SPARKASSE
Bank Malta plc

# 2021
# Pillar 3 Disclosures

PRIVATE & CORPORATE BANKING / WEALTH MANAGEMENT / FUND CUSTODY

# PILLAR 3 DISCLOSURES

# GLOSSARY OF ABBREVIATIONS

- AT1 Additional Tier 1
- CBM Central Bank of Malta
- CCR Counterparty Credit Risk
- CET 1 Common Equity Tier 1
- COI Cost-to-Income
- CRD Capital Requirements Directive
- CRR Capital Requirements Regulation
- CSRBB Credit Spread Risk in the Banking Book
- CVA Credit Valuation Adjustment
- EBA European Banking Authority
- ECAI External Credit Assessment Institution
- EVE Economic Value of Equity
- EWI Early Warning Indicator
- FVTOCI Fair Value Through Other Comprehensive Income
- FVTPL Fair Value Through Profit or Loss
- G-SII Globally Systematically Important Institution
- HQLA High Quality Liquid Assets
- ICAAP Internal Capital Adequacy Assessment Process
- ILAAP Internal Liquidity Assessment Process
- IRRBB Interest Rate Risk in the Banking Book
- LCR Liquidity Coverage Ratio
- MANCO Management Committee
- MFSA Malta Financial Services Authority
- NSFR Net Stable Funding Ratio
- O-SII Other Systematically Important Institution
- RAS Risk Appetite Statement
- RI Risk Indicator
- ROE Return on Equity
- RWA Risk Weighted Assets
- SREP Supervisory Review and Evaluation Process
- T2 Tier 2
- TIMCO Treasury and Investment Management Committee

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## 1. INTRODUCTION

Sparkasse Bank Malta public limited company (the 'Bank'), being a licensed credit institution supervised under Directive 2013/36/EU, is required to comply with the disclosure requirements laid down in Part Eight of CRR[1] (as amended in particular by Regulation (EU) 2019/876 of the European Parliament and the Council of 20 May 2019 amending Regulation (EU) No 575/2013 (herein referred to as CRR II). Commission Implementing Regulation (EU) 2021/637 of 15 March 2021 lays down the implementing technical standards with regards to the disclosures emanating from Part Eight of CRR II, including specific templates and tables to be presented.

The Bank is neither a 'large institution' nor a 'small and non-complex institution'. It is therefore required to publish the disclosures required under Titles II and III of Part Eight of the CRR in the manner set out in Article 433c CRR, subject to the exceptions for non-material, proprietary or confidential information referred to in Article 432 CRR. As an 'other institution' that is a 'non-listed institution', it has to disclose the following information on an annual basis:[2]

- points (a), (e) and (f) of Article 435(1) CRR and points (a), (b) and (c) of Article 435(2) CRR, regarding risk management objectives and policies;
- point (a) of Article 437 CRR, regarding own funds;
- points (c) and (d) of Article 438 CRR, regarding own funds requirements and risk-weighted exposure amounts;
- the key metrics referred to in Article 447 CRR; and
- points (a) to (d), (h) to (k) of Article 450(1) CRR, regarding remuneration policy.

The Bank is required to comply with the aforementioned disclosure requirements on both an individual and consolidated basis. With respect to the scope of consolidation, the group comprises both the Bank (having 21380099RT73NFBYS559 as its legal entity identifier ('LEI')) and its financial holding company, Sparkasse (Holdings) Malta Limited (having 21380033CFFM2V1ZCK65 as its LEI) (herein referred to as the 'Holding Company' or 'SHM', and together as the 'Group'). Unless otherwise specifically indicated, the disclosures presented are applicable to both the Bank and the Group.

The Bank's Board of Directors has adopted a Pillar 3 Disclosures Policy, which sets out the Bank's policy to comply with the disclosure requirements laid down in Part Eight of the CRR (following the changes introduced by CRRII; commonly referred to as Pillar 3 disclosures) and to establish the principles for internal processes, systems and controls to verify that the Bank's disclosures are appropriate and in compliance with the said requirements. In line with the said policy, this Pillar 3 Disclosures document has been approved by the Board of Directors, following review by the Audit and Risk Committee. This document is not subject to external audit.

This document includes the applicable Pillar 3 disclosures for the Bank and the Group for the reference year ending 31 December 2021. All disclosures are presented in the Bank's functional currency, that is the Euro. All figures presented in this document have been computed in line with International Financial Reporting Standards ('IFRSs') as adopted by the EU, being the Bank's and the Group's applicable accounting framework.

The table below outlines the Pillar 3 disclosure requirements applicable pursuant to Article 433c (2) CRR, all of which are required to be disclosed annually.

[1] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms

[2] Article 433c(2) CRR

| Applicable Article | Description of Disclosure | Illustrative Disclosure | Link to Section for Disclosure |
|---|---|---|---|
| Point (a) of Article 435(1) | The strategies and processes used to manage each category of risk | Selected sections from EU OVA, EU OVB, EU LIQA, EU CRA, EU MRA, EU ORA & EU OR1 | Section 2 |
| Point (e) of Article 435(1) | A declaration approved by the management body on the adequacy of the risk management arrangements of the relevant institution providing assurance that the risk management systems put in place are adequate with regard to the institution's risk profile and strategy | Selected sections from EU OVA, EU OVB & EU LIQA | |
| Point (f) of Article 435(1) | A concise risk statement approved by the management body succinctly describing the relevant institution's risk profile associated with the business strategy, including:<br>- key ratios and figures providing external stakeholders a comprehensive view of the institution's risk management, including how the risk profile interacts with the risk tolerance<br>- information on intragroup transactions and transactions with related parties which may have a material impact on the risk profile of the consolidated group | Selected sections from EU OVA, EU OVB, EU LIQA & EU CRA | |
| Point (a) of Article 435(2) | The number of directorships held by the members of the management body | Selected sections from EU OVA & EU OVB | Section 2.2 |
| Point (b) of Article 435(2) | The recruitment policy for the selection of members of the management body and their actual knowledge, skills and expertise | Selected sections from EU OVA & EU OVB | Section 2.2 |
| Point (c) of Article 435(2) | The policy on diversity with regard to the selection of members of the management body, its objectives and any relevant targets, and the extent to which these objectives and targets have been achieved | Selected sections from EU OVA & EU OVB | Section 2.2 |
| Point (a) of Article 437 | A full reconciliation of CET1 items, AT1 items and Tier 2 instruments issued by the institution | EU CC1 & EU CC2 | Section 4.1 |
| Point (c) of Article 438 | Upon demand from the competent authority, the result of the institution's internal capital adequacy assessment process | Selected sections from EU OVC | Not applicable – the Bank did not receive any such demand from the competent authority |
| Point (d) of Article 438 | The total risk weighted exposure amount and the corresponding total own funds requirement, broken down by different risk categories | EU OV1 | Section 4.2 |
| Article 447 | Disclosure of key metrics | EU KM1 | Section 9 |
| Point (a) of Article 450(1) | Information concerning the decision making process used for determining the remuneration policy, as well as the number of meetings held by the Management body overseeing remuneration during the financial year | Selected sections from EU REMA | Section 10 |

| | | | |
|---|---|---|---|
| Point (b) of Article 450(1) | Information about the link between pay and performance | Selected sections from EU REMA | Section 10 |
| Point (c) of Article 450(1) | The most important design characteristics of the remuneration system | Selected sections from EU REMA | Section 10 |
| Point (d) of Article 450(1) | The ratios between fixed and variable remuneration | Selected sections from EU REMA | Section 10 |
| Point (h) of Article 450(1) | Aggregate quantitative information on remuneration | EU REM1; EU REM2 & EU REM3 | Section 10 |
| Point (i) of Article 450(1) | The number of individuals that have been remuneration EUR1million or more per financial year | EU REM4 | Not applicable – the Bank does not have any individuals who have been remunerated EUR1million or more during the financial year |
| Point (j) of Article 450(1) | Upon demand from the relevant Member State or competent authority, the total remuneration for each member of the Management body or senior management | Selected sections from EU REMA | Not applicable – no such demand was received by the Bank from the competent authority |
| Point (k) of Article 450(1) | Information on whether the institution benefits from a derogation laid down in Article 94(3) of Directive 2013/36/EU | Selected sections from EU REMA | Section 10 |

Despite the Bank only being required to disclose the above, it was decided to make certain additional disclosures on a voluntary basis, in order to provide comprehensive information to the Bank's stakeholders. The following are the disclosures which the Bank opted to include on a voluntary basis:

- EU CCyB2 – Amount of institution-specific countercyclical capita buffer
- EU CCR1 – Analysis of CCR exposures by approach
- EU MR1 – Market Risk under the standardised approach
- EU CCR2 – Transactions subject to own funds requirements for CVA risk
- EU OR1 – Operational risk own funds requirements and risk-weighted exposure amounts
- EU LR2 – LRCom: Leverage ratio common disclosure
- EU LR1 – LRSum: Summary reconciliation of accounting assets and leverage ratio exposures

## 2. RISK MANAGEMENT OBJECTIVES AND POLICIES & GOVERNANCE ARRANGEMENTS

Article 435 of CRR requires institutions to disclose their risk management objectives and policies for each separate category of risk, as well as a description of the Bank's governance arrangements. The following section gives an overview of the Bank's risk management approach, followed by risk management objectives and policies for each category of risk.

### 2.1 OVERARCHING RISK MANAGEMENT APPROACH

*2.1.1 Interaction of the Bank's Business Model with Risk Profile*

One of the Bank's main business lines is to act as depositary and custodian, servicing a wide variety of companies in the financial services sector. The Bank's customers keep their clients' monies and assets with the Bank, and the nature of these balances is unpredictable. For this reason the Bank has adopted a policy of keeping very high liquidity balances, such that if there are changes in the circumstances of its customers, necessitating rapid withdrawals of cash, this money would be readily available. As such the liquidity risk present in the Bank's operations is lower than that of banks involved in substantial lending activities.

The substantial volume of investment services related transactions and payments processed by the Bank naturally imply that operational risk is a material risk exposure faced by the Bank, together with credit risk, which consumes the largest risk weighted assets ('RWA') allocation to Pillar 1 risks.

The Bank has a conservative risk appetite with respect to credit risk, hence the policy to invest primarily in investment grade securities. The diversification and credit quality in the bond portfolio implies a limited risk of and from default. Impairment in the credit portfolio has been minimal, historically. The conservative risk appetite of the Bank is also reflected in the small trading book which the Bank has and the positions that are purchased for it. Market risk is low and governed by loss limits.

Operational risk is monitored closely by the relevant front line departments via logging business volumes and ensuring that flows remain within capacity. A lot of effort also goes into maintaining connectivity to financial markets, sub-custodians, execution venues and reputable counterparties. Such channels are essential for the Bank's business, and a specific network management team monitors and reviews all the Bank's counterparty relationships for the provision of investment services.

*2.1.2 Material Transactions within the Group, Affiliated and Related Parties*

The Bank does not engage in any material transactions with its parent company (SHM), and its risk profile is not affected by the parent in any tangible manner. The consolidated Group structure is simple, composed of the Bank itself and its financial holding company, SHM.

*2.1.3 Key Risk Ratios and Figures*

An outline of key ratios and metrics is presented below, confirming that Bank's business was carried out within the applicable limits set out in the Risk Appetite Statement ('RAS').

| Monthly Statistics | Breaches in 2021? |
|---|---|
| Payment volume | No |
| AML flags | No |
| Settlements execution effort | No |
| Trade desk execution effort | No |
| Corporate actions processed | No |
| Forex forward transactions | No |
| **Quarterly Statistics** | |
| Transfer agent relationships | No |
| Sub-custodian relationships | No |
| Brokers and Trading counterparties | No |

The above list of metrics is used by the Risk Function to monitor that business volumes are within approved RAS limits for key high volume activities. No breaches have been notified to the Board in 2021.

As illustrated in the table below, over 2020 and 2021 the Bank was managed with a sufficient clearance over the key risk limits, as defined by the early warning and risk indicators for its regulatory and other management ratios. Having said this, the Bank recorded a cost-to-income ('COI') ratio which exceeds its early warning indicators ('EWI') in 2020, with this ratio exceeding the recovery indicator ('RI') in 2021. As explained in detail in the 2020 Annual Report, the breach of the COI ratio in 2020 was attributable primarily to a one-time specific impairment provision of EUR2.15million recognized by the Bank on one of its credit facilities. The provision, which is not in any way indicative of a general deterioration in the Bank's loan portfolio, resulted in a significant decrease in total operating income, thus driving up the COI ratio. The same provision resulted in the Bank breaching its recovery indicator for the return on equity ('ROE') ratio during 2020.

During 2021, the COI ratio continued to deteriorate, increasing to 69.8%. The primary reason for this is the ever-increasing contribution to the Depositor Compensation Scheme, which resulted in an increase in the Bank's total operating costs for 2021. The increase in total operating costs also resulted in the ROE ratio remaining below the RI of 5%, albeit registering a growth of 0.3% when compared to 2020.

| Metric | YE 2020 | YE 2021 | EWI | RI |
|---|---|---|---|---|
| Leverage ratio | 4.3% | 4.4% | 3.5% | 3.0% |
| Return on Assets | 0.4% | 0.2% | 0.2% | 0.0% |
| Return on Equity | 4.1% | 4.4% | 8.0% | 5.0% |
| Cost to Income ratio | 69.3% | 69.8% | 60.0% | 70.0% |
| Liquid Assets to Total Assets | 73.0% | 68.0% | 50% | 40% |
| LCR | 395.8% | 355.6% | 200% | 100% |
| NSFR | 440.6% | 504.0% | 200% | 100% |
| RWAs as a % of Total Assets | 16.7% | 14.0% | 25% | 35% |
| Capital Adequacy Ratio | 25.9% | 32.5% | 20.0% | 17.0% |

As at end of December 2021, the Bank's risk profile remained well within its risk appetite and tolerance limits as set by the Board. This is supported by adequate risk management arrangements in relation to the overall risk profile and business model.

The Bank has a preference for not operating at full capacity, both in terms of investment allocation and operational volumes. A degree of flexibility is retained via buffers on key metrics.

The table below summarises the Bank's strategic and processes for managing each key risk exposure:

| Primary category of risk | Strategies and processes to manage risk |
|---|---|
| Credit Risk | - Lending limits by product type for the lending portfolio<br>- Collateral obtained for lending products adjusted for haircuts on each lending facility<br>- Different levels of approvals for the granting of new and renewal of existing credit facilities, including involvement of the Credit Review Committee and Board<br>- Exposure limits by issuer type for the financial assets portfolio<br>- Investing strictly in investment grade securities<br>- Bank is well aware of exact composition of the investment portfolio |
| IRRBB | - Limiting the duration profile of the securities portfolio, with the Risk Management Function keeping the Board well informed with respect to duration risk and its implications<br>- The Bank measures its exposure to IRRBB using both an economic value of equity and an earnings-based measure |
| Market Risk | - Position and loss limits for positions with a direct P&L impact<br>- Investing in ETFs for diversified equity exposure<br>- Aiming to buy positive yielding bonds, below par |
| Operational Risk | - Operational business volume limits<br>- Controls by design to outright avoid certain risks |
| Profitability Risk | - Diversifying Malta revenue streams by opening a branch in Ireland |
| Climate and Environmental Related Risk | - Minimal involvement in financing companies which directly cause pollution<br>- Minimal amount of customers engaged in activities which expose them to disruption from extreme climate events |
| Liquidity Risk | - Maintaining high levels of liquidity, including significant balances held with the CBM, which exposure poses an insignificant liquidity risk<br>- Investing only in highly liquid securities which can be sold in a timely manner and without incurring undue costs, to meet the Bank's liquidity needs |

Stress testing takes place on an annual basis, with multiple severe but plausible scenarios used to stress different areas of the Bank's business. Stress testing forms an integral part of the ICAAP and ILAAP.

The scenarios are tailored each year in response to global macro developments and operational realities faced by the Bank, to cover all material risks relevant to the Bank. Impact from operational events, credit quality in the portfolio and liquidity adequacy are all tested in the scenarios developed.

It is worth mentioning that the scenarios developed by the Bank are also tailored for its specific characteristics, such as no immovable property collaterals being held and no material links to the Maltese tourism and construction sectors.

The Bank also performs ad-hoc stress testing as needed in order to assess the potential impact of expected or realized events which could result in the Bank having to amend strategy in certain areas.

The results of both annual and ad-hoc stress tests feed into the Bank's risk management decisions. In the event that the potential impact of an expected or realized event on the Bank is estimated to be material, the Bank would devise the appropriate corrective action including changes to the Bank's exposures where price permit exit.

Each key risk is defined in more detail in Section 3 of this document.

## 2.2 GOVERNANCE ARRANGEMENTS

The information in this section is provided in line with the requirements emanating from Article 435(2) of the CRR, taking into consideration the derogation for 'other institutions' that are 'non-listed institutions', pursuant to Article 433c(2) of the CRR.

As a 'less significant institution', the Bank is not subject to the limitation of directorships and counting rules under Article 91(3) and (4) of the CRD. The number of directorships effectively held for each member of the Board of Directors (including, without limitation, with a group company or an entity with a qualifying holding) regardless of whether the directorship is with an entity that pursues or does not pursue a commercial objective, is given in the table below. The term '*directorship*' means a position as a member of the management body of an institution or another legal entity. '*Non-Executive*' refers to a directorship in which a person is responsible for overseeing and monitoring management decision-making without executive duties within an entity. '*Executive*' refers to a directorship in which a person is responsible for effectively directing the business of an entity. The total number of directorship for each of the Bank's Board members given in the table below excludes their position as director with the Bank, but includes directorship with SHM (if any).

| | Effective number of Directorships as at 31 December 2021 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Sparkasse Bank Malta plc | | | Sparkasse (Holdings) Malta Ltd | Other entities - Commercial | | | Other - Non-Commercial | Total Other Directorships (excld. SBM) |
| | Chair | Executive | Non-Executive | | Chair | Executive | Non-Executive | | |
| Mag Harald Wanke | 1 | | | 1 | 1 | | | 1 | 3 |
| Mr Paul Mifsud | | 1 | | 1 | | | | 1 | 2 |
| Mr Andrew Manduca | | | 1 | | | | 5 | 3 | 8 |
| Mr Serge D'Orazio | | | 1 | | 3 | | 7 | | 10 |
| Mr James Bonello | | | 1 | | | | 11 | 2 | 13 |
| Mr Mark Curmi | | | 1 | | | | 1 | | 1 |

The Bank selects the members of the Board of Directors in accordance with its Policy on the suitability assessment of the members of the Board of Directors and key function holders (the 'Suitability Policy').

The knowledge, skills and expertise of the members is assessed upon nomination and on an ongoing basis. The Directors' profiles are given in the 'Board of Directors' section of the Annual Report. The internal suitability assessment carried out in 2021 confirmed that the Bank's Board of Directors has the knowledge, skills and expertise required to perform its duties diligently. The Board comprises members with extensive knowledge and practical experience in banking and careers in senior positions in the financial or professional services sector. The appointment of a new independent Non-Executive Director in 2021 further strengthened the Board's competence, in particular in risk management.

The Bank organises seminars and training sessions for members of the Board on a regular basis, which complement professional development of the Board members at their own initiative. Topics in the period under review included internal governance, AML/CFT and information security.

The Bank aims to ensure that the Board is composed of an adequate number of Directors and receives sufficient support from within the Bank so that it can continue to function in the event of a sudden or unexpected departure of a member of the Board or Senior Management. The succession planning policy envisages that the Bank may fill the open position either permanently by the appointment of a new director, or temporarily, as a casual vacancy. A casual vacancy may be filled by a suitable key function holder previously approved by a competent authority or a member of the Management Committee ('MANCO'). The members of MANCO will be able to support a person selected to replace an Executive Director and to continue the Bank's day-to-day operations in the event of an unexpected or prolonged absence of a member of Senior Management, until his or her return or replacement.

The Bank does not intend to change the overall composition of its Board of Directors for the time being.

The Bank's policy is to make reasonable efforts to achieve diversity on the Board of Directors, in terms of educational and professional background, gender, age and geographical provenance. This objective is taken into account in the selection and recruitment or replacement of Directors.

The Bank has not set any specific targets for its diversity policy so far, given the relatively compact size of the Board, which it considers to be commensurate to the Bank's needs and proportionate taking into account its size and the nature of its business. Nevertheless, the Bank has managed to achieve diversity at Board level in terms of educational and professional background, age and geographical provenance. Gender diversity is apparent in particular at the level of senior staff heading business units, internal control and support functions.

## 2.3 BOARD AND MANAGEMENT COMMITTEES

The Bank's Board of Directors is responsible for setting, approving and overseeing the implementation of the overall business strategy and key policies of the Bank, its overall risk strategy and internal governance and internal control framework.

### Audit and Risk Committee

The Board of Directors is supported in its supervisory function by Board committees. Currently, the Bank has an Audit Committee and a Risk Committee, which was constituted in November 2021. The Risk Committee is temporarily combined with the Audit Committee.

The objective of the Audit Committee is to advise the Board on the Bank's internal control, internal audit and risk management systems and the Bank's accounting policies and external audit. The Risk Committee's objective is to advise the Board of Directors on risk appetite and risk management within the Bank and overseeing the implementation of the Bank's risk management framework. Its functions are listed in the Terms of Reference of the Risk Committee.

The Audit and Risk Committee is composed of the following non-executive directors:

- Mr Andrew Manduca, Independent Non-Executive Director, Chairman of the Committee;
- Mag Harald Wanke, Chairman of the Board;
- Mr Serge D'Orazio, Independent Non-Executive Director;
- Mr Mark Curmi, Independent Non-Executive Director

### Management Committees and Sub-Committees

Senior management, namely the Managing Director (performing the role of CEO) and, since January 2022, the Chief Technology Officer, is supported in its executive functions by two (2) management committees and their respective sub-committees.

The Management Committee in Malta ('MANCO') is composed of the most senior head of all departments and its objective is to support and assist senior management in the performance of its management tasks, in particular by ensuring effective continuity, communication, coordination and cooperation between senior management and the departments, unit and functions within the Bank and between the various departments, units and functions themselves. The MANCO is chaired by and reports to the Managing Director.

The MANCO has established the following sub-committees:

- the Credit Review Committee, which is involved in the approval of credit facility proposals and monitoring credit facilities and overdrawn balances;
- the Treasury and Investment Management Committee ('TIMCO'), which supports and assists in the performance of liquidity and investment management;
- The Customer Account Evaluation Committee, which evaluates existing customer relationships, including customer transactions and changes in the customer risk profile and advises on action to be taken to mitigate ML / TF risk and escalation and de-escalation measures.

The Ireland Branch Committee is the management committee established with the objective to support and assist senior management and the Head of Ireland Branch, in the performance of their management tasks in respect of the Ireland Branch. It is chaired by the Head of Ireland Branch.

The Ireland Branch Committee has established the following sub-committees:

(i) the On-boarding Committee, which approves the engagement with potential new customers of the Ireland Branch;

(ii) the Depositary Committee, which coordinates and monitors the effective discharge of depositary obligations and running of depositary operations at the Ireland Branch.

## 3. KEY RISK EXPOSURES

This section outlines the Bank's key risk exposures, including an overview of each risk category and the strategies and processes used to manage those risks. More detailed quantifications are presented in subsequent sections of this document, provided that they fall within the scope of Pillar 3 disclosures as explained earlier in Section 1 of this document or are considered to provide valuable information to the Bank's stakeholders.

### 3.1 CREDIT RISK

*3.1.1 Credit Risk Identification*

Credit risk is one of the main risk categories to which the Bank is exposed, namely through investment in debt securities and balances held with the Central Bank of Malta ('CBM') and other credit institutions.

Credit risk is defined as the potential for loss due to failure of a borrower to meet its contractual obligation to repay a debt in accordance with the agreed terms. In determining the extent of its exposure to credit risk, the Bank shall assess the credit quality of its financial assets, including balances held with CBM and other credit institutions, loans and advances to customers, including undrawn credit lines and investments in debt securities.

The Bank's business model has steered clear of heavy involvement in the provision of credit to the general economy, focusing instead on investment services activities. The majority of credit risk exposure stems from the Bank's proprietary bond portfolio and amounts held in Nostro accounts with counterparties. The Bank's lending book is not substantial when compared to total assets.

The Bank's credit risk profile is split over the following categories:

<u>Issuer Risk</u>

Issuer risk refers specifically to the risk of default by issuers of debt securities held by the Bank; between 30% and 40% of total assets are held in a diversified portfolio of debt securities. The Bank's exposure to this risk arises from the potential deterioration in the financial condition of the issuers (various kinds, such as sovereign exposures, supranational issuers, financial institutions and corporates) caused by various factors driving into default.

<u>Default risk</u>

Default risk is defined by the Bank as the potential risk that a borrower or counterparty fails to meet their obligations in accordance with the agreed terms. The Bank's exposure to default risk arises from the possibility, remote however it may be, that one of its correspondent banks or borrowers fails to fulfil its obligations.

Concentration risk

The Bank's exposure to concentration risk stems from the probability that one of the Bank's counterparties to whom the Bank is exposed in terms of numerous exposures, defaults. For example, a correspondent bank with who the Bank holds multiple currency accounts.

The Bank exposure to concentration risk takes the following forms:

- Name concentration risk defined as the risk of imperfect diversification in the Bank's loan and investment portfolio because of large exposures to specific individual issuers or correspondent banks;
- Sectoral concentration risk defined as the risk of imperfect diversification in the Bank's investment portfolio because of uneven distribution of exposures to particular sectors or industries; and
- Country concentration risk defined as the risk of default arising from political or economic events in a specific country, including political or social unrest, exchange controls, moratoria, currency devaluation, nationalisation and expropriation of assets.

Counterparty credit risk

Counterparty credit risk arises from the risk that a counterparty to a transaction defaults before the final settlement of the transaction's cash flows. The Bank's exposure to such risk may arise from the Bank acquisition of debt securities and the Bank's execution of foreign exchange deals for and on behalf of its customers.

In the latest ICAAP report for the year ended 31 December 2020, submitted to the MFSA in 2021, the Bank identified counterparty credit risk as one of its risk exposures. The source of CCR for the Bank is the execution of foreign exchange transactions for and on behalf of its customers, as well as foreign exchange forward transactions entered into with the Bank's customers and corresponding back-to-back foreign exchange forward transactions entered into with the Bank's counterparties. As a result, CCR was included in the Bank's risk universe from May 2021 onwards.

The Bank is not exposed to general or specific wrong-way risk. Therefore, no such policies have been drafted to date. In addition, given the nature of the Bank's CCR exposure, changes in the creditworthiness of the Bank (as evidenced by an eventual credit rating downgrade or otherwise), would not result in an increase in the amount of collateral which the Bank is required to keep.

*3.1.2 Credit Risk Management Policy & Setting of Risk Limits*

In view of the Bank's limited involvement in the provision of credit, the Bank primarily relies on credit ratings of issuers and counterparties and position limits when assessing and managing credit risk.

No hedging is used, with the primary credit mitigation on the Bank's lending portfolio being collateral in excess of the loan value. The Bank applies collateral value haircuts and lends out amounts only up to the point covered by the collateral as adjusted for the haircut. Defaults in the lending portfolio are very rare and collateral coverage is sufficient on all current facilities.

In terms of the debt securities portfolio, which currently stands in excess of EUR 290 million, the Bank has a mandate to invest mostly in investment grade securities with a preference for AAA supranational bond issues. Around 25% of the bond portfolio is allocated to supranational issues in fact, with around 20% in sovereign exposures. 30% of the Bank's bonds are rated AAA.

The Bank is only allowed to buy up to EUR 5 million in unrated securities, usually local bonds.

Since most bonds currently in issue on the global market are unsecured, the Bank relies on credit ratings issued by various agencies to manage credit risk. News concerning the issuers in the portfolio is monitored on a regular basis to determine exits from certain positions if needed, ratings are checked each time the portfolio report is run and financial statements are analysed on a rotating basis. Positions are scaled down or exited from when risks are identified, and the price of the bond permits an exit.

The Bank observes a -5% price drop as a "stop-and-check" point on bond positions to determine whether there are issuer specific concerns, or whether the price movement is part of a broader trend.

Credit risk limits apply, both in terms of lending amounts and via exposures to issuers. The target portfolio diversification in terms of sovereign vs. corporate exposures and the different allocations to different corporates is determined in accordance with the Bank's Investment and Liquidity Strategy. Large exposure limits and total profit for the year before tax are borne in mind when designing these limits.

The Bank is seeking to limit the number of new lending facilities larger than one year's worth of profit before tax, except in the cases of loans backed by highly liquid collateral; in which case Large exposure limits are considered when sizing the loan.

Balances held with counterparties are reviewed daily to avoid excessive exposures to any counterparty. Prior to the Russian invasion of Ukraine, the Bank took timely risk management action to curtail exposure it may have had to counterparties exposed to this region. The ratings of counterparties are also checked, with the Bank holding assets with reputable and well-rated counterparties.

## 3.2 MARKET RISK

### *3.2.1 Market Risk Identification*

Market risk is defined as the risk that the fair value, or future cash flows, of financial instruments, will fluctuate due to changes in market variables including interest rates, foreign exchange rates and market prices. The Bank identifies the following types of market risk exposures:

- Foreign exchange risk – defined as the risk of loss brought about by a change in exchange rates vis-à-vis the Bank's foreign currency holdings. The Bank's functional currency is the Euro but it operates in various other currencies, thus giving rise to foreign exchange risk.

- Investments price risk – defined as the risk of loss due to changes in the prices of investments. The Bank is exposed to investments price risk by virtue of its investment in equity securities, units in collective investment schemes, as well as by its investments in debt securities held in the 'Hold-to-Collect-and-Sell' portfolio. Following the assessment made in the latest ICAAP report, the Bank has confirmed that its exposure to this risk is immaterial.

- Credit Valuation Adjustment ('CVA') risk – defined as the risk of changes in the mark-to-market value of the Bank's exposure to its derivative transaction counterparties. The Bank is exposed to CVA risk by virtue of it entering into foreign exchange forward transactions both with its customers as well as its counterparties in order to hedge client transactions.

- Credit Spread Risk in the Banking Book ('CSRBB') – defined as the risk driven by changes in the market perception about the price of credit risk, liquidity premium and potentially other components of credit-risky instruments, which is not explained by interest rate risk in the banking book ('IRRBB') or by expected credit default risk. The Bank's exposure to CSRBB arises from its holding of financial assets measured at fair value through other comprehensive income and those measured at fair value through profit or loss. In the last ICAAP submission, the Bank concluded that its exposure to such risk is immaterial given that less than 10% of the bank's financial assets are subject to this risk. In fact, as at the end of the financial year ended 31 December 2021, financial assets accounted for at fair value amounted to just over 0.5% of the Bank's total financial assets portfolio.

### *3.2.2 Market Risk Management Objectives and Policies*

In defining its risk appetite for foreign exchange risk, the Bank limits its open foreign exchange positions to EUR 50,000 equivalent. Any open foreign exchange positions which exceed this amount are reduced by buying or selling the respective foreign currency. The Bank monitors its foreign exchange position on a daily basis and executes transactions accordingly. As part of its portfolio of services, the Bank also offers foreign exchange forward contracts to its customers. In this respect, the Bank eliminates its exposure to foreign exchange risk by entering into 'back-to-back' transactions with its counterparties to perfectly hedge any foreign exchange forward contract entered into with its customers.

Investment price risk arises from the Bank's relatively small exposure to equity, with a maximum exposure of EUR 10million and a EUR 1million loss limit. This was a recent addition to the Bank's risk profile, whereby the Bank decided to take on a limited amount of market risk over a number of ETF positions.

The Bank defines its appetite for market risk in terms of position and loss limits as outlined in the RAS. FVTPL positions are revalued via independent pricing sources on a frequent basis, and the unrealised gain/loss is determined. The "distance to trigger" is monitored frequently.

## 3.3 OPERATIONAL RISK

*3.3.1 Operational Risk Identification*

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Such risk can take various forms in such as sanctions risk, anti-money laundering risk, internal fraud risk, external fraud risk, conduct risk, ICT risk, business process risk and key staff dependency risk. Such risks can arise by various internal and external facts which pose a threat to the Bank's operations.

*3.3.2. Operational Risk Management Objectives and Policies*

Operational Risk stems from activities all across the Bank's operations and is mitigated via the internal controls maintained by risk owners in the first line of defence. These controls are documented in an internal controls library and assessed via various audits/reviews and contribute to the reduction of the inherent risk within a particular business line/function.

Owing to the substantial investment services activity transacted by the Bank, the Bank is aware of the level of operational risk inherent in the Bank's operations. In terms of strategy, operational risk is accepted, understood and controlled.

The Bank's risk appetite statement ('RAS') limits for operational risk in terms of business volume. The Bank is expected to run its business within these limits, and to grow headcount and/or improve technology when business growth necessitates expanding limits beyond current capacity.

The Bank's Risk Management function is the second line of defence internal control function in charge of operational risk management. Staff complement is currently one Risk Manager, supported by one Risk Officer, reporting directly to the Board of Directors.

In the first line of defence, each department involved in business and support functions is responsible for risks and risk mitigating controls and submit operational risk reports on operational incidents, to the Risk Management function.

The Risk Management function receives input from the Head of Compliance and the Head of AML on risk related matters.

Inherent risks are identified by the risk owners with the guidance of the Risk Manager. Risks are also identified from sources such National Risk Assessments and incidents incurred by other banks and financial services firms.

The Bank has adopted a 5 by 5 risk assessment matrix. Overall risk assessments take place as part of each Risk Report presented to the Board, apart from the ICAAP document.

Operational risk reporting takes two broad forms:

- Operational risk reports to the Risk Management Function
- Statistics reported by the relevant departments

The Bank has a template for operational risk incidents which must be filled in for incidents which result in losses greater than EUR 500 and/or various reputational risk related incidents. These templates can be filled and submitted by anyone in the Bank. Operational incidents are communicated to the Board of Directors at least on a quarterly basis via the Risk Manager's report.

Departmental statistics are available to the Risk Management Function on a monthly basis, and are aggregated in the form of an operational risk dashboard, also forwarded to the MANCO and Board of Directors on a quarterly basis. The statistics on business volumes are compared to operational risk limits as defined in the RAS, to check for breaches.

The Risk Management Function gathers monthly departmental level data on business volumes and errors/losses, and computed error rates for presentation to the Board on an annual basis. Members of the Risk Management Function may request to join any department meetings they wish to attend, to have first-hand knowledge of risk related discussions and be able to contribute and guide accordingly.

Error rates are calculated for a number of the Bank's departments, based on the number of transactions they each undertake in the context of the overall business.

The Bank mitigates operational risk in the follow manner:

- Controls of various kinds
- Insurance policies of various types
- Outright curtailing appetite for certain risks

In a broad sense, appetite in the context of operational risk management means for example: removing a sanctioned country fro m the list of available countries to which to remit payments via online channel, to completely eliminate the risk of such a payment slipping through by error.

The Bank has many such in-built safeguards, to restrict the perimeter of possible operational risk occurring in its various forms. Examples of such are not opening accounts for PEPs and not accepting any physical cash deposits.

### 3.4 LIQUIDITY RISK

The Bank is funded primarily via customer deposits, mostly corporate in nature and there are no planned changes to this funding profile. Owing to the nature of the deposits received (demand deposits), the Bank keeps a very high level of liquidity. Fund customers deposit liquidity which can be withdrawn in a moment's notice either to be paid out as redemptions to investors or to be used to purchase securities which are then held in custody with the Bank. Other corporate entities that keep their clients' monies with the Bank may also withdraw substantial amounts in response to changes in their own customer base.

The Bank has chosen not to lend out substantial amounts, to fund long term projects and instead invests in investment grade securities which it is able to liquidate or borrow against should the need arise.

The strategy in place for liquidity risk management is precisely to maintain high cash balances with the CBM and up to 40% of total assets in investment grade securities as allowed by the Board approved RAS.

The Bank monitors its liquidity position using three main metrics, namely the Liquidity Coverage Ratio ('LCR'), the Net Stable Funding Ratio ('NSFR') and the Liquid Assets to Total Assets ratio. The Bank defines early warnings and recovery indicators for each of these limits and ensures that it operates above the prescribed early warning indicator on an ongoing basis. With respect to the LCR and NSFR, the EWI is set at a buffer which not only ensures that the minimum regulatory requirement is met, but also setting a sufficient buffer to enable to meet customer demands for withdrawals. The Finance department presents these ratios, together with other liquidity reports, to MANCO and the Board, on a quarterly basis. The table below summarises the LCR, NSFR and Liquidity Assets to Total Assets ratio as at the end of 2021 and 2020.

| Metric | YE 2020 | YE 2021 | EWI | RI |
|---|---|---|---|---|
| LCR | 396.5% | 355.6% | 200% | 100% |
| NSFR | 440.9% | 504.0% | 200% | 100% |
| Liquid Assets to Total Assets | 73.0% | 68.0% | 50% | 40% |

As outlined in the table above, the Bank has operated above the early warning indicators for all liquidity ratios presented.

The table below illustrates a breakdown of the Bank's liquid assets as at the end of the financial years ending 31 December 2021 and 2020. It also contemplates a hypothetical extreme scenario whereby 40% of the customer deposits are withdrawn at a single point in time.

| Metric | YE 2020 | YE 2021 | YE 2020 | YE 2021 |
|---|---|---|---|---|
| Cash held with CBM | EUR574.37M | | EUR620.94M | |
| Balances held with correspondent banks in Nostro accounts | EUR65.26M | | EUR46.12M | |
| Financial Assets | EUR203.0M | | EUR283.8M | |
| **Total Liquid Assets** | **EUR842.63M** | | **EUR950.86M** | |
| | | | | |
| Amounts owed to customers | | EUR830.05M | | EUR925.74M |
| Simulated 40% outflow (illustrative purposes) | | (EUR332.02M) | | (EUR462.87M) |

As illustrated in the table above, in the extreme scenario that 40% of customer deposits would be withdrawn on demand, the Bank would be able to absorb such withdrawal using its cash balances held with CBM, without the need to sell any of its financial assets or borrow against such assets. This shows that the Bank has sufficient liquidity buffers in place, which it intends to maintain at similar levels for the foreseeable future.

Institutions also need to assess whether their off-balance sheet commitments expose them to liquidity risk. Given that the Bank's off-balance sheet commitments, in the form of unutilised credit lines, which amounted to just EUR 24.5million, the Bank is confident that it can meet these commitments using available liquidity and does not consider its off-balance sheet commitments as giving rise to material liquidity risk.

Liquidity concentration risk is another aspect of liquidity risk which the Bank considers as part of its liquidity risk management. In light of the Bank's business model, the Bank generates a significant portion, amounting to 31% as at the end of 2021, of its deposits from fund customers. Despite this apparent sectoral concentration, the Bank considers this liquidity to be sticky in nature. In addition, the fund customers contributing these deposits hold underlying assets in various sectors meaning that downward pressures on one sector would not impact all of the Bank's fund customers in the same manner. The Bank also looks at depositor concentration by managing the amount of deposits that a single depositor can deposit with the Bank. This is agreed upon both initially when the Bank enters into the agreement with the said customer, as well as through ongoing customer monitoring. This ensures that depositor inflows and outflows remain within the Bank's a priori expectations.

As outlined earlier, the Group is made up of the Bank and its financial holding company, SHM. The only legal entity within the Group that has funding needs is the Bank itself. The Bank's branch in Ireland is not a subsidiary and all customer relationships entered into with the branch are banked in the Malta head office. Therefore, no liquidity is transferred within the Group.

The Bank also monitors its liquidity position through the liquidity maturity latter, which is presented in Note 37 of the Annual Report and re-presented in the table overleaf. As explained earlier, most of the Bank's deposits are demand deposits, resulting in the liquidity gap shown in the 'Less than 3 Months' bucket. Having said this, the Bank holds a portfolio of high quality liquid assets, which despite having a longer term to maturity (and therefore allocated in the other maturity buckets), can be sold on the market to meet any liquidity needs which may arise.

| 2021 | Total | Less than 3 Months | Between 3 Months and 1 Year | Between 1 Year and 5 Years | Over 5 Years |
|---|---|---|---|---|---|
| | €'000 | €'000 | €'000 | €'000 | €'000 |
| **Assets** | | | | | |
| Balances with Central Bank of Malta | 620,937 | 620,937 | - | - | - |
| Loans and advances to Banks | 46,118 | 46,118 | - | - | - |
| Loans and Advances to Customers | 10,234 | 988 | 7,856 | 1,390 | - |
| Financial Assets | 286,249 | 3,002 | 3,772 | 140,855 | 138,620 |
| | **963,538** | **671,045** | **11,628** | **142,245** | **138,620** |
| **Liabilities** | | | | | |
| Amounts owed to Banks | 2,400 | 2,400 | - | - | - |
| Amounts owed to Customers | 925,740 | 924,473 | 7 | 1,260 | - |
| | **928,140** | **926,873** | **7** | **1,260** | **-** |
| **Maturity Gap** | | **(255,828)** | **11,621** | **140,985** | **138,620** |
| **Cumulative Gap** | | **(255,828)** | **(244,207)** | **(103,222)** | **35,398** |

The Bank considers that the liquidity risk management arrangements put in place are adequate with regards to the Bank's profile and strategy. The Bank holds sufficient cash and High Quality Liquid Assets ('HQLA') to be able to meet deposit withdrawals, whether they arise in normal or stressed operating conditions. Furthermore, the Bank has adequate buffers on key liquidity ratios to permit it to withstand a number of adverse scenarios without breaching the minimum regulatory requirements.

### 3.5 LEVERAGE

In order to prevent the risk of excessive leverage, CRR II introduced the requirement for institutions to keep a Tier 1 capital leverage ratio of at least 3%. This requirement is seen as providing a credible backdrop without hampering economic growth.

In light of this, the Bank has incorporated the leverage ratio in the Bank's set of key indicators to gauge the Bank's performance and adherence to regulatory requirements. The Bank has set a recovery indicator at the minimum regulatory requirement of 3%, as well as an early warning indicator at 3.5%, which provides sufficient buffer for action to be taken when the Bank approaches the minimum regulatory requirement and thus is at risk of experiencing excessive leverage.

The Bank monitors the leverage ratio on a continuous basis and management incorporates such ratios in investment and strategic decisions.

Given that the two main components of the leverage ratio are Tier 1 capital and total exposure measure, the Bank can increase the leverage ratio either by increasing Tier 1 capital or decreasing the total exposure measure. In the short-term, the most likely course of action would be to decrease the total exposure measure. In fact, as detailed in the Bank's Risk Appetite Statement, the Bank applies limits on the deposit amounts that certain customers can transfer to and keep in their deposit accounts with the Bank. These limits are used by front line officers of the Bank to manage relationships and business flows with customers. The Transactions Monitoring Team within the AML Department, also flags large incoming deposits to the Managing Director, the Risk Manager and the Finance Manager. This ensures that sudden increases in total assets are detected intraday and addressed in a timely manner.

Strategically, the Bank may decide to take measures to increase its Tier 1 capital through retained profits or reinvestment of dividends by the Bank's parent company, SHM, or else through additional capital injections by SHM beyond the dividend amount received.

The Bank's Tier 1 capital is composed primarily of issued and fully paid up ordinary share capital and therefore no maturity considerations apply in this respect. The Bank's total exposure measure is highly dependent on the customer deposits, which due to the nature of the Bank's customer base, could be subject to significant intra-day fluctuations. These are mostly related to routine redemptions from large fund customers who may at times sell substantial amounts of investment holdings, temporarily deposit the cash settlements with the Bank and then eventually pay out redemptions to investors. Given that the Bank holds a significant portion of its assets in call deposits with the Central Bank of Malta and other correspondent banks, customer withdrawal and deposit patterns are likely to have a direct impact on the Bank's total assets and total exposure measure, at any particular time. The Bank does not hold nor does it have an appetite for entering into debt arrangements which would be utilised to meet client deposit withdrawals, explaining why customer deposit patterns are directly reflected in the Bank's total assets. The off-balance sheet exposure amount, which includes primarily the counterparty credit risk exposure arising from forward foreign exchange transactions, also contributes to the leverage exposure measure, albeit to a lesser extent when compared to total assets.

The Bank has very limited appetite for asset encumbrance. In fact, encumbered assets as at the end of the financial year represent solely those assets which are required to be kept as collateral or in pledged accounts pursuant to the Bank's business relationships with its correspondent banks and counterparties, as well as assets pledged for the variation margin arising from the Bank's foreign exchange forward transactions entered into with its customers and counterparties. All such encumbered assets are held in cash and are denominated in Euro.

### 3.6 INTEREST RATE RISK IN THE BANKING BOOK

*3.6.1 IRRBB Identification*

Interest rate risk in the banking book ('IRRBB') is defined in the 'Guidelines on the management of interest rate risk arising from non-trading book activities' issued by the EBA during July 2018, as 'the current or prospective risk to both the earnings and the economic value of an institution arising from adverse movements in interest rates that affect interest rate sensitive instruments, including gap risk, basis risk and option risk.'

Gap risk refers to the risk resulting from the term structure of interest-rate sensitive instruments that arises from differences in the timing of their rate changes, covering changes to the term structure of interest rates occurring consistently across the yield curve (also referred to as parallel risk) or differentially by period (also referred to as non-parallel risk).

On the other hand, basis risk arises from the impact of relative changes in interest rates on interest-rate sensitive instruments that have similar tenors but are priced using different interest rate indices. Basis risk arises from the imperfect correlation in the adjustment of the rates earned and paid on different interest-rate sensitive instruments with otherwise similar rate change characteristics. This risk arises mainly from hedging exposures to one interest rate with exposure to a rate which reprices under slightly different conditions.

Finally, option risk refers to the risk arising from options, whether embedded or explicit, where the institution or its customers can alter the level and timing of their cash flows. This refers primarily to the risk arising from interest-rate sensitive instruments where the holder will almost certainly exercise the option if it is in their financial interest to do so and the risk arising from the flexibility embedded implicitly or within the terms of the interest-rate sensitive instruments, such that changes in interest rates may affect a change in the behaviour of the client. Since the Bank does not enter into interest-rate hedging nor does it offer or hold interest-rate sensitive instruments with optionality, the Directors do not deem the Bank to be exposed to basis risk or option risk.

As a result, any reference to IRRBB within this document shall only be understood in terms of the Bank's exposure to gap risk.

*3.6.2 IRRBB Risk Management*

The Bank's loan business strategy is geared towards the mitigation of IRRBB. In this respect, the Bank grants loans to customers of a limited maturity, with the maximum loan maturity being limited to 5 years and a maximum overdraft term of 12 months.

In addition, the Bank grants loans subject to variable interest rates. This ensures that any changes to market interest rates are reflected in the interest rates charged on the Bank's loan portfolio. The Bank's lending rate underwent changes recently to factor in the developments related to IBOR rates.

In general, the Bank does not pay credit interest on customer deposits.

Apart from gearing its business strategy towards mitigating IRRBB, the Bank has in place a number of controls surrounding its exposure to IRRBB as outlined below:

- Monitoring of interest rates - The Bank's Finance department monitors the key macroeconomic interest rates on an ongoing basis in an effort to identify developments in the current and future interest rate environment. Any identified updates to market interest rates are reported to Credit Review Committee and eventually reflected in the interest rates charged to customers as per the Credit Facility Agreement signed by the said customer.

- Monthly gap analysis - The Bank's Finance department performs monthly gap analysis to assess the sensitivity of the Bank's interest bearing assets and liabilities to a 200 basis point change in interest rates. This assessment is performed separately for each major currency of operation, namely EUR, USD and GBP.

- Restricting replacement bond purchases to short maturities - In the context of rising inflation figures and central bank posture changing to favour sustained normalization of interest rates, bond valuations in the coming years are likely to be under pressure. Hence the Bank moved away from its previous policy of laddering the portfolio, to re-investing bond maturities into short term dated issues until the re-pricing in the bond market unfolds fully.

*3.6.3 IRRBB Risk Measurement*

The Bank measures its exposure to IRRBB using both an Economic Value of Equity ('EVE') measure and an Earnings-based measure. In estimating the exposure to IRRBB in terms of potential changes to the Bank's EVE, the Bank uses the Standardised EVE outlier test, as outlined in the '*Guidelines on the management of interest rate risk arising from non-trading book activities'* issued by the EBA during July 2018. On the other hand, for the earnings-based measure, the Bank uses the 'Gap analysis re-pricing gap' measure, whereby the Bank would calculate the impact on its net interest income as a result of a change in interest rates.

The Bank performs these quantifications on an annual basis as part of its Pillar 2 assessment in the ICAAP. In the event that a material capital requirement is identified in this respect, the Bank would implement such capital requirement as a Pillar 2 add-on for IRRBB. In the last ICAAP submission for the reference year ending 31 December 2020, no such capital requirement was identified. This assessment shall be updated in the next ICAAP submission for the reference year ending 31 December 2021.

## 4. OWN FUNDS & RISK WEIGHTED EXPOSURE AMOUNTS

Article 437 of the CRR requires institutions to disclose details regarding their own funds, including both a quantitative illustration of the components of own funds and the resulting capital ratios.

### 4.1 COMPOSITION OF REGULATORY OWN FUNDS

The tables overleaf provide an overview of the composition of the Bank's and the Group's regulatory own funds, including a detailed outline of the components of own funds and applicable regulatory adjustments. The same table provides an illustration of the Bank's and the Group's capital ratio as at financial year end 31 December 2021, including applicable buffers and excess (if any) of the total capital above the minimum regulatory requirements. No restrictions to the calculation of own funds have been applied and the capital ratios have been calculated in line with the basis laid down in the CRR.

EU CC1 - Composition of regulatory own funds

Individual

| | | Amounts | Source based on reference numbers/letters of the balance sheet under regulatory scope of consolidation |
|---|---|---|---|
| | Common Equity Tier 1 (CET1) capital: instruments and reserves | | |
| 1 | Capital instruments and the related share premium accounts | 40,200,000 | Vide EU CC2 *'Shareholders' equity'* row 1 |
| | *of which: Ordinary Share Capital* | *40,200,000* | Vide EU CC2 *'Shareholders' equity'* row 1 |
| 2 | Retained earnings | 2,432,663 | Vide EU CC2 '*Shareholders' equity*' row 4 |
| 3 | Accumulated other compherensive income (and other reserves) | 4,828,608 | Vide EU CC2 '*Shareholders' equity*' rows 2 & 3 |
| 6 | Common Equity Tier 1 (CET 1) capital before regulatory adjustments | 47,461,271 | |
| | Common Equity Tier 1 (CET 1): regulatory adjustments | | |
| 7 | Additional value adjustments (negative amount) | (2,448) | |
| 8 | Intangible assets (net of related tax liability) | (3,397,072) | Vide EU CC2 '*Assets*' row 1 |
| 28 | Total regulatory adjustments to Common Equity Tier 1 (CET1) | (3,399,519) | |
| 29 | Common Equity Tier 1 (CET1) capital | 44,061,752 | |
| 45 | Tier 1 capital (T1 = CET1 + AT1) | 44,061,752 | |
| 59 | Total capital (TC = T1 + T2) | 44,061,752 | |
| 60 | Total Risk exposure amount | 135,473,172 | |
| | Capital ratios and requirements including buffers | | |
| 61 | Common Equity Tier 1 capital | 32.5243% | |
| 62 | Tier 1 capital | 32.5243% | |
| 63 | Total capital | 32.5243% | |
| 64 | Institution CET1 overall capital requirements | 10.7501% | |
| 65 | Of which: capital conservation buffer requirement | 2.5000% | |
| 66 | Of which: countercyclical capital buffer requirement | 0.0001% | |
| EU-67b | Of which: additional own funds requirements to address the risks other than the risk of excessive leverage | 3.7500% | |
| 68 | Common Equity Tier 1 capital (as a percentage of risk exposure amount) available after meeting the minimum capital requirements | 24.2743% | |

Consolidated

| | | Amounts | Source based on reference numbers/letters of the balance sheet under regulatory scope of consolidation |
|---|---|---|---|
| | **Common Equity Tier 1 (CET1) capital: instruments and reserves** | | |
| 1 | Capital instruments and the related share premium accounts | 18,000,000 | Vide EU CC2 *'Shareholders' equity'* row 1 |
| | of which: Ordinary Share Capital | 18,000,000 | Vide EU CC2 *'Shareholders' equity'* row 1 |
| 2 | Retained earnings | 25,792,141 | Vide EU CC2 '*Shareholders' equity*' row 4 |
| 3 | Accumulated other compherensive income (and other reserves) | 4,828,608 | Vide EU CC2 '*Shareholders' equity*' rows 2 & 3 |
| 4 | Minority interests (amount allowed in consolidated CET 1) | 1,000 | Vide EU CC2 '*Shareholders' equity*' row 5 |
| 6 | Common Equity Tier 1 (CET 1) capital before regulatory adjustments | 48,621,748 | |
| | **Common Equity Tier 1 (CET 1): regulatory adjustments** | | |
| 7 | Additional value adjustments (negative amount) | (2,448) | |
| 8 | Intangible assets (net of related tax liability) | (3,397,072) | Vide EU CC2 '*Assets*' row 1 |
| 28 | Total regulatory adjustments to Common Equity Tier 1 (CET1) | (3,399,519) | |
| 29 | Common Equity Tier 1 (CET1) capital | 45,222,229 | |
| 45 | Tier 1 capital (T1 = CET1 + AT1) | 45,222,229 | |
| 59 | Total capital (TC = T1 + T2) | 45,222,229 | |
| 60 | Total Risk exposure amount | 136,511,306 | |
| | **Capital ratios and requirements including buffers** | | |
| 61 | Common Equity Tier 1 capital | 33.1271% | |
| 62 | Tier 1 capital | 33.1271% | |
| 63 | Total capital | 33.1271% | |
| 64 | Institution CET1 overall capital requirements | 10.7501% | |
| 65 | Of which: capital conservation buffer requirement | 2.5000% | |
| 66 | Of which: countercyclical capital buffer requirement | 0.0001% | |
| EU-67b | Of which: additional own funds requirements to address the risks other than the risk of excessive leverage | 3.7500% | |
| 68 | Common Equity Tier 1 capital (as a percentage of risk exposure amount) available after meeting the minimum capital requirements | 24.8771% | |

As illustrated in tables EU CC1 above, the Bank's and the Group's own funds are composed solely of Common Equity Tier 1 ('CET 1') capital, including ordinary share capital, retained earnings, property revaluation reserve, fair value reserve and minority interests in the case of the Group own funds. In light of this, rows EUR-3a to EUR-5a as per the illustrative template, have been excluded from the table depicted above. Similarly, since the Bank and the Group did not hold any Additional Tier 1 ('AT1') and Tier 2 ('T2') as at 31 December 2021, rows 30 to 58as per the illustrative template have been excluded from EU CC1 displayed above.

The regulatory adjustments section of the own funds table includes additional valuation adjustments in line with Article 105 of the CRR and intangible assets deducted from own funds pursuant to Article 37 of the CRR. Given that no additional regulatory adjustments where applied as of the end of the financial year, rows 9 to 27a as per the illustrative template have been excluded.

The next section of the own funds table sets out the applicable buffers. The Bank is subject to a capital conservation buffer of 2.5%, as well as an institution-specific countercyclical capital buffer which fluctuates in line with the Bank's exposure to selected geographies. The Bank is also subject to a 5% Pillar 2 requirement, applicable as from March 2021 onwards, which the Malta Financial Services Authority ('MFSA') established in 2021, following its Supervisory Review and Evaluation Process ('SREP') review. As at the date of writing, MFSA has not set a systemic buffer nor has it listed the Bank as a G-SII or an O-SII. In light of this, rows 67 and 67a included in the illustrative template, have been excluded from the own funds tables presented in this section.

Finally, the Bank is not subject to any amounts which are below the thresholds for deduction, applicable caps for inclusion of provisions in T2 or capital instruments subject to phase-out arrangements. Therefore, rows 72 to 85 as per the illustrative template have been excluded from the presentation of composition of own funds for the Bank.

The tables below provide a reconciliation of the Bank's and the Group's regulatory own funds to the balance sheet as presented in the Annual Report. Given that the accounting and regulatory scope of consolidation are identical, columns (a) and (b) as presented in the illustrative disclosure, have been merged into one column for the purpose of this disclosure.

### EU CC2 - Reconciliation of regulatory own funds to balance sheet in the audited financial statements

<u>Individual</u>

| | | Balance sheet as in published financial statements & Under regulatory scope of consolidation | Reference |
|---|---|---|---|
| | | As at period end | |
| Assets (include breakdown by asset classes according to the balance sheet in the published financial statements) | | | |
| 1 | Intangible assets | 3,397,072 | Vide EU CC1 row 8 |
| | **Total assets** | **3,397,072** | |
| Shareholders' equity | | | |
| 1 | Called up share capital | 40,200,000 | Vide EU CC1 row 1 |
| 2 | Fair value reserve | - | Vide EU CC1 row 3 |
| 3 | Property revaluation reserve | 4,828,608 | Vide EU CC1 row 3 |
| 4 | Retained earnings | 2,432,663 | Vide EU CC1 row 2 |
| | **Total shareholders' equity** | **47,461,271** | |

Consolidated

| | | Balance sheet as in published financial statements | Reference |
|---|---|---|---|
| | | As at period end | |
| Assets (include breakdown by asset classes according to the balance sheet in the published financial statements) | | | |
| 1 | Intangible assets | 3,397,072 | Vide EU CC1 row 8 |
| | **Total assets** | **3,397,072** | |
| Shareholders' equity | | | |
| 1 | Called up share capital | 18,000,000 | Vide EU CC1 row 1 |
| 2 | Fair value reserve | - | Vide EU CC1 row 3 |
| 3 | Property revaluation reserve | 4,828,608 | Vide EU CC1 row 3 |
| 4 | Retained earnings | 25,792,141 | Vide EU CC1 row 2 |
| 5 | Minority interests | 1,000 | Vide EU CC1 row 4 |
| | **Total shareholders' equity** | **48,621,748** | |

## 4.2 RISK WEIGHTED EXPOSURE AMOUNTS

The tables below provide an overview of the Bank's and the Group's risk weighted exposure amounts and the respective own funds requirement, for each identified risk category of exposure.

EU OV1 - Overview of total risk exposure amounts

Individual

| | | Total risk exposure amount (TREA) | | Total own funds requirement |
|---|---|---|---|---|
| | | 2021 | 2020 | 2021 |
| 1 | Credit risk (excluding CCR) | 102,596,964 | 118,583,549 | 8,207,757 |
| 2 | Of which the standardised approach | 102,596,964 | 118,583,549 | 8,207,757 |
| 6 | Counterparty Credit Risk - CCR | 10,568,720 | - | 845,498 |
| EU 8b | Of which credit valuation adjustment - CVA | 144,598 | - | 11,568 |
| 9 | Of which other CCR | 10,424,122 | - | 833,930 |
| 20 | Positions, foreign exchange and commodities risks (Market Risk) | - | 841,183 | - |
| 21 | Of which standardised approach | - | 841,183 | - |
| 23 | Operational risk | 22,307,489 | 22,080,728 | 1,784,599 |
| EU 23a | Of which basic indicator approach | 22,307,489 | 22,080,728 | 1,784,599 |
| 24 | Amounts below the thresholds for deduction (subject to 250% risk weight) | 3,820,948 | 4,246,962 | 305,676 |
| **29** | **Total** | **135,473,172** | **141,505,459** | **10,837,854** |

Consolidated

| | | Total risk exposure amount (TREA) | | Total own funds requirement |
|---|---|---|---|---|
| | | 2021 | 2020 | 2021 |
| 1 | Credit risk (excluding CCR) | 103,634,927 | 120,852,347 | 8,290,794 |
| 2 | Of which the standardised approach | 103,634,927 | 120,852,347 | 8,290,794 |
| 6 | Counterparty Credit Risk - CCR | 10,568,720 | - | 845,498 |
| EU 8b | Of which credit valuation adjustment - CVA | 144,598 | - | 11,568 |
| 9 | Of which other CCR | 10,424,122 | - | 833,930 |
| 20 | Positions, foreign exchange and commodities risks (Market Risk) | - | 841,183 | - |
| 21 | Of which standardised approach | - | 841,183 | - |
| 23 | Operational risk | 22,307,660 | 22,088,226 | 1,784,613 |
| EU 23a | Of which basic indicator approach | 22,307,660 | 22,088,226 | 1,784,613 |
| 24 | Amounts below the thresholds for deduction (subject to 250% risk weight) | 3,820,948 | 4,246,962 | 305,676 |
| **29** | **Total** | **136,511,306** | **143,781,756** | **10,920,904** |

The Bank uses the standardised approach to measure the risk weighted exposure amount and resulting capital requirement for credit risk. As a result, the entire credit risk exposure amount and own funds requirement is included in row 2 in table EU OV1 above, with r ows 3 to 5 as presented in the illustrative template being excluded for the purpose of this disclosure.

During 2021, following the submission of the ICAAP document for the year ended 31 December 2020, the Bank introduced counterparty credit risk ('CCR') and credit valuation adjustment ('CVA') in its risk universe. As a result, the total risk exposure amounts and own funds requirements for these two risks are only applicable for the year ended 31 December 2021, with no such amounts being shown for the comparative figures. The Bank calculates its risk weighted exposure amounts for CCR using the Original Exposure Method, with none of these exposures being exposures to central counterparties. In light of this, the risk weighted exposure amount and the own funds requirement presented in row 6 are split between CVA, as presented in row EU 8b and other CCR, as presented in row 9. Rows 7 to EU 8a as included in the illustrative template have been excluded for the purpose of this disclosure.

With respect to market risk, the Bank identified foreign exchange risk as being a material inherent risk exposure and calculates the total risk exposure amount and own funds requirement in this respect in line with Chapter 3 of Title IV of Part Three of the CRR. As a result, the total risk exposure amount and own funds requirement for market risk is included in row 21, with row 22 as included in the illustrative disclosure being excluded from the table displayed above. Having said this, the residual risk exposure of the Bank to foreign exchange risk is immaterial owing to the controls put in place in this respect.

Another material risk category for the Bank is operational risk, whereby the Bank uses the Basic Indicator Approach to calculate the risk weighted exposure amount and own funds requirement for this risk. Consequently, the Bank allocates the entire risk weighted exposure amount and own funds requirement for operational risk to row EU 23a, with rows EU 23b and EU 23c as presented in the illustrative disclosure being eliminated from the Bank's disclosure. In line with Article 351 of the CRR, institutions are only required to calculate an own funds requirement for foreign exchange risk provided that their overall net foreign-exchange position exceeds 2% of their total own funds. Given that for the year ended 31 December 2021, the Bank's and the Group's net foreign-exchange position was below 2% of their respective own funds, no capital allocation was made in respect of foreign exchange risk.

Row 24 of table EU OV1 displayed above includes the total risk weighted exposure amount and own funds requirement for deferred tax assets that are dependent on future profitability and arise from temporary differences, and in aggregate are equal to or less than 10% of CET 1 capital of the Bank.

Finally, the Bank does not consider settlement risk as being a material risk exposure arising from its current and future activities. In addition, the Bank did not have any securitisation exposures for the current and previous years ending 31 December 2021 and 2020, respectively. Also, for both years presented, the Bank did not have any risk weighted exposure amounts and own funds requirements in relation to large exposures exceeding the limits in Articles 395 to 401 of the CRR. Pursuant to this, rows 15, 16 to EU 19a and EU 22a as presented in the illustrative disclosure have been excluded from the EO OV1 tables presented above. All rows stating 'Not applicable' (that is rows 10 to 14 and rows 25 to 28) have also been excluded for the purpose of this disclosure.

### 4.3 COMBINED BUFFER REQUIREMENT

As explained in Section 5.1 above, the Bank's combined buffer requirement is composed of the capital conservation buffer and the countercyclical capital buffer. The capital conservation buffer amounts to 2.5% of total risk weighted exposure amount. The countercyclical capital buffer is calculated in line with the geographical exposure to the respective country for which a countercyclical capital buffer has been issued. The tables below illustrate the computation of the institution-specific countercyclical capital buffer for the Bank and the Group.

#### EU CCyB2 - Amount of institution-specific countercyclical capital buffer

Individual

| | | |
|---|---|---|
| 1 | Total risk exposure amount | 135,473,172 |
| 2 | Institution specific countercyclical capital buffer rate | 0.01% |
| 3 | Institution specific countercyclical capital buffer requirement | 18,239 |

Consolidated

| | | |
|---|---|---|
| 1 | Total risk exposure amount | 136,511,306 |
| 2 | Institution specific countercyclical capital buffer rate | 0.01% |
| 3 | Institution specific countercyclical capital buffer requirement | 18,056 |

## 5. CREDIT RISK

The Bank uses the standardised approach to calculate the total risk weighted exposure amount and capital requirement for credit risk. This approach requires institutions to assign a risk weight to its exposures, which risk weight would correspond to the credit quality step assigned to the said exposure.

For rated exposures, the Bank assigns the credit quality step to the respective exposure in line with the assigned external credit rating. In assigning the external credit rating, the Bank makes reference to ratings issued by Fitch, Moody's and S&P. No changes were implemented in this respect during 2021. Where available, the Bank uses ratings published by external credit assessment institutions ('ECAIs') for the following exposure classes:

- Central governments or central banks
- Institutions
- Corporates
- Equity

The Bank assigns risk weights to its exposures in line with Articles 111 to 134 of the CRR. With respect to rated exposures, the Bank assigns the corresponding credit quality step and risk weight in line with the below:

- When only one external credit rating is available, that credit rating is used to assign the credit quality step and risk weight;
- When two external credit ratings are available, the Bank uses the lower rating to assign the credit quality step and risk weight;
- When three external credit ratings are available, the Bank takes the lower two ratings and if these are different, the higher rating is used to assign the credit quality step and risk weight.

The tables below present the Bank's and the Group's on and off balance sheet exposures and risk weighted exposure amounts classified by exposure class. The only difference between the individual and consolidated tables lies in the 'Institutions' exposure class whereby the consolidated amount includes a balance of EUR210,968 which the parent company, SHM held with the Bank as at the end of the financial year 2021.

Given that the Bank nor the Group had exposures to the following exposures classes, rows 2, 3, 9 and 11 to 13, as per the illustrative disclosure, have been excluded from the below disclosures.

- Regional government or local authorities
- Public sector entities
- Secured by mortgages on immovable property
- Exposures associated with particularly high risk
- Covered bonds; and
- Institutions and corporates with a short-term credit assessment

In turn, the tables below illustrate a breakdown of the Bank's and the Group's exposures by exposure class and respective risk weight assigned in accordance with articles 114 to 134 of the CRR.

EU CR4 - Standardised approach - Credit risk exposure and CRM effects

Individual

| | Exposure classes | Exposures before CCF and before CRM | | Exposures post CCF and post CRM | | RWEAs and RWEAs density | |
|---|---|---|---|---|---|---|---|
| | | On-balance sheet exposures | Off-balance sheet exposures | On-balance sheet exposures | Off-balance sheet exposures | RWEAs | RWEAs density (%) |
| 1 | Central governments or central banks | 700,056,680 | - | 700,056,680 | - | 18,573,257 | 2.65% |
| 4 | Multilateral development banks | 72,527,570 | - | 72,527,570 | - | - | 0.00% |
| 5 | International organisations | 26,074,491 | - | 26,074,491 | - | - | 0.00% |
| 6 | Institutions | 117,783,138 | 8,201,546 | 117,783,138 | 8,201,546 | 38,665,809 | 30.69% |
| 7 | Corporates | 45,435,524 | 33,293,584 | 45,435,524 | 13,685,767 | 37,568,026 | 63.54% |
| 8 | Retail | 176,097 | - | 176,097 | - | 132,073 | 75.00% |
| 10 | Exposures in default | - | - | - | - | - | 0.00% |
| 14 | Collective investment undertakings | 1,411,459 | - | 1,411,459 | - | 1,411,459 | 100.00% |
| 15 | Equity | 72,660 | - | 72,660 | - | 72,660 | 100.00% |
| 16 | Other items | 17,704,919 | - | 17,704,919 | - | 16,597,802 | 93.75% |
| 17 | Total | 981,242,538 | 41,495,130 | 981,242,538 | 21,887,312 | 113,021,085 | 11.27% |

Consolidated

| | Exposure classes | Exposures before CCF and before CRM | | Exposures post CCF and post CRM | | RWEAs and RWEAs density | |
|---|---|---|---|---|---|---|---|
| | | On-balance sheet exposures | Off-balance sheet exposures | On-balance sheet exposures | Off-balance sheet exposures | RWEAs | RWEAs density (%) |
| 1 | Central governments or central banks | 700,056,680 | - | 700,056,680 | - | 18,573,257 | 2.65% |
| 4 | Multilateral development banks | 72,527,570 | - | 72,527,570 | - | - | 0.00% |
| 5 | International organisations | 26,074,491 | - | 26,074,491 | - | - | 0.00% |
| 6 | Institutions | 117,994,106 | 8,201,546 | 117,994,106 | 8,201,546 | 38,708,003 | 30.67% |
| 7 | Corporates | 45,435,524 | 33,293,584 | 45,435,524 | 13,685,767 | 37,568,026 | 63.54% |
| 8 | Retail | 176,097 | - | 176,097 | - | 132,073 | 75.00% |
| 10 | Exposures in default | - | - | - | - | - | 0.00% |
| 14 | Collective investment undertakings | 1,411,459 | - | 1,411,459 | - | 1,411,459 | 100.00% |
| 15 | Equity | 72,660 | - | 72,660 | - | 72,660 | 100.00% |
| 16 | Other items | 18,700,688 | - | 18,700,688 | - | 17,593,571 | 94.08% |
| 17 | Total | 982,449,275 | 41,495,130 | 982,449,275 | 21,887,312 | 114,059,048 | 11.36% |

EU CR5 - standardised approach

Individual

| | Exposure classes | Risk weight | | | | | | Total | Of which unrated |
|---|---|---|---|---|---|---|---|---|---|
| | | 0% | 20% | 50% | 75% | 100% | 250% | | |
| 1 | Central governments or central ban | 607,190,393 | 92,866,287 | - | - | - | - | 700,056,680 | - |
| 4 | Multilateral development banks | 72,527,570 | - | - | - | - | - | 72,527,570 | - |
| 5 | International organisations | 26,074,491 | - | - | - | - | - | 26,074,491 | - |
| 6 | Institutions | - | 83,702,223 | 40,714,193 | - | 1,568,268 | - | 125,984,684 | 2,669,021 |
| 7 | Corporates | - | 12,882,019 | 22,495,298 | - | 23,743,973 | - | 59,121,291 | 23,743,973 |
| 8 | Retail | - | - | - | 176,097 | - | - | 176,097 | 176,097 |
| 10 | Exposures in default | - | - | - | - | - | - | - | - |
| 14 | Collective investment undertakings | - | - | - | - | 1,411,459 | - | 1,411,459 | 1,411,459 |
| 15 | Equity | - | - | - | - | 72,660 | - | 72,660 | 72,660 |
| 16 | Other items | 3,399,686 | - | - | - | 12,776,854 | 1,528,379 | 17,704,919 | 17,704,919 |
| 17 | Total | 709,192,140 | 189,450,530 | 63,209,491 | 176,097 | 39,573,213 | 1,528,379 | 1,003,129,850 | 45,778,128 |

Consolidated

| | Exposure classes | Risk weight | | | | | | Total | Of which unrated |
|---|---|---|---|---|---|---|---|---|---|
| | | 0% | 20% | 50% | 75% | 100% | 250% | | |
| 1 | Central governments or central ban | 607,190,393 | 92,866,287 | - | - | - | - | 700,056,680 | - |
| 4 | Multilateral development banks | 72,527,570 | - | - | - | - | - | 72,527,570 | - |
| 5 | International organisations | 26,074,491 | - | - | - | - | - | 26,074,491 | - |
| 6 | Institutions | - | 83,913,191 | 40,714,193 | - | 1,568,268 | - | 126,195,652 | 2,879,989 |
| 7 | Corporates | - | 12,882,019 | 22,495,298 | - | 23,743,973 | - | 59,121,291 | 23,743,973 |
| 8 | Retail | - | - | - | 176,097 | - | - | 176,097 | 176,097 |
| 10 | Exposures in default | - | - | - | - | - | - | - | - |
| 14 | Collective investment undertakings | - | - | - | - | 1,411,459 | - | 1,411,459 | 1,411,459 |
| 15 | Equity | - | - | - | - | 72,660 | - | 72,660 | 72,660 |
| 16 | Other items | 3,399,686 | - | - | - | 13,772,623 | 1,528,379 | 18,700,688 | 17,704,919 |
| 17 | Total | 709,192,140 | 189,661,498 | 63,209,491 | 176,097 | 40,568,983 | 1,528,379 | 1,004,336,588 | 45,989,096 |

### 5.1 COUNTERPARTY CREDIT RISK

The Bank calculates its capital requirement for CCR using the Original Exposure Method as outlined in Section 5 of Chapter 6 of Title II of Part Three of the CRR. Article 273a(2) of the CRR states that an institution may calculate the exposure value of its derivative positions in accordance with the method set out in Section 5 (that is the Original Exposure Method), provided that the size of its on and off balance sheet derivative business is equal to or less than both of the following thresholds on the basis of an assessment carried out on a monthly basis using the data as of the last day of the month:

- 5% of the institution's total assets; and
- EUR100million

Both of these thresholds were met during the entire financial year ending 31 December 2021, meaning that the Bank continued to use the OEM to calculate the exposure value to CCR.

The table below presents an analysis of the Bank's CCR exposure and resulting risk weighted exposure amount. Given that the Bank only uses the Original Exposure Method, rows EU-2 to 5 as presented in the illustrative template have been excluded from the table displayed below. Furthermore, since the exposure to CCR arises from the activities performed by the Bank, the table below is applicable on both a Bank and Group level.

EU CCR1 - Analysis of CCR exposure by approach

Individual & Consolidated

| | | Replacement cost (RC) | Potential future credit exposure (PFE) | EEPE | Alpha used for computing regulatory exposure value | Exposure value pre-CRM | Exposure value post-CRM | Exposure value | RWEA |
|---|---|---|---|---|---|---|---|---|---|
| EU-1 | EU - Original Exposure Method (for derivatives) | 1,718,938 | 10,413,460 | | 1.4 | 16,985,358 | 16,985,358 | 16,985,358 | 10,424,122 |
| 6 | Total | 1,718,938 | 10,413,460 | | 1.4 | 16,985,358 | 16,985,358 | 16,985,358 | 10,424,122 |

## 6. MARKET RISK

As explained in Section 3 of this document, the Bank considers as material risk exposures foreign exchange risk and CVA risk. In light of this, it allocates the required capital requirement for both of these risks, as described in the following sections.

### 6.1 FOREIGN EXCHANGE RISK CAPITAL REQUIREMENT

In line with CRR, the Bank provides a Pillar 1 capital requirement for foreign exchange risk, which requirement is calculated using the standardised approach. The table below summarises the total risk weighted assets for foreign exchange risk and market risk for the Bank and the Group as at 31 December 2021. Given that the parent company operates only in Euro, no foreign exchange risk arises from transactions performed at holding level, meaning that the capital requirement on an individual and consolidated basis is identical. It is to be noted that since the Bank's exposure to interest rate risk, commodity risk and equity risk is immaterial and the Bank does not engage in options, no Pillar 1 requirement was provided in this respect during 2021 and therefore rows 1, 2 and 4 to 8 of the illustrative template were excluded from the below disclosure.

EU MR1: Market risk under the standardised approach

Individual & Consolidated

| | | RWEAs |
|---|---|---|
| | Outright products | |
| 3 | Foreign exchange risk | - |
| 9 | Total | - |

As per Article 351 of the CRR, an institution shall calculate an own funds requirement for foreign exchange risk if its overall net foreign-exchange position exceeds 2% of its own funds. As per the table below, given that the net foreign exchange position for the Bank and the Group did amounted to less than 2% of the respective own funds, no own funds requirement was required to be allocated in this respect.

| | Bank | Group |
|---|---|---|
| Total Own funds as at 31.12.2021 | 44,061,752 | 45,222,229 |
| Overall Net Foreign-Exchange Position | 826,064 | 826,064 |
| % of own funds | 1.87% | 1.83% |

### 6.2 CREDIT VALUATION ADJUSTMENT

The Bank calculates its own funds requirement for CVA risk using the Standardised Method as outlined in Article 384 of the CRR. In light of this, rows 1 to 3 and EU-4 have been excluded from the illustrative disclosure. As explained earlier, this risk was included in the Bank's risk universe following the submission of the ICAAP document for reference year ending 31 December 2020, in May 2021. Therefore, no such requirement was allocated for the previous year ending 31 December 2020. Given that CVA risk arises only from transactions performed by the Bank, the disclosure illustrated below is applicable on both an individual and consolidated basis.

EU CCR2 - Transactions subject to own funds requirements for CVA risk

Individual & Consolidated

| | | Exposure Value | RWEA |
|---|---|---|---|
| 4 | Transactions subject to the Standardised method | 16,985,358 | 144,598 |
| 5 | Total transactions subject to own funds requirements for CVA risk | 16,985,358 | 144,598 |

## 7. OPERATIONAL RISK

The Bank uses the Basic Indicator Approach to measure the own funds requirement for operational risk, which method allocates a capital requirement equal to 15% of the average over three years of the relevant indicator, as defined in Article 316 of the CRR. The tables below illustrate the Bank's and the Group's operational risk capital requirement for the year ended 31 December 2021. The figures below are based on audited figures at the end of 2021, 2020 and 2019, respectively.

EU OR1 - Operational risk own funds requirements and risk-weighted exposure amounts

Individual

| Banking activities | | Relevant indicator | | | Own funds requirements | Risk-weighted exposure amount |
|---|---|---|---|---|---|---|
| | | Year-3 | Year-2 | Year-1 | | |
| 1 | Banking activities subject to basic indicator approach (BIA) | 13,325,074 | 10,441,362 | 11,925,546 | 1,784,599 | 22,307,489 |

Consolidated

| Banking activities | | Relevant indicator | | | Own funds requirements | Risk-weighted exposure amount |
|---|---|---|---|---|---|---|
| | | Year-3 | Year-2 | Year-1 | | |
| 1 | Banking activities subject to basic indicator approach (BIA) | 13,325,207 | 10,441,502 | 11,925,546 | 1,784,613 | 22,307,660 |

As stated earlier, since the Bank uses the Basic Indicator Approach to calculate the operational risk capital requirement, rows 2 to 5 as per the illustrative template have been excluded from the above tables.

Following the SREP review performed by the MFSA for reference year ending 31 December 2020, the Authority imposed a 5% Pillar 2 capital requirement aimed at providing additional capital to cover the Bank's operational risk exposure. As outlined earlier, the Bank performs its own Pillar 2 assessment for operational risk and compares the resulting requirement with the 5% Pillar 2 requirement imposed by the MFSA. To date, there were no instances whereby the requirement estimated by the Bank exceeded that imposed by the MFSA.

## 8. LEVERAGE

The CRR requires institutions to control the risk of excessive leverage by requiring them to hold a leverage ratio of at least 3%. The tables below illustrate the computation of the Bank's and the Group's leverage ratios for the current and previous financial years.

EU LR2 - LRCom: Leverage ratio common disclosure

Individual

| | | CRR leverage ratio exposures | |
|---|---|---|---|
| | | 2021 | 2020 |
| | **On-balance sheet exposures (excluding derivatives and SFTs)** | | |
| 1 | On-balance sheet items (excluding derivatives and SFTs) | 981,242,538 | 876,553,270 |
| 7 | **Total on-balance sheet exposures (excluding derivatives and SFTs)** | 981,242,538 | 876,553,270 |
| | **Derivative exposures** | | |
| EU-9b | Exposure determined under the Original Exposure Method | 16,985,358 | - |
| 13 | **Total derivatives exposures** | 16,985,358 | - |
| | **Other off-balance sheet exposures** | | |
| 19 | Off-balance sheet exposures at gross notional amount | 24,509,902 | 24,066,182 |
| 20 | (Adjustments for conversion to credit equivalent amount) | (19,607,817) | (19,251,215) |
| 21 | (General provisions deducted in determining Tier 1 capital and specific provisions associated with off-balance sheet exposures) | (130) | (2,163) |
| 22 | **Off-balance sheet exposures** | 4,901,954 | 4,812,804 |
| | **Capital and total exposure measure** | | |
| 23 | Tier 1 capital | 44,061,752 | 37,965,783 |
| 24 | Total exposure measure | 1,003,129,850 | 881,366,073 |
| | **Leverage ratio** | | |
| 25 | Leverage ratio (%) | 4.3924% | 4.3076% |
| 25a | Leverage ratio (excluding the impact of any applicable temporary exemption of central bank reserves) (%) | 4.3924% | 4.3076% |
| 26 | Regulatory minimum leverage ratio requirement (%) | 3.0000% | 3.0000% |
| EU-26a | Additional own funds requirement to address the risk of excessive leverage (%) | 0.0000% | 0.0000% |
| EU-26b | Of which: to be made up of CET 1 capital | 0.0000% | 0.0000% |
| 27 | Leverage ratio buffer requirement (%) | 0.0000% | 0.0000% |
| EU-27a | Overall leverage ratio buffer requirement (%) | 3.0000% | 3.0000% |
| | **Choice on transitional arrangements and relevant exposures** | | |
| EU-27b | Choice on transitional arrangements for the definition of the capital measure | Fully-phased in | Fully-phased in |
| | **Disclosure of mean values** | | |
| 30 | Total exposure measure (including the impact of applicable temporary exclusion of central bank reserves) incorporating mean values from row 28 of gross SFT assets (after adjustment for sale accounting transactions and netted of amounts of associated cash payables and cash receivables) | 1,003,129,850 | 881,366,073 |
| 30a | Total exposure measure (excluding the impact of applicable temporary exclusion of central bank reserves) incorporating mean values from row 28 of gross SFT assets (after adjustment for sale accounting transactions and netted of amounts of associated cash payables and cash receivables) | 1,003,129,850 | 881,366,073 |
| 31 | Leverage ratio (including the impact of applicable temporary exclusion of central bank reserves) incorporating mean values from row 28 of gross SFT assets (after adjustment for sale accounting transactions and netted of amounts of associated cash payables and cash receivables) | 4.3924% | 4.3076% |
| 31a | Leverage ratio (excluding the impact of applicable temporary exclusion of central bank reserves) incorporating mean values from row 28 of gross SFT assets (after adjustment for sale accounting transactions and netted of amounts of associated cash payables and cash receivables) | 4.3924% | 4.3076% |

Consolidated

| | | CRR leverage ratio exposures | |
|---|---|---|---|
| | | 2021 | 2020 |
| | **On-balance sheet exposures (excluding derivatives and SFTs)** | | |
| 1 | On-balance sheet items (excluding derivatives and SFTs) | 982,449,275 | 880,297,483 |
| 7 | Total on-balance sheet exposures (excluding derivatives and SFTs) | 982,449,275 | 880,297,483 |
| | **Derivative exposures** | | |
| EU-9b | Exposure determined under the Original Exposure Method | 16,985,358 | - |
| 13 | Total derivatives exposures | 16,985,358 | - |
| | **Other off-balance sheet exposures** | | |
| 19 | Off-balance sheet exposures at gross notional amount | 24,509,902 | 24,066,182 |
| 20 | (Adjustments for conversion to credit equivalent amount) | (19,607,817) | (19,251,215) |
| 21 | (General provisions deducted in determining Tier 1 capital and specific provisions associated with off-balance sheet exposures) | (130) | (2,163) |
| 22 | Off-balance sheet exposures | 4,901,954 | 4,812,804 |
| | **Capital and total exposure measure** | | |
| 23 | Tier 1 capital | 45,222,229 | 41,635,036 |
| 24 | Total exposure measure | 1,004,336,588 | 885,110,286 |
| | **Leverage ratio** | | |
| 25 | Leverage ratio (%) | 4.5027% | 4.7039% |
| 25a | Leverage ratio (excluding the impact of any applicable temporary exemption of central bank reserves) (%) | 4.5027% | 4.7039% |
| 26 | Regulatory minimum leverage ratio requirement (%) | 3.0000% | 3.0000% |
| EU-26a | Additional own funds requirement to address the risk of excessive leverage (%) | 0.0000% | 0.0000% |
| EU-26b | Of which: to be made up of CET 1 capital | 0.0000% | 0.0000% |
| 27 | Leverage ratio buffer requirement (%) | 0.0000% | 0.0000% |
| EU-27a | Overall leverage ratio buffer requirement (%) | 3.0000% | 3.0000% |
| | **Choice on transitional arrangements and relevant exposures** | | |
| EU-27b | Choice on transitional arrangements for the definition of the capital measure | Fully-phased in | Fully-phased in |
| | **Disclosure of mean values** | | |
| 30 | Total exposure measure (including the impact of applicable temporary exclusion of central bank reserves) incorporating mean values from row 28 of gross SFT assets (after adjustment for sale accounting transactions and netted of amounts of associated cash payables and cash receivables) | 1,004,336,588 | 885,110,286 |
| 30a | Total exposure measure (excluding the impact of applicable temporary exclusion of central bank reserves) incorporating mean values from row 28 of gross SFT assets (after adjustment for sale accounting transactions and netted of amounts of associated cash payables and cash receivables) | 1,004,336,588 | 885,110,286 |
| 31 | Leverage ratio (including the impact of applicable temporary exclusion of central bank reserves) incorporating mean values from row 28 of gross SFT assets (after adjustment for sale accounting transactions and netted of amounts of associated cash payables and cash receivables) | 4.5027% | 4.7039% |
| 31a | Leverage ratio (excluding the impact of applicable temporary exclusion of central bank reserves) incorporating mean values from row 28 of gross SFT assets (after adjustment for sale accounting transactions and netted of amounts of associated cash payables and cash receivables) | 4.5027% | 4.7039% |

The first section of the tables below present the on-balance sheet exposures forming part of the total exposure measure. In this respect, rows 2 to 6 have been excluded from the illustrative template given that these items are not applicable for the Bank nor for the Group. With respect to derivative exposures, as explained earlier, the Bank uses the Original Exposure Method to calculate the exposure value of its derivative transactions. As a result, rows 8 to EU-9a and rows 10 to 12 as per the illustrative template have been excluded. Furthermore, the Bank does not engage in securities financing transactions subject to CCR, meaning that rows 14 to 18 and 28 to 29 in the illustrative disclosure are not applicable to the Bank's and the Group's leverage ratio computation and thus have been excluded from the EU LR2 tables above. The CRR allows institutions to make a number of exclusions from their total exposure measure. During financial years ending 2021 and 2020, the Bank did not elect to make any such exclusions and therefore rows EU-22a to EU-22k as per the illustrative template have been omitted.

With respect to the computation of the leverage ratio, the Group does not have any public sector investments and promotional loans. Therefore, row EU-25 is not applicable and has been excluded from this disclosure.

The tables below provide a reconciliation between the Bank's and the Group's total assets as included in the Annual Report and the leverage ratio exposure measure as per row 24 of the tables above. As outlined below, the total exposure measure is equal to the total assets adjusted for derivative financial instruments and off-balance sheet items. Derivative financial instruments include the counterparty credit risk exposure for foreign exchange forward contracts entered into by the Bank, calculated using the Original Exposure Method. Off-balance sheet items include unutilised credit lines granted to customers, following the application of a 20% credit conversion factor. All specific provisions have already been deducted from the carrying amounts of the related assets and off-balance sheet items and are therefore not a source of difference between total assets as per the balance sheet and the total exposure measure. Given that these two items are the sole sources of differentiation, rows 2 to 7, 9 and 11 to 12, as per the illustrative disclosure, have been excluded from the tables presented below.

EU LR1 - LRSum: Summary reconciliation of accounting assets and leverage ratio exposures

Individual

| | | Applicable amount |
|---|---|---|
| 1 | Total assets as per published financial statements | 981,242,538 |
| 8 | Adjustment for derivative financial instruments | 16,985,358 |
| 10 | Adjustment for off-balance sheet items (ie conversion to credit equivalent amounts of off-balance sheet exposures) | 4,901,954 |
| **13** | **Total exposure measure** | **1,003,129,850** |

Consolidated

| | | Applicable amount |
|---|---|---|
| 1 | Total assets as per published financial statements | 982,449,275 |
| 8 | Adjustment for derivative financial instruments | 16,985,358 |
| 10 | Adjustment for off-balance sheet items (ie conversion to credit equivalent amounts of off-balance sheet exposures) | 4,901,954 |
| **13** | **Total exposure measure** | **1,004,336,588** |

# 9. KEY METRICS

The tables below summarise the key regulatory metrics for the Bank and the Group as at the end of the current and previous financial years ending 31 December 2021 and 2020. The Bank is classified as an 'Other Institution' in terms of the CRR. This is because the Bank (and the Group) do not meet the definition of a large institution as defined in Article 2 point (146) of the CRR. In addition, in a communication dated 20 July 2020, the MFSA had confirmed that the Bank should not be classified as a small and non-complex institution. In light of this, pursuant to Article 433c of the CRR, the Bank and the Group shall disclose the information as per Part Eight of the CRR on an annual basis, applying also the derogation for non-listed institutions as per Article 433c(2) CRR.

Key metrics template

Individual

| | | 2021 | 2020 |
|---|---|---|---|
| | **Available own funds (amounts)** | | |
| 1 | Common Equity Tier 1 (CET1) capital | 44,061,752 | 37,965,783 |
| 2 | Tier 1 capital | 44,061,752 | 37,965,783 |
| 3 | **Total capital** | **44,061,752** | **37,965,783** |
| | **Risk-weighted exposure amounts** | | |
| 4 | Total risk exposure amount | 135,473,172 | 141,505,459 |
| | **Capital ratios (as a percentage of risk weighted exposure amount)** | | |
| 5 | Common Equity Tier 1 ratio (%) | 32.5243% | 26.8299% |
| 6 | Tier 1 ratio (%) | 32.5243% | 26.8299% |
| 7 | **Total capital ratio (%)** | **32.5243%** | **26.8299%** |
| | **Additional own funds requirements to address risks other than the risk of excessive leverage (as percentage of risk-weighted exposure amount)** | | |
| EU 7a | Additional own funds requirements to address risks other than the risk of excessive leverage (%) | 5.0000% | 0.0000% |
| *EU 7b* | *of which: to be made up to CET 1 capital (percentage points)* | *2.8125%* | *0.0000%* |
| *EU 7c* | *of which: to be made up to Tier 1 capital (percentage points)* | *3.7500%* | *0.0000%* |
| **EU 7d** | **Total SREP own funds requirements (%)** | **13.0000%** | **8.0000%** |
| | **Combined buffer and overall capital requirement (as a percentage of risk-weighted exposure amount)** | | |
| 8 | Capital conservation buffer (%) | 2.5000% | 2.5000% |
| EU8a | Conservation buffer due to macro-prudential or systemic risk identified at the leve of a Member State (%) | 0.0000% | 0.0000% |
| 9 | Institution specific countercyclical capital buffer (%) | 0.0135% | 0.0113% |
| EU 9a | Systemic risk buffer (%) | 0.0000% | 0.0000% |
| 10 | Global Systematically Important Institution buffer (%) | 0.0000% | 0.0000% |
| EU 10a | Other Systematically Important Institution buffer (%) | 0.0000% | 0.0000% |
| **11** | **Combined buffer requirement (%)** | **2.5135%** | **2.5113%** |
| **EU 11a** | **Overall capital requirements (%)** | **15.5135%** | **10.5113%** |
| **12** | **CET 1 available after meeting the total SREP own funds requirements (%)** | **17.0109%** | **16.3186%** |
| | **Leverage ratio** | | |
| 13 | Total exposure measure | 1,003,129,850 | 881,366,073 |
| 14 | Leverage ratio (%) | 4.3924% | 4.3076% |
| | **Additional own funds requirements to address the risk of excessive leverage (as a percentage of total exposure measure)** | | |
| EU 14a | Additional own funds requirements to address the risk of excessive leverage (%) | 0.0000% | 0.0000% |
| *EU 14b* | *of which: to be made up of CET 1 capital (percentage points)* | *0.0000%* | *0.0000%* |
| **EU 14c** | **Total SREP leverage ratio requirements (%)** | **3.0000%** | **3.0000%** |
| | **Leverage ratio buffer and overall leverage ratio requirement (as a percentage of total exposure measure)** | | |
| EU 14d | Leverage ratio buffer requirement (%) | 0.0000% | 0.0000% |
| **EU 14e** | **Overall leverage ratio requirement (%)** | **3.0000%** | **3.0000%** |
| | **Liquidity Coverage Ratio** | | |
| 15 | Total high-quality liquid assets (HQLA) (weighted value - average) | 769,428,302 | 640,006,386 |
| EU 16a | Cash outflows - Total weighted value | 231,721,654 | 191,011,075 |
| EU 16b | Cash inflows - Total weighted value | 11,208,418 | 25,720,267 |
| 16 | Total net cash outflows (adjusted value) | 220,513,237 | 165,290,808 |
| **17** | **Liquidity coverage ratio (%)** | **348.9261%** | **387.2002%** |
| | **Net Stable Funding Ratio** | | |
| 18 | Total available stable funding | 522,951,441.46 | 473,329,910.94 |
| 19 | Total required stable funding | 103,764,502.42 | 107,420,941.70 |
| **20** | **NSFR ratio (%)** | **503.9791%** | **440.6309%** |

As illustrated in the above table, the Bank's own funds increased by circa EUR8million during 2021. This increase is firstly attributable to the increase in share capital of EUR3.2million, pursuant to a capital injection by the Holding company. During the year, the Bank also issued bonus shares amounting to EUR3million, which however resulted in a nil impact on the Bank's own funds, as the bonus share issue was distributed from retained earnings. A second factor contributing to the increase in own funds is the increase in the property revaluation reserve following a revaluation exercise conducted during July 2021. Finally, the Bank's own funds also increased by the amount of profits generated during the year.

The increase in the Bank's own funds coupled with the decrease in the risk weighted assets, resulted in the Bank's capital adequacy ratio to increase from 26.8% in 2020 to 32.5% in 2021. Risk weighted assets decreased primarily as a result of a decrease in the Bank's credit risk weighted assets, as the Bank took actions to decrease its exposure towards other credit institutions and foreign currency denominated balances held with the Central Bank of Malta.

The overall capital requirement also increased during 2021 primarily as a result of the 5% Pillar 2 capital requirement imposed by the MFSA during 2021, presented in row EU 7a. Despite the increase in the overall capital requirement, the Bank's total capital ratio continues to be well above the said requirement, with the excess increasing to 17.0% as of 31 December 2021.

Similarly to the capital ratio, the Bank's leverage ratio increased during 2021, owing to the percentage increase in the Bank's own funds exceeding the percentage increase in the leverage exposure measure. . The leverage exposure measure has increased as a result of an increase in the balance sheet size by 12%, coupled with the introduction of the exposure measure for derivatives, which as at 31 December 2021 amounted to circa EUR17million.

Finally, as illustrated by the Bank's LCR and NSFR ratios, the Bank continues to preserve its healthy liquidity position, with an average LCR ratio of 348.9% and an NSFR ratio of 504.0%, as of the end of December 2021. Both of these ratios are well in excess of the 100% regulatory requirement.

Consolidated

| | | 2021 | 2020 |
|---|---|---|---|
| | **Available own funds (amounts)** | | |
| 1 | Common Equity Tier 1 (CET1) capital | 45,222,229 | 41,635,036 |
| 2 | Tier 1 capital | 45,222,229 | 41,635,036 |
| **3** | **Total capital** | **45,222,229** | **41,635,036** |
| | **Risk-weighted exposure amounts** | | |
| 4 | Total risk exposure amount | 136,511,306 | 143,781,756 |
| | **Capital ratios (as a percentage of risk weighted exposure amount)** | | |
| 5 | Common Equity Tier 1 ratio (%) | 33.3809% | 28.9571% |
| 6 | Tier 1 ratio (%) | 33.3809% | 28.9571% |
| **7** | **Total capital ratio (%)** | **33.3809%** | **28.9571%** |
| | **Additional own funds requirements to address risks other than the risk of excessive leverage (as percentage of risk-weighted exposure amount)** | | |
| EU 7a | Additional own funds requirements to address risks other than the risk of excessive leverage (%) | 5.0000% | 0.0000% |
| *EU 7b* | *of which: to be made up to CET 1 capital (percentage points)* | *2.8125%* | *0.0000%* |
| *EU 7c* | *of which: to be made up to Tier 1 capital (percentage points)* | *3.7500%* | *0.0000%* |
| **EU 7d** | **Total SREP own funds requirements (%)** | **13.0000%** | **8.0000%** |
| | **Combined buffer and overall capital requirement (as a percentage of risk-weighted exposure amount)** | | |
| 8 | Capital conservation buffer (%) | 2.5000% | 2.5000% |
| EU8a | Conservation buffer due to macro-prudential or systemic risk identified at the leve of a Member State (%) | 0.0000% | 0.0000% |
| 9 | Institution specific countercyclical capital buffer (%) | 0.0132% | 0.0109% |
| EU 9a | Systemic risk buffer (%) | 0.0000% | 0.0000% |
| 10 | Global Systematically Important Institution buffer (%) | 0.0000% | 0.0000% |
| EU 10a | Other Systematically Important Institution buffer (%) | 0.0000% | 0.0000% |
| **11** | **Combined buffer requirement (%)** | **2.5132%** | **2.5109%** |
| **EU 11a** | **Overall capital requirements (%)** | **15.5132%** | **10.5109%** |
| **12** | **CET 1 available after meeting the total SREP own funds requirements (%)** | **17.8677%** | **18.4462%** |
| | **Leverage ratio** | | |
| 13 | Total exposure measure | 1,004,336,588 | 885,110,286 |
| 14 | Leverage ratio (%) | 4.5027% | 4.7039% |
| | **Additional own funds requirements to address the risk of excessive leverage (as a percentage of total exposure measure)** | | |
| EU 14a | Additional own funds requirements to address the risk of excessive leverage (%) | 0.0000% | 0.0000% |
| *EU 14b* | *of which: to be made up of CET 1 capital (percentage points)* | *0.0000%* | *0.0000%* |
| **EU 14c** | **Total SREP leverage ratio requirements (%)** | **3.0000%** | **3.0000%** |
| | **Leverage ratio buffer and overall leverage ratio requirement (as a percentage of total exposure measure)** | | |
| EU 14d | Leverage ratio buffer requirement (%) | 0.0000% | 0.0000% |
| **EU 14e** | **Overall leverage ratio requirement (%)** | **3.0000%** | **3.0000%** |
| | **Liquidity Coverage Ratio** | | |
| 15 | Total high-quality liquid assets (HQLA) (weighted value - average) | 769,428,302 | 640,006,386 |
| EU 16a | Cash outflows - Total weighted value | 231,721,654 | 191,011,075 |
| EU 16b | Cash inflows - Total weighted value | 11,437,467 | 26,089,117 |
| 16 | Total net cash outflows (adjusted value) | 220,284,187 | 164,921,958 |
| **17** | **Liquidity coverage ratio (%)** | **349.2889%** | **388.0662%** |
| | **Net Stable Funding Ratio** | | |
| 18 | Total available stable funding | 524,111,919 | 476,999,164 |
| 19 | Total required stable funding | 104,283,484 | 110,243,021 |
| **20** | **NSFR ratio (%)** | **502.5838%** | **432.6797%** |

On a consolidated basis, the Group's own funds also increased during 2021, with the increase being attributable to the increase in the property revaluation reserve (as explained in the case of the Bank's own funds), as well as an increase in retained earnings brought about by the profits generated during the year. As explained in the previous section, the increase in own funds coupled with the decrease in risk weighted assets, resulted in the Group's capital ratio to increase from 29.0% in 2020 to 33.4% in 2021.

The overall capital requirement for the Group is equivalent to that applicable for the Bank on a solo basis. On a consolidated basis, the Group continues to register a significant excess over its overall capital requirement, amounting to 17.9% by the end of 2021.

On the contrary to the Bank's leverage ratio, the Group's leverage ratio registered a slight decrease in 2021, owing to the fact that the percentage increase in the Group's leverage exposure measure exceeded the percentage increase in the Group's own funds. Despite this slight decrease, the Group's leverage ratio remains well above the 3% regulatory requirement.

Finally, as in the case of the individual basis, the Group's liquidity ratios continue to be well above the 100% regulatory requirement.

## 10. REMUNERATION POLICY

### 10.1 GOVERNANCE

Being a 'less significant institution', the Bank is not required to set up a Remuneration Committee. The Bank has decided not to set up such Committee and therefor the functions of such Committee remain vested in the Board of Directors. The composition of the Board of Directors is set out in the Directors' Report.

The Bank did not engage external consultants to advise on the remuneration framework.

The Bank's current remuneration policy, applicable as at year-end 2021, is based on the following legal and regulatory requirements:

- Articles 92 to 94 of Directive 2013/36/EU (the Capital Requirements Directive)
- Banking Rule 21 '*Remuneration policies and practices*' (BR/21/2019)
- Commission Delegated Regulation (EU) 2021/93 of 25th March 2021, supplementing Directive 2013/36/EU
- Article 5 of Regulation (EU) 2019/2088 of the European Parliament and of the Council, of 27th November 2019 on sustainability-related disclosures in the financial services sector

The remuneration policy is set, approved and its implementation overseen by the Board of Directors. During 2021, the Board of Directors reviewed the remuneration policy at the December 2021 Board meeting. The remuneration policy is applicable to the Bank as a whole, including the Bank's branch in Ireland.

The remuneration policy is reviewed annually. The last review was performed in December 2021 with the main changes including (i) amendments related new rules on identification of material risk takers (also referred to as identified staff in the remuneration policy) and integration of sustainability risks, in view of new legislation in these areas, (ii) updates regarding the creation of a Risk Committee (temporarily combined with the Audit Committee) and its role, because of organisational changes, and (iii) amendments to the pay-out mechanism for the savings plan, to clarify and allow for pro rata pay-outs. The said changes are not expected to have a material impact on remuneration of the Bank's staff overall.

Remuneration of Directors, in particular in the form of directors' fees, is subject to approval by the shareholders in general meeting, on recommendation by the Board of Directors, in accordance with the Bank's memorandum and articles of association.

The Board of Directors oversees the remuneration of the members of senior management and the heads of the internal control functions, including the risk management and compliance functions, and ensures the proper involvement of the internal control and other relevant functions within the Bank, notably the compliance function, risk management function and internal audit. The Managing Director, with the support of the HR Department, is responsible for the implementation of the Bank's Remuneration Policy and determines the remuneration of members of staff other than Senior Management.

The Bank's internal control functions also play a role in the review of the remuneration policy. Firstly, the Head of Compliance analyses the Bank's compliance with applicable legislations, regulations, internal policies and risk culture, both in drafting the text of the policy and in its implementation. Secondly, the Risk Management function assists in the definition of suitable risk adjusted performance measures, as well as in assessing how the variable remuneration structure affects the Bank's risk profile and culture. Finally, the internal audit function carries out an independent review of the design, implementation and effects of the Bank's remuneration policy on its risk profile and the way these effects are managed, in accordance with the internal audit plan.

### 10.2 REMUNERATION SYSTEM

The Bank's remuneration strategy is designed to competitively reward the achievement of long-term sustainable performance by identifying and rewarding competence and loyalty. Sustainable performance can be achieved by attracting and motivating the very best people who are committed to maintaining a long-term career with the Bank and performing their role in the long-term interests of the Bank and its stakeholders.

The Board aims to ensure that the level of remuneration is aligned to the market and above all its business strategy. Performance, although of utmost importance, should not only be judged on what is achieved over the short and long-term, but also on how this is achieved. The Bank takes the view that the latter contributes to the long-term sustainability of the business.

The Bank's remuneration system is designed on the following basic principles and components:

- Fixed pay (that is salaries payable to all employees) which primarily reflects relevant professional experience and organisational responsibility;
- Allowances and benefits (as applicable);
- Savings plan, awarded to the Bank's identified and eligible staff;
- Annual performance bonus, payable to all employees upon the achievement of the Bank's pre-set performance targets, described in more detail in the subsequent sections of this report; and
- Deferred variable remuneration, awarded to the Bank's identified staff and eligible staff who are admitted as members to this scheme

Identified staff refers to staff whose professional activities have or may have a material impact on the Bank's risk profile. In identifying such staff, the Bank performs a self-assessment based on the qualitative and quantitative criteria set out in Commission Delegated Regulation (EU) 2021/93. The outcome of this assessment is included in the Bank's remuneration policy.

Performance related variable remuneration reflects and supports a sustainable and risk adjusted performance. As a general rule, the variable component of total remuneration per annum, shall not exceed, for each individual, 100% of fixed remuneration or EUR100,000, whichever is the lower.

All variable remuneration awarded by the Bank to its staff is payable exclusively in cash. This is in line with the MFSA Circular regarding Variable Remuneration issued on 10th November 2015, which provided for a derogation from the requirements for variable remuneration imposed by paragraphs (l) and (m) of Article 94 of CRD. The said MFSA Circular provided that the provisions in CRD relating to variable pay in instruments and deferral rule, as referred to in paragraphs (l) and (m) of Article 94 of CRD, are to fully apply if an individual staff member is remunerated with a variable pay of more than €100,000, or for lower values where variable pay is more than 100% of the fixed pay of the individual concerned. The Bank did not pay variable remuneration of more than €100,000 or more than 100% of the fixed pay of any staff member in 2021. .

The derogation laid down in Article 94(3) CRD was transposed into Maltese law by BR/21/2022 Remuneration Policies and Practices (paragraph 20), issued on 7th January 2022, i.e. after the Bank's accounting period ended 31st December 2021. Given that this derogation was not implemented in Malta in 2021, the Bank relied on the derogation provided for by the MFSA Circular mentioned above rather than the derogation laid down in Article 94(3) CRD. However, the Bank would be able to rely on the latter derogation in particular on the basis of Article 94(3)(a) CRD, as the Bank is not a 'large institution' as defined in point (146) of Article 4(1) CRR and the value of its assets is on average and on an individual basis in accordance with CRD and CRR less than EUR 5 billion over the four-year period immediately preceding the financial year.

*10.2.1 Annual performance bonus*

The annual performance bonus, which as stated earlier, can be awarded to all Bank staff, is linked to the achievement of the annual performance target as determined by the Board of Directors for every financial year and manifested in the Bank's budgets as approved by the Board. The annual bonus pool is determined upon the achievement of the Bank's performance target, following which the annual performance bonus for each Bank employee can be awarded and paid out. Apart from the Bank's performance in general (which determines the size of the annual bonus pool), the performance of each employee and the department of which that employee forms part, also play a role in setting the annual performance bonus. The bonus payable to each employee is limited in size and complexity and is subject to a maximum limit, expressed as a coefficient of the monthly salary and which cannot exceed 200% of an employee's monthly salary.

*10.2.2 Deferred remuneration scheme*

This scheme serves to reward and incentivise sustainable long-term service, talent and performance of key personnel at the Bank. This is achieved through financial reward in the form of deferred bonuses, the provision of which is catered for through a scheme funded through annual profits. Awards to the scheme may be reduced or reversed individually or collectively, for instance as *ex post* risk adjustments or as a recovery measure in line with the Bank's Recovery Plan.

Eligibility for participating in the scheme is limited to the Bank's identified staff as defined earlier in this report. Admission to this scheme is not automatic upon one being classified as 'identified staff', but is determined by the Board of Directors, on recommendation from the Managing Director. Such recommendation is made at the end of each financial year for participation in the scheme from the following year.

Funds are allocated to this scheme upon the attainment of the Bank's pre-set targets which are based on Return on Equity and the Capital Adequacy Ratio. Once it is determined that the pre-defined targets have been met, funds are allocated to the scheme from profits for the year under review, which funds are paid to the members of the scheme in three equal instalments payable in the current financial year and the subsequent two financial years. The deferred bonus allocations awarded to each member of the scheme are expressed as a percentage of the fixed annual salary of the said member, determined by the Managing Director. In case of Senior Management, the allocation awarded is also subject to approval from the Board of Directors.

The Bank's remuneration system is designed to ensure that everyone within the Bank works towards the same goal, while avoiding departments taking excessive risks or pursuing objectives which are in conflict with the Bank's business strategy, with the aim of securing higher remuneration. Staff involved in internal control functions are entitled to the same types of fixed and variable remuneration as other staff in the relevant category, including ''identified staff'', but assessment of their performance takes into account the nature of the function and its objectives. Furthermore, the remuneration of identified staff, being those who have a material impact on the Bank's risk profile, is partly dependent on performance targets based on the Bank's Capital Adequacy Ratio, which reflects the Bank's primary risk exposures.

*10.2.3 Malus and clawback arrangements*

Deferred remuneration awarded under the Deferred Remuneration Scheme may be subject to malus arrangements in that deferred remuneration which was awarded in previous periods but has not yet vested (and hence not paid out) could be restricted if the Bank is in a recovery situation or experiencing deteriorated or negative financial earnings.

The Bank reserves the right, without prejudice to the general principles of civil and employment law, to reclaim variable remuneration paid out to identified or eligible staff in the previous five years, if one of the following events occurs which require a performance or risk adjustment based on back testing:

- Fraudulent activity of the employee during the performance period;
- Dismissal for serious cause;
- Evidence of a severe misbehaviour or a breach of duty;
- Untruthful information provided by the employee, which information could have consequences on previous performance evaluations; or
- Severe lack of personal reliability and integrity.

### 10.3 REMUNERATION AWARDED DURING THE FINANCIAL YEAR

The table below provides a breakdown of the total remuneration awarded during the financial year to the Bank's Board of Directors (the Management body) and other identified staff. As explained in the earlier sections, fixed remuneration refers to salaries payable as well as allocations to employees' savings plans while variable remuneration includes annual performance bonuses and amounts awarded under the Deferred Remuneration scheme. Given that the Bank's holding company, Sparkasse (Holdings) Malta Ltd, does not employ any staff, the consolidated figures defer from the individual figures by the amount payable to the holding company's directors, all of which consists of fixed remuneration payable in cash. Such directors' fees are payable upon signing of the Annual Report, meaning that the entire amounts are deferred to the following financial year.

#### EU REM1 - Remuneration awarded during the financial year

Individual

| | | | MB Supervisory function | MB Management function | Other identified staff |
|---|---|---|---|---|---|
| 1 | Fixed remuneration | Number of identified staff | 5.00 | 1.00 | 12.00 |
| 2 | | Total fixed remuneration | 198,333.46 | 275,000.00 | 964,617.04 |
| 3 | | Of which: cash-based | 198,333.46 | 240,000.00 | 894,092.08 |
| 7 | | Of which: other forms | - | 35,000.00 | 70,524.96 |
| 9 | Variable remuneration | Number of identified staff | 1.00 | 1.00 | 12.00 |
| 10 | | Total variable remuneration | 50,000.00 | 69,515.91 | 232,014.12 |
| 11 | | Of which: cash-based | 50,000.00 | 69,515.91 | 232,014.12 |
| 12 | | Of which: deferred | 50,000.00 | 65,000.00 | 75,000.00 |
| 17 | Total remuneration (2 + 10) | | 248,333.46 | 344,515.91 | 1,196,631.16 |

Consolidated

| | | | MB Supervisory function | MB Management function | Other identified staff |
|---|---|---|---|---|---|
| 1 | Fixed remuneration | Number of identified staff | 5.00 | 1.00 | 12.00 |
| 2 | | Total fixed remuneration | 223,333.46 | 290,000.00 | 964,617.04 |
| 3 | | Of which: cash-based | 223,333.46 | 255,000.00 | 894,092.08 |
| 7 | | Of which: other forms | - | 35,000.00 | 70,524.96 |
| 9 | Variable remuneration | Number of identified staff | 1.00 | 1.00 | 14.00 |
| 10 | | Total variable remuneration | 50,000.00 | 69,515.91 | 232,014.12 |
| 11 | | Of which: cash-based | 50,000.00 | 69,515.91 | 232,014.12 |
| 12 | | Of which: deferred | 50,000.00 | 65,000.00 | 75,000.00 |
| 17 | Total remuneration (2 + 10) | | 273,333.46 | 359,515.91 | 1,196,631.16 |

The Bank's senior management (as at 31 December 2021) is composed of the Bank's Managing Director, who in the table above is included in the second column under 'MB Management function'. Therefore, column c as per the illustrative disclosure has been excluded from this table. Also, all of the Bank's remuneration, both fixed and variable, is payable entirely in cash. Having said this, the allocation to the savings plan is not payable until the employee leaves employment(under the conditions set out in the remuneration policy) and is therefore allocated tothe 'other forms' category. In light of this, rows 4 to 6, 8 and EU-13a to 16, as per the illustrative disclosure, have been excluded from this table.

### 10.4 DEFERRED REMUNERATION

The table below provides a breakdown of the total deferred remuneration awarded and paid to the Bank's Board of Directors (the management body) and other identified staff under the Deferred Remuneration Scheme.

As outlined earlier, deferred remuneration payable by the Bank is entirely cash based. In light of this, rows 3 to 6, 9 to 11, 13 to 18 and 21 to 22 as presented in the illustrative disclosure, have been excluded from the table presented below. In addition, since senior management for the Bank, as at 31 December 2021, is only composed of the Managing Director, who is included under 'MB Management function', rows relating to 'other senior management' (that is rows 13 to 18) as presented in the illustrative disclosure, have been excluded from the table below. Finally, given that the Bank did not make any post implicit adjustments to deferred remuneration during the current financial year, nor has it awarded deferred remuneration for previous performance periods which is subject to retention periods, columns f and EU-h as presented in the illustrative disclosure, have also been excluded from the table below.

Given that SHM does not employ any staff to whom deferred remuneration is payable, the table below applies on both and individual and consolidated basis.

EU REM3 - Deferred Remuneration

Individual & Consolidated

| | Deferred and retained remuneration | Total amount of deferred remuneration awarded for previous performance periods | Of which due to vest in the financial year | Of which vesting in subsequent financial years | Amount of performance adjustment made in the financial year to deferred remuneration that was due to vest in the financial year | Amount of performance adjustment made in the financial year to deferred remuneration that was due to vest in future performance years | Total amount of deferred remuneration awarded before the financial year actually paid out in the financial year |
|---|---|---|---|---|---|---|---|
| 1 | MB Supervisory function | 136,000.00 | 73,916.67 | 62,083.33 | - | 50,000.00 | 73,916.67 |
| 2 | Cash based | *136,000.00* | *73,916.67* | *62,083.33* | - | *50,000.00* | *73,916.67* |
| 7 | MB Management function | 136,000.00 | 73,916.67 | 62,083.33 | - | 65,000.00 | 73,916.67 |
| 8 | Cash based | *136,000.00* | *73,916.67* | *62,083.33* | - | *65,000.00* | *73,916.67* |
| 19 | Other identified staff | 188,120.01 | 99,111.67 | 89,008.34 | - | 75,000.00 | 99,111.67 |
| 20 | Cash based | *188,120.01* | *99,111.67* | *89,008.34* | - | *75,000.00* | *99,111.67* |
| 25 | Total amount | 460,120.01 | 246,945.01 | 213,175.00 | - | 190,000.00 | 246,945.01 |

## 11. DECLARATIONS BY THE BOARD OF DIRECTOR AND MANAGING DIRECTOR

This Pillar 3 Disclosures document for the accounting period ended 31st December 2021, including the declarations below, were approved by the Board of Directors of Sparkasse Bank Malta public limited company (the 'Bank') on [insert date of resolution].

### 11.1 PILLAR 3 DISCLOSURES POLICY

The Bank's Board of Directors has adopted a Pillar 3 Disclosures Policy which sets out the Bank's policy to comply with the disclosure requirements laid down in Part Eight of the CRR (following the changes introduced by CRR2; commonly referred to as 'Pillar 3 disclosures'), including the roles and responsibilities of the bodies and functions involved in ensuring compliance with Pillar 3 Disclosures requirements and the principles governing the internal processes, systems and controls to verify that the Bank's disclosures are appropriate and in compliance with the said requirements.

The Bank is allowed to omit certain disclosures listed in Titles II and III of Part Eight of the CRR where the information is regarded as being non-material, proprietary of confidential in accordance with Article 432 CRR. Presently, the Bank does not apply any disclosure waivers.

The Bank's Pillar 3 Disclosures are prepared internally based on information provided by various departments and functions, under the direction of the Managing Director. The Pillar 3 disclosures are reviewed by the Bank's Risk and Audit Committee, prior to approval by the Board of Directors.

The Risk Management function is involved in the preparation of the Pillar 3 disclosures and advises on whether or not the disclosures required under Part Eight of CRR convey the Bank's risk profile comprehensively, and if not, which additional information should be disclosed. The Compliance Department is tasked with monitoring compliance with Pillar 3 Disclosures requirements and internal policies and procedures, in accordance with the compliance monitoring programme, following a risk based approach.

The Bank's internal audit function is responsible for the independent review of internal processes, systems and controls to verify that the Bank's disclosures are appropriate and in compliance with Pillar 3 Disclosures requirements, in accordance with the internal audit plan following a risk based approach.

The Pillar 3 Disclosures document is published in electronic format on the Bank's website.

The Managing Director has confirmed that the Bank has made the disclosures required under Part Eight of CRR in accordance with the Pillar 3 Disclosures Policy.

### 11.2 RISK MANAGEMENT OBJECTIVES AND POLICIES

The Bank's overall risk profile associated with the business strategy is described in Section 2 of the Pillar 3 Disclosures document. The Board of Directors declares that the Bank's risk management arrangements put in place, as explained in Section 2 of the Pillar 3 Disclosures document, are adequate with regard to the Bank's profile and strategy.

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