HSBC Bank Malta p.l.c.

Interim Report 2018

HSBC

Contents

COMPANY ANNOUNCEMENT

The following is a Company Announcement issued by HSBC Bank Malta p.l.c. pursuant to the Listing Rules issued by the Listing Authority.

HSBC BANK MALTA p.l.c.
INTERIM RESULTS FOR 2018

6 August 2018

Strategy execution

- Transformation to achieve highest global standards of financial crime compliance now largely complete, protecting the business and customers for the long-term.
- De-risking actions reduced first half profitability in addition to the ongoing impact of negative interest rates.
- HSBC Malta has commenced transition to a new phase focused on growth and value creation. Bank is targeting to grow revenue faster than costs and increase return on equity over time.
- Commercial Banking new business pipeline has significant momentum and capacity for revenue development within existing risk appetite.
- Retail Banking and Wealth Management business volumes continue to increase supported by increased sales capacity and new digital innovations.
- Strong capital position enabled 65% dividend payout to be sustained.

Financial performance

- Reported profit before tax of €16.2m for the six months ended 30 June 2018, a decrease of €9.8m or 38% compared with the same period last year due to continuing impact of negative interest rates and the impact of risk management actions taken during 2017.
- Profit attributable to shareholders of €14.3m for the six months ended 30 June 2018 resulting in earnings per share of 4.0 cents compared with 4.7 cents in the same period in 2017.
- Common equity tier 1 capital ratio of 14.0% as at 30 June 2018, up from 13.9% at the end of 2017.
- Recommended gross interim dividend of 4.0 cents per share (2.6 cents per share net of tax).
- Cost efficiency ratio of 74% for the six months ended 30 June 2018, compared with a ratio of 63% for the same period in 2017.
- Return on equity of 6.1% for the six months ended 30 June 2018, compared with 7.1% for the same period in 2017.
- Net loans and advances to customers were €3,141m, up €12m compared with 31 December 2017.
- Customer deposits of €4,832m at 30 June 2018, up €66m compared with 31 December 2017.
- The advances to deposits liquidity ratio was marginally lower at 65%.

Dr George Brancaleone LL.D.
Company Secretary

This Company Announcement is issued by
HSBC Bank Malta p.l.c.
Company Secretary Tel: (+356) 2380 2380

Registered in Malta number C3177.

Registered Office: 116, Archbishop Street, Valletta VLT 1444, Malta.

HSBC Bank Malta p.l.c. is regulated and licensed to conduct investment services business by the Malta Financial Services Authority.

Listed on and is a member of the Malta Stock Exchange.

Commentary

Financial performance

Profit before tax for the six months ended 30 June 2018 amounted to €16.2m, a decrease of €9.8m or 38% compared with the same period last year. The performance during the first six months of 2018 mainly reflected the continuing impact of low interest rates and prioritisation of risk management actions during 2017.

Profit attributable to shareholders amounted to €14.3m resulting in earnings per share of 4.0 cents compared with 4.7 cents in the first half of 2017. The Board proposes to maintain the current dividend pay-out ratio of 65% and recommends an interim gross dividend of 4.0 cents per share (2.6 cents per share net of tax). The interim dividend will be paid on 18 September 2018 to shareholders who are on the bank's register as at 17 August 2018.

All three main business lines: Retail Banking and Wealth Management, Commercial Banking and Global Markets, continued to be profitable during the six month period under review.

Net interest income decreased to €54.1m or 10% compared with €60.3m in the same period in 2017 predominately due to a further decline in the average yield on the investment book due to continuing amortisation of higher yielding bonds as well as contraction of the Commercial Banking loan book relative to the prior year position.

Non-interest income (fees and commissions and trading income) remained broadly in line with the same period in 2017. Following the completion of the risk management actions taken by the bank in 2017, the strategic direction taken in the first half of the year started reaping positive results, in particular increased commissions as a result of higher volume of credit facilities granted and higher income generated from guarantees and derivative transactions.

Operating expenses increased to €54.9m or 5% compared with €52.2m in the same period in 2017. This increase reflects continued investment in regulatory programmes, financial crime compliance and business growth. The bank continues to exercise rigorous cost control and to implement initiatives at cost base streamlining through digitalisation, outsourcing and processes optimisation.

During the period under review, the bank concluded the remediation process for the MiFID complex instruments issue disclosed in the 2016 year-end results. The bank's guidance on the costs of this programme remains unchanged.

On 1 January 2018, the bank adopted IFRS 9 'Financial Instruments'. Adoption of this new standard reduced net assets by €8.0m, net of deferred tax of €4.3m. The bank was not required to restate comparative periods. Accordingly, all adjustments resulting from the transition, apply by adjusting the opening balance sheet as at 1 January 2018.

Since adoption, the bank registered a change in expected credit losses under IFRS 9 of €3.4m, €1.0m lower than the loan impairment charges under IAS 39 of €4.3m reported in the same period in 2017 with one specific impairment relating to a long-dated case subject to legal proceedings representing the majority of the 2018 charge. The bank continues to maintain a conservative provisioning approach. Overall asset quality remained satisfactory and total non-performing loans further declined from €168m to €155m during the first six months of 2018.

The effective tax rate is 11%. This translated into a tax expense of €1.8m, €7.2m lower than €9.1m in the same period in 2017. During the period under review, the bank benefited from a different tax treatment applied on a specific transaction.

HSBC Life Assurance (Malta) Limited reported a profit before tax of €1.8m compared to €4.4m in the same period of 2017. The decline was driven by positive market movements in 2017 which were not repeated in the first half of 2018. In addition, the insurance subsidiary registered a reduction in premium income, as a result of lower new single premium policies written when compared to prior year.

Financial position and capital

Net loans and advances to customers stood at €3,141m, €12m higher than at 31 December 2017. Following completion of the strategic repositioning of HSBC's Commercial Banking business, corporate lending stabilised in the first half of 2018.

The bank's available-for-sale investment portfolio remained broadly in line with the amount reported at 31 December 2017 and composed of highly rated securities and is conservatively positioned with the lowest investment grade of A-.

Customer deposits were €4,832m as at 30 June 2018, €66m or 1% higher than at 31 December 2017. The increase was primarily attributable to increased deposits in all segments of customers of the Commercial Banking business.

The bank's liquidity position remained broadly unchanged with the conservative advances-to-deposits ratio standing at 65%.

The bank's common equity tier 1 capital was 14.0% as at 30 June 2018, up from 13.9% at the end of 2017. Total capital ratio decreased to 14.1% compared to 14.4% at 31 December 2017 but still above the fully-loaded regulatory requirements.

Andrew Beane, Director and Chief Executive Officer of HSBC Malta, said

"Our profitability in the first half of 2018 was lower than the prior year reflecting four main factors: (1) The impact of essential de-risking actions taken during 2017. (2) The ongoing effect of negative interest rates. (3) Loan impairments arising where the sale of assets pledged as security by corporate borrowers in default for many years have been delayed by lengthy judicial processes which make the recovery of liabilities a very protracted exercise. (4) From investment in regulatory and risk programmes such as GDPR and customer due diligence.

HSBC is proud of the progress we have made to achieve the highest level of financial crime compliance standards within our bank which can give confidence to our customers as they use HSBC's services. It is essential that the financial system as a whole is able to demonstrate full and effective compliance with European Union standards.

Looking to the future, the substantive elements of HSBC's business model transformation are now complete which is enabling the bank to move into a new strategic phase characterised by a return to growth and value creation. Over time, and without increasing our risk appetite, HSBC Malta will focus on growing revenue faster than costs in order to increase our return on tangible equity and, subject to our ongoing capital management processes, sustain our signature dividend.

The early signs of this new phase are encouraging with significant increases in our commercial banking business pipeline which has led to a stabilisation of loans and advances which we expect to steadily increase over time. We are also seeing increased volumes in parts of our retail banking and wealth management business as we re-allocate capacity into sales and service activity, including insurance sales. HSBC's plans to deliver market leading customer service standards enabled by new digital innovations are a particular opportunity and represent a key focus for us in the second half of 2018 and beyond.

I would like to thank our shareholders and customers for their ongoing confidence and trust, and my colleagues for their outstanding contribution as we complete this chapter for HSBC Malta and move into a new phase."

Financial summary

Income statement

	Group		Bank	
	Half-year to			
	30 Jun 2018	30 Jun 2017	**30 Jun 2018**	30 Jun 2017
	€000	€000	**€000**	€000
Interest and similar income				
– on loans and advances, balances with Central Bank of Malta and Treasury Bills	**54,828**	59,779	**54,829**	59,780
– on debt and other fixed income instruments	**4,998**	6,583	**4,986**	6,484
Interest expense	**(5,719)**	(6,064)	**(5,719)**	(6,064)
Net interest income	**54,107**	60,298	**54,096**	60,200
– fee income	**12,950**	12,592	**10,618**	10,199
– fee expense	**(1,016)**	(829)	**(724)**	(589)
Net fee income	**11,934**	11,763	**9,894**	9,610
Foreign Exchange trading income	**2,559**	2,754	**2,559**	2,754
Net income from assets and liabilities of insurance businesses, including related derivatives, measured at fair value through profit and loss	**N/A**	5,237	**N/A**	–
Changes in fair value of other financial instruments mandatorily measured at fair value through profit and loss	**(2,711)**	N/A	**–**	N/A
Dividend income	**5**	–	**11,412**	–
Net insurance premium income	**31,466**	37,249	**–**	–
Movement in present value of in-force long-term insurance business	**(1,430)**	(462)	**–**	–
Net other operating income	**418**	1,024	**1,870**	1,045
Total operating income	**96,348**	117,863	**79,831**	73,609
Net insurance claims, benefits paid and movement in liabilities to policyholders	**(21,930)**	(35,356)	**–**	–
Net operating income before loan impairment charges	**74,418**	82,507	**79,831**	73,609
Change in expected credit losses and other credit impairment charges	**(3,355)**	N/A	**(3,355)**	N/A
Loan impairment charges	**N/A**	(4,349)	**N/A**	(4,349)
Net operating income	**71,063**	78,158	**76,476**	69,260
Employee compensation and benefits	**(24,634)**	(23,985)	**(23,282)**	(22,573)
General and administrative expenses	**(27,604)**	(25,453)	**(25,544)**	(23,197)
Depreciation of property, plant and equipment	**(1,735)**	(1,826)	**(1,735)**	(1,825)
Amortisation of intangible assets	**(929)**	(969)	**(885)**	(939)
Profit before tax	**16,161**	25,925	**25,030**	20,726
Tax expense	**(1,832)**	(9,071)	**(4,725)**	(7,251)
Profit for the period	**14,329**	16,854	**20,305**	13,475
Earnings per share	**4.0**	4.7		

Statements of comprehensive income

	Group		Bank	
	Half-year to			
	30 Jun 2018	30 Jun 2017	**30 Jun 2018**	30 Jun 2017
	€000	€000	**€000**	€000
Profit for the period	**14,329**	16,854	**20,305**	13,475
Other comprehensive income				
Items that will be reclassified subsequently to profit or loss when specified conditions are met:				
Available-for-sale investments:	**832**	(2,837)	**840**	(2,774)
– fair value gains/(losses)	**1,280**	(4,364)	**1,292**	(4,268)
– income taxes	**(448)**	1,527	**(452)**	1,494
Items that will not be reclassified subsequently to profit or loss:				
Properties:	**583**	—	**583**	—
– surplus arising on revaluation	**648**	—	**648**	—
– income taxes on revaluation surplus	**(65)**	—	**(65)**	—
Other comprehensive income for the period, net of tax	**1,415**	(2,837)	**1,423**	(2,774)
Total comprehensive income for the period	**15,744**	14,017	**21,728**	10,701

Statements of financial position

	Group		Bank	
	30 Jun 2018	31 Dec 2017	**30 Jun 2018**	31 Dec 2017
	€000	€000	**€000**	€000
Assets				
Balances with Central Bank of Malta, Treasury Bills and cash	**233,454**	164,059	**233,454**	164,059
Items in course of collection from other banks	**19,369**	18,158	**19,369**	18,158
Financial assets designated at fair value attributable to insurance operations	**N/A**	727,270	**N/A**	–
Financial assets mandatorily measured at FV through profits or loss	**718,848**	N/A	**–**	N/A
Held for trading derivatives	**8,351**	5,175	**8,351**	5,175
Loans and advances to banks	**973,700**	1,059,308	**970,322**	1,045,699
Loans and advances to customers	**3,140,882**	3,128,833	**3,140,882**	3,128,833
Available-for-sale financial investments	**920,262**	926,096	**920,260**	924,881
Prepayments and accrued income	**24,031**	24,236	**19,554**	20,199
Current tax assets	**18,348**	13,911	**16,204**	13,440
Reinsurance assets	**86,534**	85,887	**–**	–
Assets attributable to disposal group held for sale	**476,294**	473,797	**–**	–
Non-current assets held for sale	**6,270**	7,411	**6,270**	7,411
Investment in subsidiaries	**–**	–	**30,859**	30,859
Investment property	**10,602**	10,600	**7,500**	7,500
Property, plant and equipment	**55,348**	56,308	**55,456**	56,415
Intangible assets	**61,700**	64,062	**4,431**	4,575
Deferred tax assets	**23,496**	16,488	**23,496**	16,488
Other assets	**28,105**	16,384	**26,289**	15,686
Total assets	**6,805,594**	6,797,983	**5,482,697**	5,459,378
Liabilities				
Deposits by banks	**33,520**	54,703	**33,520**	54,703
Customer accounts	**4,832,252**	4,765,995	**4,894,953**	4,850,931
Held for trading derivatives	**8,337**	5,228	**8,337**	5,228
Accruals and deferred income	**14,314**	17,838	**12,739**	15,303
Current tax liabilities	**1,286**	–	**1,115**	–
Liabilities under investment contracts	**177,631**	203,136	**–**	–
Liabilities under insurance contracts	**648,770**	658,792	**–**	–
Provisions for liabilities and other charges	**22,277**	20,099	**21,538**	19,410
Deferred tax liabilities	**26,797**	26,295	**5,489**	5,578
Subordinated liabilities	**29,297**	29,277	**30,000**	30,000
Liabilities attributable to disposal group held for sale	**476,294**	473,797	**–**	–
Other liabilities	**77,126**	63,785	**70,230**	58,088
Total liabilities	**6,347,901**	6,318,945	**5,077,921**	5,039,241
Equity				
Called up share capital	**108,092**	108,092	**108,092**	108,092
Revaluation reserve	**37,845**	36,430	**37,843**	36,420
Retained earnings	**311,756**	334,516	**258,841**	275,625
Total equity	**457,693**	479,038	**404,776**	420,137
Total liabilities and equity	**6,805,594**	6,797,983	**5,482,697**	5,459,378
Memorandum items				
Contingent liabilities	**124,311**	122,959	**126,313**	122,961
Commitments	**1,102,996**	1,215,457	**1,127,996**	1,215,501

The financial statements were approved and authorised for issue by the Board of Directors on 6 August 2018 and signed on its behalf by:

Sonny Portelli
Chairman

Andrew Beane
Chief Executive Officer

Statements of changes in equity

	Group			
	Share capital	Revaluation reserve	Retained earnings	Total equity
	€000	€000	€000	€000
At 31 Dec 2017	**108,092**	**36,430**	**334,516**	**479,038**
Impact on transition to IFRS9	**–**	**–**	**(8,049)**	**(8,049)**
At 1 Jan 2018	**108,092**	**36,430**	**326,467**	**470,989**
Profit for the period	**–**	**–**	**14,329**	**14,329**
Other comprehensive income				
– available-for-sale investments:				
fair value losses, net of tax	**–**	**832**	**–**	**832**
– properties:				
surplus arising on revaluation, net of tax	**–**	**583**	**–**	**583**
Total other comprehensive income	**–**	**1,415**	**–**	**1,415**
Total comprehensive income for the period	**–**	**1,415**	**14,329**	**15,744**
Transactions with owners, recognised directly in equity				
Contributions by and distributions to owners				
– dividends	**–**	**–**	**(29,040)**	**(29,040)**
Total contributions by and distributions to owners	**–**	**–**	**(29,040)**	**(29,040)**
At 30 Jun 2018	**108,092**	**37,845**	**311,756**	**457,693**
At 1 Jan 2017	108,092	41,333	324,099	473,524
Profit for the period	–	–	16,854	16,854
Other comprehensive income				
– available-for-sale investments:				
fair value losses, net of tax	–	(2,837)	–	(2,837)
fair value gains reclassified to profit or loss on disposal, net of tax	–	(130)	130	–
Total other comprehensive income	–	(2,967)	130	(2,837)
Total comprehensive income for the period	–	(2,967)	16,984	14,017
Transactions with owners, recognised directly in equity				
Contributions by and distributions to owners				
– share-based payments	–	–	6	6
– dividends	–	–	(9,602)	(9,602)
Total contributions by and distributions to owners	–	–	(9,596)	(9,596)
At 30 Jun 2017	108,092	38,366	331,487	477,945
	Bank			
At 31 Dec 2017	**108,092**	**36,420**	**275,625**	**420,137**
Impact on transition to IFRS9	**–**	**–**	**(8,049)**	**(8,049)**
At 1 Jan 2018	**108,092**	**36,420**	**267,576**	**412,088**
Profit for the period	**–**	**–**	**20,305**	**20,305**
Other comprehensive income				
– available-for-sale investments:				
fair value losses, net of tax	**–**	**840**	**–**	**840**
– properties:				
surplus arising on revaluation, net of tax	**–**	**583**	**–**	**583**
Total other comprehensive income	**–**	**1,423**	**–**	**1,423**
Total comprehensive income for the period	**–**	**1,423**	**20,305**	**21,728**
Transactions with owners, recognised directly in equity				
Contributions by and distributions to owners				
– dividends	**–**	**–**	**(29,040)**	**(29,040)**
Total contributions by and distributions to owners	**–**	**–**	**(29,040)**	**(29,040)**
At 30 Jun 2018	**108,092**	**37,843**	**258,841**	**404,776**
At 1 Jan 2017	108,092	41,224	271,078	420,394
Profit for the period	–	–	13,475	13,475
Other comprehensive income				
– available-for-sale investments:				
fair value losses, net of tax	–	(2,774)	–	(2,774)
fair value gains reclassified to profit or loss on disposal, net of tax	–	(130)	130	–
Total other comprehensive income	–	(2,904)	130	(2,774)
Total comprehensive income for the period	–	(2,904)	13,605	10,701
Transactions with owners, recognised directly in equity				
Contributions by and distributions to owners				
– share-based payments	–	–	6	6
– dividends	–	–	(9,602)	(9,602)
Total contributions by and distributions to owners	–	–	(9,596)	(9,596)
At 30 Jun 2017	108,092	38,320	275,087	421,499

Statements of cash flows

	Group		Bank	
	Half-year to			
	30 Jun 2018	30 Jun 2017	**30 Jun 2018**	30 Jun 2017
	€000	€000	**€000**	€000
Cash flows from operating activities				
Interest, commission and premium receipts	**100,615**	116,370	**69,671**	74,061
Interest, commission and claims payments	**(81,954)**	(99,147)	**(6,199)**	(7,215)
Payments to employees and suppliers	**(52,681)**	(47,969)	**(52,572)**	(44,437)
Cash flows (used in)/from operating activities before changes in operating assets/liabilities	**(34,020)**	(30,746)	**10,900**	22,409
Decrease/(increase) in operating assets:				
– financial assets designated at fair value	**8,422**	80,614	**–**	–
– reserve deposit with Central Bank of Malta	**155**	(453)	**155**	(453)
– loans and advances to customers and banks	**(84,791)**	71,338	**(84,791)**	71,338
– Treasury Bills	**5,266**	6,933	**5,266**	6,933
– other receivables	**(3,491)**	7,238	**(2,705)**	1,215
(Decrease)/increase in operating liabilities:				
– customer accounts and deposits by banks	**57,333**	(118,670)	**20,070**	(112,501)
– other payables	**18,118**	(7,710)	**7,007**	(3,404)
Net cash from operating activities before tax	**(33,008)**	8,544	**(44,098)**	(14,463)
– tax (paid)/recovered	**(5,840)**	(3,693)	**(4,024)**	(3,024)
Net cash from/(used in) operating activities	**(38,848)**	4,851	**(48,122)**	(17,487)
Cash flows from investing activities				
Dividends received	**–**	11	**11,412**	11
Interest received from financial investments	**11,526**	16,280	**9,240**	10,291
Purchase of other available-for-sale financial investments	**(114,542)**	(122,286)	**(114,542)**	(122,286)
Proceeds from sale and maturity of financial investments	**107,202**	48,296	**105,989**	48,296
Purchase of property, plant and equipment and intangible assets	**(749)**	(600)	**(787)**	(439)
Proceeds on sale of property, plant and equipment and intangible assets	**–**	261	**11**	156
Net cash flows (used in)/from investing activities	**3,437**	(58,038)	**11,323**	(63,971)
Cash flows from financing activities				
Dividends paid	**(29,040)**	(9,602)	**(29,040)**	(9,602)
Subordinated loan stock	**–**	(58,172)	**–**	(58,172)
Net cash flows used in financing activities	**(29,040)**	(67,774)	**(29,040)**	(67,774)
Net (decrease)/increase in cash and cash equivalents	**(64,451)**	(120,961)	**(65,839)**	(149,232)
Cash and cash equivalents at beginning of period	**848,649**	938,856	**835,035**	867,736
Effect of exchange rate changes on cash and cash equivalents	**893**	7,631	**893**	7,631
Cash and cash equivalents at end of period	**785,091**	825,526	**770,089**	726,135

Basis of preparation

The condensed interim financial statements have been extracted from HSBC Bank Malta p.l.c.'s (the 'bank') and its subsidiary undertakings (collectively referred to as the 'local group') unaudited management accounts for the six-month period ended 30 June 2018. These condensed interim financial statements are being published in accordance with Chapter 5 of the Listing Rules issued by the Listing Authority and the Prevention of Financial Markets Abuse Act 2005.

Standards applied during the half-year to 30 June 2018

The condensed interim financial statements have been prepared in accordance with IAS 34, Interim Financial Reporting, adopted by the EU. They do not include all the information required for a complete set of annual financial statements, and should be read in conjunction with the financial statements for the year ended 31 December 2017.

The local group has adopted the requirements of IFRS 9 from 1 January 2018. IFRS 9 includes an accounting policy choice to remain with IAS 39 hedge accounting, which HSBC has exercised. The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application. As permitted by IFRS 9, HSBC has not restated comparatives.

Apart from IFRS 9, the local group adopted interpretations and amendments to standards which had an insignificant effect on the interim consolidated financial statements.

The accounting policies applied in these condensed interim financial statements are the same as those applied by the local group in its financial statements as at and for the year ended 31 December 2017.

As required by IAS 34, Interim Financial Reporting, adopted by the EU, these interim financial statements include comparative statements of financial position information at the previous financial year end and comparative profit or loss statements and statements of profit or loss and comprehensive income information for the comparable interim periods of the immediately preceding financial year.

Related party transactions with other members of the HSBC Group covering the period 1 January to 30 June 2018 did not materially affect the performance of the period under review and financial position at the end of the reporting date.

Certain comparative amounts have been reclassified to comply with the current period's presentation.

IFRS 9 transitional requirements

Adoption reduced net assets of the local group at 1 January 2018 by €8.0m, net of deferred tax of €4.3m, as set out on page 7. The local group has adopted the regulatory transitional arrangements adopted by the EU on 27 December 2017. These permit banks to add back to their capital base a proportion of the impact that IFRS 9 has upon their loan loss allowances during the first five years of use. The proportion that banks may add back starts at 95% in 2018, and reduces to 25% by 2022. As a result, the CET 1 after the regulatory transitional period of five years is expected to reduce by 30 basis points.

Changes in accounting policy as a result of newly adopted standards

IFRS 9 'Financial Instruments'

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

Classification and measurement

The classification and measurement of financial assets now depends on how these are managed (the entity's business model) and their contractual cash flow characteristics.

If a financial asset is held within a business model other than 'hold to collect' or 'hold to collect and sell' then the financial asset is required to be measured at fair value through profit or loss ('FVTPL') without further analysis. For those financial assets where the contractual cash flows arising on specified dates that are solely payments of principal and interest ('SPPI') on the principal amount outstanding, classification at amortised cost or fair value through other comprehensive income ('FVOCI') will depend on whether the business model is to hold financial assets for the collection of contractual cash flows or whether the objective of the business model is achieved by both the collection of contractual cash flows and selling financial assets. If an instrument contains contractual cash flows which do not represent solely payments of principal and interest, then the classification to be used is FVTPL even if it is held in a business model that is either hold to collect or hold to collect and sell.

The local group's business model is determined by key management personnel and reflects the strategic purpose and intention for the portfolio and how the performance of the portfolio is assessed. Since the business model is set at a portfolio level, the classification assessment for this criterion is accordingly performed at that level. Because the key distinction between the two business models identified in IFRS 9 is whether or not 'sales' are intrinsic to achieving the desired objectives, it is important to identify what is meant by 'sales'. For the purposes of the business model assessment, these are transfers which would result in derecognition.

For those assets where the intention of the business model is to hold the financial assets to collect the contractual cash flows or to hold to collect and to sell, the local group assesses whether the cash flow characteristics of these assets meet the SPPI requirements of IFRS 9. 'Principal' is the fair value of the financial asset at initial recognition. It is not the amount that is due under the contractual terms of an instrument. 'Interest' is the compensation for time value of money and credit risk of a basic lending-type return. A basic lending-type return could also include consideration for other basic lending risks (for example, liquidity risk) and consideration for costs associated with holding the financial asset for a particular period of time (for example, servicing or administrative costs) and/or a profit margin.

Unlike the business model assessment, the SPPI assessment is performed for each individual product or portfolio of products. The following considerations are made when assessing consistency with SPPI:

- variable interest rates and modified relationships with the time value of money;
- leverage, being a contractual cash flow characteristic of some financial assets that increases the variability of the contractual cash flows with the result that they do not have economic characteristics of interest;

- contractual terms that allow the issuer to prepay (or the holder to put a debt instrument back to the issuer) before maturity and the prepayment amount substantially represents unpaid amounts of principal and interest, which may include reasonable compensation for early termination of the contract;
- contractual terms that allow the issuer or holder to extend the contractual term and the terms of the extension option result in contractual cash flows during the extension period that are solely payments of principal and interest, which may include reasonable compensation for the extension of the contract;
- contractual cash flows may be caused by an underlying contingent event (a trigger) such as contractual term resetting interest to a higher amount in the event of a missed payment; and
- contractual changes in interest rates.

More specifically, from the assessment that the local group conducted the following classification and measurement matters have been determined:

- loans and advances to banks and to customers that were classified as loans and receivables under IAS 39 are measured at amortised cost under IFRS 9;
- financial assets designated at FVTPL remained at FVTPL, because it is required under IFRS 9 or designation continued;
- debt securities and treasury bills classified as available-for-sale under IAS 39 are classified at FVOCI under IFRS 9 given that the objective of the business model is achieved by both the collection of contractual cash flows and selling of the financial assets; and
- equity securities remained measured at fair value, with fair value movements recognised in other comprehensive income, since the equity securities currently held by the local group are held for reasons other than to generate a capital return.

There is no financial impact arising out of these changed classifications as the accounting measurements are principally the same as under IAS 39.

Impairment

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

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

Significant increase in credit risk ('SICR')

The general principle of IFRS 9 ECL accounting requires that the credit risk of financial instruments within the scope of impairment to be assessed for significant increase since initial recognition at each balance sheet date. If there is a significant increase in credit risk, the financial instruments are transferred into Stage 2 and lifetime ECL is recognised. The principle of SICR can be achieved by performing an assessment to compare the risk of default occurring at the reporting date with the risk of default occurring at the date of initial recognition.

Wholesale exposures are usually managed on an individual basis for credit purposes, through relationship managers who have access to the customers and their financial information. A Customer Risk Rating ('CRR') is assigned to each customer and is reviewed at least annually.

Although the CRR is assigned on an obligor/counterparty level rather than at the financial instrument level, it can still be used to assess significant increase in credit risk as long as it meets the underlying principles.

In applying the above, the CRR of the counterparty is inferred onto the outstanding financial instruments. For example, if a customer has a CRR of 3.1 when a loan is underwritten, the loan will have an initial recognition CRR of 3.1. If at the subsequent period end, the customer's CRR has deteriorated to 5.2 and a second loan is being granted to the customer, both loans will have CRR of 5.2 on that day. For the first loan, the CRR has increased from 3.1 to 5.2. If this is considered significant, it will be transferred to Stage 2. For the second loan, the initial recognition CRR is 5.2. It will remain in Stage 1 until the CRR has increased significantly in subsequent periods. While all outstanding loans to the same obligor/counterparty will have the same CRR at the reporting date, the respective loans might be in different stages depending on the initial recognition CRR, unless the obligor is in the 'Watch or Worry Status', in which case all associated facilities (excluding those cases on the list for non-credit related reasons) will be transferred to Stage 2 immediately.

A CRR on its own is not a measure that meets all the requirements of IFRS 9 (e.g. it does not incorporate forward-looking information). However, within the HSBC Group, CRRs are used to determine regulatory Probabilities of Default ('PDs'), and with appropriate adjustments, these PDs are used for IFRS 9 purposes. Each CRR is associated with an external rating grade by reference to long-run default rates for that grade, represented by the average of issuer-weighted historical default rates. This mapping between internal and external ratings is indicative and may vary over time. Therefore regulatory PD models calibrated at the level of HSBC Group are leveraged to derive a measure that is appropriate to assess significant increase in credit risk under IFRS 9.

As regulatory PDs are generally calculated over 12 months, one of the adjustments required is to incorporate the term structure into the PD to obtain the lifetime PD. The lifetime PD is determined by calculating the PD for each year over the life of the financial instrument. For example, for a five-year loan, PDs are calculated for each of the five years. The year-1 PD is calculated as the probability of the loan defaulting within the first year of it being issued. The year-2 PD is calculated as the probability of the loan surviving the first year but defaulting in the second year. The same principle of survival applies to the PDs of years 3-5. These yearly PDs are added together to arrive at the cumulative lifetime PD. As each year passes, the cumulative lifetime PD reduces in line with the reduction in the residual life of the loan. Albeit, significant increase in credit risk is measured by comparing the average PD for the remaining term estimated at origination with the equivalent estimation at reporting date.

Retail exposures, unlike Wholesale exposures, are not managed on a credit-by-credit basis (e.g. through relationship managers), due to the high volume of relatively low value and homogeneous exposures. As a result, it is not feasible to replicate the Wholesale approach for Retail exposures. The Retail methodology takes into account the nature of the Retail exposures and the underlying credit risk management practices. The Retail portfolio comprises mortgages, personal loans and overdrafts, as well as credit cards.

Utilisation of the Retail methodology to determine whether a significant increase in credit risk has occurred is based on meeting the following three criteria:

a. the credit risks of exposures within the portfolio are similar;

b. any increase in the credit risk below the threshold is not considered significant; and

c. the risk measure used (e.g. PD) includes all available information, including forward-looking information.

Given how Retail customers are accepted and managed for credit risk, Retail customers within a particular segment will have similar credit risk at initial recognition. The measure, or threshold, used to assess significant increase in credit risk for the Retail portfolios is the average PD 12 months prior to exposures falling more than 30 days past due. Portfolio segments whose 12-month default rate is higher than this threshold would be classified as Stage 2. However, with respect to mortgages, through the look back method, it has been determined that all exposures that are one day past due would require such exposures to be classified as Stage 2. In this respect, the transfer criteria for the mortgages portfolio is assessed on the instrument's delinquency period.

Definition of default

IFRS 9 requires an assessment of the extent of increase in credit risk of a financial instrument since initial recognition. This assessment is performed by considering the change in the risk of default occurring over the remaining life of the financial instrument. As a result, the definition of default is important.

IFRS 9 does not specifically define default, but requires it to be applied on a consistent basis with internal credit risk management practice for the relevant instruments and requires consideration of qualitative factors where appropriate. In addition, IFRS 9 also introduces a rebuttable presumption that default does not occur later than when a financial asset is 90 days past due unless there is reasonable and supportable information to demonstrate that a more lagging criterion is more appropriate.

In this respect, the local group determines that a financial instrument is credit-impaired and in Stage 3 by considering relevant objective evidence, primarily whether:

- contractual payments of either principal or interest are past due for more than 90 days;
- there are other indications that the borrower is unlikely to pay such as that a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition; and
- the loan is otherwise considered to be in default. If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due, even where regulatory rules permit default to be defined based on 180 days past due.

Therefore, the definitions of credit-impaired and default are aligned as far as possible so that Stage 3 represents all loans which are considered defaulted or otherwise credit-impaired.

Renegotiated loans

A 'renegotiated loan' is a loan where the contractual payment terms have been renegotiated or otherwise modified because the local group has significant concerns about the borrower's ability to meet contractual payments when due. In general, renegotiated loans are regarded as credit-impaired upon renegotiation unless the concession is insignificant and there are no other indicators of impairment. Moreover, loans are considered renegotiated irrespective of whether the modification is significant or not. Thus, de-recognition or otherwise of the financial asset would not have a bearing on whether the financial asset remains classified in the respective stage allocation. A range of forbearance strategies are employed upon the renegotiation of a loan in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid default, foreclosure or repossession. They include extended payment terms, a reduction in interest or principal repayments, approved external debt management plans, debt consolidations, the deferral of foreclosures, and other forms of loan modifications and re-ageing (re-ageing is an account action where the customer account is reclassified as being up to date without the customer having paid the arrears in full).

The local group's policies and practices are based on criteria which enable local management to judge whether repayment is likely to continue. Forbearance measures typically provide a customer with terms and conditions that are more favourable than those provided initially. Forbearance/renegotiation is only granted in situations where the customer has showed a willingness to repay the borrowing and is expected to be able to meet the revised obligations.

As suggested previously, Wholesale renegotiated loans are considered credit-impaired and accordingly classified as Stage 3 assets. They can be cured out of the credit impaired status subsequently. When evidence suggests that the renegotiated asset is no longer credit-impaired, the asset is transferred out of Stage 3. This is assessed on the basis on historical and forward looking information and an assessment of the credit risk over the expected life of the asset, including information about the circumstances that led to the renegotiation.

Similarly, Retail renegotiated loans are also classified as Stage 3 assets. In contrast, Retail renegotiated loans do not cure out of the credit impaired status. This is due to operational reasons in view of challenges in model monitoring and model limitations. However, the effect of this treatment is considered insignificant.

With respect to Wholesale exposures the local group has incorporated evidence of credit impairment/default into the internal CRR used to rate Wholesale exposures. A defaulted or credit-impaired financial asset is assigned CRR 9 or 10. These exposures are usually managed by the local group's loan management unit ('LMU').

With respect to Retail exposures, evidence of credit impairment/default is also incorporated into the PD model. A retail exposure with a PD of 1 i.e. 100% probability is considered defaulted and credit-impaired.

Expected credit loss

In general, the local group calculates ECL using three main components: PD, loss given default ('LGD'), and exposure at default ('EAD'). The local group calculates the ECL for the Wholesale portfolio at an instrument level, whilst the ECL for Retail portfolios is calculated on a collective basis.

The 12-month ECL is calculated by multiplying the 12-month PD, LGD, and EAD. Lifetime ECL is calculated on a similar basis for the residual life of the exposure. The 12-month and lifetime PDs represent the probability of default occurring over the next 12 months and the remaining maturity of the instrument, respectively. With respect to the Wholesale portfolio, given the local group's inherent lack of history of defaults to derive coherent PDs, proxy PDs are used as part of a Smaller Site Methodology. These proxy PDs are derived from regulatory PDs determined at HSBC Group level, and are adjusted for a scalar and a management overlay to reflect the economic realities of the market the local group operates in. The scalar denotes a risk parameter that helps translate the regulatory PDs into PDs relevant to the local scenario. In contrast, PDs for the Retail portfolio are based on internally developed statistical models using the local group's data.

The LGD represents expected losses on the EAD given the event of default, taking into account, among other attributes, the mitigating effect of collateral value at the time it is expected to be realised and the time value of money. The LGD used for the Wholesale portfolio is driven by the loan-to-value ratio of the individual facilities, and takes into account other assumptions, including market value haircut (which includes costs to sell), time to sell and discounting the collateral from the date of realisation back to the date of default. Similarly, the LGD for the Mortgages portfolio is also driven by the loan-to-value ratio of exposures, taking into account similar assumptions as those in the Wholesale portfolio. In contrast, the LGD for the remaining Retail portfolios (personal loans, overdrafts and credit cards), is based on the local group's recovery history.

The EAD represents the expected balance at default, taking into account the repayment of principal and interest from the balance sheet date to the default event together with any expected drawdowns of committed facilities. The ECL is measured from the initial recognition of the financial asset. The maximum period considered when measuring ECL (be it 12-month or lifetime ECL) is the maximum contractual period over which the local group is exposed to credit risk. With respect to non-revolving credit facilities, the contractual life of the facility is considered. In contrast, in respect of revolving credit facilities, the local group distinguishes between individually managed exposures and collectively managed exposures. For individually managed exposures, which mostly form part of the Wholesale portfolio, credit risk management actions are taken no less frequently than on an annual basis and therefore this period is to the expected date of the next substantive credit review. The date of the substantive credit review also represents the initial recognition of the new facility. In contrast, with respect to the remaining revolving credit facilities, the lifetime of such exposures is defined as the point where 95% of the defaults have materialised – thus, the lifetime of such assets may be longer than 12 months.

Forward-looking information

The recognition and measurement of ECL is highly complex and involves the use of significant judgement and estimation, including in the formulation and incorporation of multiple forward-looking economic conditions into the ECL estimates to meet the measurement objective of IFRS 9.

Three scenarios are considered to capture non-linearity across credit portfolios. If the economic environment is considered to be particularly adverse and results in a more pronounced non-linearity impact, senior management will exercise judgement, recommend overlays and/or commission additional scenarios. This approach on the whole is operationally feasible and will result in transparent outcomes.

The three scenarios will include a central or baseline view driven by a consensus among professional industry forecasts. Two additional outer scenarios – an 'upside' and a 'downside' – will be constructed using a 'rules-based' system supported by a scenario narrative that will reflect the current top and emergent risks. The key point to note is that the 'outer' scenarios will be economically plausible states of the world and will not necessarily be as severe as scenarios used in stress testing. The period of forecast is five years after which the forecasts will revert to a more 'through the cycle' view.

A Forward Economic Guidance ('FEG') methodology has been developed to generate the economic inputs to help drive the IFRS 9 ECL models used by credit risk. The scenarios have probabilities attached, based on a mixture of quantitative analysis and management judgement, with reference to an assessment of the economic risk landscape. The scenarios are enriched to produce the necessary variables that are required by the impairment models. For further guidance on the application of FEG, refer to the Report on Transition to IFRS 9 'Financial Instruments' published by HSBC Group.

Presentation of ECL in statement of financial position ('SOFP')

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.

For financial assets measured at fair value through other comprehensive income, the loss allowance is presented within other comprehensive income and not against the carrying amount of the assets. The carrying amount of the asset is always the fair value.

Hedge accounting

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

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

IFRS 15 'Revenue from Contracts with Customers'

In May 2014, the IASB issued IFRS 15 'Revenue from Contracts with Customers' and it is effective for annual periods beginning on or after 1 January 2018. IFRS 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue for performance obligations as they are satisfied.

The local group adopted the standard on its mandatory effective date, and the standard was applied on a retrospective basis, recognising the cumulative effect of initially applying the standard as an adjustment to the opening balance of retained earnings. IFRS 15 had no significant effect, when applied, on the consolidated financial statements of the local group and the separate financial statements of the bank.

HSBC Bank Malta p.l.c. is a member of the HSBC Group, whose ultimate parent company is HSBC Holdings plc. HSBC Holdings plc, the parent company of the HSBC Group, is headquartered in London. The HSBC Group serves customers worldwide from around 3,800 offices in 66 countries and territories in Europe, Asia, North and Latin America, and the Middle East and North Africa. With assets of US $2,607bn at 30 June 2018, HSBC Group is one of the world's largest banking and financial services organisations.

Net operating income

Net operating income includes net income from Life insurance business analysed as follows:

	Group	
	Half-year to	
	30 Jun 2018	30 Jun 2017
	€000	€000
Net interest income	11	99
Net fee and commission income	1,173	1,279
Net income from insurance financial instruments designated at fair value	(2,711)	5,237
Net earned insurance premiums	31,466	37,249
Net other operating expense including movement in present value of in-force long-term insurance business	(1,430)	(462)
	28,509	43,402
Net insurance claims incurred and movement in policyholders' liabilities	(21,930)	(35,356)
	6,579	8,046

Summary of financial instruments to which the impairment requirements in IFRS 9 are applied

	At 30 Jun 2018		At 1 Jan 2018	
	Gross carrying/ nominal amount	Allowance for ECL[1]	Gross carrying/ nominal amount	Allowance for ECL[1]
	€000	€000	€000	€000
Loans and advances to customers at amortised cost	3,192,183	(51,301)	3,169,474	(51,150)
– personal	2,102,743	(11,647)	2,098,841	(11,623)
– corporate and commercial	954,642	(37,457)	921,066	(37,631)
– non-bank financial institutions	134,798	(2,197)	149,567	(1,896)
Loans and advances to banks at amortised cost	973,703	(3)	1,059,312	(4)
Other financial assets measured at amortised cost	1,004,063	(28)	1,007,259	(116)
– cash and balances at central banks	31,025	–	35,517	–
– Items in the course of collection from other banks	19,369	–	18,158	–
– financial investments	920,262	–	926,096	–
– prepayments, accrued income and other assets[2]	33,407	(28)	27,488	(116)
Total gross carrying amount on-balance sheet	5,169,949	(51,332)	5,236,045	(51,270)
Loans and other credit related commitment	773,068	(1,129)	824,358	(1,139)
– personal	382,477	(89)	314,255	–
– corporate and commercial	386,210	(1,040)	500,624	(1,139)
– financial	4,381	–	9,479	–
Financial guarantee and similar contract	118,106	(400)	116,024	(653)
– corporate and commercial	118,106	(400)	116,024	(653)
Total nominal amount off-balance sheet[3]	891,174	(1,529)	940,382	(1,792)
	6,061,123	(52,861)	6,176,427	(53,062)

	Fair value	Memorandum allowance for ECL[4]	Fair value	Memorandum allowance for ECL[4]
	€000	€000	€000	€000
Debt instruments measured at Fair Value through Other Comprehensive Income ('FVOCI')	1,071,835	(21)	1,004,298	(23)

1 *The total ECL is recognised in the loss allowance for the financial asset unless the total ECL exceeds the gross carrying amount of the financial asset, in which case the ECL is recognised as a provision.*
2 *Includes only those financial instruments which are subject to the impairment requirements of IFRS 9. 'Prepayments and accrued income' and 'other assets' as presented within the statement of financial position on page 6 includes both financial and non-financial assets.*
3 *Represents the maximum amount at risk should the contracts be fully drawn upon and clients default.*
4 *For the purposes of this disclosure gross carrying value is defined as the amortised cost of a financial asset, before adjusting for any loss allowance. As such the gross carrying value of Debt Instruments at Fair Value through OCI as presented above will not reconcile to the balance sheet as it excludes fair value gains and losses.*

Summary of credit risk (excluding debt instruments measured at FVOCI) by stage distribution and ECL coverage by industry sector at 30 June 2018

	Gross carrying/nominal amout[1]				Allowance for ECL				ECL coverage %			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
	€000	€000	€000	€000	€000	€000	€000	€000	%	%	%	%
Loans and advances to customers at amortised cost:	2,870,348	146,376	175,459	3,192,183	(10,235)	(7,500)	(33,566)	(51,301)	0.4	5.1	19.1	1.6
– personal	1,990,785	29,691	82,268	2,102,744	(4,028)	(3,555)	(4,064)	(11,647)	0.2	12.0	4.9	0.6
– corporate and commercial	752,347	111,049	91,245	954,641	(4,322)	(3,716)	(29,419)	(37,457)	0.6	3.3	32.2	3.9
– non-bank financial institutions	127,216	5,636	1,946	134,798	(1,885)	(229)	(83)	(2,197)	1.5	4.1	4.3	1.6
Loans and advances to banks at amortised cost	973,703	–	–	973,703	(3)	–	–	(3)	–	–	–	–
Other financial assets measured at amortised cost	1,004,063	–	–	1,004,063	(28)	–	–	(28)	–	–	–	–
Loan and other credit-related commitments	710,133	59,087	3,848	773,068	(888)	(241)	–	(1,129)	0.1	0.4	–	0.1
– personal	357,574	22,951	1,952	382,477	(69)	(20)	–	(89)	–	0.1	–	–
– corporate and commercial	348,463	35,873	1,874	386,210	(819)	(221)	–	(1,040)	0.2	0.6	–	0.3
– financial	4,096	263	22	4,381	–	–	–	–	–	–	–	–
Financial guarantee and similar contracts:	103,236	14,279	591	118,106	(256)	(140)	(4)	(400)	0.2	1.0	0.7	0.3
– personal	2,155	298	13	2,466	(17)	(10)	(4)	(31)	0.8	3.4	30.8	1.3
– corporate and commercial	101,081	13,981	578	115,640	(239)	(130)	–	(369)	0.2	0.9	–	0.3
– financial	–	–	–	–	–	–	–	–	–	–	–	–
At 30 Jun 2018	5,661,483	219,742	179,898	6,061,123	(11,410)	(7,881)	(33,570)	(52,861)	0.2	3.6	18.7	0.9

Reconciliation of allowances for loans and advances to banks and customers including loan commitments and financial guarantees

	Allowance for ECL
	€000
At 1 Jan 2018	53,062
ECL income statement charge/(release) for the period	3,355
Assets written off	(3,556)
Exchange and other movements	–
At 30 Jun 2018	52,861
ECL income statement charge/(release) for the period	3,837
Add: Recoveries	(482)
Add: Modification gains or (losses) on contractual cash flows that did not result in derecognition	–
Add/(less): Others	–
Total ECL income charge/(release) for the period	3,355

Summary of financial instruments to which the impairment requirements in IFRS 9 are applied – by global business

	Gross carrying/nominal amount				Allowance for ECL			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
	€000	€000	€000	€000	€000	€000	€000	€000
Loans and advances to customers at amortised cost	2,870,348	146,376	175,459	3,192,183	(10,235)	(7,500)	(33,566)	(51,301)
– RBWM	1,882,127	95,980	115,051	2,093,158	(2,603)	(1,908)	(7,140)	(11,651)
– CMB	988,221	50,396	60,408	1,099,025	(7,632)	(5,592)	(26,426)	(39,650)
– GM	–	–	–	–	–	–	–	–
– Corporate Centre	–	–	–	–	–	–	–	–
Loans and advances to banks at amortised cost	973,703	–	–	973,703	(3)	–	–	(3)
– RBWM	–	–	–	–	–	–	–	–
– CMB	–	–	–	–	–	–	–	–
– GM	–	–	–	–	–	–	–	–
– Corporate Centre	973,703	–	–	973,703	(3)	–	–	(3)
Other financial assets measured at amortised cost	1,004,063	–	–	1,004,063	(28)	–	–	(28)
– RBWM	35,437	–	–	35,437	(9)	–	–	(9)
– CMB	41,752	–	–	41,752	(19)	–	–	(19)
– GM	920,817	–	–	920,817	–	–	–	–
– Corporate Centre	6,057	–	–	6,057	–	–	–	–
Total gross carrying amount on balance sheet at 30 Jun 2018	4,848,114	146,376	175,459	5,169,949	(10,266)	(7,500)	(33,566)	(51,332)
Loans and other credit related commitments	710,133	59,087	3,848	773,068	(888)	(241)	–	(1,129)
– RBWM	526,768	33,812	2,875	563,455	(69)	(20)	–	(89)
– CMB	183,365	25,275	973	209,613	(819)	(221)	–	(1,040)
– GM	–	–	–	–	–	–	–	–
– Corporate Centre	–	–	–	–	–	–	–	–
Financial guarantee and similar contracts	103,236	14,279	591	118,106	(256)	(140)	(4)	(400)
– RBWM	5,165	749	33	5,947	(17)	(10)	(4)	(31)
– CMB	98,071	13,530	558	112,159	(239)	(130)	–	(369)
– GM	–	–	–	–	–	–	–	–
– Corporate Centre	–	–	–	–	–	–	–	–
Total nominal amount off-balance sheet at 30 Jun 2018	813,369	73,366	4,439	891,174	(1,144)	(381)	(4)	(1,529)
Debt instruments measured at FVOCI	1,071,835	–	–	1,071,835	(1)	–	–	(1)
– RBWM	–	–	–	–	(1)	–	–	(1)
– CMB	–	–	–	–	–	–	–	–
– GM	–	–	–	–	–	–	–	–
– Corporate Centre	1,071,835	–	–	1,071,835	–	–	–	–
At 30 Jun 2018	6,733,318	219,742	179,898	7,132,958	(11,411)	(7,881)	(33,570)	(52,862)

Segmental analysis

Class of business

The local group provides a comprehensive range of banking and related financial services to its customers. The products and services offered to customers are organised by global businesses.

- **Retail Banking and Wealth Management ('RBWM')** offers a broad range of products and services to meet the personal banking and wealth management needs of individual customers. Typically, customer offerings include personal banking products (current and savings accounts, mortgages and personal loans, credit cards, debit cards and local and international payment services) and wealth management services (insurance and investment products, global asset management services and financial planning services).
- **Commercial Banking ('CMB')** offers a broad range of products and services to serve the needs of our commercial customers, including small- and medium-sized enterprises, mid-market enterprises and corporates. These include credit and lending and international trade and receivables finance. CMB also offers its customers access to products and services offered by other global businesses, for example Global Markets ('GM').
- **GM** provides tailored financial solutions to corporate and institutional clients. The client-focused business line delivers a full range of banking capabilities including assistance with managing risk via interest rate derivatives, the provision of foreign exchange spot and derivative products, and payment services.
- **Corporate Centre** ('CC') comprises mainly of Central Treasury, including Balance Sheet Management.

The local group's internal reporting to the Board of Directors and Senior Management is analysed according to these business lines. For each of the businesses, the Senior Management, in particular the Chief Executive Officer, as chief operating decision-maker, reviews internal management reports in order to make decisions about allocating resources and assessing performance.

The Board considers that global businesses represent the most appropriate information for the users of the financial statements to best evaluate the nature and financial effects of the business activities in which the local group engages, and the economic environments in which it operates. As a result, the local group's operating segments are considered to be the global businesses.

	Retail Banking and Wealth Management		Commercial Banking		Global Markets		Corporate Centre		Group total	
	Half-year to									
	30 Jun 2018	30 Jun 2017	**30 Jun 2018**	30 Jun 2017	**30 Jun 2018**	30 Jun 2017	**30 Jun 2018**	30 Jun 2017	**30 Jun 2018**	30 Jun 2017
	€000	€000	**€000**	€000	**€000**	€000	€000	€000	**€000**	€000
Group										
Net interest income	**32,081**	32,428	**18,205**	21,363	**—**	(202)	**3,821**	6,709	**54,107**	60,298
Net non-interest income	**12,239**	15,057	**6,872**	5,675	**1,181**	1,477	**19**	—	**20,311**	22,209
External employee compensation and benefits	**(18,071)**	(17,437)	**(6,021)**	(5,794)	**(258)**	(367)	**(284)**	(387)	**(24,634)**	(23,985)
General and administrative expenses	**(19,384)**	(17,318)	**(7,527)**	(7,236)	**(237)**	(439)	**(456)**	(460)	**(27,604)**	(25,453)
External depreciation	**(1,167)**	(1,230)	**(517)**	(522)	**(16)**	(31)	**(35)**	(43)	**(1,735)**	(1,826)
External amortisation	**(640)**	(663)	**(263)**	(268)	**(8)**	(16)	**(18)**	(22)	**(929)**	(969)
External net impairment	**(1,008)**	(3,039)	**(2,349)**	(1,310)	**—**	—	**2**	—	**(3,355)**	(4,349)
Profit before tax	**4,050**	7,798	**8,400**	11,908	**662**	422	**3,049**	5,797	**16,161**	25,925
Total assets	**3,528,338**	3,576,285	**1,163,509**	1,116,437	**13,850**	5,312	**2,099,897**	2,099,949	**6,805,594**	6,797,983
Total equity	**219,831**	235,185	**165,486**	172,456	**7,956**	7,727	**64,420**	63,670	**457,693**	479,038

Fair values of financial assets and liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The following table sets out the fair values of financial assets and liabilities as at the reporting date.

Fair values are determined according to the following hierarchy:

- *Level 1 – valuation technique using 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.

The valuation techniques utilised in preparing these condensed interim financial statements are consistent with those applied in the preparation of financial statements for the year ended 31 December 2017. There were no transfers between levels of the fair value hierarchy during the period under review.

Fair values of financial assets and liabilities carried at fair value and basis of valuation:

		Valuation techniques		
	Quoted market price Level 1	Using observable inputs Level 2	With significant unobservable inputs Level 3	Total
	€000	€000	€000	€000
Group				
At 30 Jun 2018				
Assets				
Treasury bills	**–**	**154,551**	**–**	**154,551**
Held for trading derivatives	**–**	**8,351**	**–**	**8,351**
Financial assets designated at fair value				
– attributable to insurance operations	**N/A**	**N/A**	**N/A**	**N/A**
– mandatorily measured at Fair Value through profits and loss	**710,756**	**434**	**7,658**	**718,848**
– available-for-sale financial investments	**918,611**	**–**	**1,651**	**920,262**
Assets attributable to disposal group held for sale	**357,285**	**116,480**	**2,529**	**476,294**
Total assets	**1,986,652**	**279,816**	**11,838**	**2,278,306**
Liabilities				
Held for trading derivatives	**–**	**8,337**	**–**	**8,337**
Liabilities under investment contracts	**177,196**	**435**	**–**	**177,631**
Liabilities attributable to disposal group held for sale	**357,285**	**116,480**	**2,529**	**476,294**
Total liabilities	**534,481**	**125,252**	**2,529**	**662,262**
At 31 Dec 2017				
Assets				
Treasury bills	–	80,512	–	80,512
Held for trading derivatives	–	5,175	–	5,175
Financial assets designated at fair value				
– attributable to insurance operations	719,385	411	7,474	727,270
Available-for-sale financial investments	925,001	–	1,095	926,096
Assets attributable to disposal group held for sale	331,271	139,792	2,734	473,797
Total assets	1,975,657	225,890	11,303	2,212,850
Liabilities				
Held for trading derivatives	–	5,228	–	5,228
Liabilities under investment contracts	202,725	411	–	203,136
Liabilities attributable to disposal group held for sale	331,271	139,792	2,734	473,797
Total liabilities	533,996	145,431	2,734	682,161
Bank				
At 30 Jun 2018				
Assets				
Treasury bills	**–**	**154,551**	**–**	**154,551**
Held for trading derivatives	**–**	**8,351**	**–**	**8,351**
Financial assets designated at fair value				
– attributable to insurance operations	**N/A**	**N/A**	**N/A**	**N/A**
– mandatorily measured at Fair Value through profits and loss	**–**	**–**	**–**	**–**
– available-for-sale financial investments	**918,609**	**–**	**1,651**	**920,260**
Total assets	**918,609**	**162,902**	**1,651**	**1,083,162**
Liabilities				
Held for trading derivatives	**–**	**8,337**	**–**	**8,337**
Total liabilities	**–**	**8,337**	**–**	**8,337**
At 31 Dec 2017				
Assets				
Treasury bills	–	80,512	–	80,512
Held for trading derivatives	–	5,175	–	5,175
– available-for-sale financial investments	923,786	–	1,095	924,881
Total assets	923,786	85,687	1,095	1,010,568
Liabilities				
Held for trading derivatives	–	5,228	–	5,228
Total liabilities	–	5,228	–	5,228

Level 3

(a) Financial assets mandatorily measured at fair value through profits and loss

	2018	2017
	€000	€000
At 1 Jan	**7,474**	5,840
Purchase during the period	**144**	2,787
Disposals during the period	**–**	(282)
Transferred to assets attributable to disposal group held for sale	**–**	(1,003)
Gains recognised in profit or loss	**40**	132
At 30 Jun	**7,658**	7,474

The financial assets mandatorily measured at fair value through profit or loss (under IAS 39 referred to as 'Financial assets designated at fair value attributable to insurance operations') categorised within Level 3 comprise holding of units in collective investment schemes which were acquired by HSBC Life Assurance (Malta) Limited as part of the portfolio transfer of unit linked investment contracts from HSBC Life (Europe) Limited, effective on 30 November 2014. These holdings consist of shares in alternative funds which are unlisted and have illiquid price sources. In view of the absence of quoted market prices or observable inputs for modelling value, the fair value of the shares held is derived using the net asset value as sourced from the respective custodians, which is not supported by audited financial statements.

The units in collective investment schemes categorised as Level 3 are held to cover linked liabilities and accordingly, corresponding liabilities to customers under investment contracts are also categorised as Level 3. Investment risk attributable to these Level 3 assets is borne by the policyholder in view of the policyholder's decision to invest in such assets. Accordingly, the disclosure of key unobservable inputs to Level 3 financial instruments and the sensitivity of Level 3 fair value to reasonably possible alternatives in respect of significant unobservable assumptions was not deemed necessary and relevant.

(b) Available-for-sale financial investments

These investments consist of shares in unlisted companies, which have illiquid prices sources. In view of no quoted market or observable inputs for modelling their value, the fair value of the shares held is derived using the net asset value of the respective companies as reported in the latest available financial statements.

Any changes in the unobservable inputs of both classes of financial assets categorised in Level 3 are not considered to result in significantly higher or lower fair value measurement, given that the amounts invested are considered to be immaterial.

VISA valuation

As disclosed in the bank's *Annual Report and Accounts of 2017*, the Level 3 investments predominantly comprise preferred stock of Visa Inc., which were received in 2016 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 pre-tax value of the convertible preference shares together with the deferred cash payment, expected in 2019, has been estimated at €2,286,584.

(c) Non-financial investments at fair value

The local group's land and buildings, within property, plant and equipment, comprised, commercial branches, bank offices and other operational premises. Investment property comprises commercial property leased out as offices to third parties including the local group's intermediate parent. All the recurring property fair value measurements use significant unobservable inputs and are accordingly categorised within Level 3 of the fair valuation hierarchy.

	Group		Bank	
	30 Jun 2018	31 Dec 2017	30 Jun 2018	31 Dec 2017
	€000	€000	€000	€000
Assets				
Property	**44,025**	43,610	**44,133**	43,709
Investment property	**10,602**	10,600	**7,500**	7,500
	54,627	54,210	**51,633**	51,209

The local group's land and buildings within property, plant and equipment and investment property are fair valued annually by an independent firm of property valuers having appropriate recognised professional qualifications and experience in the location and category of the property being valued. Fair values are determined on the basis of open market value taking cognisance of the specific location of the property, the size of the site together with its development potential, the availability of similar properties in the area and, whenever possible, having regard to recent market transactions for similar properties in the same location.

Valuations are carried out on a regular basis such that the carrying amount of property does not differ materially from that which would be determined using fair values at the end of the reporting period. The Directors have reviewed the carrying amounts of the properties as at 30 June 2018, on the basis of the valuations carried out by the independent property valuers. Adjustments to the carrying amounts of the local group's land and buildings within property, plant and equipment, and investment property, as at 30 June 2018 were not deemed necessary.

The valuation processes and techniques utilised in preparing these condensed interim financial statements were consistent with those applied in the preparation of financial statements for the year ended 31 December 2017.

Fair values of financial assets and liabilities not carried at fair value

Certain financial assets and liabilities are either carried at amortised cost or cost less impairment. The fair values of these financial assets and liabilities are not disclosed given that the carrying amount is a reasonable approximation of the fair value because these are either re-priced to current market rates frequently or are short term in nature.

The following table sets out the carrying amounts and fair values of financial assets and liabilities not carried at fair value:

	Group		Bank	
	Half-year to			
	30 Jun 2018	31 Dec 2017	**30 Jun 2018**	31 Dec 2017
	€000	€000	**€000**	€000
Assets				
Balances with Central Bank of Malta and cash	**78,903**	83,547	**78,345**	83,547
Items in the course of collection from other banks	**19,369**	18,158	**19,369**	18,158
Loans and advance to banks	**973,700**	1,059,308	**970,322**	1,045,699
Loans and advance to customers	**3,140,882**	3,128,833	**3,140,882**	3,128,833
Accrued interest	**21,389**	23,139	**17,814**	19,120
Other assets	**14,929**	8,951	**14,929**	8,951
	4,249,172	4,321,936	**4,241,661**	4,304,308
Liabilities				
Deposits by banks	**33,520**	54,703	**33,520**	54,703
Customer accounts	**4,832,252**	4,765,995	**4,894,953**	4,850,931
Subordinated liabilities	**29,297**	29,277	**30,000**	30,000
Accrued interest	**13,924**	17,575	**12,499**	15,040
Other liabilities	**47,477**	39,446	**47,477**	39,446
	4,956,470	4,906,996	**5,018,449**	4,990,120

Asset encumbrance

The disclosure on asset encumbrance is a requirement in terms of Banking RULE 07 transposing the provisions of the EBA Guidelines on Disclosures of Encumbered and Unencumbered Assets (EBA/GL/2014/03).

The objective of this disclosure is to facilitate an understanding of available and unrestricted assets that could be used to support potential future funding and collateral needs. An asset is defined as encumbered if it has been pledged as collateral against an existing liability, and as a result is no longer available to the group to secure funding, satisfy collateral needs or be sold to reduce the funding requirement.

The disclosure is not designed to identify assets which would be available to meet the claims of creditors or to predict assets that would be available to creditors in the event of a resolution or bankruptcy.

Encumbered and unencumbered assets

	Group		Bank	
	30 Jun 2018	31 Dec 2017	**30 Jun 2018**	31 Dec 2017
	€000	€000	**€000**	€000
Total assets	**6,805,594**	6,797,983	**5,482,697**	5,459,378
Less:				
Assets pledged against the provision of credit lines by Central Bank of Malta				
– debt securities	**62,344**	62,880	**62,344**	62,880
Less:				
Debt securities pledged in terms of Depositor Compensation Scheme	**25,193**	25,510	**25,193**	25,510
Less:				
Cash pledged in terms of the Recovery and Resolution Regulations	**709**	508	**709**	508
Less:				
Other assets that cannot be pledged as collateral	**1,515,299**	1,494,943	**200,150**	175,199
Assets available to support funding and collateral needs	**5,202,049**	5,214,142	**5,194,301**	5,195,281

The local group does not encumber any of the collateral received or any of its own debt securities issued.

As at 30 June 2018, the local group did not have any outstanding liabilities associated with encumbered assets and collateral received.

The bank undertakes the following types of encumbrance:

- Pledging of debt securities against the provision of credit lines by the Central Bank of Malta.
- Pledging of debt securities in favour of the Depositor Compensation Scheme.

Dividends

	Group			
	Half-year to			
	30 Jun 2018	30 Jun 2017	**30 Jun 2018**	30 Jun 2017
	cent per share	cent per share	**€000**	€000
Gross of income tax				
Per 30 cent share				
– Prior year's final	**12.4**	4.1	**44,678**	14,773
– Proposed interim	**4.0**	4.7	**14,412**	16,934
	16.4	8.8	**59,009**	31,707
Net of income tax				
Per 30 cent share				
– Prior year's final	**8.1**	2.7	**29,041**	9,602
– Proposed interim	**2.6**	3.1	**9,368**	11,008
	10.7	5.7	**38,356**	20,610

Statement pursuant to Listing Rule 5.75.3 issued by the Listing Authority

I confirm that to the best of my knowledge:

- the condensed interim financial statements give a true and fair view of the financial position of the group and the bank as at 30 June 2018, as well as of their financial performance and cash flows for the period then ended, in accordance with IAS 34 Interim Financial Reporting, adopted by the EU; and
- the commentary includes a fair review of the information required under Listing Rule 5.81 to 5.84.

Andrew Beane

Chief Executive Officer

HSBC Bank Malta p.l.c.

116 Archbishop Street
Valletta VLT 1444
Malta
Telephone: 356 2380 2380
www.hsbc.com.mt