

CREDORAX BANK LIMITED

Annual Report and Financial Statements
31 December 2018

Company Registration Number: C46342

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Directors' report

The directors present their annual report and the audited financial statements of Credorax Bank Limited (the "Bank") for the year ended 31 December 2018.

Principal activity

The Bank's principal activity is the provision of integrated acquiring and payment processing services to merchants within the EU and two other EEC States, and is also a principal level member with Visa (Europe), MasterCard and Union Pay. During the financial year under review, the Bank continued operating as a credit institution under the Banking Act, Cap 371 of the Law of Malta, in accordance with the credit institution license granted by the Malta Financial Services Authority.

Review of the business

The Bank exceeded processing volumes of €4,130 million (2017: €3,724 million) and generated revenues of €89 million (2017: €67 million). Total net assets amounted to €34 million (2017: €28 million). The Bank's financial position is satisfactory and the directors expect that the current position will continue to improve in the future.

During 2018, the Bank changed the terms and conditions of its merchants' agreements, which prohibits the Bank from selling or pledging the funds receivable from card schemes. These receivables and related payables are no longer recognised in the statement of financial position of the Bank as they meet the requirements of a pass-through arrangement under IFRS 9 (refer to note 6).

Key performance indicators

The Board of Directors tracks the Bank's progress in implementing its strategy with a range of financial measures or key performance indicators ('KPIs'). Progress is assessed by comparison with the Bank's budgets and historical performance. The financial KPIs tracked by the Board of the Bank are presented in the following table.

	2018	2017	YOY
	€'000	€000	
Processing Values	4,130,266	3,724,713	11%
Revenues	89,393	67,493	32%
Operating profits	30,012	16,341	84%
EBITDA (before extraordinary gains)	16,174	3,686	339%
Shareholders' Equity	34,237	27,687	24%
Total Assets	110,469	135,846	-19%
CET 1 Capital Ratio *	32.4%	17.8%	82%

* The improved CET1 capital ratio is an effect of receivables from card schemes no longer being recognised in the statement of financial position as they meet the requirements of a pass-through arrangement.

The Board of Directors does not monitor any specific non-financial KPIs.

Risk management

Credorax Bank Limited faces a range of business, financial, operational and reputational risks. The directors believe that the Bank's most important risks are: (i) credit risk to the extent that the card schemes of which it is a member may chargeback credit card purchases; (ii) settlement risk whereby the Bank fails to settle with merchants due to lack of availability of funds as a result of settlement failure by the bank where merchant funds are held; and (iii) reputational risk.

Directors' report (continued)

Accordingly, the Bank adopts a robust risk management approach to understand what its risks are, how much risk is acceptable and to manage its risks. Such approach aims to create value for shareholders while meeting regulatory requirements and ensuring that stakeholders are protected without compromising integrity, ethical behaviour and transparency.

The Bank's risk management approach depends on the interaction of a number of key components, which operate together as an integrated whole including: (1) a robust risk identification and risk assessment process; (2) monitoring of the Bank's Risk Appetite Statement; (3) embedding the Bank's risk management objectives within policy documents and procedures; and (4) quantifying the residual risk to which the Bank is exposed.

Successfully embedding this risk management framework into the Bank's governance and working practices is deemed vital by the Directors to the overall effectiveness of this framework. It requires the Bank's Board, Board Committees and Senior Management to consider actively the ways in which they act and behave ensuring that risk management is a core element of the Bank's culture.

In this context, the Bank has adopted a sound corporate governance framework, which consists of three key functions: the Board, the entity-wide risk management function, and the independent assessment of risk governance that enables the Bank to create and sustain stakeholder value.

In relation to the Bank's use of financial instruments and the assessment of its assets, liabilities, financial position and financial performance, Note 2 within this set of financial statements provides for the Bank's financial risk management objectives and policies, and its exposure to credit risk, market risk, and liquidity risk.

Dividends and Reserves

At an extraordinary general meeting held on 1 August 2018, the Bank approved and paid an interim dividend of four million Euro (€4,000,000) from the Bank's profits available for distribution, to the Bank's shareholder, Credorax Inc. The directors of the Bank do not recommend the payment of a final dividend.

The directors propose that the balance of retained earnings amounting to €10,699,810 (2017: €3,612,866) be carried forward to the next financial year. After the reporting date, a dividend of €7,000,000 was proposed by the Board of Directors and distributed.

Directors

The directors of the Bank who held office during the year were:

Binyamin Nachman
Frederick Ellul
Nathan Shaked
Igal Rotem
David Blumberg
Tonio Fenech
Anthony Depasquale
Aviram Shemer
Joshua Floum
Yaron Eitan – resigned 27 July 2018

In accordance with the Bank's articles of association, all the directors remain in office until they resign or are otherwise removed from office.

Directors' report (continued)

Ultimate shareholders holding five per cent or more of the share capital of the Bank are as follows:

	31 December 2017	31 December 2018	17 April 2019
Blumberg Capital II, L.P.	15.66%	15.63%	15.59%
Israeli VC Partners, LP	10.71%	10.69%	10.66%
Blumberg Capital Opportunity Fund (CR), L.P.	10.28%	10.26%	10.24%
Binyamin Nachman	5.53%	5.52%	5.51%

Statement of directors' responsibilities for the financial statements

The directors are required by the Maltese Banking Act, 1994 and the Maltese Companies Act, 1995 to prepare financial statements that give a true and fair view of the state of affairs of the Bank as at the end of each reporting period and of the profit or loss for that period.

In preparing the financial statements, the directors are responsible for:

- ensuring that the financial statements have been drawn up in accordance with International Financial Reporting Standards as adopted by the EU;
- selecting and applying appropriate accounting policies;
- making accounting estimates that are reasonable in the circumstances; and
- ensuring that the financial statements are prepared on the going concern basis unless it is inappropriate to presume that the Bank will continue in business as a going concern.

The directors are also responsible for designing, implementing and maintaining internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and that comply with the Maltese Banking Act, 1994 and the Maltese Companies Act, 1995. They are also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

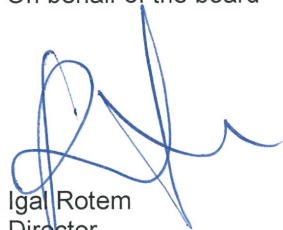
The financial statements of Credorax Bank Limited for the year ended 31 December 2018 are included in the Annual Report 2018, which is published in hard-copy printed form and will be made available on the Bank's website. The directors are responsible for the maintenance and integrity of the Annual Report on the website in view of their responsibility for the controls over, and the security of, the website. Access to information published on the Bank's website is available in other countries and jurisdictions, where legislation governing the preparation and dissemination of financial statements may differ from requirements or practice in Malta.

Directors' report (continued)

Auditors

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

On behalf of the board



Igal Rotem
Director

80, Palazzo Homedes
Strait Street
Valletta
VLT 1436

17 April 2019



Aviram Shemer
Director



Independent auditor's report

To the Shareholders of Credorax Bank Limited

Report on the audit of the financial statements

Our opinion

In our opinion:

- Credorax Bank Limited's financial statements give a true and fair view of the Bank's financial position as at 31 December 2018, and of the Bank's financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU; and
- The financial statements have been prepared in accordance with the requirements of the Maltese Banking Act (Cap. 371) and the Maltese Companies Act (Cap. 386).

Our opinion is consistent with our additional report to the Audit Committee.

What we have audited

Credorax Bank Limited's financial statements, set out on pages 14 to 67, comprise:

- the statement of financial position as at 31 December 2018;
- the statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Basis for opinion

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

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



Independent auditor's report - continued

To the Shareholders of Credorax Bank Limited

Independence

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

To the best of our knowledge and belief, we declare that non-audit services that we have provided to the Bank are in accordance with the applicable law and regulations in Malta and that we have not provided non-audit services that are prohibited under Article 18A of the Accountancy Profession Act (Cap. 281).

The non-audit services that we have provided to the Bank, in the period from 1 January 2018 to 31 December 2018, are disclosed in note 28 to the financial statements.

Our audit approach

Overview



Overall materiality: €894k, which represents 1% of total acquiring revenues.

Fee and commission income and settlement processing obligations.



Independent auditor's report - continued

To the Shareholders of Credorax Bank Limited

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

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

Materiality

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

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

Overall materiality	€894K (2017: €674K)
How we determined it	1% of total acquiring revenues
Rationale for the materiality benchmark applied	We chose total acquiring revenues as the benchmark because, in our view, it is a key financial statement metric used in assessing the performance of the Bank and is not as volatile as other profit and loss measures. We chose 1% based on our professional judgement, noting that it is also within the range of revenue related thresholds that we consider acceptable.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above €45K as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.



Independent auditor's report - continued

To the Shareholders of Credorax Bank Limited

Key audit matters

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

Key audit matter

How our audit addressed the Key audit matter

Fee and commission income and settlement processing obligations

Fee and commission income is recognised based on the nature, number and value of transactions processed and the rates agreed with merchants, while settlement processing obligations are recognised on the basis of payment volumes processed, the income attributable to the Bank as well as the settlement cycle (time taken to receive cash from card schemes, and remit it to merchants) and collateral reserves agreed by the Bank with merchants.

Payment transaction details, upon which fee and commission income and settlement processing obligations are determined, are processed through the Bank's proprietary acquiring platforms. This calculation is complex given the extent of automation and the high volume of business.

There is a risk that the systems may not be configured correctly from the outset such that revenues and settlement amounts are calculated incorrectly, that data does not correctly flow through the operational IT systems, and that unauthorised changes may be made to any of these systems, which may result in the misstatement of revenue and settlement balances.

We assessed and tested the design and operating effectiveness of the controls over the calculation of fee and commission income and settlement processing obligations. This included testing general IT controls relating to access to programs and data, program changes, program development, and computer operations in order to address the risk of unauthorised changes being made to the operation of IT application controls.

We also tested the operating effectiveness of the automated calculation of fees and commissions charged to merchants as well as the effectiveness of the controls over the reconciliation of gateway submissions, card scheme incoming and outgoing files and merchant balances posted on the Bank's acquiring platform. We have also tested the controls that are in place to verify that merchant payments made through different payment channels are accurate.

In addition, we performed detailed testing in relation to fee and commission income on a sample basis by vouching items recorded within the Bank's systems back to source data. This included agreeing merchant related standing data (such as rates and settlement cycle details) to merchant contracts (and contracts addendums) to ensure that the appropriate inputs are assigned to each merchant in the system based on signed contractual terms.



Independent auditor's report - continued

To the Shareholders of Credorax Bank Limited

Key audit matter

How our audit addressed the Key audit matter

There is also the risk that transaction fee and settlement details are not recorded accurately, i.e. as stipulated within the merchant agreements.

We focused on fee and commission income and settlement processing obligations due to the complexities involved in the respective calculations.

Relevant references in the Annual Report and Financial Statements:

Accounting policy: Note 1;

Note on fee and commission income: Note 23; and

Note on settlement processing obligations: Note 20.

We tested the reconciliation between the balances held with other banks attributable to merchants and balances that are expected to be recovered from card schemes to the settlement processing obligations including those that are not recognised in the Statement of Financial Position.

We agreed funds that are expected to be recovered from card schemes to receipts after year-end, loans and advances to banks attributable to merchants to third-party confirmations and third-party reports. We also tested, on a sample basis, merchants' settlement processing obligation balances to supporting documentation.

We have also reviewed merchant complaints relating to merchant balances and payments.

The combination of the tests over the Bank's controls and the detailed testing that we carried out gave us sufficient evidence to enable us to conclude that the Bank's fee and commission income and settlement processing obligations balance are reasonable and appropriate.

De-recognition of receivables from card schemes and related settlement processing obligations to merchants

During the year, the Bank amended its terms and conditions with merchants such that with immediate effect, the Bank could not sell or pledge receivables from card schemes resulting from the transactions it processes on behalf of its merchants.

In addition, the Bank's terms and conditions clarified that merchants will not be compensated for non-performance, insolvency or bankruptcy of the card schemes. Accordingly, merchants assume the credit risk in respect of card schemes for all transactions the execution of which has been initiated, but for which no settlement has been received by card schemes.

Our audit work included the following audit procedures:

- We reviewed the relevant parts of the merchant contracts and amended terms and conditions to the merchant contracts;
- We reviewed external legal opinions obtained by the Bank, that assessed the terms and conditions of the merchant contracts, particularly, the fact that the Bank owes no obligation to a merchant unless it receives prior settlement from Card Schemes;
- We reviewed internal legal counsel's assessment of the amended terms and conditions to the merchant contracts;



Independent auditor's report - continued

To the Shareholders of Credorax Bank Limited

Key audit matter

As a result, the Bank determined that based on the requirements of IFRSs as adopted by the EU, receivables from card schemes should be de-recognised from the statement of financial position.

In terms of IFRS 9, an entity can de-recognise a financial asset if it retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows in an arrangement where the entity:

- has no obligation to make payments unless it collects equivalent amounts from the assets;
- is prohibited from selling or pledging the assets; and
- has an obligation to remit any cash it collects from the assets without material delay.

This is often referred to as a 'pass-through arrangement'.

The Bank has determined that the amended terms and conditions meet the requirements of a pass through arrangement and that therefore receivables from card schemes and related settlement obligations to merchants should be derecognised.

This de-recognition had a significant impact on the statement of financial position and also on the statement of cash flows. Therefore, we determined this to be a key audit matter.

Relevant references in the Annual Report and Financial Statements:

- Accounting policy: Note 1;
- Credit risk management: Note 2.2;
- Funds receivable from merchants: Note 6

How our audit addressed the Key audit matter

- We assessed the Bank's accounting treatment against the de-recognition requirements included in IFRSs as adopted by the EU. In particular, we assessed the amended terms and conditions of the merchant agreements to test that the pass through arrangement requirements as included in IFRS 9 were met; and
- Assessed whether the relevant disclosures in the financial statements comply with IFRSs as adopted by the EU requirements.

Based on the evidence obtained, we found management's conclusions in respect of the de-recognition accounting treatment applied by the Bank to be in accordance with IFRS 9.



Independent auditor's report - continued

To the Shareholders of Credorax Bank Limited

Other information

The directors are responsible for the other information. The other information comprises the directors' report and additional regulatory disclosures (but does not include the financial statements and our auditor's report thereon).

Our opinion on the financial statements does not cover the other information, including the directors' report.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

With respect to the directors' report, we also considered whether the directors' report includes the disclosures required by Article 177 of the Maltese Companies Act (Cap. 386).

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

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

In addition, in light of the knowledge and understanding of the Bank and its environment obtained in the course of the audit, we are required to report if we have identified material misstatements in the directors' report and other information that we obtained prior to the date of this auditor's report. We have nothing to report in this regard.

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

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

In preparing the financial statements, the directors are responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Bank or to cease operations, or have no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.



Independent auditor's report - continued

To the Shareholders of Credorax Bank Limited

Auditor's responsibilities for the audit of the financial statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.



Independent auditor's report - continued

To the Shareholders of Credorax Bank Limited

Auditor's responsibilities for the audit of the financial statements - continued

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

Report on other legal and regulatory requirements

Opinion on other matters prescribed by the Banking Act (Cap. 371)

In our opinion:

- we have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;
- proper books of account have been kept by the bank, so far as appears from our examination of those books;
- the bank's financial statements are in agreement with the books of account; and
- to the best of our knowledge and according to the explanations given to us, the financial statements give the information required by any law in force in the manner so required.

Other matters on which we are required to report by exception

We also have responsibilities under the Maltese Companies Act (Cap. 386) to report to you if, in our opinion:

- returns adequate for our audit have not been received from branches not visited by us.
- certain disclosures of directors' remuneration specified by law are not made in the financial statements, giving the required particulars in our report.



Independent auditor's report - continued

To the Shareholders of Credorax Bank Limited

Appointment

We were first appointed as auditors of the Bank for the year ended 31 December 2009. Our appointment has been renewed annually by shareholder resolution representing a total period of uninterrupted engagement appointment of 10 years. The Bank became licensed as credit institution in terms of the Maltese Banking Act (Cap. 371) on 9 June 2015.

PricewaterhouseCoopers

78, Mill Street
Qormi
Malta

A handwritten signature in black ink, appearing to read 'Lucienne Pace Ross', written in a cursive style.

Lucienne Pace Ross
Partner

17 April 2019

Statement of financial position

	Notes	As at 31 December	
		2018	2017
		€	€
ASSETS			
Cash and balances with Central Bank of Malta			
Repayable on call and at short notice	4	7,057,141	220,297
Attributable to merchants	4	36,237,390	12,507,296
Funds receivable from card schemes	5	-	57,081,738
Funds receivable from merchants	6	2,686,708	-
Loans and advances to banks and financial institutions			
Repayable on call and at short notice	7	10,356,457	9,462,147
Term placements with other banks	7	7,410,936	-
Attributable to merchants	7	25,505,422	29,738,101
Loans and advances to customers	8	1,086,798	1,741,126
Financial investments	9	2,672,053	2,105,057
Funds advanced under collateral arrangements	10	6,452,100	12,241,683
Property and equipment	11	234,973	258,644
Intangible assets	12	2,841,604	2,480,834
Deferred tax assets	13	-	1,511,751
Other assets	14	7,927,137	6,497,042
Total assets		110,468,719	135,845,716
EQUITY			
Share capital	15	23,000,000	23,000,000
Share based compensation reserve	16	537,515	511,645
Fair value reserve	17	-	562,049
Retained earnings		10,699,810	3,612,866
Total equity		34,237,325	27,686,560
LIABILITIES			
Amounts owed to customers	20	5,193,145	5,419,538
Settlement processing obligations	21	64,626,158	100,018,186
Current tax liabilities		2,785,029	-
Deferred tax liabilities	13	464,238	-
Other liabilities	22	3,162,824	2,721,432
Total liabilities		76,231,394	108,159,156
Total equity and liabilities		110,468,719	135,845,716
MEMORANDUM ITEMS			
Commitments	34	2,182,644	2,084,549

The notes on pages 18 to 67 are an integral part of these financial statements. The financial statements on pages 14 to 67 were authorised for issue by the board on 17 April 2019 and were signed on its behalf by:

Igal Rotem
Director

Aviram Shemer
Director

Statement of comprehensive income

	Notes	Year ended 31 December	
		2018 €	2017 €
Interest income	23	584,101	303,736
Fee and commission income	24	88,808,591	67,189,044
Fee and commission expense	25	(68,172,307)	(55,263,381)
Net fee and commission income		20,636,284	11,925,663
Net trading income	26	8,228,084	4,075,770
Net income from financial instruments measured at FVPL	27	563,812	35,875
Operating income		30,012,281	16,341,044
Employee compensation and benefits	28	(6,187,757)	(6,333,563)
General and administration expenses	29	(7,312,380)	(5,014,762)
Net impairment charges	30	-	(1,306,695)
Reversal of provision for future chargebacks		920,352	-
Changes in expected credit losses and other impairment allowances	30	(1,258,171)	-
Depreciation and amortisation expense	11, 12	(738,884)	(301,828)
Profit before income tax		15,435,441	3,384,196
Tax expense	31	(4,813,865)	(451,907)
Profit for the year		10,621,576	2,932,289
Other comprehensive income			
Items that are or may be subsequently reclassified to profit or loss			
Fair value gains on available-for-sale investments		-	441,043
Total comprehensive income for the year		10,621,576	3,373,332

The notes on pages 18 to 67 are an integral part of these financial statements.

Statement of changes in equity

	Notes	Share capital €	Share based compensation reserve €	Fair value reserve €	Retained earnings €	Total €
Balance at 1 January 2017		23,000,000	1,071,018	121,006	3,680,577	27,872,601
Comprehensive income						
Profit for the year		-	-	-	2,932,289	2,932,289
Other comprehensive income:						
Fair value gains on available-for-sale investments		-	-	441,043	-	441,043
Total comprehensive income		-	-	441,043	2,932,289	3,373,332
Transactions with owners						
Share based compensation	18					
value attributable to:						
- employees' services	28,38	-	191,941	-	-	191,941
- disbursed services	28,38	-	27,143	-	-	27,143
Recharge of value of employee services determined by reference to vested share options granted by the parent entity	16	-	(778,457)	-	-	(778,457)
Dividends	37	-	-	-	(3,000,000)	(3,000,000)
Total transactions with owners		-	(559,373)	-	(3,000,000)	(3,559,373)
Balance at 31 December 2017		23,000,000	511,645	562,049	3,612,866	27,686,560
Balance at 1 January 2018		23,000,000	511,645	562,049	3,612,866	27,686,560
Changes on initial application of IFRS 9		-	-	(562,049)	465,368	(96,681)
Restated balance at 1 January 2018		23,000,000	511,645	-	4,078,234	27,589,879
Comprehensive income						
Profit for the year		-	-	-	10,621,576	10,621,576
Total comprehensive income		-	-	-	10,621,576	10,621,576
Transactions with owners						
Share based compensation	18					
value attributable to:						
- employees' services	28,38	-	89,021	-	-	89,021
- disbursed services	28,38	-	24,151	-	-	24,151
Recharge of value of employee services determined by reference to vested share options granted by the parent entity	16	-	(87,302)	-	-	(87,302)
Dividends	37	-	-	-	(4,000,000)	(4,000,000)
Total transactions with owners		-	25,870	-	(4,000,000)	(3,974,130)
Balance at 31 December 2018		23,000,000	537,515	-	10,699,810	34,237,325

The notes on pages 18 to 67 are an integral part of these financial statements.

Statement of cash flows

	Notes	Year ended 31 December	
		2018	2017
		€	€
Cash flows from operating activities			
Interest received		418,841	115,430
Fees and commission received		98,181,049	73,253,417
Fees and commission paid		(68,096,370)	(55,068,400)
Payments to employees and suppliers		(9,750,981)	(7,973,764)
Cash flows from operating activities before changes in operating assets and liabilities		20,752,539	10,326,683
(Increase)/decrease in operating assets:			
Loans and advances to customers		694,884	(1,030,198)
Funds (advanced) / received under collateral arrangements		(1,418,879)	1,379,999
Funds receivable from card schemes		22,539,833	(30,196,925)
Funds receivable from merchants		(2,686,708)	-
Other assets:			
Loans and advances to group undertakings		(21,600,434)	(22,358,040)
Repayments from group undertakings		10,738,647	9,044,410
Other advances		1,159,084	2,410,738
Increase/(decrease) in operating liabilities:			
Amounts owed to customers		(97,605)	578,171
Settlement processing obligations		(2,245,115)	33,704,458
Other liabilities		441,390	174,459
Cash generated from operations		28,277,636	4,033,755
Tax paid		(788)	(973)
Net cash generated from operating activities		28,276,848	4,032,782
Cash flows from investing activities			
Dividends received		32,020	35,875
Purchase of debt instruments		(126,770)	(88,100)
Proceeds from maturity of debt instruments		86,670	-
Purchase of equipment	11	(78,036)	(55,197)
Proceeds from disposal of equipment	11	-	1,300
Purchase of intangible assets	12	(962,163)	(1,433,959)
Net cash used in investing activities		(1,048,279)	(1,540,081)
Net movement in cash and cash equivalents		27,228,569	2,492,701
Cash and cash equivalents at beginning of year		51,927,841	49,435,140
Cash and cash equivalents at end of year	32	79,156,410	51,927,841

The notes on pages 18 to 67 are an integral part of these financial statements.

Notes to the financial statements

1. Summary of significant accounting policies

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

1.1 Basis of preparation

The Bank's financial statements have been prepared in accordance with the requirements of International Financial Reporting Standards (IFRSs) as adopted by the EU and with the requirements of the Banking Act, 1994 and the Maltese Companies Act, 1995. These financial statements are prepared under the historical cost convention, as modified by the fair valuation of investments at fair value through profit or loss.

The preparation of financial statements in conformity with IFRSs as adopted by the EU requires the use of certain accounting estimates. It also requires the directors to exercise their judgment in the process of applying the Bank's accounting policies (see Note 3 – Critical accounting estimates, and judgments in applying accounting policies).

1.1.1 Standards, interpretations and amendments to published standards effective in 2018

In 2018, the Bank adopted amendments and interpretations to existing standards that are mandatory for the Bank's accounting period beginning on 1 January 2018. In particular, the Bank has initially adopted IFRS 9 (see 1.1.1.1) and IFRS 15 (see 1.1.1.2) from 1 January 2018.

The Bank adopted IFRS 9 as issued by the IASB in July 2014, on 1 January 2018 which is the date of initial application of the standard. As permitted by the transitional provisions of IFRS 9, the Bank elected not to restate comparative figures. Any adjustments to the carrying amounts of financial assets and liabilities at the date of transition were recognised in the opening retained earnings of the current period. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9.

The Bank also adopted IFRS 15, 'Revenue from contracts with customers' from 1 January 2018, but the adoption did not result in changes in accounting policies and there are no adjustments to amounts recognised in the financial statements.

1.1.1.1 IFRS 9 'Financial Instruments'

The adoption of IFRS 9 has resulted in changes to the accounting policies for the recognition, classification and measurement of financial instruments and impairment of financial assets. Adoption reduced fair value of financial assets by €96,681 arising from additional impairment allowances, net of deferred tax.

The transitional requirements of IFRS 9 necessitated a review of the designation of financial instruments at fair value.

Reconciliation of statement of financial position balances from IAS 39 to IFRS 9

The following table shows the measurement categories and reconciles the carrying amounts of financial assets, from their previous measurement categories in accordance with IAS 39, to their new measurement categories upon transition to IFRS 9 on 1 January 2018. The differences between IAS 39 and IFRS 9 consist of remeasurement adjustments, which change the carrying value of the financial instruments due to expected credit losses, with a corresponding impact on retained earnings, and reclassification adjustments between measurement categories.

1. Summary of significant accounting policies (continued)

1.1 Basis of preparation (continued)

1.1.1 Standards, interpretations and amendments to published standards effective in 2018 (continued)

1.1.1.1 IFRS 9 'Financial Instruments' (continued)

Reconciliation of statement of financial position balances from IAS 39 to IFRS 9 (continued)

	IAS 39 Measurement category	IAS 39 Carrying amount €	Reclassifi- cation €	Remeasure- ment €	IFRS 9 Carrying amount €	IFRS 9 Measurement category
Financial Assets						
Cash and balances with Central Bank of Malta	Amortised cost (Loans and receivables)	12,727,593	-	-	12,727,593	Amortised cost
Funds receivable from card schemes	Amortised cost (Loans and receivables)	57,081,738	-	-	57,081,738	Amortised cost
Loans and advances to banks and financial institutions	Amortised cost (Loans and receivables)	39,200,248	-	-	39,200,248	Amortised cost
Loans and advances to customers	Amortised cost (Loans and receivables)	1,741,126	-	(33,654)	1,707,472	Amortised cost
Financial investments	FVOCI (Available-for-sale - equity instruments)	2,021,541	(2,021,541)	-	-	FVPL
Financial investments	FVPL	-	2,021,541	-	2,021,541	FVPL
Financial investments	Amortised cost (Held-to-maturity)	83,516	-	-	83,516	Amortised cost
Funds advanced under collateral arrangements	Amortised cost (Loans and receivables)	12,241,683	-	(22,095)	12,219,588	Amortised cost
Other assets	Amortised cost (Loans and receivables)	5,974,618	-	(92,991)	5,881,627	Amortised cost
Total carrying amount on-balance sheet		131,072,063	-	(148,740)	130,923,323	
Loan commitments		2,084,549	-	-	2,084,549	
Total nominal amount off-balance sheet		2,084,549	-	-	2,084,549	

1. Summary of significant accounting policies (continued)

1.1 Basis of preparation (continued)

1.1.1 Standards, interpretations and amendments to published standards effective in 2018 (continued)

1.1.1.1 IFRS 9 'Financial Instruments' (continued)

Reconciliation of statement of financial position balances from IAS 39 to IFRS 9 (continued)

Further to the above, as at 31 December 2017 provision for future chargebacks, netted off against settlement processing obligations included an amount of €315,153 which as from 1 January 2018 are considered part of expected credit loss allowances against receivables from merchants.

The total remeasurement loss of €96,681 net of deferred tax was recognised in opening retained earnings at 1 January 2018.

The reclassifications to new categories under IFRS 9, from previous categories under IAS 39 had no changes to the assets' measurement basis.

As at 31 December 2017, there were no impairment allowances measured under IAS 39. The remeasurement of €148,740 represents the new impairment allowance measured in accordance with the expected credit loss model under IFRS 9 at 1 January 2018. Accordingly, a table reconciling the impairment allowances as at 31 December 2017 to those at 1 January 2018 is not warranted.

Equity	IAS 39 Carrying amount €	IFRS 9 Reclassifi- cation €	Carrying amount post reclassifi- cation €	IFRS 9 Remeasure- ment €	IFRS 9 Carrying amount €
Share capital	23,000,000	-	23,000,000	-	23,000,000
Share based compensation reserve	511,645	-	511,645	-	511,645
Fair value reserve	562,049	(562,049)	-	-	-
Retained earnings	3,612,866	562,049	4,174,915	(96,681)	4,078,234
	27,686,560	-	27,686,560	(96,681)	27,589,879

€2,021,541 of available-for-sale non-traded equity instruments have been reclassified as 'Financial assets measured at fair value through profit or loss' in accordance with IFRS 9. Accordingly, the adoption of IFRS 9 results in a transfer of €562,049 from the FVOCI reserve (formerly Fair value reserve) to retained earnings.

All financial liabilities except for held for trading derivatives which are measured at fair value through profit or loss remain measured at amortised cost following initial application of IFRS 9 therefore there is no impact from reclassification/remeasurement arising upon transition to IFRS 9 on such financial liabilities.

1. Summary of significant accounting policies (continued)

1.1 Basis of preparation (continued)

1.1.1 Standards, interpretations and amendments to published standards effective in 2018
(continued)

1.1.1.2 IFRS 15 'Revenue from contracts with customers'

IFRS 15 'Revenue from contracts with customers' establishes a comprehensive framework for revenue recognition in determining whether, how much and when revenue is recognised, by introducing the concept of recognising revenue for performance obligations as they are satisfied. It replaced IAS 18 'Revenue', IAS 11 'Construction Contracts' and related interpretations.

IFRS 15 is based on the principle that revenue is recognised when control of a good or service transfers to a customer, in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. In this way, the notion of control replaces the notion of risks and rewards under IAS 18. To this effect, IFRS 15 requires the entity to determine whether it is the principal or the agent in the transaction based on whether it controls the goods or services before they are transferred to the customers.

The Bank initially applied IFRS 15 on its effective date, 1 January 2018. In the case of the Bank, IFRS 15 did not result in any change to the amount or the date at which the revenue is recognised. Despite the change of the notion from risk and rewards to control for revenue recognition, the Bank is still considered to be principal in the provision of its services in terms of IFRS 15, based on the conclusion that the Bank is deemed to exercise full control over its services before they are transferred to customers. Thus, the change from risk and reward to control had no impact on the agent-principal assessment, resulting revenue continuing to be recognised on a gross basis.

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

Certain new standards, amendments and interpretations to existing standards have been published by the date of authorisation for issue of these financial statements but are mandatory for accounting period beginning after 1 January 2019. The Bank has not early adopted these revisions to the requirements of IFRSs as adopted by the EU.

IFRS 16 Leases

IFRS 16 introduces a single on-balance sheet lease accounting model and requires lessees to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value.

Lessees are required to initially recognise a right-of-use asset representing their right of use of the underlying asset and a corresponding lease liability representing the obligation to make lease payments. The lease liability is measured at the present value of the lease payments to be made over the lease term. The nature of expenses related to these leases will now change as the new standard replaces the straight-line operating lease expense with a depreciation charge for right-of-use assets and interest expense on lease liabilities.

1. Summary of significant accounting policies (continued)

1.1 Basis of preparation (continued)

1.1.2 Standards, interpretations and amendments to published standards that are not yet effective (continued)

IFRS 16 Leases (continued)

Lease payments need to be presented in the statement of cash flow, by classifying the payment on the lease liability within the financing activities, and the interest of the lease liability within the operating or financing activities.

The Bank plans to apply IFRS 16 initially on 1 January 2019, and thus the Bank does not need to restate comparative amounts for the year prior to first adoption. The Bank will measure the lease liability at the present value of the remaining lease payments amounting to €781,345. Right-of-use assets will be measured on transition at the amount equal to the lease liability, adjusted for any prepaid or accrued expenses. Accordingly, the implementation is expected to increase assets and liabilities by the same amount, with no effect on net assets and retained earnings.

1.2 Foreign currency translation

(a) Functional and presentation currency

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

(b) Transactions and balances

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

1.3 Financial assets

1.3.1 Policy applicable from 1 January 2018

1.3.1.1 Initial recognition

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

1. Summary of significant accounting policies (continued)

1.3 Financial assets (continued)

1.3.1 Policy applicable from 1 January 2018 (continued)

1.3.1.1 Initial recognition (continued)

At initial recognition, the Bank measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are incremental and directly attributable to its acquisition of the financial asset. Transaction costs of financial assets carried at fair value through profit or loss are expensed in profit or loss immediately. Immediately after initial recognition, an Expect Credit Loss allowance (ECL) is recognised for financial assets measured at amortised cost, which results in accounting loss being recognised in profit or loss when an asset is newly originated.

1.3.1.2 Classification and measurement

On initial recognition the Bank classifies its financial assets in the following measurement categories: (a) amortised cost; and (b) fair value through profit or loss (FVPL). The classification varies depending on whether the financial asset is a debt or an equity instrument.

Debt instruments

Classification and subsequent measurement of debt instruments depends on:

- The Bank's business model for managing the asset; and
- The cash flow characteristic of the asset.

Based on these factors, the Bank classifies its debt instruments into the 'Amortised cost' category.

Financial assets are measured at amortised cost if they meet both the following conditions and are not designated as at FVPL:

- the assets are held within a business model whose objective is to hold assets to collect contractual cash flows; and
- their contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest ('SPPI') on the principal amount outstanding.

The carrying amount of these financial assets is adjusted by an expected credit loss allowance recognised and measured as described in 1.3.1.3. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

Business model assessment. The business model reflects how the Bank manages the assets in order to generate cash flows, whether the objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of 'other' business model and measured at FVPL. Factors considered by the Bank in determining the business model for a group of assets include past experience on how the cash flows for the assets were collected, how the asset's performance is evaluated and reported to the Bank's management, and how risks are assessed and managed.

Assessment of whether contractual cash flows are solely payments of principal and interest (SPPI). Where the business model is to hold assets to collect contractual cash flows, the Bank assesses whether the financial instruments' cash flows represent solely payments of principal and interest.

1. Summary of significant accounting policies (continued)

1.3 Financial assets (continued)

1.3.1 Policy applicable from 1 January 2018 (continued)

1.3.1.2 *Classification and measurement (continued)*

Debt instruments (continued)

In making this assessment, the Bank considers whether the contractual cash flows are consistent with a basic lending arrangement, i.e. interest includes only the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at FVPL. For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the outstanding principal and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

Debt instruments are not reclassified subsequent to their initial recognition. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent and none occurred during the period.

Equity instruments

The Bank classifies its equity instruments into the 'FVPL' category. Consequently, the Bank subsequently measures all equity investments at fair value through profit or loss. The Bank does not elect, at initial recognition, to irrevocably designate equity investments at fair value through other comprehensive income.

1.3.1.3 *Impairment of amortised cost financial assets*

The Bank recognises loss allowances for ECL on financial assets measured at amortised cost and certain loan commitments.

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

- A financial instrument that is not credit-impaired on initial recognition is classified as 'Stage 1' and has its credit risk continuously monitored by the Bank. At initial recognition, an impairment allowance (or provision) is required for ECLs resulting from default events that are possible within the next 12 months ('12-month ECLs').
- If a significant increase in credit risk ('SICR') since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired. An allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL').
- If the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'. Assets in Stage 3 also carry a lifetime ECL allowance or provision.

Purchased or originated credit impaired financial assets ('POCI') are treated differently, as set out below. 'POCI' financial assets cannot be transferred between categories.

1. Summary of significant accounting policies (continued)

1.3 Financial assets (continued)

1.3.1 Policy applicable from 1 January 2018 (continued)

1.3.1.3 Impairment of amortised cost financial assets (continued)

Significant increase in credit risk

The Bank's principal financial assets carried at 'Amortised cost' include balances with the Central Bank of Malta, loans and advances to banks and financial institutions, funds advanced under collateral arrangements and debt securities, the majority of which attract an 'investment grade' rating from Rating agencies such as Standard & Poor's and Moody's. The other financial assets within these categories of assets are 'not rated', albeit, the Bank considers these financial assets as having 'low credit risk' in terms of paragraphs 5.5.10 and B5.5.23 of IFRS9. This consideration is made in the light of the fact that all obligors within these categories are considered by the Bank to have a strong capacity to meet their obligations, and that adverse changes in economic conditions should not reduce their ability to fulfil obligations.

The Bank assumes that the credit risk on these financial assets has not increased significantly since initial recognition if the financial instrument is determined to have low credit risk, within the meaning of paragraph 5.5.10 of IFRS 9, at the reporting date. If, on the other hand, these financial assets suffer a significant increase in credit risk, for example following a downgrade to below investment grade, the financial instrument will be re-classified as a Stage 2 exposure. This will impact the measurement of the loss allowance, moving from a 12-month ECL assumption to a lifetime ECL assumption.

In respect of receivables from merchants, and receivables from group undertakings (within 'Other assets'), the Bank applies the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognised from initial recognition of the receivables.

Definition of default and credit impaired assets

The Bank determines that a financial instrument is credit impaired and in Stage 3 by considering relevant objective evidence, primarily when there are indications that the obligor is unlikely to pay. If such unlikelihood to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due.

Purchased or originated credit impaired ('POCI') assets

Integral to the Bank's business is the risk of incurring financial losses due to the inability to recover gross transaction amounts due from merchants that arise from chargebacks raised by cardholders, that exceed funds withheld by the Bank from merchants to serve as collateral ('merchant reserves').

The Bank monitors the Net Expected Exposure, an internal metric to assess chargeback performance and hence potential future risk of losses vis-à-vis collateral held. Receivables from merchants arising as a result of chargeback transactions exceeding merchant reserves are considered originated credit impaired. Lifetime ECL is recognised in profit or loss until such exposures are derecognised.

1. Summary of significant accounting policies (continued)

1.3 Financial assets (continued)

1.3.1 Policy applicable from 1 January 2018 (continued)

1.3.1.3 Impairment of amortised cost financial assets (continued)

Write-off

The Bank writes off financial assets, in whole or in part, when it has exhausted all practical recovery efforts and has concluded there is no reasonable expectation of recovery. In addition, the Bank has a write-off policy for the designation and writing off irrecoverable amounts with respect to merchant balances. The objective is to ensure timely and accurate write-off of negative merchant balances in the period in which the balances are reasonably determined as uncollectable and after all avenues to collect the amounts due have failed.

Measurement of ECL

The Expected Credit Loss ('ECL') is measured on either a 12-month (12M) or Lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether an asset is considered to be credit-impaired. Expected credit losses are the discounted product of the Probability of Default ('PD'), Exposure at Default ('EAD') and Loss Given Default ('LGD'), defined as follows:

- The PDs estimates are estimates at date of calculating ECL allowances. In the absence of sufficient internal historical default data, in order to estimate its PDs, the Bank makes reference to external information published by Moody's. More specifically, the Bank assigns a PD to each of its exposures on the basis of the credit rating of the counterparty or issuer, by reference to Moody's default rates.

The Bank calibrates unrated counterparties to Moody's default rates by reference to external ratings of comparable financial assets. The Bank assigns a 1-year default rate to all exposures deemed to have low credit risk, and for very short term financial assets, the 1 year default rate is scaled down to estimate a PD over a one or two day horizon, dependable on the said exposure. This is consistent within the meaning of paragraph 5.5.10 of IFRS 9, at the reporting date.

Receivables from merchants and from group undertakings are calibrated on the same basis. Receivables from merchants typically have a contractual life which is lower than 12 months, usually a few days. In respect of receivables for group undertakings, the Bank's credit risk management actions are taken no less frequently than on an annual basis and therefore the life in respect of receivables from group undertakings is also considered to be no longer than 12 months. A 100% probability of default is assigned to exposures classified as 'Stage 3'. In the case of chargebacks raised by cardholders, that exceed funds withheld by the Bank from merchants to serve as collateral, expected credit losses of the same amount are held. Such exposures are classified as 'POCI'.

- EAD is based on the amounts the Bank expects to be owed at the time of default, over the next 12 months ('12M EAD') or over the remaining lifetime ('Lifetime EAD'). For the majority of the Bank's financial assets, since they are of a short-term nature, the 12M EAD and Lifetime EAD are equivalent.
- LGD represents the Bank's expectation of the extent of loss on a defaulted exposure. In estimating LGD, the Bank refers to the historical recovery rates published by Moody's. Calibration is performed in the same manner as described for PD estimates above. In the case of receivables from merchants arising as a result of chargeback transactions a 100% LGD is assumed.

1. Summary of significant accounting policies (continued)

1.3 Financial assets (continued)

1.3.1 Policy applicable from 1 January 2018 (continued)

1.3.1.3 *Impairment of amortised cost financial assets* (continued)

Measurement of ECL (continued)

The ECL is calculated as a factor of the 12-month PD, LGD and EAD.

In this respect, the recognition of ECL should incorporate forward-looking information. However, since the average duration of the instruments in scope are short-term, principally within one year and the majority of which within a few days of the reporting period, no forward-looking elements are included within the Bank's expected credit loss model.

There were no changes to the model during the year.

Presentation of ECL in statement of financial position

For financial assets that are measured at amortised cost, the ECL allowance is presented against the carrying amount of the assets on the balance sheet, thereby reducing the carrying amount.

1.3.1.4 *Derecognition*

The Bank derecognises a financial asset when the contractual rights to receive cash flows from the financial assets have expired or have been transferred and the Bank has transferred substantially all risks and rewards of ownership or the Bank has not retained control of the asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset and the consideration received is recognised in profit or loss.

The Bank is involved in transactions whereby it retains the contractual rights to receive cash flows from assets but assumes a contractual obligation to pay those cash flows to other entities and transfers substantially all of the risks and rewards. These transactions are accounted for as 'pass through' transfers that result in derecognition if the Bank:

- (i) has no obligation to make payments unless it collects equivalent amounts from the assets;
- (ii) is prohibited from selling or pledging the assets; and
- (iii) has an obligation to remit any cash it collects from the assets without material delay.

1.3.2 Policy applicable before 1 January 2018

1.3.2.1 *Financial assets classification*

The Bank classified its financial assets in the following categories: at fair value through profit or loss, loans and receivables, available for sale and at amortised cost, depending on the purpose for which the financial assets were acquired.

1. Summary of significant accounting policies (continued)

1.3 Financial assets (continued)

1.3.2 Policy applicable before 1 January 2018 (continued)

1.3.2.1 *Financial assets classification (continued)*

(a) *Financial assets at fair value through profit or loss*

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

A financial asset is classified as held-for-trading if it was acquired principally for the purpose of selling or repurchasing it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking.

The Bank has not designated any financial assets upon initial recognition as fair value through profit or loss (fair value option), and held-for-trading financial instruments consisted solely of derivative contracts.

Financial instruments included in this category were recognised initially at fair value, with transaction costs taken directly to profit or loss. Gains and losses arising from changes in fair value were included directly in profit or loss and are reported as 'Net trading income'.

(b) *Loans and receivables*

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

- (a) those that the Bank intends to sell immediately or in the short term, which are classified as held-for-trading, and those that the entity upon initial recognition designates as at fair value through profit or loss;
- (b) those that the Bank upon initial recognition designates as available-for-sale; or
- (c) those for which the holder may not recover substantially all of their initial investment, other than because of credit deterioration.

Loans and receivables mainly consisted of loans and advances to banks, loans and advances to customers, funds receivable from card schemes and funds advanced as collateral. They were initially recognised at fair value – which is the cash consideration to originate or purchase the loan including any transaction costs – and measured subsequently at amortised cost using the effective interest rate method. Amortised cost is the initial measurement amount adjusted for the amortisation of any difference between the initial and maturity amounts using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability (and groups of financial assets or financial liabilities) and of allocating the 'Net interest income' over the relevant period.

1. Summary of significant accounting policies (continued)

1.3 Financial assets (continued)

1.3.2 Policy applicable before 1 January 2018 (continued)

1.3.2.1 *Financial assets classification (continued)*

(c) Available-for-sale financial assets

Available-for-sale investments are financial assets that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices, or that are not classified as loans and receivables or financial assets at fair value through profit or loss.

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

The Bank's available-for-sale investments represent the Bank's interest in Visa Europe Limited.

(d) Financial Assets at amortised cost

Non-derivative investment securities, with fixed or determinable payments and fixed maturity, where the Bank has both the positive intent and the ability to hold them to maturity, other than those that upon initial recognition are designated as at fair value through profit or loss, those that are designated as available-for-sale financial assets and those that meet the definition of loans and receivables, are classified as held-to-maturity financial assets.

Those investment securities classified as held-to-maturity financial assets are subsequently measured at amortised cost using the effective interest method, less any impairment losses. Interest calculated using the effective interest method and impairment losses are recognised in profit or loss.

1.3.2.2 *Impairment of financial assets*

Assets carried at amortised cost

The Bank assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The criteria that the Bank uses to determine that there is objective evidence of an impairment loss include:

- (a) significant financial difficulty of the obligor;
- (b) a breach of contract, such as a default or delinquency in interest or principal payments;
- (c) it becomes probable that the obligor will enter bankruptcy or other financial reorganisation.

1. Summary of significant accounting policies (continued)

1.3 Financial assets (continued)

1.3.2 Policy applicable before 1 January 2018 (continued)

1.3.2.2 *Impairment of financial assets (continued)*

Assets carried at amortised cost (continued)

The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in profit or loss.

Assets classified as available-for-sale

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

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

In assessing objective evidence of impairment of equity securities at the reporting date the Bank considers all available evidence, including observable data or information about events specifically relating to the issuer, and also to information about significant changes in technology, markets, economics or the law that provides evidence that the cost of the equity securities may not be recovered.

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

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

1. Summary of significant accounting policies (continued)

1.3 Financial assets (continued)

1.3.2 Policy applicable before 1 January 2018 (continued)

1.3.2.3 Derecognition

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Bank has transferred substantially all risks and rewards of ownership or the Bank has not retained control of the asset.

1.4 Derivative financial instruments

Derivative financial instruments, including currency forwards, are initially recognised at fair value on the date on which a derivative contract is entered into, and are subsequently re-measured at their fair value. Fair values for currency forwards are determined using forward exchange market rates at the end of the reporting period. Discounting techniques, reflecting the fact that the respective exchange or settlement will not occur until a future date, are used when the time value of money has a significant effect on the fair valuation of these instruments. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in profit or loss under 'Net trading income'.

1.5 Intangible assets

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Costs associated with maintaining computer software programmes are recognised as an expense as incurred.

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

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

Directly attributable costs that are capitalised as part of the software product include the software development employee costs and an appropriate portion of relevant overheads.

Other development expenditures that do not meet this criteria are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

1. Summary of significant accounting policies (continued)

1.5 Intangible assets (continued)

Computer software development costs recognised as assets are amortised over their estimated useful lives, which does not exceed five years.

At the end of each reporting period, intangible assets are reviewed for indicators of impairment or changes in estimated future economic benefits (see Note 1.7). If such indicators exist, the intangible assets are analysed to assess whether their carrying amount is fully recoverable.

1.6 Property and equipment

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

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

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

	%
Leasehold improvements	20
Fixtures and fittings and office furniture	10 – 20
Computer and electronic equipment	17 – 20

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

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

1.7 Impairment of non-financial assets

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). The impairment test can also be performed on a single asset when the fair value less cost to sell or the value in use can be determined reliably.

1. Summary of significant accounting policies (continued)

1.8 Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise cash in hand and deposits held at call with banks.

Cash and cash equivalents include cash in hand and all liquid investments with an initial maturity of three months or less when purchased. These amounts also include cash that the Bank holds related to reserve funds collected from merchants that serve as collateral to minimise contingent liabilities associated with any losses that may occur under the merchant agreement. The Bank records a corresponding liability in settlement processing obligations in the statement of financial position.

Cash and cash equivalents also include settlement related cash balances. Settlement related cash balances represent surplus funds that the Bank holds when the incoming amount from the card networks precedes the funding obligation to the merchant.

1.9 Share capital

Ordinary shares are classified as equity when there is no obligation to transfer cash or other assets. Incremental costs directly attributable to the issue of an equity instrument are deducted from the initial measurement of the equity instruments.

1.10 Financial liabilities

The Bank recognises a financial liability on its statement of financial position when it becomes a party to the contractual provisions of the instrument.

Financial liabilities not at fair value through profit or loss are recognised initially at fair value, being the fair value of consideration received, net of transaction costs that are directly attributable to the acquisition or the issue of the financial liability. These liabilities are subsequently measured at amortised cost using the effective interest method. The Bank derecognises a financial liability from its statement of financial position when the obligation specified in the contract or arrangement is discharged, is cancelled or expires.

Financial liabilities measured at amortised cost comprise principally amounts owed to customers and settlement processing obligations. Settlement processing obligations represent transactions that have been processed but not yet funded together with funds withheld from merchants that serve as collateral to minimise contingent liabilities associated with any losses that may occur under the merchant agreement ("merchant reserve").

1.11 Offsetting financial instruments

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

1. Summary of significant accounting policies (continued)

1.12 Current and deferred tax

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

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

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

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

1.13 Share based compensation

The Bank's parent, Credorax Inc., established a share based compensation plan ("the Plan") for the Group's employees, whereby share options are granted to directors and selected employees in exchange for their services. The fair value of the employee services received in exchange for the grant of share options is recognised as an expense in profit or loss and as a corresponding increase in shareholders' equity ('Share based compensation reserve'). Upon vesting, Credorax Inc. recharges to the Bank the grant-date fair value of the share options. The recharge is derecognised from shareholders' equity and recognised by the Bank as a liability to the parent.

The total amount to be expensed from grant date over the vesting period is determined by reference to the fair value of the options granted at the grant date. Total compensation expense is recognised from grant-date over the vesting period (the period during which an employee is required to provide service in exchange for the benefit or the requisite service period) rateably through graded vesting. Accordingly, the Bank amortises the compensation cost arising on the grant of share options over the nominal vesting period for employees based on the graded vesting of the plan. At the end of each reporting period, the entity revises its estimates of the number of options that are expected to be vested. It recognises the impact of the revision of original estimates, if any, in profit or loss, with a corresponding adjustment to equity.

1.14 Provisions for legal proceeding and future chargebacks

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a current legal or constructive obligation which has arisen as a result of past events, and for which a reliable estimate can be made.

1. Summary of significant accounting policies (continued)

1.15 Revenue recognition

The Bank's revenues principally represent the consideration received or receivable from the merchants for services provided. This includes acquiring revenues, other fees charged on a per transaction basis, income from foreign exchange services and interest.

Acquiring revenues relate to services provided to process transactions between the card-issuing banks and the Bank's merchants. Revenue is recognised when the transactions are successfully processed via the Bank's acquiring platform and is recognised per transaction. Acquiring revenue also includes the amount of interchange fees and scheme fees. The Bank is considered a principal for the acquiring services it provides to the merchants, accordingly, such revenues are reported using the gross presentation.

Income from foreign exchange services is generated on settling foreign currency transactions on behalf of merchants. Revenue is recognised when the Bank's obligation in relation to the transaction is fulfilled.

Given the nature of its transaction-based business, the Bank's revenues are recognised when the services are provided at the point in time when the transaction takes place, since there are no further performance obligations following the processing of transactions. The Bank does not provide any services which are rendered over a period of time.

Costs of sales which primarily consist of fees charged by card schemes as well as interchange fees, are matched to the revenue generated and are recognised when incurred.

Net fee and commission income is revenue after deducting scheme fees, interchange fees and sales commissions. This is monitored by the Bank's Management and used as a performance indicator of the financial effects of the activities in which the Bank engages.

The Bank does not have any contracts for the provision of services that result in the initial recognition of contract assets or contract liabilities.

1.16 Operating leases

The Bank is the lessee

Leases in terms of which the Bank does not assume substantially all the risks and rewards of ownership are classified as operating leases. Leased assets held under operating lease are not recognised in the Bank's statement of financial position. Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease.

The impact of the IFRS 16 'Leases accounting' that has been issued but is not yet effective until 1 January 2019, the date when the Bank will be initially applying it, is disclosed in note 1.1.2 to these financial statements.

1.17 Dividend distribution

Interim dividends to the Bank's shareholder are approved by the directors and recognised when paid. Final dividends are recognised as liability in the Bank's financial statements upon approval by the Bank's shareholders at the Annual General Meeting.

2. Financial risk management

2.1 Introduction

The Bank's activities potentially expose it to a variety of financial risks including credit risk, market risk, specifically foreign exchange risk, and liquidity risk. Accordingly, the directors provide principles for overall risk management as well as policies covering specific areas, such as foreign exchange risk, credit risk and investment of excess liquidity.

The Bank's risk management policies are designed to identify and analyse risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems.

The Bank's treasury function is responsible for managing assets, liabilities and the overall financial position of the Bank and is also responsible for the management of funding and liquidity risks. The Bank's risk oversight function has the overall responsibility for the development of the Bank's risk strategy and the implementation of risk principles, framework, policies and related limits.

2.2 Credit risk

2.2.1 Introduction

Credit risk is the risk that the Bank will incur losses as a result of a counterparty failing to fulfil its contractual obligations to the Bank. Credit risk arises from the Bank's financial assets which are inherently and predominantly subject to credit risk.

2.2.2 Maximum exposure to credit risk

The following table presents the maximum exposure to credit risk from balance sheet and off-balance sheet financial instrument, before taking account of any collateral held or other credit enhancements. For financial assets recognised on the statement of financial position, the maximum exposure to credit risk equals their carrying amount. For loan commitments, it is generally the full amount of the committed facilities.

Financial Assets	31 Dec 2018 €	1 Jan 2018 €
Balances with Central Bank of Malta	43,293,475	12,727,593
Funds receivable from card schemes	-	57,081,738
Funds receivable from merchants	4,150,627	315,153
Loans and advances to banks and financial institutions	43,282,867	39,200,248
Loans and advances to customers	1,108,219	1,741,126
Financial investments at amortised cost	129,514	83,516
Funds advanced under collateral arrangements	6,454,903	12,241,683
Other assets	7,434,526	5,974,618
Gross carrying amount	105,854,131	129,365,675
Allowances for expected credit losses	(1,617,553)	(463,893)
Carrying amount on-balance sheet	104,236,578	128,901,782
Loan commitments	2,182,644	2,084,549
Carrying amount off-balance sheet	2,182,644	2,084,549

2. Financial risk management (continued)

2.2 Credit risk (continued)

2.2.2 Maximum exposure to credit risk (continued)

Funds receivable from merchants include an amount of €1,463,919 (1 January 2018 €315,153), for which allowances for expected credit losses of the same amount is held.

Credit risk mitigation practices are in place in respect of loans and advances to customers in the form of reserves, merchant funds, funds pursuant to a funding delay or other retained funds which serve as a security against such exposures. As at 31 December 2018, the Bank retained €879,131 (2017: €563,122) in merchant funds in its possession.

2.2.3 Concentration of credit risk exposure

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

Within its daily operations the Bank transacts with banks and other financial institutions. The Bank primarily places short-term funds with pre-approved banks and financial institutions subject to limits in place and subject to the respective institution's credit rating being within controlled parameters. Actual exposures are monitored against these limits on a daily basis and in real time. The credit status of the pre-authorised banks is also monitored on an ongoing basis. As at 31 December 2018 and 2017, loans and advances to banks consisted primarily of amounts repayable on call and funds attributable to merchants.

Credit risk also arises from amounts owed by group undertakings (within "other assets"), which are unsecured, interest free and have no fixed date or repayment. The Bank takes cognisance of the related party relationship and the credit arrangements with group undertakings and management does not expect any losses from non-performance or default which has not been provided for.

Funds receivable from merchants represent receivables in respect of prefunded amounts to merchants. These represent instances, where through special arrangements the Bank agrees to transfer the money before receiving it from the card schemes. In the event that the amounts are not received from the card schemes, the Bank has the right to claim the money back from the merchants. Accordingly, the credit risk emanating from the Bank's exposure to merchants is deemed by the directors to be contained.

As at 31 December 2017, the Bank was significantly exposed to concentration risk in respect of its receivable from two card schemes. Card schemes interpose themselves between issuing and acquiring banks to ensure the performance of transactions being processed by using several layers of financial safeguards to cover losses resulting from default of one or more members.

The Bank also bears the risk of incurring financial losses due to the inability to recover gross transaction amounts due from merchants that arise from chargebacks raised by a cardholder (i.e. a claim from a cardholder where the payment has been made but the merchant has failed to deliver the goods or services). In this regard, the Bank's risk is generally mitigated by funds withheld from merchants that serve as collateral ('merchant reserves'). Thus, in the ordinary course of business (before any chargebacks occur or when chargebacks are fully secured by collateral), the Bank recognises a net liability position to merchants. However, credit risk arises when the value of chargeback transactions exceed the value of collateral held. As at 31 December 2018, receivables amounting €1,463,919 (2017: €315,153) from 130 merchants (2017: 200 merchants) related to chargeback transactions in excess of collateral held.

2. Financial risk management (continued)

2.2 Credit risk (continued)

2.2.4 Allowances for expected credit losses

The following disclosure presents the gross carrying/nominal amount of financial instruments measured at amortised cost to which the impairment requirements in IFRS 9 are applied and the associated allowance for ECL. Due to the forward-looking nature of IFRS 9, the scope of financial instruments on which ECL are recognised is greater than the scope of IAS 39.

Financial Assets	Stage Classification	31 Dec 2018		At 1 Jan 2018	
		Gross carrying/nominal amount €	Allowance for ECL €	Gross carrying/nominal amount €	Allowance for ECL €
Balances with Central Bank of Malta	Stage 1	43,293,475	-	12,727,593	-
Funds receivable from card schemes	Stage 1	-	-	57,081,738	-
Funds receivable from merchants	Stage 1	2,686,708	-	-	-
Funds receivable from merchants	POCI	1,463,919	(1,463,919)	315,153	(315,153)
Loans and advances to banks and financial institutions	Stage 1	43,282,867	(10,052)	39,200,248	-
Loans and advances to customers	Stage 1	1,108,219	(21,421)	1,741,126	(33,654)
Financial investments at amortised cost	Stage 1	129,514	-	83,516	-
Funds advanced under collateral	Stage 1	6,454,903	(2,803)	12,241,683	(22,095)
Other assets	Stage 1	7,434,526	(119,358)	5,974,618	(92,991)
Total carrying amount on-balance sheet		105,854,131	(1,617,553)	129,365,675	(463,893)
Loan commitments	Stage 1	2,182,644	-	2,084,549	-
Total nominal amount off-balance sheet		2,182,644	-	2,084,549	-

The financial assets recorded in each stage have the following characteristics:

- Stage 1: unimpaired and without significant increase in credit risk on which a 12-month allowance for ECL is recognised;
- POCI: purchased or originated as credit impaired on which a lifetime ECL is recognised.

As at 31 December 2018 and 1 January 2018, all the Bank's financial assets, except for receivables from merchants where chargebacks exceeded collateral are classified in 'Stage 1'. The Bank recognises 12-month allowances for expected credit losses in respect of these financial assets.

2. Financial risk management (continued)

2.2 Credit risk (continued)

2.2.4 Allowances for expected credit losses (continued)

As at 31 December 2018, gross carrying amounts of financial assets in Stage 1 amounted to €104,390,212 (1 January 2018: €129,050,522), with allowances for ECL totalling €153,634 (1 January 2018: €148,740).

At the end of the reporting period, the Bank has no past due or impaired financial assets within these asset categories, except for merchants whose chargeback transactions exceed the value of collateral held by the Bank, all of which can be classified immediately as credit-impaired as the amount will automatically fall within the 'past due' criteria. As at 31 December 2018, receivables amounting to €1,463,919 (1 January 2018: €315,153) from 130 merchants (1 January 2018: 200 merchants) related to chargeback transactions in excess of collateral held.

Further to the above Expected Credit Loss allowance, the Bank provides for any potential future losses from chargebacks beyond receivables recognised on-balance sheet that falls under the scope of IAS 37 'Provisions, Contingent Liabilities and Contingent Assets'.

The Bank did not recognise any expected credit losses in respect of commitments, representing undrawn credit facilities, since these had no material financial impact.

The following table explains the changes in the loss allowance between the beginning and the end of the annual period due to these factors:

	Non-credit impaired Stage 1		Credit impaired POCI		Total	
	Gross carrying amount	Allowance for ECL	Gross carrying amount	Allowance for ECL	Gross carrying amount	Allowance for ECL
	€	€	€	€	€	€
At 1 January 2018	129,050,522	(148,740)	315,153	(315,153)	129,365,675	(463,893)
Net movements in EAD	(24,660,310)	(4,894)	1,318,313	(1,318,313)	(23,341,997)	(1,323,207)
Assets written off	-	-	(169,547)	169,547	(169,547)	169,547
	(24,660,310)	(4,894)	1,148,766	(1,148,766)	(23,511,544)	(1,153,660)
At 31 December 2018	104,390,212	(153,634)	1,463,919	(1,463,919)	105,854,131	(1,617,553)
ECL charge						1,153,660
Recoveries						(65,036)
Assets written off						169,547
Total change in ECL for the period						1,258,171

2. Financial risk management (continued)

2.2 Credit risk (continued)

2.2.4 Allowances for expected credit losses (continued)

During the year, the Bank did not experience any transfer of financial assets between stages. As a result there is no re-measurement of ECL arising from transfer of stages.

Similarly, during the year the Bank did not change any of its risk parameters. Accordingly there are no changes in ECL attributable to changes in PDs and LGDs since the beginning of the year.

'Net movement in EAD' represents the impact on gross carrying amounts and the associated ECL allowance impact from volume movements in those financial assets subject to IFRS 9 ECL requirements.

2.3 Market risk

The Bank takes on exposure to market risks, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads and foreign exchange rates. In the normal course of business, the Bank's market risk arises principally from its exposure to different currencies, primarily resulting from its acquiring business. Following the receipt of preference shares in Visa Inc. in exchange for the Bank's membership interest in Visa Europe, the Bank is also moderately exposed to equity price risk.

(a) Interest rate risk

The Bank's placements with the Central Bank of Malta amounting to €42,994,656 (2017: €12,723,221), balances with other banks and financial institutions repayable on call and at short notice amounting to €8,956,457 (2017: €8,033,576), term placements with other banks amounting to €7,410,936 (2017: €nil), loans and advances to customers of €1,086,798 (2017: €1,741,126) and debt instruments amounting to €129,514 (2017: €83,516), are the Bank's interest-bearing financial instruments. The Bank's interest rate risk is not deemed to be significant given that these assets are either re-priced to current market rates frequently, or are short-term in nature or are otherwise immaterial. Accordingly, a sensitivity analysis disclosing how profit or loss and equity would have been affected by changes in interest rates that were reasonably possible at the end of the reporting period is not deemed necessary.

(b) Currency risk

The Bank manages its currency risk on an ongoing basis by ensuring that foreign currency liabilities are utilised to fund assets denominated in the same foreign currency thereby matching asset and liability positions as much as is practicable. When it is not possible to match the asset and liability currency positions, the Bank hedges its open foreign exchange exposures by entering into forward foreign exchange contracts with terms which match those of the hedged items.

2. Financial risk management (continued)

2.3 Market risk (continued)

(b) Currency risk (continued)

The table below summarises the Bank's exposure to foreign currency exchange rate risk at 31 December 2018. Included in the table are the Bank's financial instruments at carrying amounts, categorised by currency.

As at 31 December 2018	Total €	EUR €	USD €	GBP €	Other €
Financial assets					
Cash and balances with Central Bank of Malta					
Repayable on call and at short notice	7,057,141	683,822	6,373,319	-	-
Attributable to merchants	36,237,390	18,776,241	17,461,149	-	-
Funds receivable from merchants	2,686,708	255,472	155,444	1,493,095	782,697
Loans and advances to banks and financial institutions					
Repayable on call and at short notice	10,356,457	4,173,050	1,171,131	2,221,666	2,790,610
Term placements with other banks	7,410,936	-	7,410,936	-	-
Attributable to merchants	25,505,422	7,318,290	3,099,882	6,524,534	8,562,716
Loans and advances to customers	1,086,798	-	1,086,798	-	-
Financial investments	2,672,053	2,542,539	129,514	-	-
Funds advanced under collateral arrangements	6,452,100	119,838	6,332,262	-	-
Other assets	7,315,168	1,350,369	5,964,799	-	-
Total financial assets	106,780,173	35,219,621	49,185,234	10,239,295	12,136,023
Financial liabilities					
Amounts owed to customers	5,193,145	3,031,276	1,718,508	443,361	-
Settlement processing obligations	64,626,158	26,003,541	21,225,373	8,051,767	9,345,477
Other liabilities	3,162,824	3,159,017	-	3,807	-
Total financial liabilities	72,982,127	32,193,834	22,943,881	8,498,935	9,345,477
Net on balance sheet financial position		3,025,787	26,241,353	1,740,360	2,790,546
Notional amounts of derivative instruments			(27,937,838)	-	-
Net open position			(1,696,485)	1,740,360	2,790,546

2. Financial risk management (continued)

2.3 Market risk (continued)

(b) Currency risk (continued)

As at 31 December 2017	Total €	EUR €	USD €	GBP €	Other €
Financial assets					
Cash and balances with Central Bank of Malta					
Repayable on call and at short notice	220,297	220,297	-	-	-
Attributable to merchants	12,507,296	-	12,507,296	-	-
Funds receivable from card schemes	57,081,738	8,857,062	29,191,060	8,700,639	10,332,977
Loans and advances to banks and financial institutions					
Repayable on call and at short notice	9,462,147	342,946	4,322,370	1,563,458	3,233,373
Attributable to merchants	29,738,101	13,699,702	3,780,708	4,643,799	7,613,892
Loans and advances to customers	1,741,126	-	1,741,126	-	-
Financial investments	2,105,057	2,021,541	83,516	-	-
Funds advanced under collateral arrangements	12,241,683	6,245,436	5,996,247	-	-
Other assets	5,974,618	1,163,696	4,810,922	-	-
Total financial assets	131,072,063	32,550,680	62,433,245	14,907,896	21,180,242
Financial liabilities					
Amounts owed to customers	5,419,538	3,111,634	2,304,057	3,847	-
Settlement processing obligations	100,018,186	23,984,651	45,590,113	12,850,771	17,592,651
Other liabilities	2,721,432	2,721,432	-	-	-
Total financial liabilities	108,159,156	29,817,717	47,894,170	12,854,618	17,592,651
Net on balance sheet financial position		2,732,963	14,539,075	2,053,278	3,587,591
Net open position			14,539,075	2,053,278	3,587,591

Under the scenario that the euro appreciates by 20% against the USD and the GBP, the effect would be a decrease of €8,775 (2017: €3,318,471) in the carrying amount of financial instruments with the adverse impact recognised in profit or loss. Should the euro depreciate against the USD and the GBP currencies by 20%, the effect would be a gain of €8,775 (2017: €3,318,471) in the carrying amount of financial instruments and the favourable impact would be recognised in profit or loss.

(c) Equity price risk

The Bank is exposed to market price risk arising from the uncertainty about the future market prices of the investment held by the Bank in the preference shares of Visa Inc. that are classified in the statement of financial position as financial assets at fair value through profit or loss. The preference shares are convertible into ordinary shares of Visa Inc., they have no maturity and represent a residual interest in the issuer's net assets.

In view of the absence of quoted market prices for such instruments, the fair value of the preference shares has been determined on the basis of an internal valuation model, which is dependent on a number of assumptions including the value of Visa Inc.'s ordinary shares, which have a quoted price

2. Financial risk management (continued)

2.4 Liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn.

The Bank is exposed to liquidity risk in relation to meeting future obligations associated with its financial liabilities, which comprise principally amounts owed to customers, settlement processing obligations, current taxation and other liabilities (refer to Notes 20, 21 and 22). The Bank's settlement processing obligations are generally repayable within one month from the end of the reporting period, other than for funds withheld from merchants that serve as collateral to minimise losses ("merchant reserve"), which are repayable within 180 days from the end of the reporting period.

The Bank manages this risk by monitoring future cash flows together with changes in available liquidity on a regular basis. Except for prefunded merchants, Credorax only settles settlement processing obligations after the cash is collected from the card schemes. The Bank manages in a very active manner the relationship between the aggregate of funds receivable from card schemes and funds attributable to merchants, and its settlement processing obligations. These positions are considered not to impose liquidity risk as they are interrelated from a liquidity perspective. Senior management is updated on a regular basis on the cash flow position of the Bank.

As part of its liquidity risk management framework, management monitors the Bank's "cash flow ladder" or "maturity gap analysis", that allows forecasting of liquidity needs on a monthly basis.

Due to the nature of the business and the composition of the balance sheet, the bank assesses its liquidity risk currently to be very limited. As part of the liquidity management, and due to a recent change in terms and conditions of the merchants, the Bank will only forward funds to merchants, once funds are subsequently received from card schemes, except for instances where merchants have prefunded agreements. Therefore, other than prefunded transactions, the Bank is not exposed to liquidity risk.

2. Financial risk management (continued)

2.4 Liquidity risk (continued)

The following tables analyse financial assets and liabilities at the end of the reporting period by remaining period to maturity.

As at 31 December 2018	Total €	Within 3 months €	Between 3 months and one year €	Between one year and 3 years €	No maturity date €
Financial assets					
Cash and balances with Central Bank of Malta					
Repayable on call and at short notice	7,057,141	6,758,322	-	-	298,819
Attributable to merchants	36,237,390	36,237,390	-	-	-
Funds receivable from merchants	2,686,708	2,686,708	-	-	-
Loans and advances to banks and financial institutions					
Repayable on call and at short notice	10,356,457	10,356,457	-	-	-
Term placements with other banks	7,410,936	-	7,410,936	-	-
Attributable to merchants	25,505,422	25,505,422	-	-	-
Loans and advances to customers	1,086,798	182,846	560,041	343,911	-
Financial investments	2,672,053	-	-	129,514	2,542,539
Funds advanced under collateral arrangements	6,452,100	-	-	-	6,452,100
Other assets	7,315,168	5,964,403	1,350,765	-	-
Total financial assets	106,780,173	87,691,548	9,321,742	473,425	9,293,458
Financial liabilities					
Amounts owed to customers	5,193,145	5,193,145	-	-	-
Settlement processing obligations	64,626,158	52,700,171	6,947,599	-	4,978,388
Other liabilities	3,162,824	3,162,824	-	-	-
Total financial liabilities	72,982,127	61,056,140	6,947,599	-	4,978,388
Maturity gap		26,635,408	2,374,143	473,425	
Cumulative gap		26,635,408	29,009,551	29,482,976	

Assets which are not immediately accessible and readily available consist of term placements with other banks representing amounts pledged against a letter of credit issued in favour of card schemes that serve as collateral against the credit risk of the Bank. In addition, the Bank holds €298,819 with the Central Bank of Malta pledged in favour of the Depositor Compensation Scheme.

Similarly, financial investments amounting to €2,542,539 are also not readily available, since they are illiquid. Additionally, Funds advanced under collateral arrangements amounting to €6,452,100 are considered to be encumbered.

2. Financial risk management (continued)

2.4 Liquidity risk (continued)

As at 31 December 2017	Total €	Within 3 months €	Between 3 months and one year €	Between one year and 3 years €	No maturity date €
Financial assets					
Cash and balances with Central Bank of Malta					
Repayable on call and at short notice	220,297	217,669	-	-	2,628
Attributable to merchants	12,507,296	12,507,296	-	-	-
Funds receivable from card schemes	57,081,738	57,081,738	-	-	-
Loans and advances to banks and financial institutions					
Repayable on call and at short notice	9,462,147	9,462,147	-	-	-
Attributable to merchants	29,738,101	29,738,101	-	-	-
Loans and advances to customers	1,741,126	167,542	513,165	1,060,419	-
Financial investments	2,105,057	-	83,516	-	2,021,541
Funds advanced under collateral arrangements	12,241,683	-	-	-	12,241,683
Other assets	5,974,618	4,810,923	-	1,163,695	-
Total financial assets	131,072,063	113,985,416	596,681	2,224,114	14,265,852
Financial liabilities					
Amounts owed to customers	5,419,538	5,419,538	-	-	-
Settlement processing obligations	100,018,186	90,567,083	4,873,416	-	4,577,687
Other liabilities	2,721,432	2,721,432	-	-	-
Total financial liabilities	108,159,156	98,708,053	4,873,416	-	4,577,687
Maturity gap		15,277,363	(4,276,735)	2,224,114	
Cumulative gap		15,277,363	11,000,628	13,224,742	

Assets which are not immediately accessible and readily available consist of €2,628 the Bank held with the Central Bank of Malta pledged in favour of the Depositor Compensation Scheme.

The contractual undiscounted cash outflows attributable to the Bank's financial liabilities approximate to the carrying amounts of the Bank's liabilities. Accordingly, a table analysing the Bank's undiscounted cash outflows by maturity grouping was deemed by the directors to be unnecessary.

Similarly, financial investments amounting to €2,021,541 are also not readily available, since they are illiquid. Additionally, Funds advanced under collateral arrangements amounting to €12,241,683 are considered to be encumbered.

2. Financial risk management (continued)

2.5 Capital risk management

The Bank's objectives when managing capital, which is a broader concept than the 'equity' on the statement of financial position, are:

- to comply with the capital requirements set by the Malta Financial Services Authority (MFSA);
- to safeguard the Bank's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders; and
- to maintain a strong capital base to support the development of its business.

Capital adequacy and the use of regulatory capital are monitored on a regular basis by the Bank's management, employing techniques based on the guidelines developed by the Basel Committee and the European Union Directives and Regulations, as implemented by the MFSA for supervisory purposes.

The Bank is required to maintain a ratio of total regulatory capital to risk-weighted assets ('Capital requirements ratio') above a prescribed minimum level of 12% and a CET1 capital ratio of 10%, in line with the Bank's licence conditions. The Bank has processes to ensure that the minimum regulatory requirements in relation to own funds are met at all times.

The minimum capital requirements are calculated for credit, market and operational risks. During the year, the Bank utilised the Standardised Approach for credit risk, the Basic Indicator Approach for operational risk and the Basic Method for foreign exchange risk in order to calculate the Pillar 1 minimum capital requirements. For credit risk, under the standardised approach, risk weights are determined according to credit ratings provided by internationally recognised credit agencies such as Fitch or their equivalents and by using the applicable regulatory risk weights for unrated exposures. The Basic Indicator Approach requires that the Bank allocates capital for operational risk by taking 15% of the average gross income, while the Basic Method requires the Bank to allocate 8% of its overall net foreign exchange position to calculate the capital requirement for foreign exchange risk.

2. Financial risk management (continued)

2.5 Capital risk management (continued)

The following table shows the components of the Bank's capital base in accordance with the applicable requirements.

	2018	2017
	€	€
Common Equity Tier 1 (CET1) Capital		
Share capital	23,000,000	23,000,000
Fair value reserve	-	562,049
Retained earnings		
Previous year's retained earnings	3,612,866	3,680,577
Profit for the year	11,086,944	2,932,289
Dividends	(4,000,000)	(3,000,000)
	33,699,810	27,174,915
Deductions:		
Intangible assets	(2,841,604)	(2,480,834)
Regulatory adjustments relating to unrealised gains and losses pursuant to Articles 467 and 468	-	(112,410)
Deferred tax assets that rely on future profitability and do not arise from temporary differences	-	(1,233,271)
Forseeable final dividend charge	(7,000,000)	-
	23,858,206	23,348,400
Tier 2 capital		
Amount to be added to Tier 2 capital with regard to additional filters and deductions pre CRR	-	112,410
	-	112,410
Total own funds	23,858,206	23,460,810

2. Financial risk management (continued)

2.6 Fair values of financial assets and liabilities

IFRS 13 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Bank's market assumptions.

Fair values are consequently determined according to the following hierarchy:

- *Level 1 – quoted market price:* financial instruments with quoted prices for identical instruments in active markets.
- *Level 2 – valuation technique using observable inputs:* financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.
- *Level 3 – valuation technique with significant unobservable inputs:* financial instruments valued using models where one or more significant inputs are unobservable.

Financial instruments measured at fair value

The table below analyses the Bank's financial assets and liabilities which are measured at fair value by level of the fair value hierarchy.

	Level 3 €
As at 31 December 2018	
Financial assets at fair value	
Financial assets measured at FVPL	2,542,539
	2,542,539
 As at 31 December 2017	
Financial assets at fair value	
Financial assets classified as available-for-sale	2,021,541
	2,021,541

No transfers of financial instruments between different levels of the fair value hierarchy have occurred during the financial years ended 31 December 2018 and 2017.

The best evidence of fair value is a quoted price in an actively traded market. The fair values of financial instruments that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities issued. Where a financial instrument has a quoted price in an active market, the fair value of the total holding of the financial instrument is calculated as the product of the number of units and quoted price.

The judgement as to whether a market is active may include, but is not restricted to, the consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads. The bid/offer spread represents the difference in prices at which a market participant would be willing to buy compared with the price at which they would be willing to sell.

2. Financial risk management (continued)

2.6 Fair values of financial assets and liabilities (continued)

Financial instruments measured at fair value (continued)

In the event that the market for a financial instrument is not active, a valuation technique is used. Valuation techniques may incorporate assumptions about factors that other market participants would use in their valuations, including:

- the likelihood and expected timing of future cash flows on the instrument. Judgement may be required to assess the counterparty's ability to service the instrument in accordance with its contractual terms. Future cash flows may be sensitive to changes in market rates;
- selecting an appropriate discount rate for the instrument. Judgement is required to assess what a market participant would regard as the appropriate spread of the rate for an instrument over the appropriate risk-free rate;
- judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivative products.

Fair values for the Bank's derivative contracts are determined utilising valuation techniques, involving primarily the use of discounted cash flow techniques. The fair values referred to are determined by reference to market prices or rates (forward foreign exchange rates) quoted at the end of the reporting period. The valuation techniques used are supported by observable market prices or rates since these variables include only data from observable markets. Accordingly, the Bank's derivative financial instruments are categorised as level 2 instruments. Since the Bank entered into the open derivative on 31 December 2018, the fair value of such a derivative is nil. The Bank held no derivative financial instruments as at 31 December 2017.

As part of a transaction explained in Notes 9 and 27, during 2016 the Bank received preference shares convertible into ordinary shares of Visa Inc. in exchange for its membership interest in Visa Europe Limited. Accordingly, as at 31 December 2018 and 2017, financial assets measured at FVPL (formerly available-for-sale financial assets) comprise the Bank's investment in such preference shares.

These preference shares are classified as Level 3 as the valuation is dependent upon a number of assumptions including the value of Visa Inc.'s ordinary shares, which are quoted, a discount rate, a further discount for lack of marketability, and a conversion ratio, which as explained in Note 9, can be adjusted for potential losses from Visa Europe's interchange litigations. As at the reporting date, there were no identical transactions with regularly available market prices in respect of such preference shares.

Accordingly, in order to determine the fair value of the Visa Inc. preference shares as at 31 December 2018 and 2017, the Bank considered a range of potential outcomes, including the likely value of the potential level of losses from Visa Europe interchange litigation under different scenarios, based on probability weightings.

It is reasonably possible that if Visa Europe interchange litigation progresses within the next financial year and more information becomes available about the likely value of the potential losses, changes in assumptions determining the fair value could require a material adjustment to the carrying amount of the Visa Inc. preference shares.

2. **Financial risk management** (continued)

2.6 Fair values of financial assets and liabilities (continued)

Financial instruments measured at fair value (continued)

Changes to assumptions will change the overall fair value of the preference shares. In this respect, if the discount for the lack of marketability was assumed to shift by 500 basis points, it would result in the following effects on the fair value of the instruments:

	2018 Increase/ (decrease) €	2017 Increase/ (decrease) €
Discount for the lack of marketability increases by 5%	(170,754)	(100,737)
Discount for the lack of marketability decreases by 5%	172,635	129,982

With respect to the outcome of litigation proceedings, as further notifications, claims and settlements evolve, the Bank will re-evaluate the likely litigation cost as part of the fair valuation process.

Financial instruments not measured at fair value

Certain financial assets and liabilities are carried at amortised cost. The following table sets out the carrying amounts of these financial assets and liabilities:

	2018 €	2017 €
Financial assets		
Cash and balances with Central Bank of Malta	43,294,531	12,727,593
Funds receivable from card schemes	-	57,081,738
Funds receivable from merchants	2,686,708	-
Loans and advances to banks and financial institutions	43,272,815	39,200,248
Loans and advances to customers	1,086,798	1,741,126
Debt and other fixed income instruments	129,514	83,516
Funds advanced under collateral arrangements	6,452,100	12,241,683
Other assets	7,315,168	5,974,618
	104,237,634	129,050,522
Financial liabilities		
Amounts owed to customers	5,193,145	5,419,538
Settlement processing obligations	64,626,158	100,018,186
Other liabilities	3,162,824	2,721,432
	72,982,127	108,159,156

The fair values of these financial assets and liabilities are not disclosed given that the carrying amount is a reasonable approximation of fair value because these are either re-priced to current market rates frequently or are short-term in nature, or are otherwise immaterial.

3. Critical accounting estimates and judgements

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

In the opinion of the directors, other than for the fair valuation of the Bank's interest in Visa Inc., measured at FVPL, the accounting estimates and judgements made in the course of preparing these financial statements are not difficult, subjective or complex to a degree which would warrant their description as critical in terms of the requirements of IAS 1. Information about assumptions and estimation uncertainties relating to fair valuation of the financial instruments referred to is disclosed in Note 2.

The directors believe that there are no other areas involving a higher degree of judgement that have a significant risk of resulting in a material adjustment and that may have a significant effect on the amounts recognised in the financial statements; and there are no key assumptions and key sources of estimation uncertainty relating to estimates that require directors' most difficult, subjective or complex judgements.

4. Cash and balances with Central Bank of Malta

	2018	2017
	€	€
Cash in hand	1,056	687
Balances with Central Bank of Malta		
Repayable on call and at short notice	7,056,085	219,610
Attributable to merchants	36,237,390	12,507,296
	43,294,531	12,727,593

As at 31 December 2018 and 31 December 2017, no mandatory reserve deposit was required in terms of Article 32 of the Central Bank of Malta Act, Cap. 204 of the Laws of Malta. Included in this balance is an amount of €298,819 (2017: €2,628) pledged in favour of the Depositors Compensation Scheme.

The balances with the Central Bank of Malta are held to fulfil any Liquidity Coverage Ratio (LCR) requirement. A negative deposit facility interest rate of 0.40% (2017: 0.40%) applies to the Bank's average reserve holdings in excess of the minimum reserve requirements.

5. Funds receivable from card schemes

Funds receivable from card schemes as at 31 December 2017 relate to receivables from VISA and Mastercard as at the end of the reporting period in relation to acquiring transactions processed on behalf of merchants, which are subsequently transferred to merchants.

In these transactions, the Bank retains the contractual rights to receive cash flows from assets but assumes a contractual obligation to pay those cash flows to the respective merchants, at which point it transfers substantially all of the risks and rewards.

6. Funds receivable from merchants

	2018	2017
	€	€
Funds receivable from merchants	2,686,708	-
Allowances for expected credit losses	-	-
	2,686,708	-

During 2018, the Bank changed the terms and conditions of its merchants' agreements, clarifying that the Bank has no obligation to make payments to merchants unless it collects equivalent amounts from the card schemes, that the Bank is prohibited from selling or pledging the funds receivable from card schemes and that the Bank has an obligation to remit any cash it collects from card schemes without material delay. The change in terms and conditions resulted in a prospective accounting change of the receivables from card schemes. These receivables and relating payables are no longer recognised in the statement of financial position of the Bank as they meet the requirements of a pass-through arrangement under IFRS 9. The Bank's statement of comprehensive income and statement of changes in equity were unaffected by this change.

The funds receivable from merchants as at 31 December 2018 represent balances where the Bank agrees to transfer the amounts due to the merchants before receipt by the card schemes. In the event that the amounts are not received from the card schemes, the Bank has the right to claim the funds back from the merchants

7. Loans and advances to banks and financial institutions

	2018	2017
	€	€
Repayable on call and at short notice	10,356,457	9,462,147
Term placements with other banks	7,420,988	-
Attributable to merchants	25,505,422	29,738,101
	43,282,867	39,200,248
Allowances for expected credit losses	(10,052)	-
	43,272,815	39,200,248

Loans and advances to banks with a contractual maturity of three months or less are included in cash and cash equivalents for the purposes of the statement of cash flows. Term placements with other banks represent amounts pledged against a letter of credit issued in favour of card schemes that serve as collateral against the credit risk of the Bank.

Funds attributable to merchants are cash balances that the Bank holds on behalf of its acquiring merchants when the incoming amount from the card schemes precedes the merchants' funding obligation, in accordance with the contracted settlement cycle. These funds also include amounts that serve as collateral to minimise losses that may occur under the merchant agreement ("merchant reserves"). The Bank records a corresponding liability as settlement processing obligations in the statement of financial position.

8. Loans and advances to customers

	2018	2017
	€	€
Term loan	1,108,219	1,741,126
Allowances for expected credit losses	(21,421)	-
	1,086,798	1,741,126

Loans and advances to customers consist of a credit facility with a fixed maturity date. The advance is subject to a fixed interest rate at 4.15%.

Any reserves, as well as any rolling reserve, fixed reserve, merchant funds, funds pursuant to a funding delay or other retained funds, serve as a security against the loans and advances to customers. As at 31 December 2018, the Bank retained €879,131 (2017: €563,122) in merchant funds in its possession.

During the financial year ended 31 December 2018, there were no instances of non-performing exposures.

9. Financial investments

	2018	2017
	€	€
Financial assets measured at FVPL		
Investment in Series C Visa Inc. preferred stock	2,542,539	-
Financial assets classified as available-for-sale		
Investment in Series C Visa Inc. preferred stock	-	2,021,541
Financial assets at amortised cost		
Debt and other fixed income instruments	129,514	83,516
	2,672,053	2,105,057

Financial assets measured at FVPL as at 31 December 2018 (available-for-sale as at 31 December 2017) comprise preference shares of Visa Inc., with a face value of €5.8 million, which were received by the Bank in exchange for its membership interest in Visa Europe Limited, as part of a transaction in which Visa Europe Limited was acquired by Visa Inc.

The preference shares are convertible into ordinary shares of Visa Inc., they have no maturity and represent a residual interest in the issuer's net assets.

The purpose of the preference shares is to provide Visa Inc. with protection against all litigation risk associated with interchange fees linked to the activity of Visa Europe Limited. In this respect, ordinary shares of Visa Inc. will be issued to the holders of preference shares on a periodic assessment of the ongoing risk of liability to Visa. Following the determination of any liability, Visa makes a "conversion adjustment" to the Class A Common Equivalent Number for the preference shares. Accordingly, the conversion adjustment feature transfers specific litigation risk of Visa Inc. to the holders of the preference shares. As a result, the holders of the preference shares, including the Bank, are exposed to litigation risk. The conversion ratio adjustment is dependent upon the uncertain outcome of litigation, which is still in an embryonic stage. Hence, the value of these shares depends on the level and success of any future litigation.

9. Financial investments (continued)

Due to the pace at which developments in respect of litigation claims relating to interchange fees and point of sales rules against both VISA and Mastercard have occurred, it is not possible to assess future litigation cost, with a degree of certainty. The estimation of these litigation costs has been factored into an internal valuation model for the preference shares, based on the professional judgement of the Bank's Senior Management. Thus, the estimation arrived at for the purposes of these financial statements remains the best available forecast. Accordingly, the reported amounts are sensitive to the assumptions, estimates and model used for the purposes of valuing the preference shares. In this respect, a sensitivity analysis has been performed as disclosed within Note 2.6 'Fair value of financial assets and liabilities'.

As further notifications, claims and settlements evolve, the Bank will re-evaluate the likely litigation cost as part of the fair valuation process.

Financial investments at amortised cost as at 31 December 2018 and 2017 comprise of an investment in debt security with fixed income and maturity.

10. Funds advanced under collateral arrangements

	2018	2017
	€	€
Funds advanced under collateral arrangements	6,454,903	12,241,683
Allowances for expected credit losses	(2,803)	-
	<u>6,452,100</u>	<u>12,241,683</u>

Funds advanced under collateral arrangements represent amounts pledged in favour of card schemes that serve as collateral against the credit risk of the Bank.

11. Property and equipment

	Leasehold improvements €	Computer and electronic equipment €	Fixtures, fittings and office furniture €	Total €
Cost				
As at 1 January 2017	52,636	665,327	350,051	1,068,014
Additions	-	53,885	1,312	55,197
Disposals	-	(2,627)	-	(2,627)
As at 31 December 2017	52,636	716,585	351,363	1,120,584
Additions	-	67,382	10,654	78,036
As at 31 December 2018	52,636	783,967	362,017	1,198,620
Accumulated depreciation				
As at 1 January 2017	52,636	490,792	189,141	732,569
Charge for the year	-	87,718	42,616	130,334
Depreciation released on disposals	-	(963)	-	(963)
As at 31 December 2017	52,636	577,547	231,757	861,940
Charge for the year	-	70,772	30,935	101,707
As at 31 December 2018	52,636	648,319	262,692	963,647
Net Book Value				
As at 31 December 2017	-	139,038	119,606	258,644
As at 31 December 2018	-	135,648	99,325	234,973

12. Intangible assets

	Computer software and licenses €
Cost	
As at 1 January 2017	893,959
Additions	2,025,591
As at 31 December 2017	2,919,550
Additions	997,947
As at 31 December 2018	3,917,497
Accumulated amortisation	
As at 1 January 2017	267,222
Charge for the year	171,494
As at 31 December 2017	438,716
Charge for the year	637,177
As at 31 December 2018	1,075,893
Net Book Value	
As at 31 December 2017	2,480,834
As at 31 December 2018	2,841,604

As at 31 December 2017, software amounting to €1,984,082 relate to assets in the course of development, put into use in early 2018.

13. Deferred taxation

Deferred income taxes are calculated on all temporary differences under the liability method using a principal tax rate of 35% (2017: 35%).

The gross movement on the deferred income tax account is as follows:

	2018 €	2017 €
At beginning of year	1,511,751	1,962,685
IFRS 9 transitional adjustment	52,059	-
Recognised in profit or loss (Note 31)	(2,028,048)	(450,934)
At end of year	(464,238)	1,511,751

	2018 €	2017 €
The balance at 31 December represents temporary differences attributable to:		
Unrealised movements on financial assets measured at FVPL	(379,066)	-
Accelerated tax depreciation on fixed assets	(138,944)	(29,837)
Allowances for expected credit losses	53,772	-
Unabsorbed tax losses	-	1,541,588
	(464,238)	1,511,751

Whereas tax losses and notional deductions have no expiry date and may be carried forward indefinitely, capital allowances expire upon disposal of the related asset.

The impact of all movements in the table above are recognised in profit or loss.

14. Other assets

	2018 €	2017 €
Amounts owed by group undertakings (Note 38)	6,083,761	4,810,922
Deferred cash consideration receivable from Visa Inc.	1,350,765	1,163,696
	7,434,526	5,974,618
Allowances for expected credit losses	(119,358)	-
	7,315,168	5,974,618
Prepayments	611,969	522,424
	7,927,137	6,497,042

Amounts owed by group undertakings are unsecured, interest free and have no fixed date for repayment.

14. Other assets (continued)

Credorax Inc. and all of its subsidiaries are subject to a common assignment agreement in respect of the settlement of debts arising from services between entities in the normal course of business. The agreement allows for the assignment of debt amongst parties and entitles the assignees to set-off any assigned debt against receivables from the debtor counterparty in the normal course of business. It is intended to allow group undertakings to settle debts on a net basis and is deemed legally enforceable. Accordingly, amounts owed by/to group undertakings are reported in the statement of financial position on a net basis.

15. Share capital

	2018	2017
	€	€
Authorised Ordinary shares of €1 each		
200,000,000 (2017: 200,000,000) Ordinary shares of €1 each	200,000,000	200,000,000
Issued and fully paid		
23,000,000 (2017: 11,000,000) Ordinary shares of €1 each	23,000,000	23,000,000

16. Share based compensation reserve

The share based compensation reserve comprises the fair value of services provided by directors and selected employees of Credorax Bank Limited in exchange for the grant of share options (see Note 18) which is recognised as an expense in the Bank's profit or loss, over the vesting period and as a corresponding increase in shareholder's equity in accordance with the Bank's accounting policy.

Upon vesting of the share options granted, Credorax Inc. recharges to the Bank the grant-date fair value of the share options. Accordingly, the recharge is recognised by the Bank as a liability to the parent. During 2018, vested share options recognised as a liability to the parent amounted to €87,302 (2017: €778,457).

Unsettled balances are recognised in the statement of financial position as payables within amounts owed to group undertakings and are subject to the group's assignment agreement explained further in Note 14.

17. Fair value reserve

As at 31 December 2017, the fair value reserve reflects the effects of the fair value measurement of financial assets classified as available-for-sale, net of deferred taxes. Any gains or losses are not recognised in profit or loss until the asset has been sold or impaired.

18. Share based employee compensation

During 2012, Credorax Inc., the Bank's parent, introduced a share based employee compensation plan ("the Plan") under which options to purchase ordinary shares of Credorax Inc. are granted to directors and selected employees of Group companies, including those of Credorax Bank Limited.

No consideration is payable on the grant of an option. Options may generally be exercised to the extent that they have vested. The options vest according to the relevant schedule generally within four years after the grant date and expire within ten years after the date of grant. The exercise price is determined by the Board of Directors of Credorax Inc. Outstanding options comprise options existing as at the end of the reporting period not cancelled or exercised by their respective beneficiaries (employees and directors). Options are cancelled when the entity that is granting the options cancels the grant of the equity instrument through a decision taken by the Board of Directors. Options are forfeited when the beneficiary leaves the Bank. Options that vested as of the termination date may be exercised but only within such period of time ending on the earlier of ninety (90) days following the termination date or the expiration date.

The weighted average grant-date fair value of the share options granted to the Bank's officers and employees during the year amounted to USD7.00 (2017: USD9.59). The entity applied a binomial option pricing model to determine the grant date fair value of share options granted up to 31 December 2014 and a Black-Scholes pricing model for the grant date fair value of share options granted from 2015 onwards. Model inputs include the share price of Credorax Inc. at grant date, exercise price, expected volatility of 50.12% (2017: 43.65%) which is based on historical volatility of the share price, dividend yield of nil% (2017: nil%), contractual life of ten years, and a risk free interest rate between 2.54% and 2.94% (2017: between 1.75% and 2.06%).

A summary of the share option activity for the year ended 31 December is as follows:

	2018	Weighted average exercise price USD	2017	Weighted average exercise price USD
	Number of share options		Number of share options	
Outstanding as at 1 January	941,983	9.59	949,067	9.60
Granted	145,500	7.56	119,000	7.56
Forfeited	(329,250)	8.70	(60,834)	9.97
Exercised	-	-	(65,250)	4.26
Balance at 31 December	758,233	7.00	941,983	9.69

During the financial year under review, 85,325 (2017: 136,125) options at a weighted exercise price of USD9.07 (2017: USD9.55) had vested. As at 31 December 2018, 520,983 (2017: 462,813) share options were exercisable at a weighted average price of USD6.88 (2017: USD8.58).

No options were exercised during the financial year ended 31 December 2018. The weighted average share price at the date of exercise for share options exercised during the financial year ended 31 December 2017 was USD4.26.

18. Share based employee compensation (continued)

The weighted average remaining contractual life of options outstanding as at 31 December 2018 and 2017, analysed by exercise price were as follows:

	2018		2017	
	Options granted	Weighted average remaining contractual life	Options granted	Weighted average remaining contractual life
Option price				
USD2.60	95,866	3.01	95,866	4.17
USD3.80	84,750	4.02	84,750	5.00
USD5.00	21,467	2.25	21,467	3.25
USD6.40	65,900	4.35	135,900	5.23
USD7.56	227,750	9.15	115,250	9.62
USD9.00	89,500	5.23	250,250	6.08
USD11.01	173,000	7.01	238,500	7.83

The total expense recognised in the Bank's financial statements throughout the period in relation to share based employee compensation amounted to €113,172 (2017: €219,084) and is included within employee benefit expense and directors' emoluments (refer to Notes 28 and 38).

19. Derivative financial instruments

The Bank enters into derivatives primarily to manage its foreign exchange risk. The derivative financial instrument at 31 December 2018 related to the forward purchase of USD 32 million against the euro at contractual rate of 1.1481. The foreign exchange forward contract matures within one month from the end of the reporting period. Since the Bank entered into the derivative on 31 December 2018, the fair value of such a derivative is nil. The Bank held no derivative financial instruments as at 31 December 2017.

20. Amounts owed to customers

	2018	2017
	€	€
Redeemable at notice	5,190,608	4,668,079
Repayable on demand	2,537	751,459
	5,193,145	5,419,538

Amounts owed to customers are classified as liabilities at amortised cost.

21. Settlement processing obligations

	2018	2017
	€	€
Amounts owed to merchants	63,740,603	99,303,523
Other settlement processing obligations	885,555	714,663
	64,626,158	100,018,186

As disclosed in Note 6, by 31 December 2018 the Bank fulfilled the derecognition criteria as per IFRS 9 for its receivables from card schemes and corresponding merchants' obligations, to reflect the fact that the Bank's obligation to pay the merchants is only created once the equivalent amount is received from the card schemes.

Amounts owed to merchants relate to funds already received from card schemes in the process of settlement to merchants. The prior year's amounts owed to merchants also included amounts that were still receivable by the card schemes.

Settlement processing obligations at the end of the reporting period exceed balances with Central Bank of Malta and loans and advances to banks and financial institutions attributable to merchants by €2,883,346. The Bank deposited the additional funds attributable to merchants after the end of the reporting period from balances held in operating bank accounts. In this respect, as at the end of the reporting period, the Bank had sufficient funds in its operating bank accounts to cover the additional funds requirement.

22. Other liabilities

	2018	2017
	€	€
Indirect taxation	49,126	165,509
Accruals and payables	3,113,698	2,555,923
	3,162,824	2,721,432

23. Interest income

	2018	2017
	€	€
On loans and advances to banks	333,608	50,854
On loans and advances to customers	47,202	64,575
Other interest	203,291	188,307
	584,101	303,736

24. Fee and commission income

	2018	2017
	€	€
Acquiring revenue	87,123,037	65,829,819
Other fees	1,685,554	1,359,225
	88,808,591	67,189,044

25. Fee and commission expense

	2018	2017
	€	€
Transaction and other processing fees	38,441,554	32,265,668
Fees paid to card schemes	21,773,350	16,109,447
Sales commissions	7,493,467	6,509,640
Other fee and commission expenses	463,936	378,626
	68,172,307	55,263,381

26. Net trading income

	2018	2017
	€	€
Net fair value (losses) / gains on derivative financial instruments	(974,883)	243,713
Net gains from foreign exchange activities	9,202,967	3,832,057
	8,228,084	4,075,770

27. Net income from financial instruments measured at FVPL

	2018	2017
	€	€
Changes in fair value	520,996	-
Dividend income	42,816	35,875
	563,812	35,875

28. Employee compensation and benefits

	2018	2017
	€	€
Wages and salaries	5,186,421	5,064,480
Social security costs	144,067	101,631
Employees' share based compensation	89,021	191,941
Disbursed salaries	744,097	948,368
Share based compensation attributable to disbursed salaries	24,151	27,143
	6,187,757	6,333,563

Average number of persons employed by the Bank during the year:

	2018	2017
Managerial	21	17
Supervisory and clerical	71	76
Others	2	3
	94	96

29. General and administration expenses

	2018	2017
	€	€
Services from group undertakings:		
Technical support	3,332,112	2,164,154
Sales and marketing	594,848	570,024
Travelling and accommodation	410,548	358,092
Legal and professional fees	865,576	416,519
Auditor's remuneration	125,000	125,000
Property operating lease rentals payable	263,685	348,304
Consultancy fees	510,454	306,429
Other expenses	1,210,157	726,240
	7,312,380	5,014,762

Fees charged by the auditors for services rendered during the financial year relate to the following:

	2018	2017
	€	€
Annual statutory audit	125,000	125,000
Tax advisory services	22,350	8,950
Other non-assurance services	90,000	90,000
	237,350	223,950

30. Provisions for credit losses and other impairment allowances

A. Net impairment charges

Merchants are liable for any chargebacks or losses that occur under the merchant agreement. In the event, however, that a merchant is unable to fulfil obligations, the Bank is held liable for any such losses vis-à-vis card schemes. Impairment losses arise when the value of such chargebacks exceed the collateral that the Bank holds to minimise such losses in the form of a merchant reserve. Other impairment losses include provisions arising from past events for which the Bank has a valid expectation that future chargebacks will exceed the value of the collateral as at the end of the reporting period.

	2018	2017
	€	€
Net impairment losses:		
Provisions for future chargebacks	-	1,582,473
Net movement in impairment allowances	-	(1,088,190)
Recovery of amounts written off in prior years	-	(123,633)
Amounts written off during the year	-	936,045
	-	1,306,695

The recovery of amounts written off in prior years includes the impact of insurance and litigation proceeds upon closure of legal case in respect of a previously written off debt.

B. Changes in expected credit losses and other impairment allowances

	2018	2017
	€	€
Recovery of amounts written off in prior years	(65,036)	-
Amounts written off during the year	169,547	-
Changes in expected credit losses:		
Receivables from merchants	1,148,766	-
Loans and advances to banks	(1,005)	-
Loans and advances to customers	(12,233)	-
Funds advanced under collateral arrangements	(8,235)	-
Other assets	26,367	-
	1,258,171	-

31. Tax expense

	2018	2017
	€	€
Current tax	(2,785,817)	(973)
Deferred tax (Note 13)	(2,028,048)	(450,934)
	(4,813,865)	(451,907)

31. Tax expense (continued)

The tax recognised in profit or loss differs from the theoretical amount that would arise using the basic tax rate as follows:

	2018 €	2017 €
Profit before tax	15,435,441	3,384,196
Tax at the applicable rate of 35%	(5,402,404)	(1,184,469)
Tax effect of:		
Non-taxable income	65,474	56,407
Income subject to tax at 15%	1,051	1,297
Expenses not deductible for tax purposes	(2,291)	(4,119)
Application of notional interest deduction	721,022	678,977
Other	(196,717)	-
	(4,813,865)	(451,907)

32. Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise balances with contractual maturity of not more than three months, which form part of an integral part of the Bank's cash management.

	2018 €	2017 €
Cash and balances with Central Bank of Malta (Note 4)	43,294,531	12,727,593
Loans and advances to banks and financial institutions (Note 7)	35,861,879	39,200,248
	79,156,410	51,927,841

33. Significant non-cash transactions

At an extraordinary general meeting held on 1 August 2018, the Bank approved and paid an interim dividend of four million Euro (€4,000,000) from the Bank's profits available for distribution, to the Bank's shareholder, Credorax Inc. The dividend payment obligation was offset against the debt due by the ultimate parent, Credorax Inc. in accordance with the terms of the common assignment agreement entered into between Credorax Inc. and all of its subsidiaries (refer to Note 14).

As disclosed in Note 18, during 2018, the parent contributed to the entity's equity amounts of €113,172 (2017: €219,084) in respect of share options granted to employees of the Bank.

34. Commitments

	2018	2017
	€	€
Undrawn credit facilities	2,182,644	2,084,549

The above commitments exclude commitments in relation to capital expenditure and operating leases which are disclosed in Note 35.

35. Capital and lease commitments

As at 31 December 2018 and 2017, the Bank was party to non-cancellable operating lease agreements of properties in respect of which the future minimum lease payments extend over a number of years. Specific lease arrangements include an option to renew the lease after the original term but the amounts presented in the table below do not reflect lease charges applicable to the renewal period.

	2018	2017
	€	€
Not later than 1 year	279,500	255,676
Later than 1 year and not later than 5 years	478,000	804,000
	757,500	1,059,676

Other commitments relating to the acquisition of new software licenses and operating expenditure are as follows:

	2018	2017
	€	€
Not later than 1 year	281,084	753,822
Later than 1 year and not later than 5 years	829,870	-
	1,110,954	753,822

36. Contingencies

As at 31 December 2018, the Bank had no (2017: one) legal proceeding outstanding against it arising in its normal course of business.

37. Dividend distribution

Dividend distribution to the Bank's shareholder is recognised as a liability in the Bank's financial statements in the period in which the dividends are approved by the Bank's shareholders.

The following dividends were recognised as distributions during the year ended 31 December.

	2018	2017
	€	€
Net dividend	4,000,000	3,000,000
Dividends per share	0.17	0.13

37. Dividend distribution (continued)

After the reporting date, the following dividends were proposed by the Board of Directors. The dividends have not been recognised as liabilities in these financial statements.

	2018	2017
	€	€
Net dividend	7,000,000	-
Dividends per share	0.30	-

38. Related party transactions

Related parties of the Bank include the ultimate parent, all entities controlled by the ultimate parent ('group undertakings'), key management personnel, close family members of key management personnel and entities which are controlled or jointly controlled by key management personnel or their close family members.

Key management personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of Credorax Bank Limited, being the Directors.

The following main transactions were carried out with related parties:

	2018	2017
	€	€
Purchases of services from group undertakings	3,831,450	2,647,226
<i>Disbursements by group undertakings</i>		
Staff salaries	768,248	975,511
<i>Directors' emoluments (including non-executive directors)</i>		
Salaries and other emoluments	79,000	79,000
Share based compensation	-	4,486
	79,000	83,486

Further to the above, during 2018 the Bank advanced a total of €21,600,434 (2017: €22,358,040) to finance the operations of the group entities, of which €10,738,647 (2017: €9,044,410) were repaid. Balances with related parties as at the end of the reporting period are disclosed in Note 14 to the financial statements.

39. Statutory information

Credorax Bank Limited is a limited liability company and is incorporated in Malta.

The immediate and ultimate parent company of Credorax Bank Limited is Credorax Inc., a company registered in the British Virgin Islands, with its registered address at Commerce House, Wickhams Cay 1, Po Box 3140, Road Town, Tortola.

Additional Regulatory Disclosures
31 December 2018

1. Risk management

1.1 Overview of risk disclosures

The Additional Regulatory Disclosures ('ARDs') were prepared by Credorax Bank Limited ('the Bank') in accordance with the Pillar 3 quantitative and qualitative disclosure requirements as governed by Banking Rule 07 ('BR/07'): Publication of Annual Report and Audited Financial Statements of Credit Institutions authorised under the Banking Act, 1994, issued by the Malta Financial Services Authority ('MFSA'). These disclosures are based on the disclosure requirements of Directive 2013/36/EU (Capital Requirements Directive) and EU Regulation No. 575/2013 (Capital Requirements Regulation) of the European Parliament and of the Council of 26 June 2013 and are presented on a solo basis at the level of the Bank. These ARDs are published on an annual basis as part of the Annual Report of the Bank and seek to increase public disclosure relative to the Bank's capital structure and adequacy as well as its risk management policies and practices.

In line with the banking regulatory requirements, these ARDs are not subject to an external audit, except to the extent that any disclosures are equivalent to those made in the Financial Statements which are prepared in accordance with the requirements of International Financial Reporting Standards ('IFRS') as adopted by the EU. Through internal verification procedures, the Bank ensures that these disclosures are presented fairly.

1.2 Risk management framework

The Bank's business model throughout the years has been that of providing integrated acquiring and payment processing services to merchants within the EU and two other EEC States. Moreover, Credorax Bank Limited operates as a credit institution under the Banking Act, Cap 371 of the Laws of Malta, whereby it is licensed to accept deposits and also provide loans to its merchants.

The Bank is committed to creating lasting value for shareholders by focusing on expanding its growing customer base, and by employing specialised staff that work with merchants to find solutions for electronic payment transactions. In keeping with this mission, the Bank's strategy targets sustainable growth and a medium risk profile. In this respect, the Bank's return on assets calculated as its net profit after tax expressed as a percentage of average total assets, for the reporting period ended 31 December 2018 is 8.62% (2017: 2.48%). The directors believe that the Bank's financial position is expected to improve and will continue to improve in the future.

The management team selects the Bank's merchants with prudence and caution through customer due diligence measures. The Bank is especially conscious of the risks involved in the acquiring and banking business, not only as a result of its exposure to the arising credit risk involved but also to the operational risk intrinsic within the business. Therefore, it strives to minimise its exposure to operational risk by taking on merchants only when it knows how to manage the resulting risk. This culture is fostered across the entire Bank.

The Bank takes on risk with the aim of generating profits and therefore considers risk management a core competency that helps produce higher returns for its various stakeholders. The Bank has tailored its risk management objectives and policies to manage the specific risks arising from payment acquiring while considering international guidelines, such as the Basel III Accord, corresponding Directives and Regulations of the European Union, including technical standards, as well as contemporary international banking practices. In addition, the Bank is also in compliance with the requirements of the PMLFTR, PCI Data Security Standards and the PCI Payment Application Data Security Standards. In this respect, the Board of Directors ('Board') deems the risk management framework adopted by the Bank to be adequate and hence gives assurance to the Bank's stakeholders that the risk management systems adopted by the Bank are appropriate in relation to the Bank's risk profile and strategy.

1. Risk management (continued)

1.2 Risk management framework (continued)

The main categories of risk to which the Bank is exposed to are:

- Credit risk: Credit risk stems from the loss of equity and profit as a result of the possible non-prompt repayment or non-payment of existing and contingent obligations by the Bank's counterparties. This relates to legitimate merchant transactions that generate chargebacks, which the merchant is unable to fund in the normal course of business. In these circumstances, Credorax Bank Limited is obliged to honour the chargebacks by accepting the chargebacks, which may result in significant losses.
- Market risk: Risk of losses arising from unfavourable changes in the level and volatility of interest rates, foreign exchange rates or other price risk. The Bank's market risk arises mainly from its foreign exchange exposure.
- Liquidity risk: The risk that the Bank is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn.
- Operational risk: Risk of damage resulting from the lack of skilful management or good governance within the Bank and the inadequacy of proper control, which might involve internal operations, personnel, system or external occurrences that in turn affect the income and capital funds of financial institutions. The Bank has adopted an operational risk management framework and procedures, which provide for the identification, assessment, management, monitoring and reporting of the Bank's operational risks.

The Bank aims to manage these risks by applying methods that meet best practice and considers it important to have a clear distribution of responsibilities for risk management across the Bank. In this respect, the Bank adopts the three lines of defence model in risk management.

The first line of defence is constituted by the functions that own and manage risks, namely the Bank's management, represented mainly through the Executive Committee members and the functions reporting to them. The Executive Committee chaired by the Bank's Managing Director (who does not form part of the Board of Directors) is composed of the VP Human Resources; the Portfolio Manager; the Chief Operations Officer; the Chief Financial Officer and the Chief Underwriting Officer. The Executive Committee is mainly responsible for the overall day-to-day management of the Bank, in accordance with such policies and directions as the Board may determine from time to time.

The Underwriting Committee deals with the risks involved when on-boarding prospective merchants and is primarily responsible for monitoring the Bank's portfolio quality, and for ensuring that the Bank is adhering to its several merchant acquiring policies, with particular attention to the Credit Risk policy at all times. The Credit risk policy addresses the underwriting process where the Bank assesses the merchants' ability to meet current and future obligations, validate the legitimacy of their business whilst considering the potential risk of fraud, high chargeback rates and business failure. The underwriting process, governed also by the Customer Acceptance policy and the Acceptable Industry policy, provides an opportunity to reject a merchant that is determined to have an unacceptable history of chargeback volumes, has a weak financial position, is not operating a valid business model or falls under the prohibited list of merchants. Furthermore, where a merchant poses certain risks, the said merchant is escalated to the Underwriting Committee where it is subjected to a thorough analysis from a legal, operational, fraud and risk perspective. The Underwriting Committee is composed of the Chief Underwriting Officer, the Head of Risk Operations, the Head of Policy and Scheme Compliance, the Head of Risk Strategy and Implementation, the Head of Compliance, the Portfolio Manager and the Managing Director. The Chief Underwriting Officer ensures that underwriting procedures and checks are in line with regulatory requirements and the Bank's risk appetite, while at the same time is responsible for the financial and credit risk exposure of the Bank's acquiring portfolio as guided by the Bank's policies.

1. Risk management (continued)

1.2 Risk management framework (continued)

The second line is represented by the Enterprise Risk Manager and the Head of Compliance, who reports to the Risk Oversight Committee. The Risk Oversight Committee is responsible to oversee the Bank's overall risk management framework. This means that the Committee is responsible for ensuring the proper implementation and review of the Bank's risk policies so that they conform to the Bank's risk appetite, and for ensuring that all risk controls are operating effectively. The Committee reports to the Board on the Bank's risk profile. The Risk Oversight Committee convened four times during the period under review.

The Bank's Enterprise Risk Manager ensures a comprehensive approach towards the identification and assessment of the Bank's risks. His role is separate from the fraud and risk function referred to above, which is specific to the Bank's acquiring business. Further to the identification and assessment, the Enterprise Risk Manager is tasked with monitoring the Bank's risk profile relative to established risk appetite triggers, and to assess how these can be mitigated and escalated where appropriate.

The Internal Auditor form the third line of defence who reports to the Audit Committee. However, the Board of Directors is ultimately responsible for the establishment and oversight of the Bank's risk management framework through the development and monitoring of compliance with the Bank's risk management policies. The aim of the risk management framework is to support the Bank in achieving its goals and objectives and ensure that the risks are commensurate with the rewards.

The Board establishes the risk appetite of the Bank which is the maximum risk that the Bank is willing to assume to meet business targets. The risk appetite is set in a process based on a thorough analysis of its current risk profile. The Bank identifies a number of key risk components and for each, determines a target that represents the Bank's perception of the component in question. The Bank's risk appetite is a key tool to ensure coherence between the Bank's strategic considerations regarding risk-taking and day-to-day decisions.

The Audit Committee is appointed to oversee the quality and integrity of the Bank's financial statements, it's compliance with legal and regulatory requirements, the qualifications, performance and independence of the external auditor, the performance of the Internal Auditor, the quality of the Bank's internal controls, and any related party transactions. In executing its responsibilities, the Audit Committee receives and reviews regularly reports made by the internal and the external auditors, and monitors any identified control issues through to a satisfactory conclusion.

The Bank's independent Internal Audit function reviews the adequacy and proper operation of internal controls in individual areas of operation, and performs ad-hoc reviews of risk management controls and procedures. The function reports its findings to the Audit Committee.

2. Capital risk management

2.1 Own funds

The level of own funds represents the Bank's available capital and reserves for the purposes of assessing capital adequacy from a regulatory perspective. The total capital ratio is a measure of the long-term financial strength of a bank, usually expressed as a ratio of its own funds or capital to the measure of the Bank's risk exposure.

2. Capital risk management (continued)

2.1 Own funds (continued)

The Bank has processes to ensure that the minimum regulatory requirements in relation to own funds are met at all times, through the assessment of its capital resources and requirements. During the financial period ended 31 December 2018, the Bank has complied with all the externally imposed capital requirements to which it was subject.

In December 2013, the European Banking Authority ('EBA') issued its Implementing Technical Standards ('ITS') on own funds disclosures. The disclosure requirements of these technical standards have been integrated within the Bank's disclosures set out below. For regulatory purposes, the capital base is divided into Common Equity Tier 1 ('CET1') capital and Tier 2 capital. The Bank's CET1 capital includes ordinary share capital, retained earnings and other regulatory adjustments relating to items that are included in equity but treated differently for capital adequacy purposes. The Bank does not maintain a Reserve for General Banking Risks since it does not have loans and advances which are classified as "Non-performing".

Regulatory transitional arrangements (including paragraph 4 of the CRR article 473a) with regards to IFRS 9: Financial instruments were introduced by the European Parliament and the Council on 27 December 2017. These permit banks to add back to their own funds a proportion of the impact of IFRS 9 during the first five years of implementation. The proportion that banks may add back starts at 95% in 2018 and reduces to 25% by 2022. Given the immaterial impact of the IFRS9 provision for the year ended 31 December 2018, the Bank has opted not to apply these regulatory transitional arrangements.

(a) Share capital

The Bank's share capital as at 31 December 2018 is analysed as follows:

	2018 No. of shares	2018 €
Authorised		
200,000,000 (2017: 200,000,000) Ordinary shares of €1 each	200,000,000	200,000,000
Issued and fully paid up		
23,000,000 (2017: 23,000,000) Ordinary shares of €1 each	23,000,000	23,000,000

(b) Retained earnings

The retained earnings represent earnings not paid out as dividends. Retained earnings form part of own funds only if those profits have been verified by the Bank's independent external auditor. During 2018, by virtue of a resolution dated 1 August 2018 the Bank's shareholders approved to distribute interim dividends amounting to €4,000,000 (2017: €3,000,000).

The Directors proposed a final dividend amounting to €7,000,000 to be paid to shareholders. This dividend is subject to approval by shareholders and has not been included as a liability in these financial statements.

2. Capital risk management (continued)

2.1 Own funds (continued)

	As at 31 December 2018
	€
Common Equity Tier 1 (CET1) capital	
<i>Common Equity Tier 1 (CET1) capital: instruments and reserves</i>	
Share capital	23,000,000
Retained Earnings	
Previous year's retained earnings	3,612,866
Profit for the year	11,086,944
Dividends	(4,000,000)
	33,699,810
<i>Common Equity Tier 1 (CET1) capital: regulatory adjustments</i>	
Intangible assets	(2,841,604)
Forseeable final dividend charge	(7,000,000)
	(9,841,604)
Total regulatory adjustments to CET1	(9,841,604)
CET1 capital	23,858,206
Total capital	23,858,206
Total risk weighted assets	73,556,076
Capital ratios	
CET1 capital	32.4%
Tier 1 capital	32.4%
Total capital	32.4%
Institution specific buffer requirement	6.5%
of which: capital conservation buffer	1.9%
of which: countercyclical buffer	0.1%
Common Equity Tier 1 available to meet buffers	20.4%

2. Capital risk management (continued)

2.2 Credit risk

2.2.1 Introduction to credit risk

Credit risk is the risk that the Bank will incur losses as a result of a counterparty failing to fulfil its contractual obligations to the Bank. Credit exposures arise principally through the Bank's participation in processing and settlement of payment transactions.

Credit risk constitutes the Bank's largest risk in view of its acquiring activities and therefore the Bank is fully aware of the connotations of such risk and places great importance on its effective management. The portfolio of merchants and their performance is monitored on an ongoing basis and the relevant management bodies, including the Board of Directors and the Risk Oversight Committee, are kept informed on an ongoing basis of developments of irregular merchant trends, high chargebacks and other relevant information.

2.2.2 Credit risk management

All new merchants are reviewed by the risk function to ensure that the credit risk they represent is within the Risk Appetite agreed by the Board of Directors. The on-boarding of merchants is based on the Bank's internal assessment which serves as an effective mitigant to credit risk arising from chargebacks. In examining a merchant's creditworthiness, the Net Expected Exposure ("NEE"), business age, partner reliability, as well as the industry sector in which the merchant operates are considered.

As part of the risk assessment, Credit Risk Analysts, approve, reject or amend the processing terms, namely fixed and rolling reserve, funding delay, frequency of settlement, and any other merchant processing terms suggested by the sales team on behalf of the partner or merchant. Any matters not considered to fall within the parameters of normal business practices are escalated to the Head of Risk Operations who will in turn decide whether further escalation is required to the Chief Underwriting Officer or the Underwriting Committee.

Subsequent to on-boarding, in order to manage its credit risk exposures arising from its payment processing operations, the Bank compiles and updates due diligence reports in respect of its merchants and IPSPs, and establishes appropriate transaction volumes and value limits. The Bank monitors its merchants' adherence to limits in relation to chargebacks on a daily basis to prevent any collection losses that are inherent in the Bank's payment processes. The Bank has also set limits of authority and has segregation of duties in place so as to maintain impartiality and independence during the underwriting and on-boarding process and to control ongoing merchant compliance.

If in any given month the chargeback ratio or NEE is in excess of these thresholds, a report explaining the cause of the breach and the action plan to lower the exposure to an acceptable level is provided by the Chief Underwriting Officer to the Risk Oversight Committee.

2. Capital risk management (continued)

2.2 Credit risk (continued)

2.2.2 Credit risk management (continued)

The Bank's principal credit risk exposures reflecting regulatory information submitted to the MFSA are as follows:

	2018 Average value €	2018 Year end exposure value €
Central banks	26,542,810	43,294,531
Multilateral development banks	96,009	129,514
Institutions	42,385,689	49,724,914
Corporates	56,529,511	10,016,630
Equity	2,345,137	2,542,539
Other items	2,255,869	2,197,709
	130,155,025	107,905,837

The exposures set out in the preceding table are based on the sum of on-balance sheet exposures and off-balance sheet exposures, adjusted for the credit conversion factors stipulated within Article 166(10) of the CRR. Due to the specificities of the risks inherent within the payment acquiring business, the above analysis does not represent the Bank's maximum exposure to credit risk, which however is considered as part of the Bank's Pillar II risks.

Credit risk mitigation practices in respect to loans and advances to customers include reserves, merchant funds, funds pursuant to a funding delay or other retained funds which serve as a security against such exposures. As at 31 December 2018, the Bank retained €879,131 (2017: €563,122) in merchant funds in its possession.

Credit risk exposures analysed by residual maturity

	Total €	Within three months €	Within one year but over three months €	More than one year €	No maturity €
As at 31 December 2018					
Central banks	43,294,531	42,995,712	-	-	298,819
Multilateral development banks	129,514	-	-	129,514	-
Institutions	49,724,914	35,861,878	7,410,936	-	6,452,100
Corporates	10,016,630	3,148,275	560,041	343,911	5,964,403
Equity	2,542,539	-	-	-	2,542,539
Other items	2,197,709	28,396	1,350,765	-	818,548
Total	107,905,837	82,034,261	9,321,742	473,425	16,076,409

2. Capital risk management (continued)

2.2 Credit risk (continued)

2.2.2 Credit risk management (continued)

Credit risk exposures analysed by geographical region

The geographical concentration of the Bank's exposure classes as at the end of the reporting period is analysed in the following table. For the purposes of this table, the Bank has allocated exposures classes to regions based on the country of domicile of the counterparties.

As at 31 December 2018	Total	Malta	Other EU countries	Rest of the world
	€	€	€	€
Central banks	43,294,531	43,294,531	-	-
Multilateral development banks	129,514	-	129,514	-
Institutions	49,724,914	24,286,057	19,106,595	6,332,262
Corporates	10,016,630	-	3,773,506	6,243,124
Equity	2,542,539	-	-	2,542,539
Other items	2,197,709	818,548	-	1,379,161
Total	107,905,837	68,399,136	23,009,615	16,497,086

The Bank's exposures are primarily concentrated within the financial services industry.

2.2.3 Credit quality of the Bank's merchants

As noted earlier the material part of the Bank's credit risk arises from the potential future losses that may arise as a result of chargebacks for which merchants would not be in a position to honour.

The Bank's Risk function performs formal risk assessment procedures for each merchant in order to determine the exposure that each merchant represents to Credorax Bank Limited, together with a formal assessment on its business introducers, also referred to as partners. As highlighted previously, the Bank focuses on the compilation, together with ongoing and event-driven updating of due diligence analysis taking cognisance of collateral measurement and of effective transaction monitoring to ensure that the merchant is not being used as a vehicle for money laundering or terrorist financing.

The Bank's credit concentration risk can arise through the imperfect diversification of its merchant portfolio, at an individual merchant level or potentially on an industry or country basis. In this regard, the directors are cognisant that significant reliance on specific merchants, particular industries or sectors can be detrimental to the Bank, and therefore have in place appropriate concentration limits within the Bank's Risk Appetite Statement.

2. Capital risk management (continued)

2.2 Credit risk (continued)

2.2.3 Credit quality of the Bank's merchants (continued)

The following table shows 2018 processing volumes analysed by industry:

	€'000
Entertainment and recreation	1,432,310
Wholesale and retail trade	945,541
Financial activities	910,530
Other	841,885
	4,130,266

The following table shows the geographical analysis of 2018 processing volumes:

	€'000
United Kingdom	2,268,274
Czech Republic	523,789
Malta	292,602
Cyprus	233,164
Netherlands	235,936
France	149,903
Gibraltar	113,797
Other	312,801
	4,130,266

Credorax provides a smart acquiring solution to merchants across hundreds of industries; however, some of these industries require the fulfilment of certain conditions for successful onboarding. Furthermore, some industries fall outside Credorax's risk appetite. This assessment is mostly based on the legality of the product, risk from a card scheme perspective, and legal complexities.

The Bank estimates merchants' credit risk based on processing volumes, chargeback and refund rates and delivery timeframe for future services committed to by merchants. When the amount of chargebacks exceed the amount of the collateral, i.e. the reserves and funding delay, management considers this to be an impairment trigger. At this point, the Bank evaluates whether the exposure should be impaired. Impaired merchant exposures are therefore those exposures arising from chargebacks in excess of collateral and for which the Bank has determined that it is probable that it will be unable to recover. As at 31 December 2018, receivables amounting to €1,463,919 (2017: €315,153) from 130 merchants (2017: 200 merchants) related to chargebacks transactions in excess of collateral held.

Credorax Bank Limited places strong emphasis on the value and quality of the collateral, depending on the amount of the exposure, the risk profile of the merchant, and the level of credit risk involved. The collateral utilised to secure against merchants' credit risk comprises of fixed or rolling reserves.

2. Capital risk management (continued)

2.2 Credit risk (continued)

2.2.3 Credit quality of the Bank's merchants (continued)

At the end of the reporting period, fixed reserves amount to €5,104,727 (2017: €10,538,806), while the rolling reserves amount to €14,383,764 (2017: €16,043,019).

2.3 Interest rate risk

The Bank's placements with the Central Bank of Malta amounting to €42,994,656 (2017: €12,723,221), balances with other banks and financial institutions repayable on call and at short notice amounting to €8,956,457 (2017: €8,033,576), term placements with other banks amounting to €7,410,936 (2017: €nil), loans and advances to customers of €1,086,798 (2017: €1,741,126) and the debt and other fixed income instruments amounting to €129,514 (2017: €83,516) are the Bank's interest bearing financial instruments. However, the Bank's interest rate risk is not deemed to be significant given that the assets are either re-priced to current market rates frequently or are short-term in nature or are otherwise immaterial. Accordingly, a sensitivity analysis disclosing how profit or loss and equity would have been affected by changes in interest rates that were reasonably possible at the end of the reporting period is not deemed necessary.

2.4 Currency risk

The Bank manages its currency risk on an ongoing basis by ensuring that foreign currency liabilities are utilised to fund assets denominated in the same foreign currency thereby matching asset and liability positions as much as is practicable. When it is not possible to match the asset and liability currency positions, the Bank hedges its open foreign exchange exposures by entering into forward foreign exchange contracts with terms which match those of the hedged items.

The following table summarises the Bank's exposure to foreign currency exchange rate risk at 31 December. Included in the table are the Bank's financial instruments at carrying amounts, categorised by currency.

As at 31 December 2018	Long Position €	Short Position €	Net exposure €
GBP	10,239,295	8,498,935	1,740,360
USD	49,185,234	50,881,719	(1,696,485)
Other	12,136,023	9,345,477	2,790,546
	71,560,552	68,726,131	2,834,421

Based on the above positions, the regulatory risk capital charge in respect of currency risk is €362,473 (2017: €1,614,396).

2. Capital risk management (continued)

2.5 Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. The Bank's Board of Directors is primarily responsible for the development and implementation of policies and procedures to ensure that operational risks are managed effectively. The Bank mitigates the possibility of impact risk events through the implementation of a Business Continuity Plan ("BCP"), which encompasses risk mitigation achieved through back-up information security infrastructures, back-up disaster recovery sites and insurance covers over particular business risks. Such systems enable the Bank to operate on an ongoing basis and limit losses in the event of severe business disruption.

The Bank's management of operational risk relies on a framework of policies and procedures implemented across the Bank's operational functions through transaction processing and business execution. The implementation of these policies and procedures is overseen by the Bank's risk oversight function. Regular reporting of operational risk events to the Board of Directors is carried when required. The Bank currently uses the Basic Indicator Approach to assess the operational risk capital requirements and accordingly allocates 15% of average gross income for a three-year period in accordance with regulatory requirements. The operational risk regulatory capital requirement as at December 2018 amounted to €2,885,830 (2017: €1,956,595).

2.6 Capital requirements

Minimum capital requirements are calculated for credit, market and operational risks. The Bank utilises the Standardised Approach for credit risk, the Basic Indicator Approach for operational risk and the Basic Method for foreign exchange risk in order to calculate the Pillar 1 minimum capital requirements. For credit risk, under the Standardised Approach risk weights are determined according to credit ratings provided by internationally recognised credit agencies such as Moody's, Fitch Ratings or their equivalents and by using the applicable regulatory risk weights for unrated exposures. The capital charge for foreign exchange risk using the Basic Method is calculated at 8% of the higher of the sum of all the net short positions and the sum of all the net long positions in each foreign currency. The Basic Indicator Approach requires that the Bank allocates capital for operational risk by taking 15% of the average gross income. The total capital ratio is calculated in accordance with the requirements of the CRR.

2. Capital risk management (continued)

2.6 Capital requirements (continued)

The Bank's capital requirements and Total capital ratio computation are as follows:

	Exposure value €	Risk weighted assets €	Capital required €
As at 31 December 2018			
Central banks	43,294,531	4,766,894	381,352
Multilateral development banks	129,514	-	-
Institutions	49,724,914	14,103,894	1,128,311
Corporates	10,016,630	10,016,630	801,330
Equity	2,542,539	2,542,539	203,403
Other	2,197,709	1,522,326	121,786
Credit risk	107,905,837	32,952,283	2,636,182
Foreign exchange risk		4,530,913	362,473
Operational risk		36,072,880	2,885,830
Total capital required		73,556,076	5,884,485
Total own funds			
Common Equity Tier 1 capital			23,858,206
Total own funds			23,858,206
Total capital ratio			32.4%

As required by the CRR, the minimum level of the Capital Requirements Ratio stands at 8%. The Bank fully implemented the CRD IV capital requirements with effect from January 2019. In this respect, Banking Rule BR/15: 'Capital Buffers of Credit Institutions authorised under the Banking Act, 1994', requires additional buffers, namely the 'capital conservation buffer', the 'countercyclical buffer', 'other systemically important institutions (O-SII) buffer' and the 'systemic risk buffer'. Automatic restrictions on capital distributions apply if the local group's CET1 capital falls below the level of its CRD IV combined buffer.

The Bank is required to maintain a capital conservation buffer of 2.5%, made up of CET1 capital, on the risk weighted exposures of the Bank as from 1 January 2019. This buffer is being phased in over the period from 1 January 2016 to 31 December 2018, with full transitional application effective as from 1 January 2019.

CRD IV contemplates a countercyclical buffer in line with Basel III, in the form of an institution-specific countercyclical buffer and the application of increased requirements to address macro-prudential or systemic risk. This is set in the range of 0-2.5% of relevant credit exposure RWAs, whereby the rate consists of the weighted average of the 'countercyclical buffer' rates that apply in the jurisdiction where the relevant exposures are located. Since the Bank's exposures are predominately to institutions in Malta, and to interbank exposures, the Bank is subject to a very low countercyclical buffer requirement of 0.04% arising from UK exposures.

2. Capital risk management (continued)

2.6 Capital requirements (continued)

The O-SII buffer is also institution specific and may be set at a maximum of 2% of a systemically important institution's total risk exposure amount. Given the Bank's position, in terms of its systematic relevance to the financial system in Malta, it is unlikely that the Bank will be required to maintain an O-SII buffer.

In addition to the measures above, CRD IV sets out a 'systemic risk buffer' for the financial sector as a whole, or one or more sub-sectors, to be deployed as necessary by each EU member state with a view to mitigating structural macro prudential risk. The 'systemic risk buffer' may range between 0% and 5%. There are currently no indications that the Bank will need to maintain a systemic risk buffer.

2.7 Exposures to equities

The Bank is exposed to market price risk arising from the uncertainty about the future market prices of the investment held by the Bank in the preference shares of Visa Inc. that are classified in the statement of financial position as financial assets at FVPL. The preference shares are convertible into ordinary shares of Visa Inc. they have no maturity and represent a residual interest in the issuer's net assets. Furthermore, in view of the absence of quoted market prices for such instruments, the fair value of the preference shares has been determined on the basis of an internal valuation model, which is dependent on a number of assumptions including the value of Visa Inc.'s ordinary shares, which have a quoted price.

The impact of a change in the fair value of such instruments resulting from a change in equity prices, is included in these financial statements as part of the sensitivity analyses that have been performed on the key assumptions used in the valuation of such instruments, within Note 2.6 'Fair value of financial assets and liabilities'.

In terms of Article 35 of the CRR, institutions shall not make adjustment to remove from their own funds unrealised gains on assets measured at fair value. Concurrently, Article 468, by way of derogation from Article 35, implements this in a phased approach from 1 January 2014 to 31 December 2017, which requires a portion of the unrealised gains to be recognised as Tier 2 capital.

2.8 Use of External Credit Assessment Institutions

The Bank uses an External Credit Assessment Institution ('ECAI') in calculating its risk-weighted exposure amounts for central banks, multilateral development banks, institutions and corporates for which a credit assessment is available. The credit quality of such exposures is determined by reference to credit ratings applicable to issuers published by Moody's and Fitch Ratings. The Bank maps these ratings to the credit quality steps prescribed in the CRR as required by *'Implementing Technical Standard on the credit quality steps for ECAIs credit assessments'*.

2. Capital risk management (continued)

2.8 Use of External Credit Assessment Institutions (continued)

The following table represents the exposure values for which an ECAI is used:

At 31 December 2018	Credit quality step	Central banks €	Multilateral development banks €	Institutions €	Total €
AAA to AA-	1	-	129,514	5,704,371	5,833,885
A+ to A-	2	43,294,531	-	21,134,486	64,429,017
BBB+ to BBB-	3	-	-	22,886,057	22,886,057
Total		43,294,531	129,514	49,724,914	93,148,959

2.9 Internal Capital Adequacy Assessment Process (ICAAP)

The Bank's policy is to maintain a strong capital base so as to maintain investor and creditor confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The amount of internal capital allocated to the Bank's exposures differs from the regulatory capital allocation, as the regulatory requirements do not reflect the differing risk profile of the Bank. In this respect, the Bank allocates the majority of its capital against the risks resulting from chargebacks which merchants would not be able to fund in the ordinary course of business.

The Bank considers the Internal Capital Adequacy Assessment Process (ICAAP) embedded in Pillar II as a tool that ensures a proper measurement of material risks and capital and allows better capital management and an improvement in risk management. Therefore, it facilitates a better alignment between material risks and regulatory capital in order to have better capital deployment and improvements in the risk management and mitigation techniques adopted by the Bank.

In addition, stress testing is employed to ascertain what the Bank's key sensitivities are, so as to ensure that the capital level is sufficient to withstand unlikely, but possible, stress scenarios.

The ICAAP as required by the MFSA Banking Rule 12, shall be submitted to the MFSA in April 2019.

3. Asset encumbrance

In the ordinary course of business, the Bank is required by card schemes to pledge an amount of funds in their favour to serve as collateral against the credit risk of the Bank. Thus, the Bank's encumbered assets as at 31 December 2018 amounted to €14,161,855 (median value during 2018 amounted to €13,765,731). None of the Bank's other assets are considered encumbered as at the end of the reporting period, except for €298,819 with the Central Bank of Malta which is pledged in favour of the Depositor Compensation Scheme. Furthermore, as at 31 December 2018, the Bank did not have any outstanding liabilities associated with encumbered assets.

3. Asset encumbrance (continued)

Accordingly, as at 31 December 2018, the Bank's pool of unencumbered assets that could be used to support potential future funding and collateral needs, amounted to €19,786,832 (median value during 2018 amounted to €9,896,302) of total assets. Of this amount, €17,114,779 (median value during 2018 amounted to €7,309,469) were assessed to be readily realisable.

Funds held in a fiduciary capacity amount to €61,742,812 (median value during 2018 amounted to €55,057,339) have been excluded from the balance of unencumbered assets above. This balance represents the surplus cash, which in the ordinary course of business arises since the incoming amounts from the card schemes precede when the funding to merchants falls due. This significantly mitigates the Bank's liquidity risk.

4. Remuneration policy

The achievement of the Bank's objectives is dependent on the quality and commitment of its employees. Accordingly, the Bank offers remuneration packages, composed of fixed and variable pay and selected benefits, aimed at attracting, retaining and motivating people with the requisite knowledge and experience. Remuneration packages reflect the extent of decision-making and risk management responsibilities assigned to respective individuals.

Taking into consideration the size of the Bank, the non-complex operations and the straightforward remuneration structure, the Board of Directors does not deem necessary the establishment of a Remuneration Committee for the Bank, although this will be reviewed on an annual basis. Consequently, the Board of Directors performs the functions of the Remuneration Committee for the Bank. The Board of the Bank determines the remuneration policy which is applicable to the Bank's employees as well as that applicable to Material Risk Takers ("MRTs"), that is, staff whose professional activities have a material impact on the Bank's risk profile and which are identified on the basis of quantitative and qualitative criteria set out in Commission Delegated Regulation 604/2014.

Currently, the Bank's MRTs are deemed to be represented by members of the Executive Committee, which includes all the respective function Heads and the Managing Director, the Head of Treasury and Head of Risk Operations as identified staff members heading material business units, and staff who are responsible for the internal control functions, including the Head of Compliance & MLRO, Enterprise Risk Manager and Internal Auditor.

On the other hand, the remuneration of the Board members, which are currently all non-executive directors except for one executive director, is determined by the Remuneration Committee of Credorax Inc. (the parent company).

The key features of the Bank's Remuneration Policy are:

- all the Bank's employees receive only fixed remuneration (with the exception of sales people) comprising the base salary and fixed pay allowances. Fixed remuneration is established according to the employee's role, including job complexity, and local market conditions. It is influenced by the level of education, the degree of seniority and organisational responsibility, the level of expertise and skills required, the constraints and job experience and the relevant business sector and region. It may be increased following performance reviews,

4. Remuneration policy (continued)

- the Bank's Sales Operations team members are entitled to cash-based variable pay which does not however exceed 100% of fixed remuneration. The variable element of their compensation is dependent on the achievement of pre-set targets in terms of the processing volumes and profitability (which includes any chargebacks and losses) of their merchant portfolio. Sales people introduce prospective merchants and partners to the Bank but have no approval authority during the onboarding stage. Once successfully onboarded, the merchants and partners introduced by a sales person will be included in the sales person's portfolio and performance as aforementioned will be monitored and rewarded when targets are met and exceeded. In this way, variable compensation paid in cash is intended to reward the accomplishment of targets and merchant quality, which are set in line with the Bank's goals and direction.
- where a staff member benefits from variable remuneration, the characteristics of their variable remuneration, as well as the process and criteria that will be used to assess the impact of their activities on the risk profile of the institution and their variable remuneration should be transparent to the staff member. In particular the appraisal process with regard to the individual's performance should be properly documented and should be transparent to the staff concerned.
- the fixed and variable remuneration of the MRTs do not exceed a total remuneration of EUR 500,000 or more, nor is it within the 0.3% of the number of staff who have been awarded the highest total remuneration.
- no performance-related compensation is awarded to directors or selected employees, with the exception of the Sales Operations team members which are entitled to cash based variable remuneration and share based compensation awarded to senior management and selected employees.
- Additionally, the Bank's non-executive directors are not eligible to receive performance incentives. The variable component of the remuneration is mainly rewarded through a share-based compensation plan established for the Group's employees by the Bank's parent company, Credorax Inc., whereby share options are granted to directors and selected employees in exchange for their services at the discretion of the Board. No consideration is payable on the grant of an option and is awarded to employees on the basis of both financial and non-financial performance. Financial performance is assessed by reference to key risk adjusted financial metrics, while non-financial performance is assessed by reference to factors including leadership, team management, team work, creativity, motivation and cooperation.
- Options may generally be exercised to the extent that they have vested. The options are subject to deferral and vest according to the relevant schedule generally within four years after the grant date and expire within ten years after the date of grant. The exercise price is determined by the Board of Directors of Credorax Inc. based on the fair value of shares at grant date. In this manner, variable compensation through share-based compensation does not exceed 100% of fixed remuneration and is structured in a manner that incentivises staff to pursue the goals and interests of the Bank, enabling them to share in its success while promoting sound risk management.
- It is the Bank's policy not to award severance pays unless this is required by law.

The Board of Directors considers that the packages offered to senior management ensure that the Bank attracts and retains management staff that is capable of fulfilling its duties and obligations. Furthermore, it is the Bank's policy to engage its senior management staff on the basis of indefinite contracts of employment after a period of probation, rather than on fixed term contracts.

Accordingly, the applicable notice periods, after probation, are those provided for in the relevant legislation.

The table on the following page sets out the fixed and variable remuneration of the Bank's MRTs during financial year 2018.

4. **Remuneration policy** (continued)

Remuneration – fixed and variable amounts

	2018 Senior Management	2017 Senior Management
Weighted average number of MRTs	12	7
	€	€
Fixed Pay		
Cash-based remuneration	927,583	834,933
Total fixed pay	927,583	834,933
Variable Pay		
Deferred share options		
- Vested	30,125	27,318
- Unvested	85,750	71,088
Total variable pay	115,875	98,406
Total remuneration	1,043,458	933,339

Total Non-Executive Directors' fees attributable for the financial year ended 31 December 2018 amounted to €81,500 (2017: €83,486), of which €2,500 (2017: €4,486) was variable. All the variable remuneration awarded during the year was deferred. Other directors who are employed within the Group are not paid any fees for their directorship.

5. **Leverage**

The leverage ratio is a regulatory and supervisory tool intended to provide a transparent and non-risk based measurement of an institution to supplement the risk based capital requirements.

The leverage ratio is calculated in terms of capital as a proportion of total exposures. Capital is defined as Tier 1 capital in line with Article 25 of the CRR, whilst total exposure relates to the total on and off-balance sheet exposures less the deductions applied to Tier 1 capital.

During 2016, the European Commission published a Proposal to amend Regulation 575/2013 (CRR), which included the introduction of a 3% leverage ratio as a binding Pillar I requirement. Although this Proposal is still in draft and further discussions are expected, the Bank abides by the minimum 3% Tier 1 leverage ratio, based on fully-transitioned Basel III standards.

The following page shows the Bank's leverage ratio, determined in accordance with the requirements stipulated by implementing regulation EU 2016/200.

5. **Leverage** (continued)

	2018 €
Tier 1 capital	23,858,206
Total exposure measure for the purposes of the leverage ratio	108,124,100
	22.1%

The total exposure measure for the purposes of the leverage ratio has been determined as follows:

	2018 €
On-balance sheet exposures (excluding derivatives)	
On-balance sheet items (excluding derivatives)	110,468,719
Asset amounts deducted in determining Tier 1 capital	(2,841,604)
	107,627,115
Derivative exposures	
Derivatives exposures at gross notional amount	-
Adjustments for PFE associated with derivative transactions	278,721
	278,721
Off-balance sheet exposures	
Off-balance sheet exposures at gross notional amount	2,182,644
Adjustments for conversion to credit equivalent amounts	(1,964,380)
	218,264

The following table provides a reconciliation of accounting assets and leverage ratio exposures.

	2018 €
Total assets as per published financial statements	110,468,719
Adjustments for derivative instruments	278,721
Adjustments for off-balance sheet items	218,264
Other adjustments	
Deduction for intangible assets	(2,841,604)
	108,124,100

The table in the following page shows the different on balance sheet exposures in relation to the calculation of the leverage ratio.

5. **Leverage (continued)**

Total on-balance sheet exposures (excluding derivatives and intangible assets), of which:	2018
	€
Exposures treated as sovereigns	43,294,531
Multilateral development banks	129,514
Institutions	49,724,914
Corporates	9,737,908
Equity	2,542,539
Other exposures	2,197,709

The risk of excessive leverage is managed as part of the Bank's risk appetite framework and monitored using a leverage ratio metric within our Risk Appetite Statement. The Risk Appetite Statement articulates the type and level of risk that the Bank is willing to accept in its business activities in order to achieve its strategic business objectives. The Risk Appetite Statement is monitored via the risk dashboard, which includes comparisons of actual performance against the risk appetite and tolerance thresholds assigned to each metric, to ensure that any excessive risk is highlighted, assessed and mitigated appropriately. The risk dashboard is monitored monthly and presented to the Risk Oversight Committee on a quarterly basis.

The Bank manages the risk of excessive leverage by ensuring a sound relationship between the size of the Tier 1 capital and the sum of the on-balance sheet and off-balance sheet exposures. It should however be noted that the leverage ratio of the Bank typically exceeds significantly the minimum regulatory threshold of 3% in view of the Bank's asset exposures.

6. **Other directorships**

According to the 'Guide to banking supervision' issued by the European Central Bank in November 2014, a credit institution is considered significant if any one of the following conditions is met:

- the total value of its assets exceeds €30 billion or – unless the total value of its assets is below €5 billion – exceeds 20% of national GDP;
- it is one of the three most significant credit institutions established in a Member State;
- it is a recipient of direct assistance from the European Stability Mechanism; or
- the total value of its assets exceeds €5 billion and the ratio of its cross-border assets/liabilities in more than one other participating Member State to its total assets/liabilities is above 20%.

Credorax Bank Limited does not meet any of the above criteria, and therefore is currently not considered significant by banking supervisors. Accordingly, the Bank is exempt from the requirements of article 91 of CRD IV.

6. Other directorships (continued)

The number of other directorships held by the members of the Bank's Board of Directors are listed in the table below:

Director	Position	Number of other directorships held
Binyamin Nachman	Non-Executive Director	2
Frederick Ellul	Non-Executive Director	2
Nathan Shaked	Non-Executive Director	3
Igal Rotem	Executive Director	-
David Blumberg	Non-Executive Director	14
Tonio Fenech	Non-Executive Director	6
Anthony Depasquale	Non-Executive Director	7
Aviram Shemer	Non-Executive Director	-
Joshua Floum	Non-Executive Director	1

For the purpose of the above disclosure, the number of other directorships held within the same group are counted as a single directorship.

7. Recruitment and diversity policy

The Bank is aware that a vigorous and professional approach to recruitment and selection of prospective members of the Board of Directors and management or other employees within the Bank helps it to attract and appoint those individuals having the necessary skills and attributes compatible with achieving the Bank's overall objectives. Thus, the Bank ensures that appointments at all levels made within the Bank are based on each individual's knowledge, skills, expertise and merit, as required by Maltese legislation and in line with policy.

The Bank undertakes a rigorous selection process for all prospective members of the Board and management together with other employees, bearing in mind the key activities, tasks and skills required for the vacant position. As part of the selection process, multiple interviews are conducted, during which the individual's knowledge, experience, skills and competency are evaluated against those of other individuals.

Bearing its objectives in mind, the Bank endeavours to appoint directors with diverse skills and expertise that allow the Board to create value for shareholders by ensuring that the specific risks pursued by the Bank in the acquiring and payment processing services, as well as risks that are intrinsic to banking business in general are appropriately managed and mitigated within the Board's approach. The Bank will continue to promote this diversity by recruiting the ideal individual for the vacant position, regardless of the individual's gender, race, family, disability, sexual orientation, identity or preference.

5 Year Summary

Statements of financial position

	2018	2017	2016	2015	2014
	€	€	€	€	€
ASSETS					
Cash and balances with Central Bank of Malta					
Repayable on call and at short notice	7,057,141	220,297	9,116,861	15,998	171
Attributable to merchants	36,237,390	12,507,296	-	-	-
Funds receivable from card schemes	-	57,081,738	26,884,813	21,557,080	12,531,902
Funds receivable from merchants	2,686,708	-	-	-	-
Loans and advances to banks and financial institutions					
Repayable on call and at short notice	10,356,457	9,462,147	723,188	409,062	5,200,314
Term placements with other banks	7,410,936	-	-	-	-
Attributable to merchants	25,505,422	29,738,101	39,595,091	32,968,713	26,619,137
Loans and advances to customers	1,086,798	1,741,126	948,677	-	-
Derivative financial instruments	-	-	-	33,880	-
Financial investments	2,672,053	2,105,057	1,580,498	15,816,020	-
Funds advanced under collateral arrangements	6,452,100	12,241,683	14,417,960	11,868,612	7,100,304
Property and equipment	234,973	258,644	335,445	408,264	410,787
Intangible assets	2,841,604	2,480,834	626,737	590,816	280,933
Deferred taxation	-	1,511,751	1,962,685	1,911,605	1,535,996
Other assets	7,927,137	6,497,042	4,192,175	291,395	207,982
Total assets	110,468,719	135,845,716	100,384,130	85,871,445	53,887,526
EQUITY AND LIABILITIES					
Equity					
Share capital	23,000,000	23,000,000	23,000,000	11,000,000	8,866,726
Share based compensation reserve	537,515	511,645	1,071,018	2,554,209	1,214,206
Fair value reserve	-	562,049	121,006	15,816,020	-
Retained earnings / (accumulated losses)	10,699,810	3,612,866	3,680,577	(3,529,328)	(2,803,735)
Total equity	34,237,325	27,686,560	27,872,601	25,840,901	7,277,197
Liabilities					
Derivative financial instruments	-	-	53,633	-	-
Amounts owed to customers	5,193,145	5,419,538	5,081,156	1,757,242	-
Settlement processing obligations	64,626,158	100,018,186	64,883,400	56,156,734	41,532,978
Current taxation	2,785,029	-	-	-	-
Deferred taxation	464,238	-	-	-	-
Other liabilities	3,162,824	2,721,432	2,493,340	2,116,568	5,077,351
Total liabilities	76,231,394	108,159,156	72,511,529	60,030,544	46,610,329
Total equity and liabilities	110,468,719	135,845,716	100,384,130	85,871,445	53,887,526

5 Year Summary

Statements of comprehensive income

	2018 €	2017 €	2016 €	2015	2014 €
Interest Income	584,101	303,736	83,846	11,641	12,942
Fee and commission income	88,808,591	67,189,044	50,025,012	44,053,068	23,528,294
Fee and commission expense	(68,172,307)	(55,263,381)	(41,093,220)	(32,717,077)	(17,149,888)
Net fee and commission expense	20,636,284	11,925,663	8,931,792	11,335,991	6,378,406
Net trading income	8,228,084	4,075,770	2,330,055	79,950	361,891
Net income from financial instruments measured at FVPL	563,812	35,875	17,590	-	-
Gain on disposal of membership interest in Visa Europe	-	-	19,248,515	-	-
Operating income	30,012,281	16,341,044	30,611,798	11,427,582	6,753,239
Employee compensation and benefits	(6,187,757)	(6,333,563)	(7,426,329)	(7,931,211)	(4,700,231)
General and administration expense	(7,312,380)	(5,014,762)	(3,961,429)	(3,792,467)	(3,169,863)
Net impairment charges	-	(1,306,695)	247,870	(651,280)	(3,162,718)
Reversal of provision for future chargebacks	920,352	-	-	-	-
Changes in expected credit losses and other impairment allowances	(1,258,171)	-	-	-	-
Depreciation and amortisation expense	(738,884)	(301,828)	(312,011)	(151,945)	(175,774)
Profit / (loss) before tax	15,435,441	3,384,196	19,159,899	(1,099,321)	(4,455,347)
Income tax (expense) / credit	(4,813,865)	(451,907)	50,006	373,728	1,558,173
Profit / (loss) for the year	10,621,576	2,932,289	19,209,905	(725,593)	(2,897,174)
Other comprehensive income: Items that are or may be subsequently reclassified to profit or loss					
Fair value gains on available-for-sale investments	-	441,043	3,553,501	15,816,020	-
Fair value gains reclassified to profit or loss on disposal	-	-	(19,248,515)	-	-
Other comprehensive income for the year net of tax	-	441,043	(15,695,014)	15,816,020	-
Total comprehensive income for the year	10,621,576	3,373,332	3,514,891	15,090,427	(2,897,174)

5 Year Summary

Statements of cash flows

	2018 €	2017 €	2016 €	2015	2014 €
Cash flows from operating activities					
Net cash generated from operations	28,277,636	4,033,755	(558,533)	2,035,337	5,648,237
Tax paid	(788)	(973)	(1,074)	(1,882)	(5,101)
Net cash generated from / (used in) operating activities	28,276,848	4,032,782	(559,607)	2,033,455	5,643,136
Cash flows from investing activities					
Dividend received	32,020	35,875	17,590	-	-
Purchase of debt instruments	(126,770)	(88,100)	-	-	-
Proceeds from maturity of debt instruments	86,670	-	-	-	-
Purchase of intangible assets	(962,163)	(1,433,959)	(199,113)	(318,993)	(252,303)
Proceeds from disposal of equipment	-	1,300	-	-	-
Purchase of property and equipment	(78,036)	(55,197)	(76,000)	(140,311)	(146,022)
Disposal of membership interest in Visa Europe	-	-	16,858,497	-	-
Net cash (used in) / generated from investing activities	(1,048,279)	(1,540,081)	16,600,974	(459,304)	(398,325)
Cash flows from financing activities					
Proceeds from issuance of share capital	-	-	-	-	6,100,000
Net cash from financing activities	-	-	-	-	6,100,000
Net movement in cash and cash equivalents	27,228,569	2,492,701	16,041,367	1,574,151	11,344,811
Cash and cash equivalents at beginning of year	51,927,841	49,435,140	33,393,773	31,819,622	20,474,811
Cash and cash equivalents at end of year	79,156,410	51,927,841	49,435,140	33,393,773	31,819,622