The Group revalued its property in 2017 following a change in its accounting policy for owned properties and started measuring these at their fair value. The revaluation resulted in a fair value gain of \$3.4 million in 2017, compared to a fair value loss of \$0.02 million in 2016 as a result of the retrospective application. As a result of significant recoveries made by the Bank and its subsidiaries in India and Egypt on legacy loans, net impairments for the year improved from a loss of \$2.30 million in 2016 to a net recovery position of \$2.30 million in 2017. This was partly offset by increases in coverage on other impaired legacy credits. Administrative costs on the other hand increased by \$4.33 million (or 12.1%) in 2017 as a result of increased mandatory regulatory costs and other variable staff-related expenses.



\*CI ratio calculated in line with stated formula.

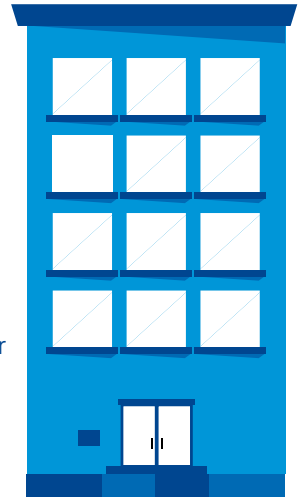
\*ROE and ROA ratios are calculated through utilising Profit After Tax, Average Equity and Average Assets.

## Assets and Liabilities

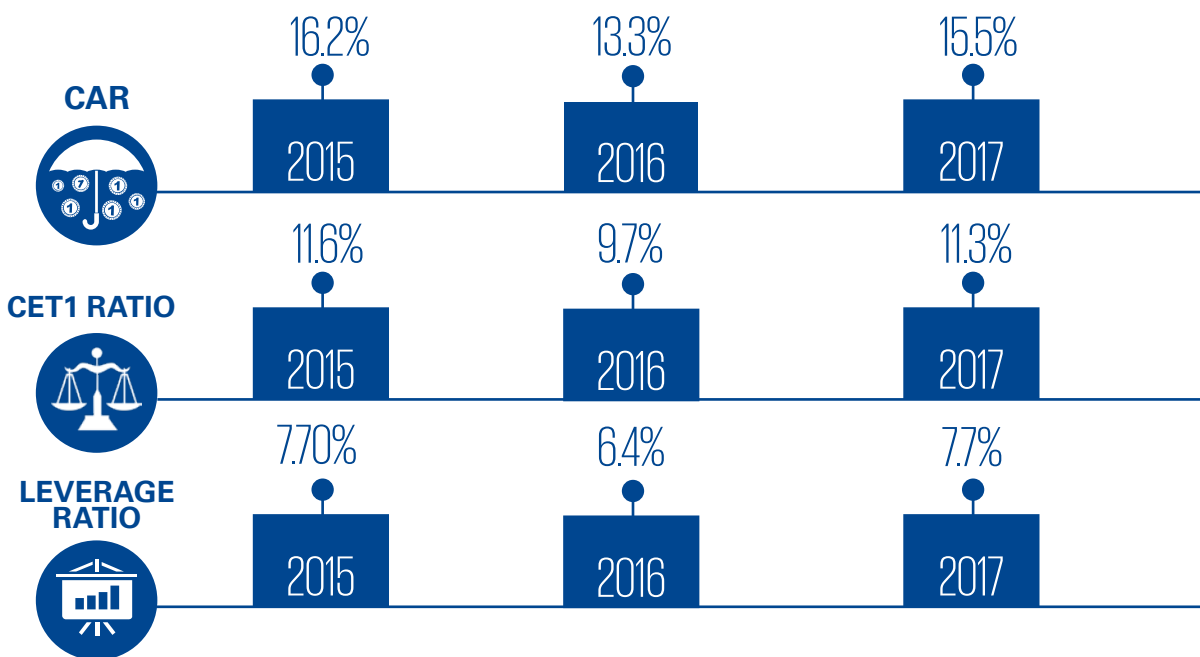
The Group's asset base declined by 5.8% from \$1.74 billion as at 31<sup>st</sup> December 2016 to \$1.64 billion as at 31<sup>st</sup> December 2017. A significant decline is noted in loans and advances to banks of \$228.27 million (or 50.2%). This drop in both business and treasury assets was partially offset by an increase in treasury balances held with the Central Bank. During the year under review, trading assets were reduced by \$126.89 million whilst loans and advances to customers increased by \$139.75 million.

As at 31<sup>st</sup> December 2017, the Group's Total Liability base stood at \$1.47 billion, resulting in a decline of \$96.23 million or 6.1% from prior year. The main decline was noted in customer deposits of \$101.51 million (or 10.7%),

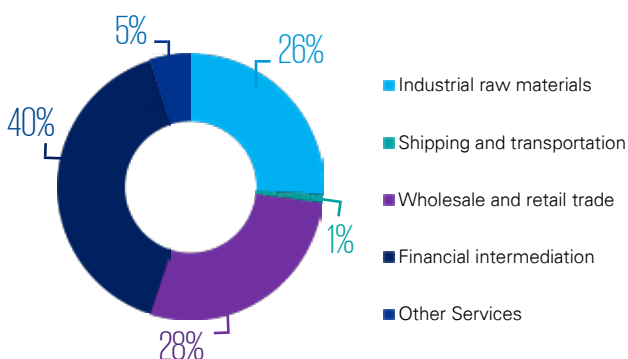
which was also reflective of the slight contraction in the Group's asset base. Bank deposits also declined by \$35.75 million to \$493.19 million as at year end. On the other hand, debt securities in issue, comprising of unsecured promissory notes, increased by \$46.43 million (or 564.4%).



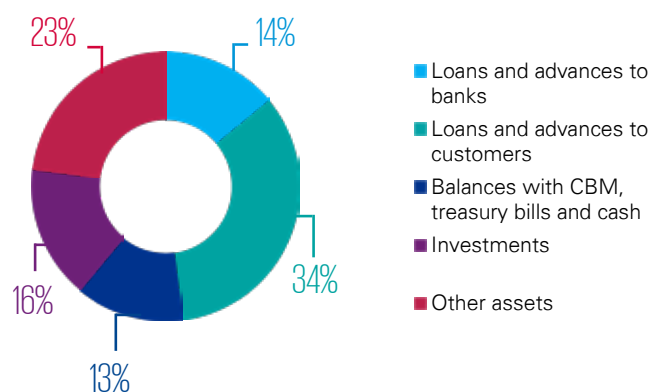
## Core Regulatory Ratios



Concentration of Loans and Advances to Customers



Total Assets



# IIG Bank Malta Ltd

Financial Year ended 31<sup>st</sup> December 2017



2



2010



26

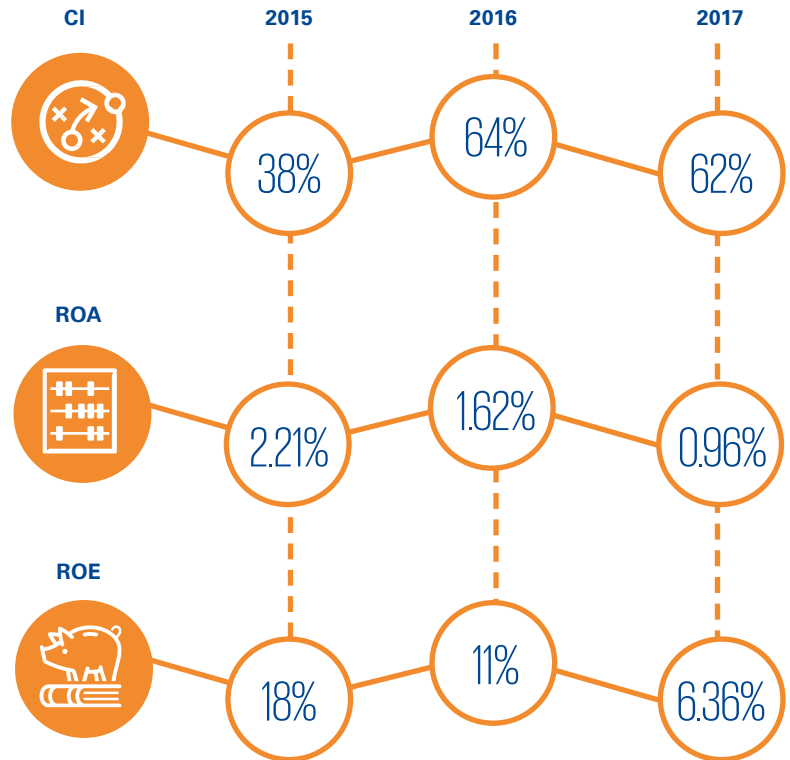


Trade Finance



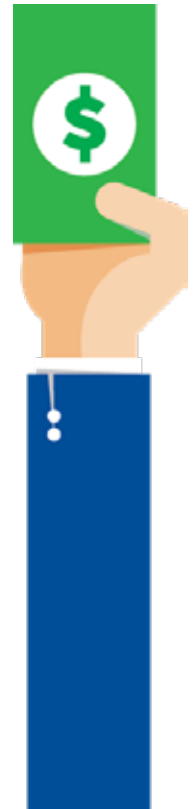
Credit Institution

## Core Financial Ratios



### Profitability

During the financial year ended 31<sup>st</sup> December 2017, the Bank registered a Profit before Tax of \$2.66 million, reflecting a decline of 39.3% (or \$1.71 million) when compared to profitability generated during the previous year. This deterioration in profitability was mainly a result of a significant reduction in the gains generated from the disposal of AFS Financial Assets which fell from \$5.40 million in 2016 to \$1.02 million in 2017. The reduction in PBT was also driven by an increase of 104.8% (or \$0.36 million) in Net Trading Losses, predominately generated from Foreign Exchange Losses of \$5.07 million as opposed to the Foreign Exchange Gains of \$2.68 million in 2016. During the financial year 2017, the Bank also experienced a reduction in Net Interest Income of 12.5% (or \$0.69 million) and an increase in its Administrative Expenses of 30.2% (or \$0.88 million) when compared to the financial year ended 2016. Conversely net income generated from Fees and Commissions increased by 48.8% (or \$0.40 million) over the previous year. This increase in Net Fees and Commission Income is generated from trade finance services which is the Bank's primary business activity.

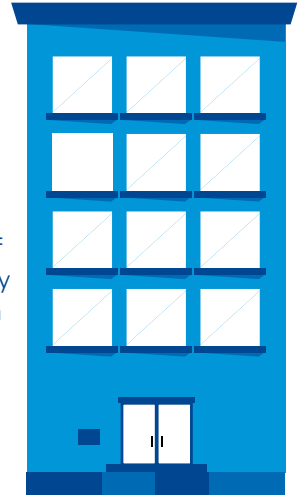


## Assets and Liabilities

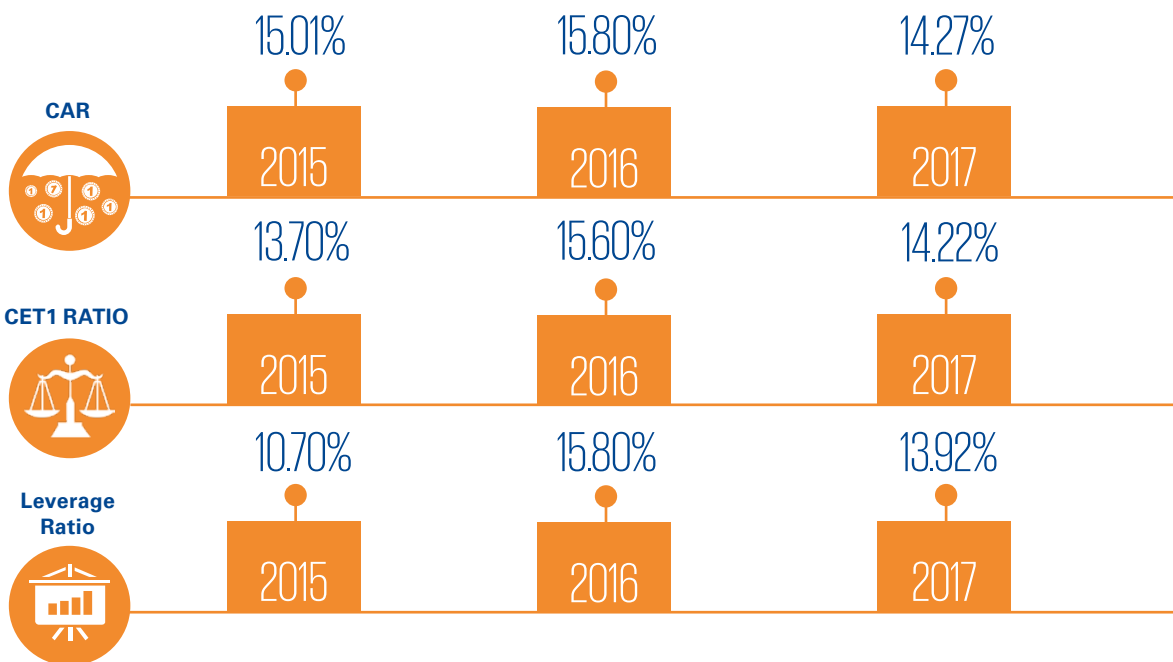
In 2017, the Bank's asset base increased by 24.3% (or \$37.43 million) over the previous year, primarily driven by developments undertaken on the Bank's Computer Software licences which bolstered intangible assets. Furthermore, the Bank also experienced an increase in Financial Assets designated as FVTPL by 119.8% (or \$13.90 million). These mainly consist of placements in the form of investments in two separate funds which both seek to invest in stable assets such as Malta Government T-Bills, term deposits with Prime European Banks, and international investment grade government and corporate bonds. Loans and Advances to Banks also increased by 154.1% (or \$31.88 million) whilst Loans and Advances to Customers reduced by 8.8% (or \$7.80 million).

During the year under review, the Bank reported a liability base of \$163.00 million, that is, a year-on-year increase of 27.0% from 2016 to 2017. The main contributor to this increase in the Bank's liabilities during 2017 were

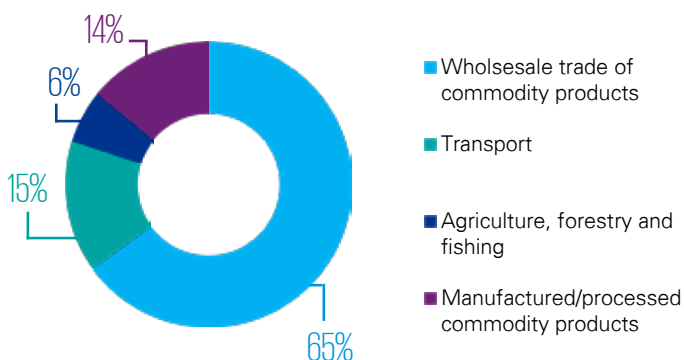
customer deposits, which increased by 32.5% over the previous year, amounting to \$159.87 million as at December 2017. However, this increase was counteracted by an 80% decline (or \$2.68 million) in Amounts owed to Banks which mainly relate to participations in the European Central Bank's open market operations. Moreover, derivative financial instruments, which consist of derivative contracts utilised by the Bank to hedge its Foreign Exchange position arising out of customer deposits, decreased by 100% (or \$1.37 million) over the previous year.



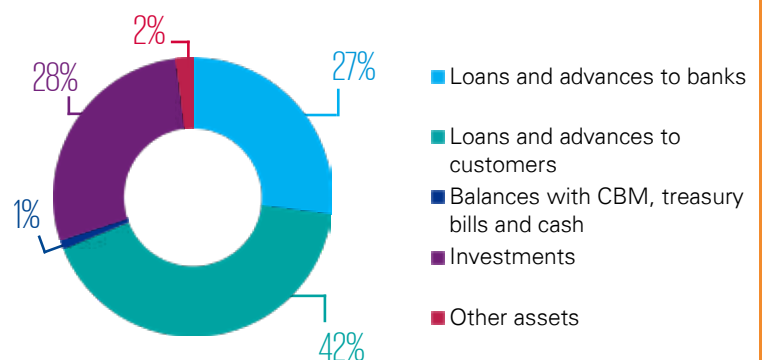
## Core Regulatory Ratios



Concentration of Loans and Advances to Customers



Total Assets



# Izola Bank plc

Financial Year ended 31<sup>st</sup> December 2017



1



1994



2018

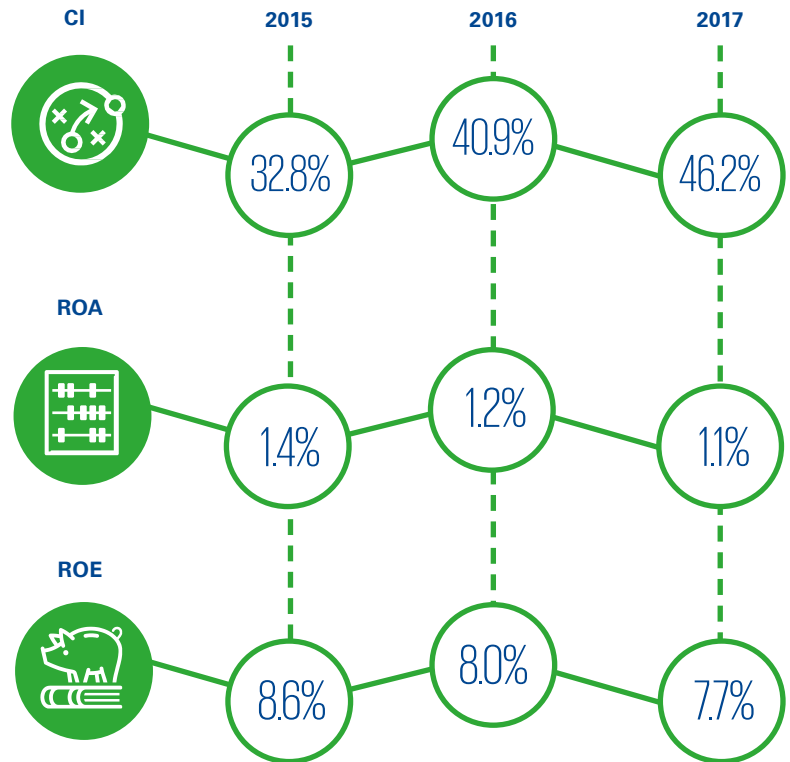


Corporate banking and factoring services to resident and non-resident customers



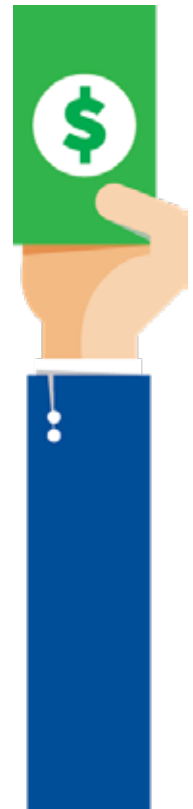
Credit Institution

## Core Financial Ratios



### Profitability

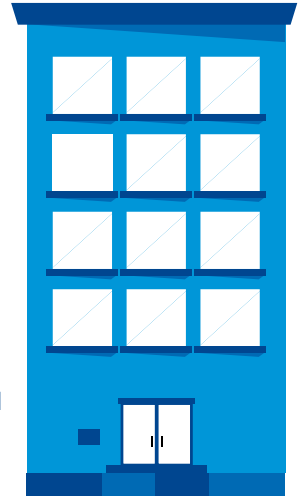
The Bank's Profit before Tax for the year ended 31<sup>st</sup> December 2017 stood at €3.56 million, representing a decline of 4% or €0.16million over prior year (2016: €3.72 million). As a result of growth in factoring activities, the Bank registered a growth in its net fee and commission income of €0.73 million (30.1%). This growth was partially offset by a decline in net interest income of €0.20 million (10.0%). Operating income increased by €0.44m (26.2%) as a result of gains made from disposal of available-for-sale investments. The growth in the factoring business brought about an increase in other administrative expenses of €0.48 million (43.7%) comprising of insurance expenses, regulatory and compliance costs and increased marketing spend to support such growth. Personnel expenses also increased by €0.22 million (23.7%) as a result of the increase in the staff complement from a weekly average of 23 to 28 staff members. The factoring business also brought about an increase in overall impairment allowance of €0.32 million (1130.1%), which increase is mainly noted from collective allowances on factored receivables.



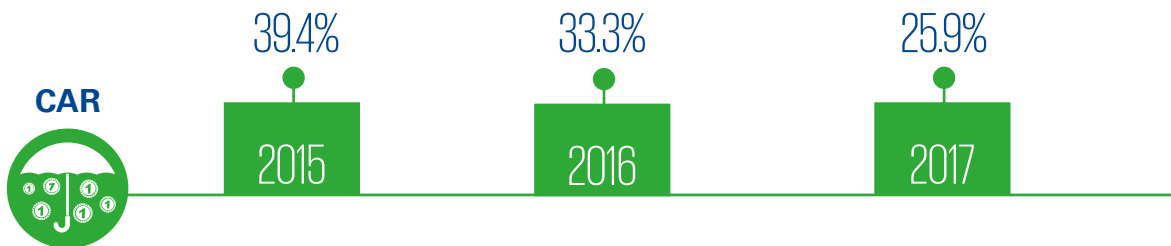
## Assets and Liabilities

The Bank's asset base during the year ended 31<sup>st</sup> December 2017 increased by €9.21 million (4.7%), from €197.42 million to €206.63 million. This increase was significantly driven by a growth in the factoring business with factored receivables increasing by €28.3 million (140.1%). The Bank acquired new premises in 2017 at a cost of €5.47 million. In addition to this, its existing property was revalued upwards by €1.8 million reflecting the booming Maltese real estate market. On the other hand, the bank reduced its loans and advances to banks and balances with Central Bank of Malta by €11.7 million and €9.7 million respectively.

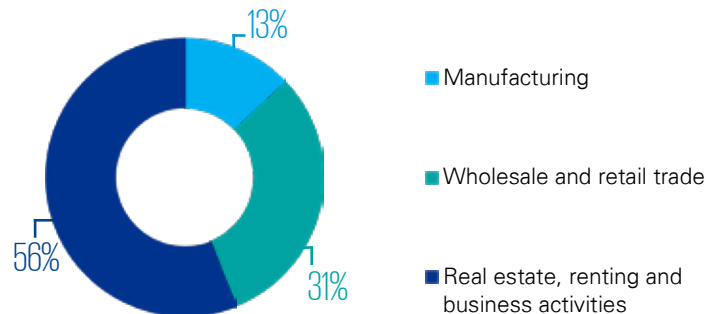
The Bank's liability base also increased by €8.21 million (4.9%) to €177.16 million (2016: 168.95 million) which increase was mainly driven by an increase in customer deposits of €13.43 million. In line with the decline in balances held with the Central Bank of Malta, balances owed to the Central Bank of Malta also declined by €5 million.



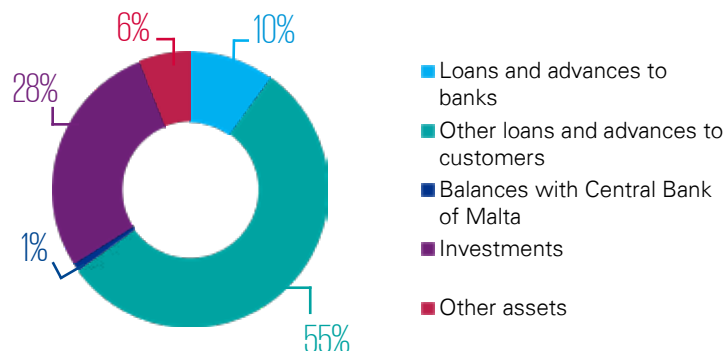
## Core Regulatory Ratios



Concentration of Loans and Advances to Customers



Total Assets



# Sparkasse Bank Malta plc

Financial Year ended 31<sup>st</sup> December 2017



1



2000\*

\*Banking licence issued in 2005



59

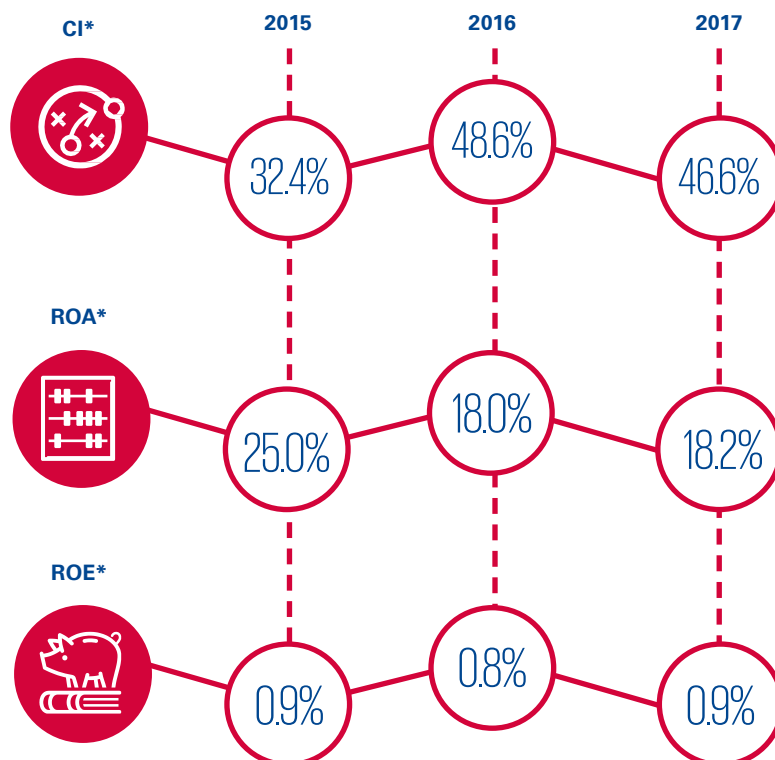


- > Private Banking
- > Investment Services
- > Custody/ Depository Services



- > Credit Institution
- > Investment Services Category 2 and 4A

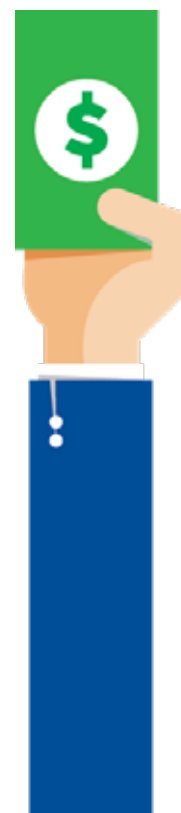
## Core Financial Ratios



### Profitability

The Bank's Profit before Tax for the year ended 31<sup>st</sup> December 2017 increased to €4.58 million from €4.12 million in 2016. The main driver behind the increase in profits was the increase in net fee and commission income of €0.88 million (17.3%) generated by the Bank's business lines. Net interest income fell by 18.0% to €0.91 million from the previous year as a result of a back drop of negative interest rates within the Euro zone. The Bank's other operating income declined by €0.12 million as a result of a decrease in its profits on foreign exchange activities by €0.43 million, partly set-off by a reversal of impairment provision of €0.21 million. Overall, the results from operating activities increased by €0.56 million to €8.56 million.

Operating expenses increased solely by €0.1 million. The increase in staff complement from a weekly average of 51 to 59 staff members brought about an increase in staff remuneration of €0.36 million. This increase in costs was offset by a decrease in other operating costs of €0.42 million.

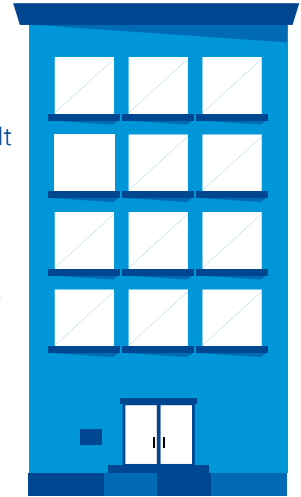


\*CI ratio calculated in line with stated formula  
\*ROA ratio calculated in line with stated formula  
\*ROE ratio calculated in line with stated formula

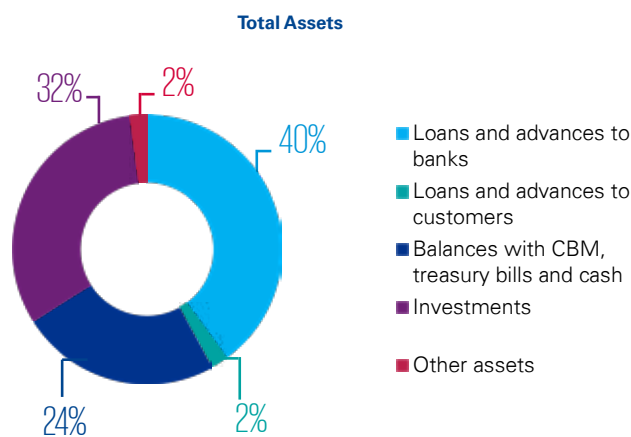
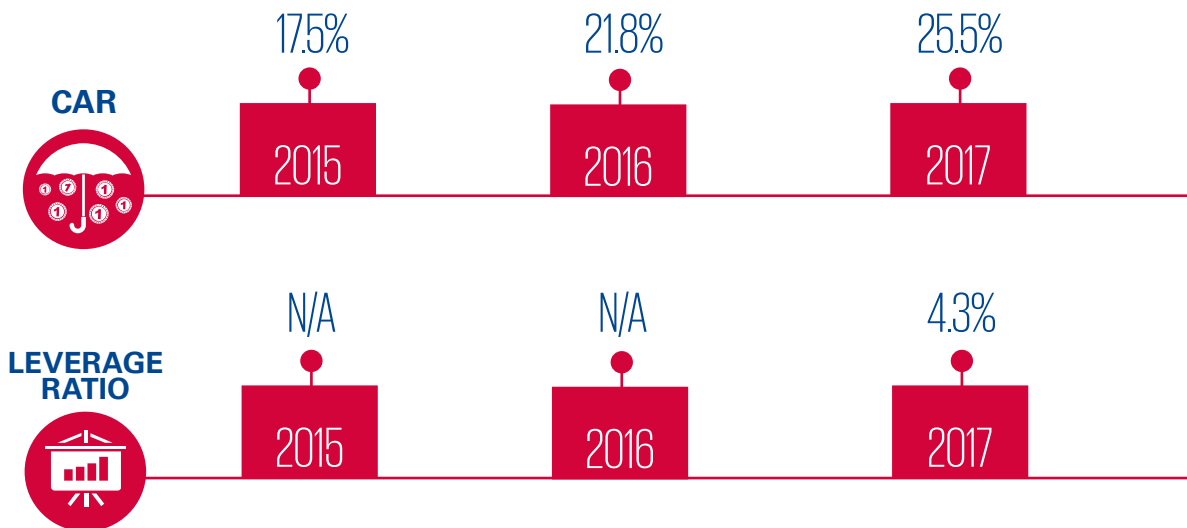
## Assets and Liabilities

The Bank's asset base grew by 7.3%, from €484.81 million to €520 million during the year in view of the Bank on-boarding new relationships in line with its targets contributing to an overall increase in its customer base. Loans and advances to banks increased by €39.0 million (22.9%), which increase was partially set off by a decline in cash and balances held with Central Bank of Malta by €31.2 million (20.3%) to €122.85 million. The Bank increased its exposure to financial assets by acquiring High Quality Liquid Assets of €19.3 million to €168.45 million.

The Bank's liability base also increased by €33 million to €495 million. This is as a result of an increase in customer deposits of €27.8 million to €482.04 million and an increase in bank deposits of €3.85 million or 151.3%, year-on-year.



## Core Regulatory Ratios



# IFRS 9: Transition Review



**Jonathan Dingli**  
Partner  
Accounting Advisory Services

The International Financial Reporting Standard (IFRS) 9 Financial Instruments brought about a new set of accounting rules for financial instruments replacing IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 was released in three phases:

Phase 1: Classification and Measurement;  
Phase 2: Impairment; and  
Phase 3: Hedge accounting.

IFRS 9 came into force for financial reporting periods beginning on or after 1 January 2018.

Locally, most banks have released the pre-transition disclosure in their annual financial statements, with the large banks also publishing their interim reports under IFRS 9. We have set out below interesting observations that emerged during our review of these disclosures.

## **Classification and Measurement**

Phase 1: Classification and Measurement introduced new requirements on how the Banks should classify and measure financial assets. As expected, the changes in classification did not result in a significant financial impact on retained earnings and reserves on most local banks. Having said that, the impact highly depends on the business models applied by the Banks and the complexity of the Banks' products and services.

As stated in the pre-transition disclosures, banks do not envisage any changes in the measurement basis for loans and advances to banks and to customers that were classified as Loans and Receivables under IAS 39. The majority of these loans will continue to be measured at amortised cost (AC) in the Balance Sheet. Most financial assets that were classified as Available-for-sale (AFS) under IAS 39 are likely to continue being measured at FVOCI, although reclassifications have been made to AC for assets that form part of high quality liquid portfolios due to insignificant sales. We observed changes in measurement category for certain debt instruments that were voluntarily designated as at FVTPL prior to the adoption of IFRS 9. The change in measurement is a result of the outcome of the business model assessment.

In limited cases, financial assets previously classified as held-to-maturity were not considered to have SPPI cash flows and have accordingly been measured at FVTPL. From the reviews performed, leverage-type feature is the common trigger for SPPI failure. Overall, the implementation of the SPPI testing presented significant challenges for banks that hold contracts with non-standardised and complex terms where individual, rigorous assessment is required.

In terms of the business model assessment, a question often asked is: how should we interpret 'infrequent-significant or frequent-insignificant sales'? For sales out of a Hold-to-Collect (HTC) portfolio, IFRS 9 does not define the terms or lay down any thresholds. Therefore it is an area where judgement will be applied. However, the industry seems to be pitching this threshold to between 5% - 10% of sales out of the HTC portfolio over the life of the portfolio for sales which are infrequent-significant or frequent-insignificant.

One other issue making the current debate is the accounting for equity instruments under the new FVOCI election. It's interesting to observe that banks still elected to measure equity instruments at FVOCI despite the prohibition on recycling gains and losses in profit or loss.

We believe that banks are now in a better position to understand that the classification and measurement requirements cannot be overlooked. Moreover, classification of financial assets is the first step to identify portfolios subject to the expected credit loss model.

### Impairment

The impairment requirements under IFRS 9 have resulted in banks witnessing a paradigm shift from an incurred-loss model to a forward-looking expected credit loss (ECL) model. While it is still crucial to consider historical and current information, IFRS 9 requires bankers to incorporate forward-looking economic scenarios:



### Past Events

One of the main elements used by banks in determining their ECL relates to past events, as historical losses incurred by customers may be reflective of the same customers' behaviours in the future. The more granularities the banks' information systems have in place, the more reliable the data is in determining the ECL, as it enables them to incorporate jurisdictional-specific, industry-specific, and customer-specific information in their models. For instance, in determining customer-specific future credit risk, such level of data granularity has enabled several banks to incorporate customers' historical patterns of days past due, defaults, losses and recoveries over a number of past years.

### Current conditions

In the absence of available internal historical data, a number of banks have established an internal scale that would determine internal ratings to their counterparties based on past and current events. Such internal ratings are eventually mapped to external ratings provided by reputable international credit rating agencies, hence deriving a probability of default for each exposure.

In determining their ratings, banks shall look beyond historical events and consider any current events that might alter the expected credit risks associated to customers, and implement manual overlays so as to have the ECL reflect any current triggers.



**By way of example, a retail bank issues a home loan to a customer, who five years down the line loses his/her employment and finds it difficult to find an alternative job due to a mismatch in the labour market. Consequently, ECL associated to such customer are likely to increase. As soon as the customer relationship manager becomes aware of such situation, the credit risk team is to be informed so that on top of historical behavioural patterns, a manual adjustment will reflect the current situation.** ”

Therefore, some banks have implemented credit-risk monitoring systems that allows the implementation of managerial overlays, so as to incorporate significant events into the model and have an ECL that realistically reflects the customers' current credit-risk.

### Forward-looking economic conditions

The third element to be considered by banks relates to forward-looking economic variables that help preparers determine the impact of such variables on the customers' credit risk. In doing so, banks shall use reliable independent sources so as to obtain forecasts of relevant variables.



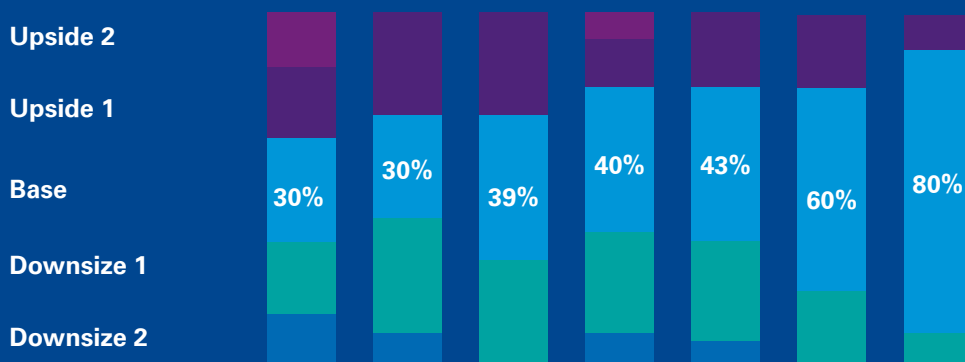
**For example, if the preparer is a retail bank providing home mortgages, the housing price index is an important element to consider. Likewise, if the bank issues a commercial loan to a customer who is coming from the construction industry, the housing price index is also crucial as this is likely to affect the customer's economic standing. In addition, preparers shall also calibrate their model by incorporating relevant forecasts of macroeconomic variables of the jurisdiction / region in which the customer is operating – such as GDP growth, inflation and unemployment. ”**

It is empirical for banks to have a robust model in place that facilitates continuous re-calibration – hence enabling them to incorporate fresh data and implement the necessary alterations as deemed relevant.

### Multiple scenarios

In reaching an ECL estimate, IFRS 9 also requires preparers to consider a number of scenarios in which, ECL will vary (for example baseline, upside and downside). Therefore, banks shall use multiple scenarios and apply a sensitivity analysis in order to derive a weighted-average ECL.

The following relates to the weights assigned to multiple forward-looking scenarios by seven different banks in Europe:

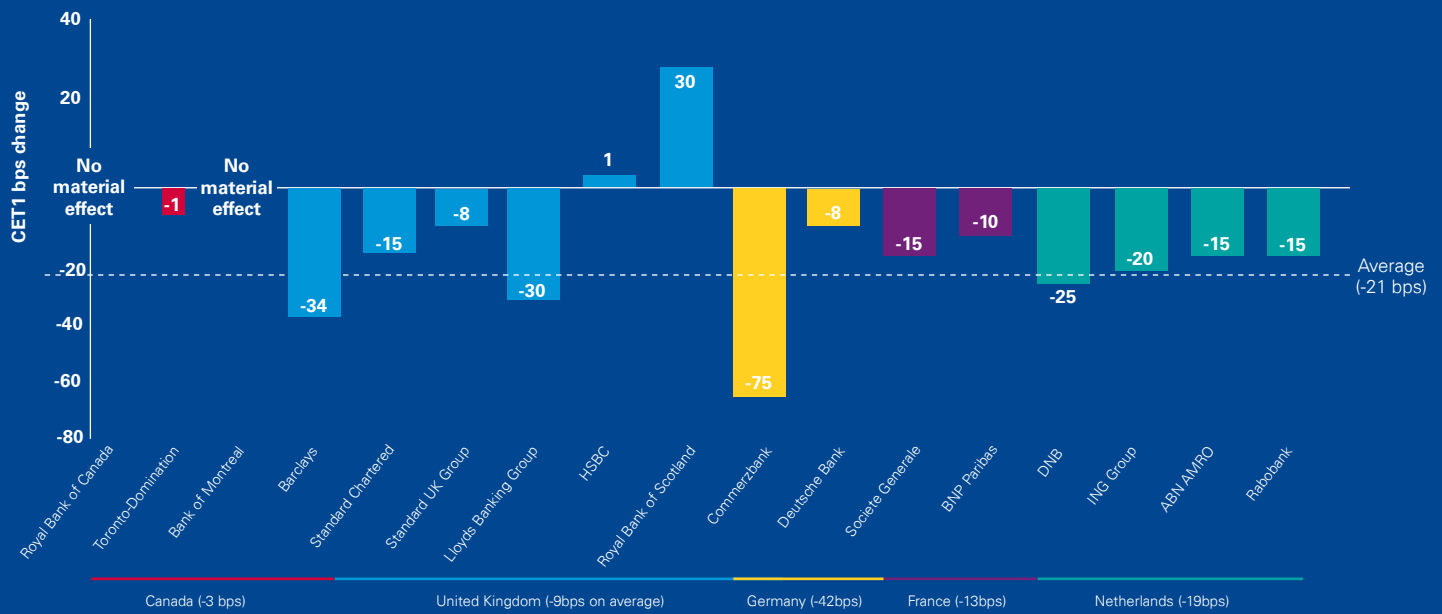


Source: Real Time – IFRS 9 Publication (KPMG, 2018)

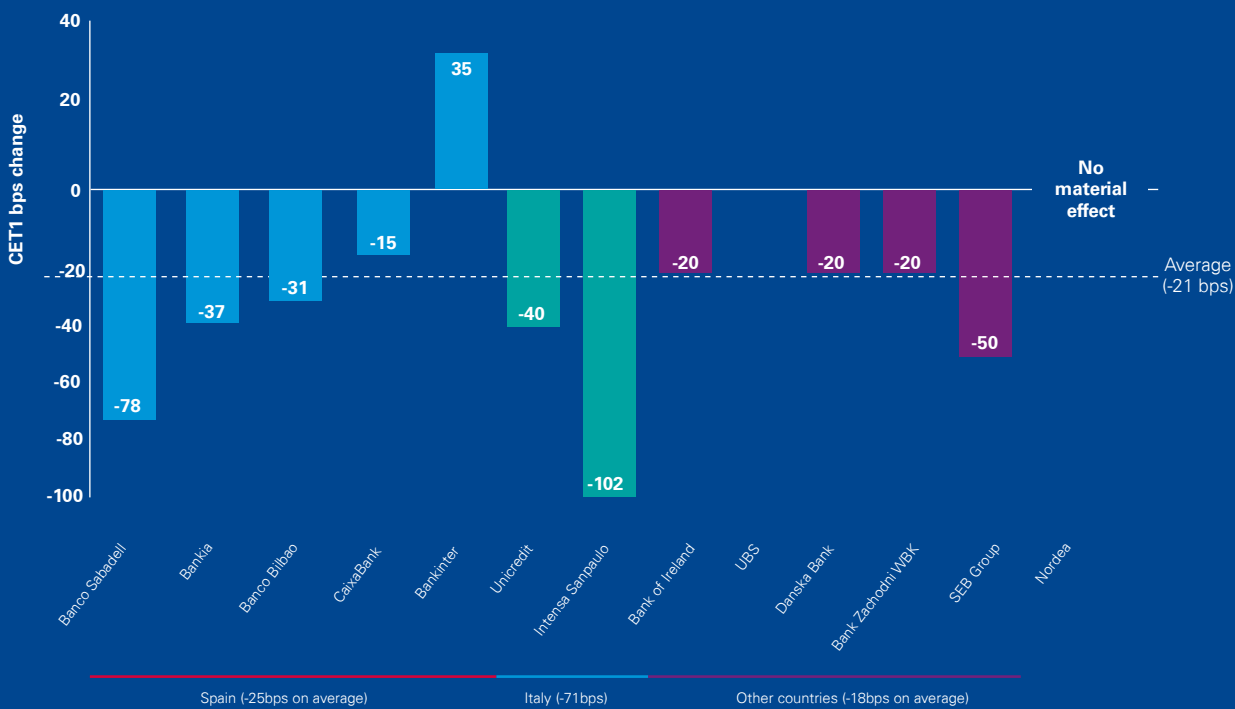


European banks that have disclosed their IFRS 9 transitional impact and that were included in the European Banking Authority (EBA) assessment will have an average negative impact of 21 basis points (bps). Therefore, IFRS 9 will also have an impact on CET1. The following illustrations represent the reported transitional impact of IFRS 9 on CET1:

### Reported Transitional Impact of IFRS 9 on CET1



### Reported Transitional Impact of IFRS 9 on CET1



Source: Real Time – IFRS 9 (KPMG, 2018)

Most of the banks have just finalised the implementation of the standard. However, the truth is that the IFRS 9 journey is not over yet. We expect the standard to evolve as auditors, banks and regulators gain more experience. An illustration to this is the concerns raised on the treatment of investments in equity instruments which are carried at FVOCI. The European Commission is seeking advice on the possibility of introducing recycling and as a consequence developing a new impairment model for equity instruments. Discussions are still underway.

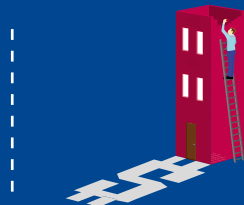
The new IFRS 9 requirements and the new ECL model explained above have led to a change in the provision for doubtful debts in the financial reports of several banks, as well as CET1. Going forward, banks are required to incorporate an ongoing maintenance structure in their ECL models. As the macroeconomic context changes, banks need to re-calibrate the model and incorporate fresh data.





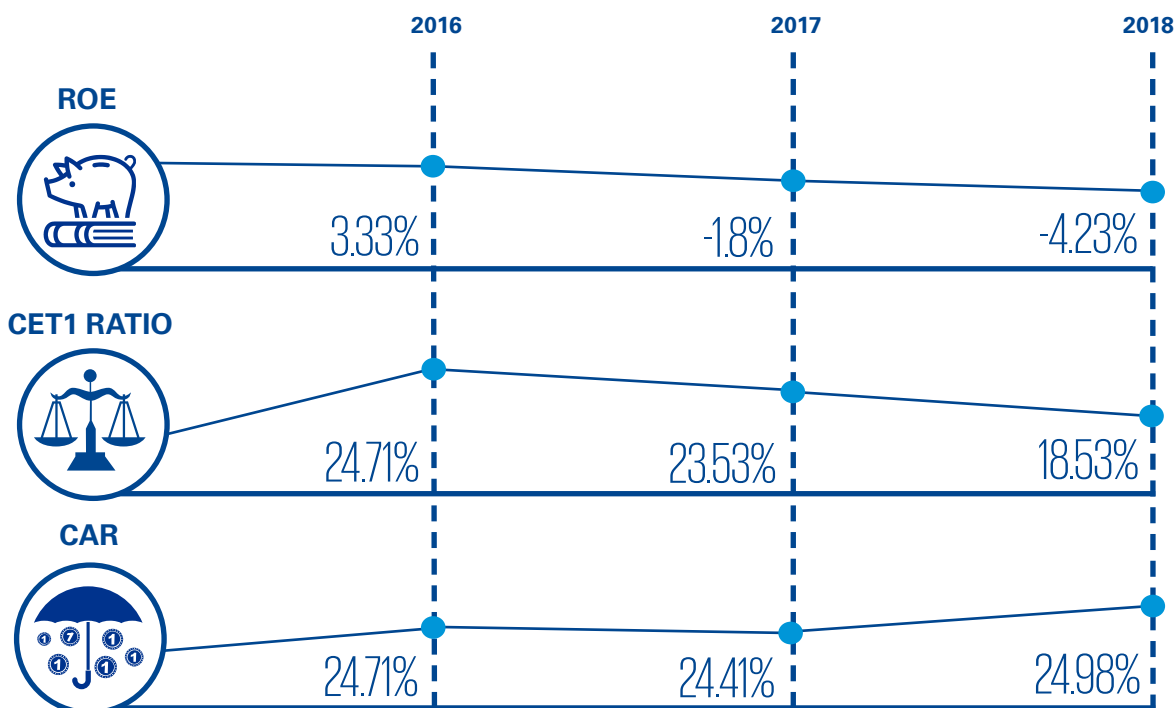
# International Banks





## Main activities:

During the financial year under review, the Bank was mainly engaged in lending to the agricultural sector in the UK and developing corporate banking business in Malta.



## Profitability



**23.8% Operating Expenses**

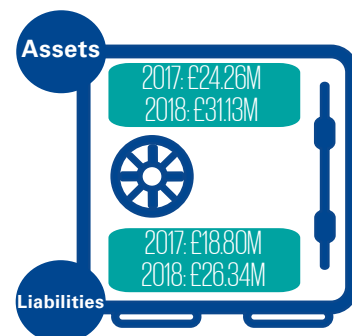
The main contributor to this increase in Operating Expenses is the increase in General Administrative Expenses of 71.3% (or £0.28 million) when compared to the previous financial year.



**14.4% Operating Income**

This increase in Operating Income is mostly attributed to a decrease in the Interest Expense of 16.3% (or £0.12 million).

## Assets and Liabilities



**28.3% Total Assets**

This increase is mainly due to an increase in the Balance with Central Bank of Malta, and Cash and Cash Equivalents of 146.2% (or £6.25 million).



**40.1% Total Liabilities**

The increase in liabilities is a reflection of an increase of 32.97% (or £5.60 million) in amounts owed to customers when compared to the previous financial year.

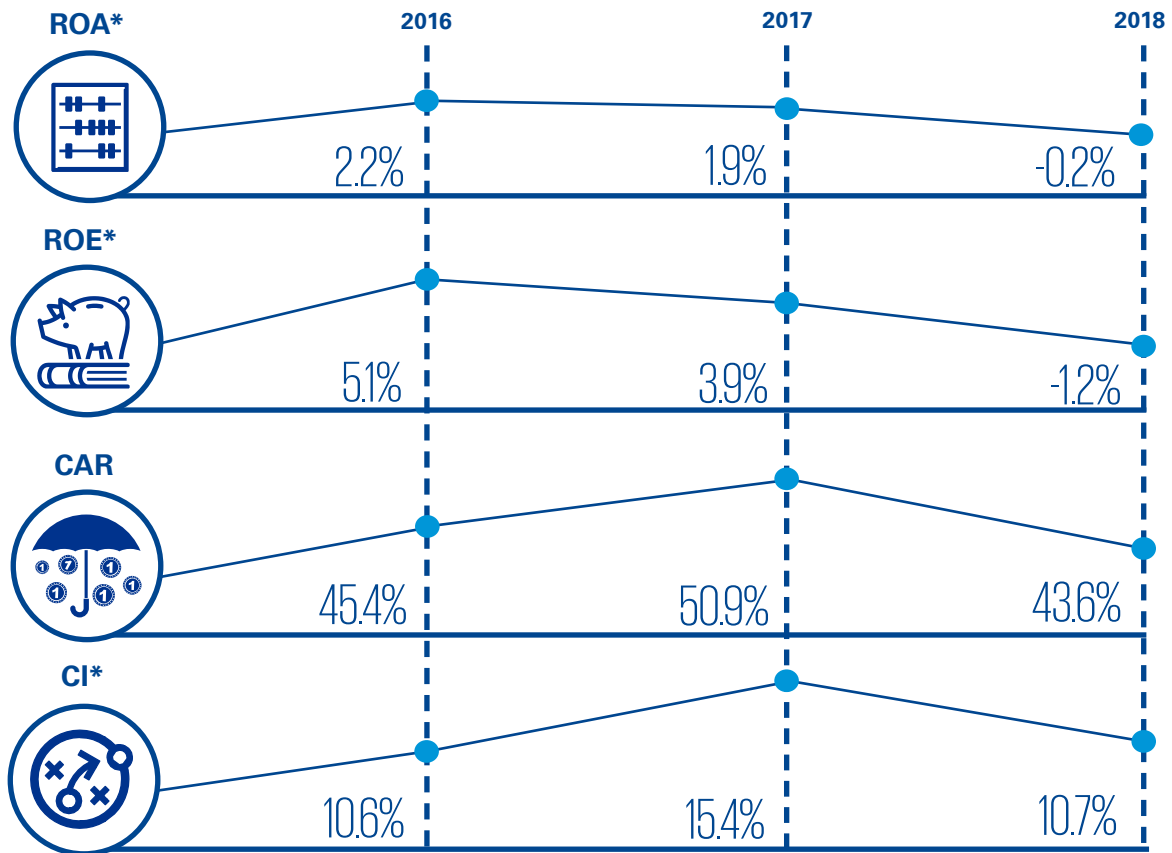


## 2003\*

\*The entity obtained its licence to operate as a Credit Institution in 2005.

### Main activities:

The Bank's primary focus is the provision of infrastructure and utilities solutions, corporate lending and asset finance solutions to clients around Europe.



### Profitability

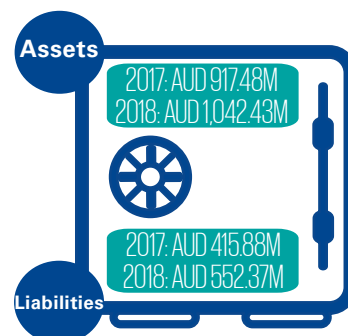


The significant increase is predominantly due to an increase of AUD27.35 million (or 100%) in Loan Impairment Charges arising from Specific Provisions taken during the year.



Operating income increased by AUD0.47 million. The increase in Operating Income is mainly driven by an increase in net Interest Income of AUD0.94 million (or 4.2%) driven mainly by an increase in Loans and Advances To Customers. This increase was partially set-off by a decrease in Net Fee and Commission Income of AUD0.47 million (or 38.8%).

### Assets and Liabilities

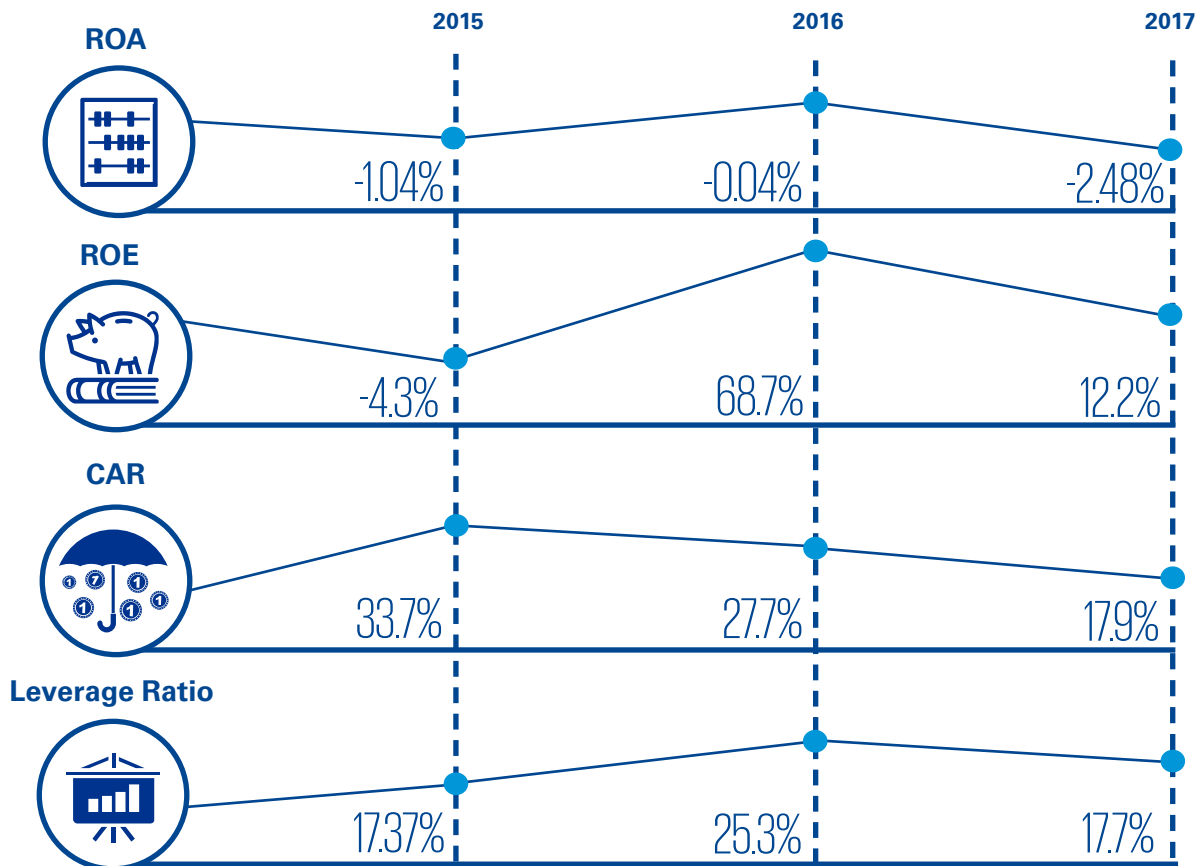


This growth is largely driven by a significant increase in Loans and Advances to Customers of AUD95.18 million (or 12.9%).



The spike in liabilities was fuelled primarily by the 34.7% increase in Amounts Owed to Banks (branches of the ultimate parent bank) of AUD141.07 million.

\*ROA ratio calculated in line with stated formula  
\*RoE ratio calculated in line with stated formula  
\*CI ratio calculated in line with stated formula



### Profitability



13.1% **Operating Expenses**

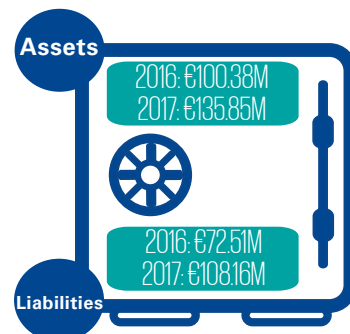
The main contributors to the year-on-year increase in OPEX were increases in General Administrative Expenses by 26.6% (or €1.05 million) when compared to previous financial year, and an increase in impairment charges.



46.6% **Operating Income**

This decrease is mostly attributed to the one-off VISA gain experienced in the previous financial year of €19.25 million. If one had to exclude this one-off gain, the Bank registered improved levels of operating income year-on-year.

### Assets and Liabilities



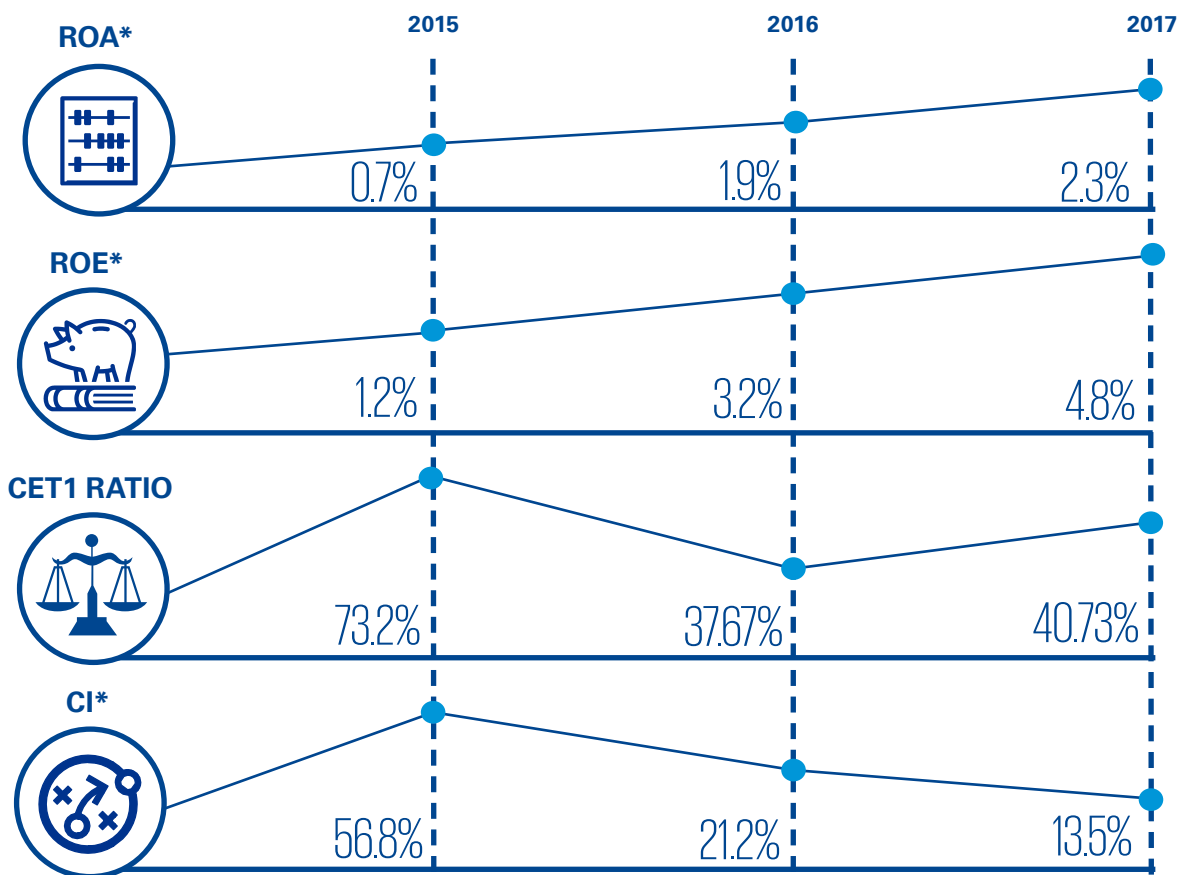
35.3% **Total Assets**

This growth is largely contributed to an increase in Loans and Advances to Banks by €9.96 million (or 24.7%) and Funds receivable from Card Schemes by 112.3% (or €30.20 million), with the latter signifying higher processing volumes.

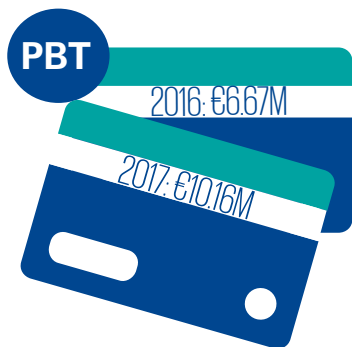


49.2% **Total Liabilities**

The increase in liabilities is a reflection of an increase in Settlement Processing Obligations by €35.13 million (54.2%) and Amounts Owed to Customers by 6.7% (or €0.34 million) when compared to the the previous year.



## Profitability



11.2% **Operating Expenses**

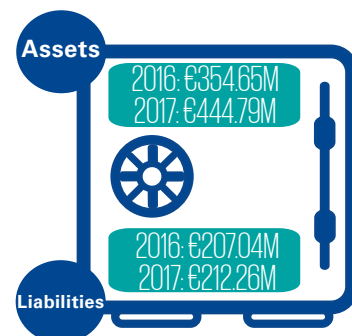
This decrease in operating expenses is highly attributable to a decrease of 62.8% (or €0.41 million) in Impairment Loss on Financial Assets over 2016.



38.8% **Operating Income**

The main contributor to this increase is the growth experienced in Interest Income of 114.0% (or €7.86 million).

## Assets and Liabilities



25.4% **Total Assets**

This growth is highly attributed to an increase of €141.38 million (or 67.2%) in Loans and Advances to Customers and a growth in Investment Securities of €5.89 million (or 88.6%).



57.5% **Total Liabilities**

This increase in Total Liabilities is driven by an increase in Amounts Owed to Customers of 86.6% (or €83.97 million).

\*ROA ratio calculated in line with stated formula  
\*RoE ratio calculated in line with stated formula  
\*CI ratio calculated in line with stated formula



# Malta - The Blockchain Island



Malta has repeatedly made the news as one of the few countries that is actively supporting the regulation of cryptocurrencies and development of DLT's. In short, the vision is to create a digital economy. Malta is today moving swiftly towards becoming the Blockchain Island, supported by the recently set up Malta Digital Innovation Authority.

With legislation and regulation formally coming into force on the 1st of November 2018, Malta now sits atop the DLT ladder as the first jurisdiction to have actually designed an entire ecosystem for DLT.

KPMG Malta has hopped onto the front seat to assist businesses and related entities set up in Malta.

We are poised to walk through Malta's DLT terrain, to seize the opportunities and to bring your blockchain innovations to life, as well as to provide ongoing advice and assistance on the new regulations coming into force within the Virtual Financial Assets (VFA) sector.

## The KPMG Malta VFA Team

Regulatory advisory and assistance with Initial VFA Offerings and to VFA Services providers

- Assistance with, and reviews of, licencing application documentation required for submission to the Regulator under the scope of the Virtual Financial Assets Act
- Evaluation workshops aimed at assessing business models and related regulatory implications
- Reviews of business plans, financial models, white papers and related funding requirements
- Advice and assistance with ensuring compliance with regulatory requirements
- Advisory and assistance with ensuring a good corporate governance, risk management and internal controls infrastructure
- Reviews of Financial Instrument Tests
- Training to Board of Directors and C-Suite cohort
- Advice and assistance with assessment of regulatory implications emanating from other jurisdictions in connection with VFAOs

## KPMG's Global Cryptocurrency Framework

We work with VFA entities, large financial services organizations and exchanges to help integrate crypto into their businesses. Our cross-functional teams include, cyber security professionals, technology and operations professionals, smart contract developers, regulatory compliance professionals, tax professionals, accounting advisors and auditors.



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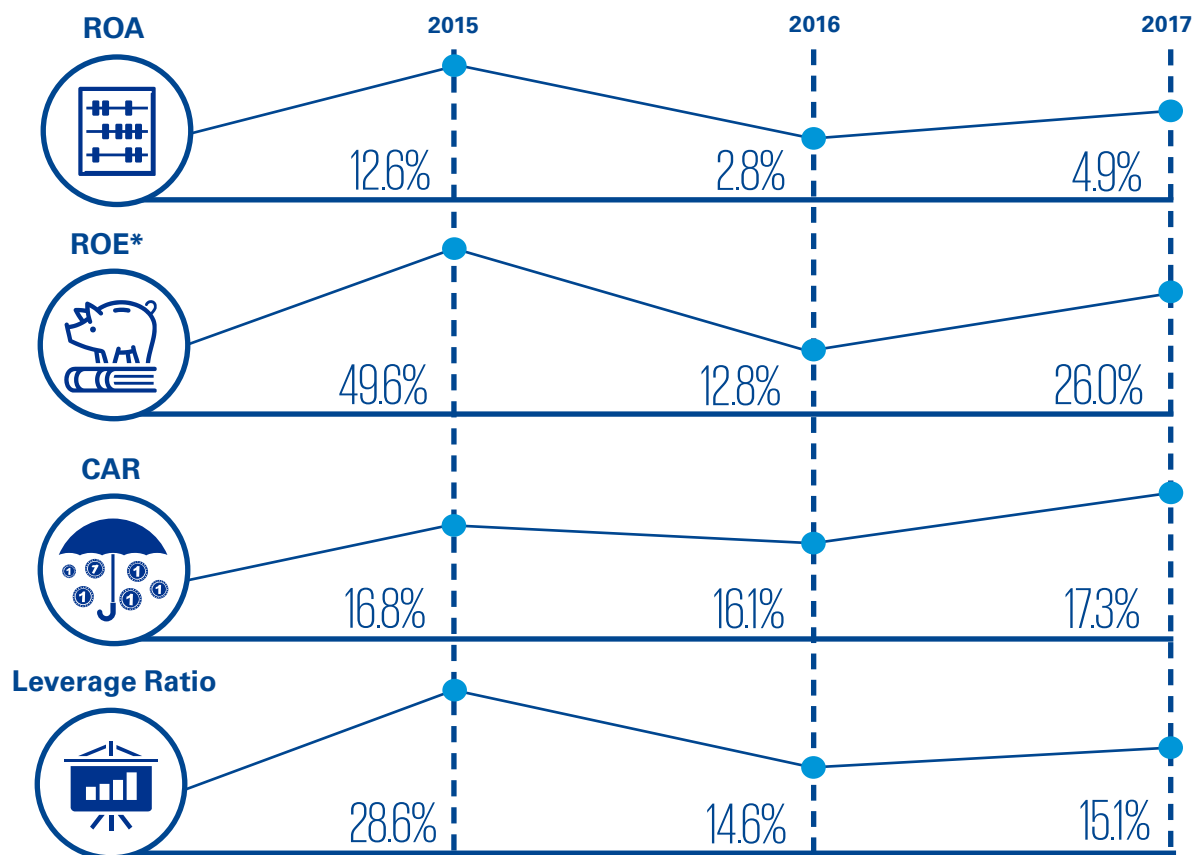
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## Main activities:

The Bank provides unsecured consumer loans and other consumer and business orientated financial products, distributed through a mobile platform, as well as over the internet.



## Profitability



**39.2% Operating Expenses**

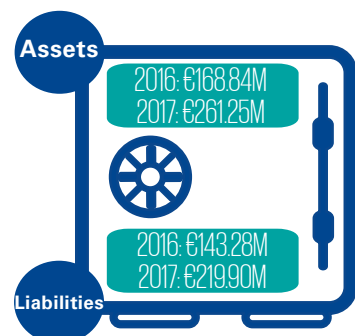
This increase is significantly driven by the increase in operating costs and net Impairment Losses of €8.95 million and €10.02 million respectively.



**50.6% Operating Income**

This significant increase is mainly driven by an increase in net interest income of € 26.8 million year-on-year. (44.8%) resulting from an increase in loans and advances to customers.

## Assets and Liabilities



**54.7% Total Assets**

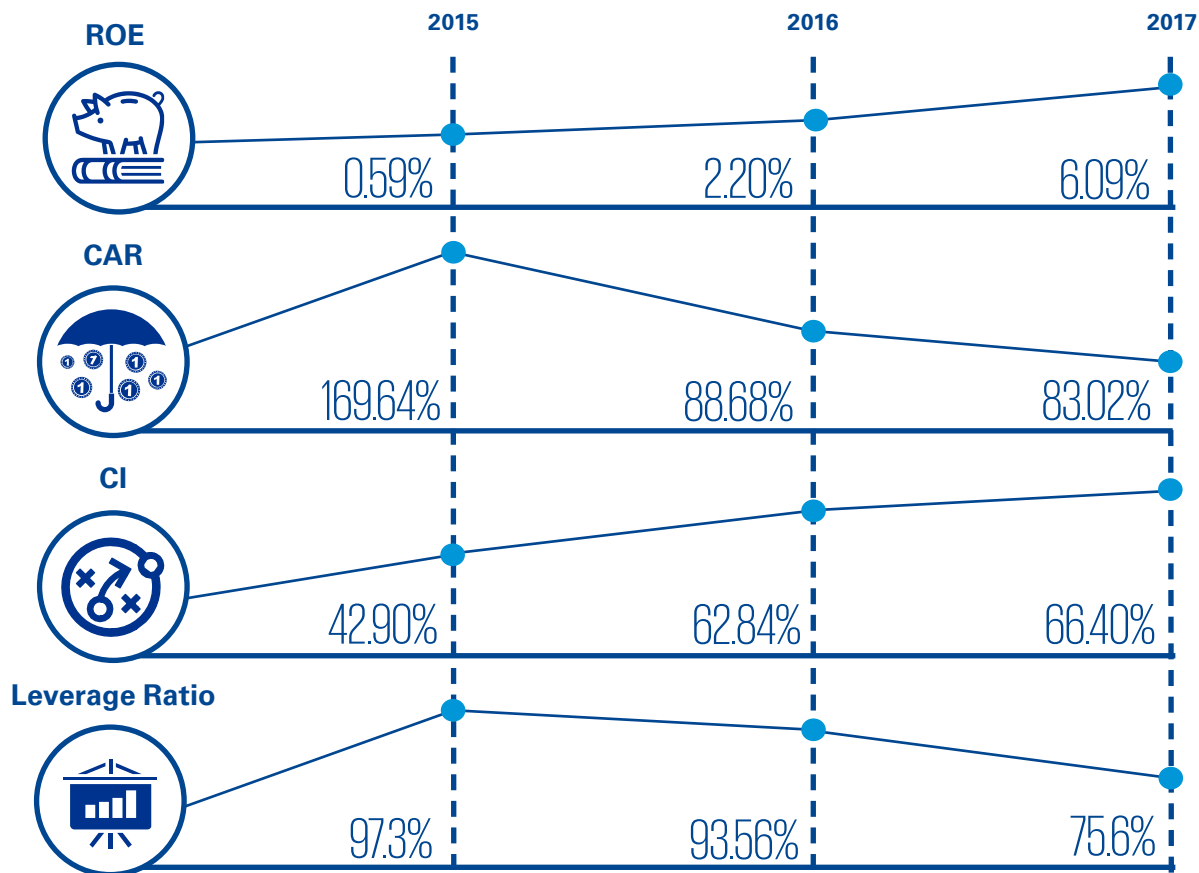
This growth is mainly driven by an increase in Balances with Central Bank of Malta of €55.46 million (260.5%) and an increase in Loans and advances to customers of €33.40 million (37.5%) and to group companies of €4.12 million (1170.4%).



**53.5% Total Liabilities**

This increase is mainly due to an increase in Customer deposits of €72.72 million. Other drivers include increase in Debt Securities and Other liabilities amounting to €1.35 million and €1.98million respectively.

\*ROE ratio calculated in line with stated formula



## Profitability



**110.4% Operating Expenses**

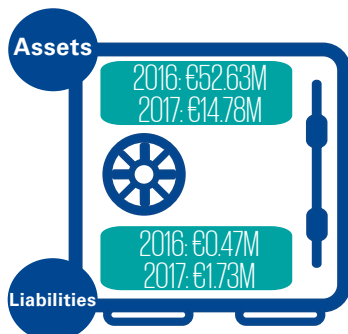
This increase in operating expenses is highly attributable to an increase of 18.9% (or €0.25 million) in Administrative Expenses over 2016.



**12.5% Operating Income**

The main contributor to this increase is the growth experienced in Net Fee and Commission Income of 141.0% (or €1.18 million).

## Assets and Liabilities



**71.9% Total Assets**

This decrease is highly attributed to a decrease of €39.19 million (or 95.3%) in Loans and Advances to Customers.



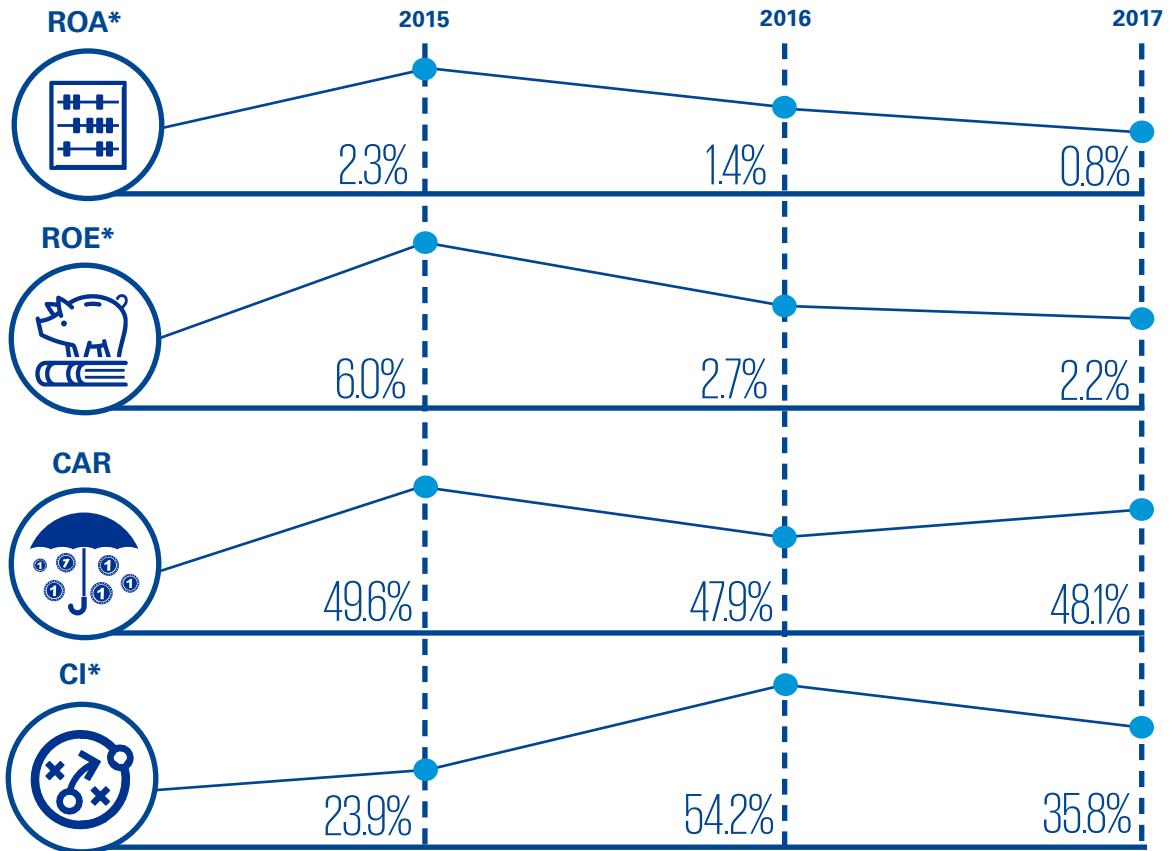
**268.6% Total Liabilities**

This growth in Total Liabilities is contributed to by an increase in Amounts Owed to Customers of €1.57 million.

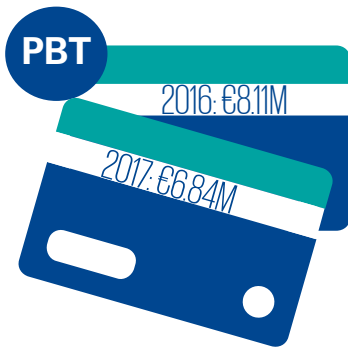


## Main activities:

The Bank targets high net worth individuals and large corporate clients through the provision of wide-ranging banking services, including the provision of loans and deposit-taking facilities.



## Profitability



14.3%

**Operating Expenses**

The main contributor for this decrease was a reduction in legal and professional fees of €0.44 million (63.5%).

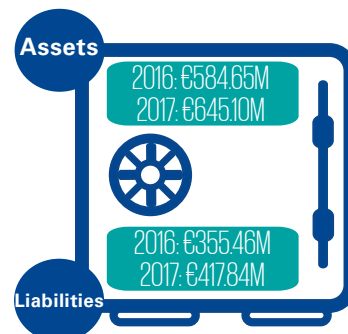


38.5%

**Operating Income**

This decrease is mainly attributable to a reduction in interest income by €1.99 million (11.1%) and an increase in interest expense of €2.61 million (82.4%).

## Assets and Liabilities



10.3%

**Total Assets**

This growth is largely attributable to an increase in Loans and advances to banks repayable on call and short notice by €110.94 million (207.3%).



17.5%

**Total Liabilities**

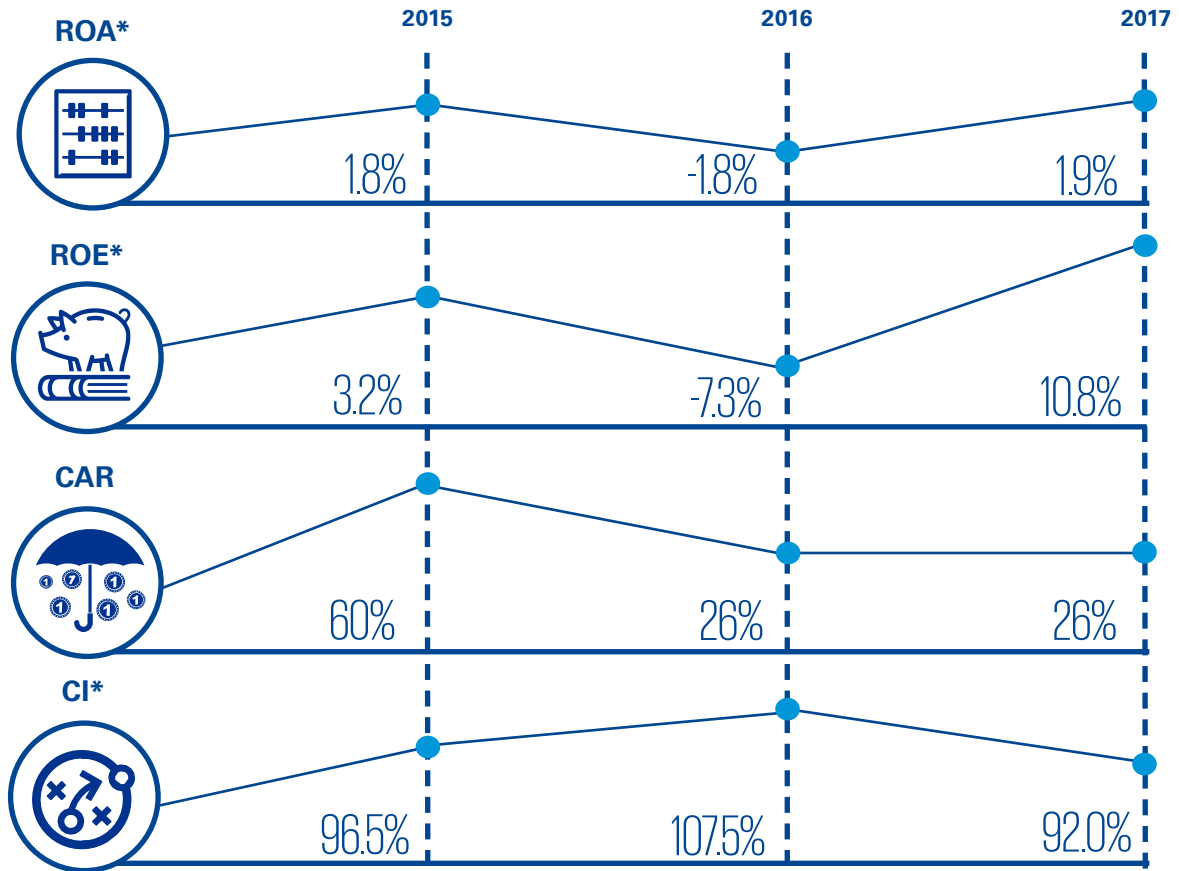
The increase in liabilities was brought about due to an increase in bank deposits of €48.80 (42.0%).

\*ROA and ROE ratios for 2015 and 2016, and CI Ratio for 2015 calculated in line with stated formula

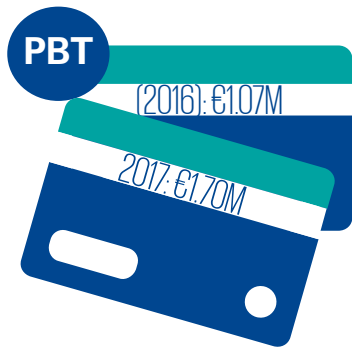


## Main activities:

The Bank focuses mainly on providing credit products to individuals and corporates in specific niche market segments.



## Profitability



**27.8% Operating Expenses**

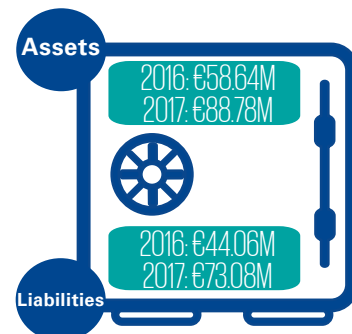
The main contributor to this increase is the growth in Net Impairment Losses of 73.9% (or €4.77 million).



**49.5% Operating Income**

The main contributor to this increase is the increase in Interest Income and Fee and Commission Income of €1.67 million (or 474.6%) and €7.06 million (or 37.2%) respectively.

## Assets and Liabilities



**51.4% Total Assets**

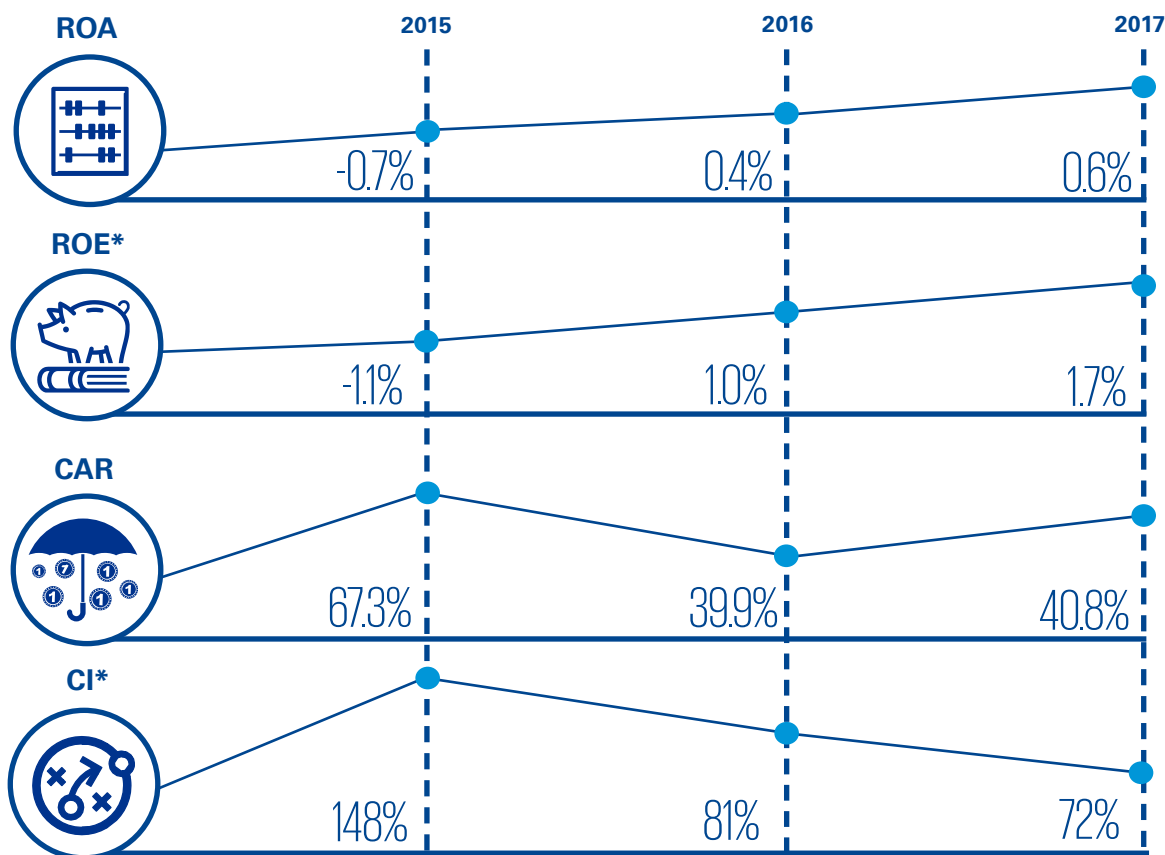
This growth in Total Assets is highly attributable to an increase in the Amounts Due from Banks of 65.7% (or €23.33 million) and Loans and Advances of 64.0% (or €4.99 million).



**65.9% Total Liabilities**

The increase in Total Liabilities is mainly contributed to Amounts due to customers which increased by 79.9% (or €27.47 million).

\*ROA ratio calculated in line with stated formula  
\*RoE ratio calculated in line with stated formula  
\*CI ratio calculated in line with stated formula



## Profitability



10.9%

**Operating Expenses**

The main contributor for this decrease was a reduction in Net impairment charges of €0.27 million (110.7%).

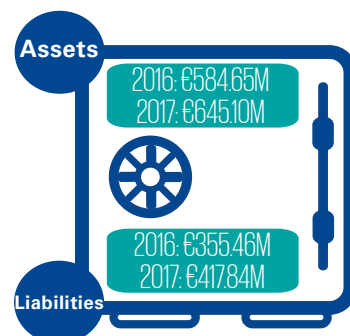


14.8%

**Operating Income**

This increase is driven by an increase in interest income earned from Loans and Advances to Customers of €1.13 million (29.2%) and partially set-off by the increase in unrealised fair value losses incurred from year-end mark to market of derivatives held for risk management purposes of €0.42 million (130.6%).

## Assets and Liabilities



5.9%

**Total Assets**

This net increase is driven by the bank's growing Investment of €4.07 million (153.0%) in available-for-sale investment securities and Derivative assets held for risk management. Loans and advances to banks (mainly foreign banks) also increased by €13.16 million (515.6%) whereas loans and advances to customers decreased by €8.35 million (5.8%).



8.7%

**Total Liabilities**

The growth in liabilities is significantly driven by an increase in Deposits from Banks of €9.29 million (10.7%). The Bank had no derivative liabilities held for risk management during the financial year ended 31<sup>st</sup> December 2017 (2016: €1.53 million).

\*ROE and CI ratios for financial year ended 2015 calculated in line with stated formula



# Vision

The ability to visualise a completed project is what motivates an entrepreneur. Connecting the dots to realise that vision can be a daunting task. It takes the right tools to create meaningful connection.



## Market Research



## Market Analysis

**KPMG's Economics specialists bring passion, experience, and expertise, to the table to help you recognise your vision.**

Services offered:

- Market analysis
- Economic analysis of policy
- Economic Impact Assessments & Cost Benefit Analysis
- Business plan development
- EU Funding
- Regulatory and strategic policy
- Macro-economic Strategy



## Impact



## Make it happen

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# RegTech: From Compliance to a Transformation Agent



**Alex Azzopardi**

Director

Internal Audit and Regulatory Advisory Services

The aftermath of the banking crises was an ever-increasing complex and demanding regulatory landscape for the banking industry. The most impactful change came through the CRD IV package. But this is not the only regulatory change that has become effective for the banking industry in recent years. Changes include new legislative texts and guidance notes around matters which range from Recovery and Resolution, Payment Services, Data Protection, Anti-Money Laundering and Non-Performing Loans.

Regulatory Compliance is clearly an area of focus for the Board and Senior Management. We publish the key risks areas for different industries on a yearly basis. It helps us ensure that our clients are knowledgeable about what changes in the risk landscape are just over the horizon. An area which is constantly featuring for any regulated industry is Compliance Risk. We expect that compliance with laws and regulations will remain one of the topmost areas of concern within the banking industry for a number of years to come.

The function's role however goes beyond ensuring that there is accurate and timely reporting to the regulatory/supervisory authorities. An effective Compliance Function provides a second line of defence across all aspects of the institution's operations including ensuring that developments in regulation are identified in good enough time for alignment to take place.

We are today seeking how to make the Compliance function more efficient and effective turning it into a potential source of competitive advantage for the institution. Input from the Compliance function is key for strategic ventures such as mergers and takeovers. Consistent and regular messaging of the importance attached to compliance and corporate values enhances loyalty towards the institution, thus reducing staff turnover. A strong Compliance culture within the different institutions ensures that the reputation of the industry and the jurisdiction is kept at the highest levels. It is thus clear that our view towards compliance should no longer be one where we minimise costs but one where we maximise value.

Within this context we are seeing the rise of the use of technology in achieving compliance with regulation, or, put more simply, RegTech. RegTech is one of the fastest growing areas of a wider drive by the Financial Services Industry to implement technology within its processes – also referred to as FinTech. During the first half of 2018, global investment in RegTech reached USD1.37bn. Companies are expected to allocate 34% of their total regulatory spending by 2022 to RegTech as opposed to 4.8% in 2017 (KPMG, The Pulse of FinTech, July 2018).

We would be seriously underestimating the power of RegTech if we view it as 'just another way of achieving regulatory compliance'. It certainly provides for a stronger Compliance function, enhancing risk mitigation and reducing the fixed costs around compliance. But there is more to it; indeed much more. RegTech solutions have the potential to transform businesses, providing your customers with a better service, hence driving customer the customer experience and enabling you to launch new products. Key for this vision to materialise is the role of data. Our organisations have at their disposal data that is significant in volume, is received at a fast pace and is available in a variety of structures and formats – in other words, 'big data'. A new term has now been coined: "smart data" – the application of AI on big data to, amongst others, identify emerging risks, gain insights into regulatory practices and predict compliance failures.

This is a revolutionary way of looking at RegTech. Although this transformation has not yet been fully achieved, it certainly looks like it is a question of 'when' rather than 'if'. And as financial institutions journey along this path, they will embed RegTech to assist in finding solutions to the complexity and uncertainty that surrounds them in the business environment rather than just to ensure leaner compliance with current regulation.

We understand that this may be uncharted territory for most. However, we strongly believe that the discussion in the Boardroom should not be one of 'whether' you go down this route. It should be one of 'how'. And as the discussion turns to exploring the best way to achieve the optimal use of RegTech, you will be needing strong partners to assist you along the way. KPMG has invested heavily in this area and can assist you through the entire lifecycle of the RegTech transformation journey: from ideation to the provision of managed services. Our wide range of product offerings includes RegTech solutions which are both in-house as well as developed in collaboration with select technology partners.

The potential arising from RegTech is significant. Using it effectively will mean enabling your institution to deal with the shifts in the competitive environment. Are you ready for this transformation?



**We are today seeking how to make the Compliance function more efficient and effective turning it into a potential source of competitive advantage for the institution. ”**



On the other hand, partnering provides a **more rapid route** that is built on a well modelled API economy **that is rapidly disrupting the financial services industry.**



..but releases the burden of **legacy systems** and silo mentalities and enables **new organisational structures based on a start-up model.**

A parallel operation starts with the customer proposition and organises itself to fulfil it without legacy controls.



Setting up a parallel operation is a **costly route...**



However, apart from the challenging transformation route banks need to consider alternatives, such as...



...the setting up of a parallel operation or partnering with a fintech; both challenging routes that need to be considered carefully.

In the meantime local banks are **struggling**

to make the transformation journey to digital as their organisational foundations are built on cost effectiveness rather than customer experience.



Digital centric customers are on the rise and it is expected that by 2020,

**68%**

of banking customers will be Digital-Only users.



**Eric Muscat**  
Partner  
IT Advisory Services



**Marco Vassallo**  
Partner  
Emerging Technologies

## Your Solution:

### PROOF OF CONCEPTS

- Provide an ideal way into the **disruptive tech world**
- Require **limited upfront investment** while **mitigating risks**
- Can easily mature by **scaling up and out** to meet the constantly changing needs

Established businesses are **risking falling behind** new tech-driven start-ups



90% of startups fail but as the repercussions are far lower, many of them afford to **take more risks**

**Startups embrace Emerging Technologies** as it often fits within their fail-fast strategy...



Technology is **disrupting** industries across a much wider spectrum and at an ever-faster rate, making far easier for established businesses to fall behind. As in other industries, banks and financial institutions have not been immune to the force of this technological disruption.



## How powerful is this?

With Intelligent Automation, RPAs can be combined with more advanced cognitive technologies to perform complex tasks that have historically required human intelligence and situational analysis.

## How will it help me?

Using bots will free-up time for employees who can otherwise be invested in tasks that bring in much greater added value to the business. In addition, usage of RPA drives up employee engagement which in today's world is a crucial element within an organisation through the elimination of boring and repetitive tasks.

## What is RPA?

Robotic Process Automation (RPA) is a technology that is used to automate predictable, repetitive, mundane and unappealing processes and tasks that traditionally were considered to only be achievable by human employees.



Research by McKinsey & Co. shows that up to

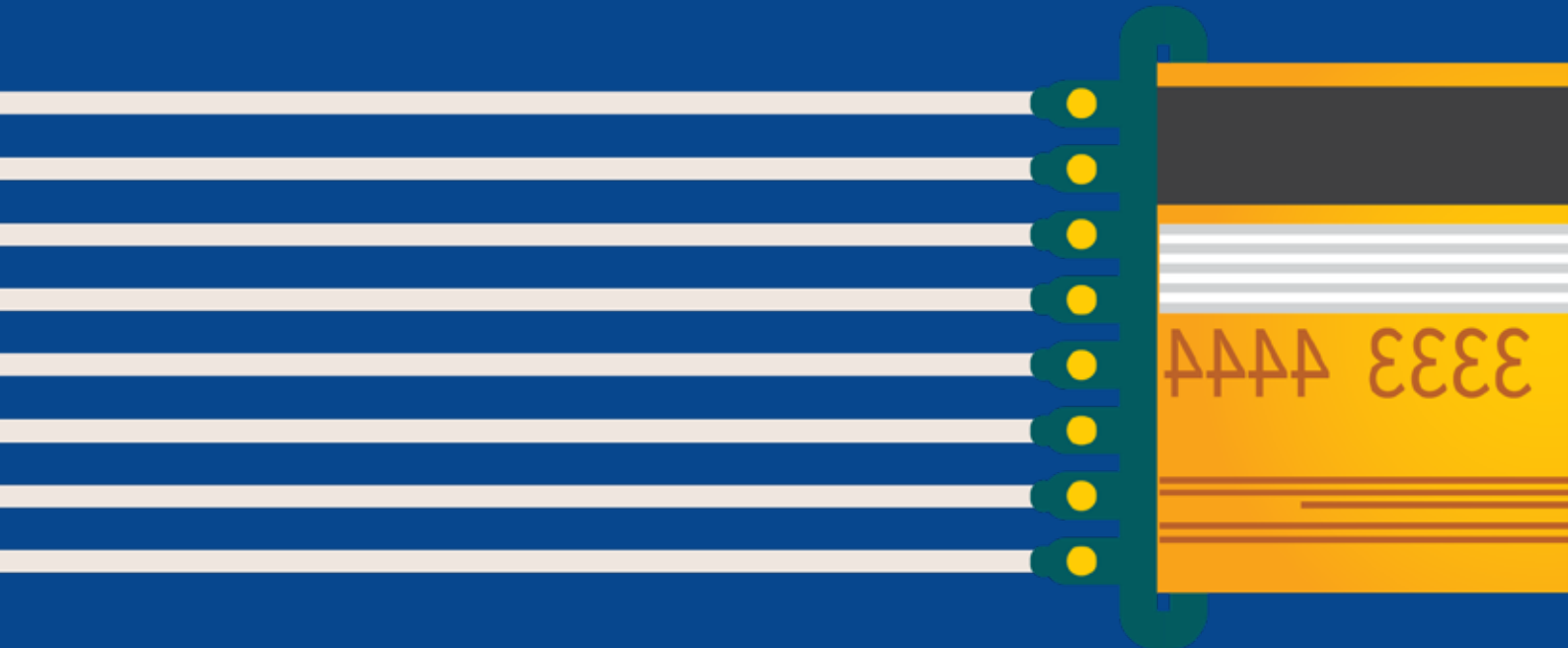
# 45%

of activities individuals currently perform in the workplace can be automated using already demonstrated technologies directly impacting the bottom-line.



# About KPMG

KPMG is a global network of professional services firms providing Audit, Tax and Advisory services. We operate in 153 countries and territories and have 207,000 people working in member firms around the world. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.





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