HSBC Bank Malta p.l.c.

# Annual Report and Accounts 2009

HSBC

The world's local bank

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## The HSBC Group

HSBC Bank Malta p.l.c. is a member of the HSBC Group, whose ultimate parent company is HSBC Holdings plc. Headquartered in London, HSBC Holdings plc is one of the largest banking and financial services organisations in the world. The HSBC Group's international network comprises around 8,000 offices in 87 countries and territories in Europe, the Asia-Pacific region, the Americas, the Middle East and Africa.

**HSBC Bank Malta p.l.c.**
*Registered in Malta: number C3177*
*Registered Office and Head Office:*
233 Republic Street
Valletta VLT 1116
Malta
Telephone: 356 2597 0000
Customer Service: 356 2380 2380
Facsimile: 356 2380 4923
www.hsbc.com.mt

**HSBC Holdings plc**
*Registered Office and Group Head Office:*
8 Canada Square
London E14 5HQ
United Kingdom
Telephone: 44 020 7991 8888
Facsimile: 44 020 7992 4880
www.hsbc.com

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## Chairman's Statement


In 2009 HSBC Bank Malta p.l.c. commemorated its tenth anniversary and I am pleased to advise it has delivered a strong performance in spite of challenging economic conditions and volatile markets.

### Results

Profit before taxation was €71.2 million. This represents a decrease of 25.9 per cent over prior year but is satisfactory in these uncertain times.

HSBC Bank Malta was in no way directly exposed to the financial crisis, however, there was no escaping the consequences of the economic slowdown.

The low interest rate environment experienced during 2009 has led to considerable margin compression and tougher competition for customer deposits and this had a negative impact on profits.

Profit attributable to shareholders decreased by 27.3 per cent to €45.9 million. On the basis of these results the Board is recommending a final gross ordinary dividend of 8.0 euro cent per share. This follows on the interim gross dividend of 7.7 euro cent per share (5.0 euro cent net of tax) paid in August 2009. This brings the total dividend for the year to 15.7 euro cent.

During 2009 the number of the bank's shareholders continued to grow and now exceeds 10,300. This reflects the confidence the public has in our organisation and its future performance.

HSBC Bank Malta p.l.c. is a subsidiary of London-based HSBC Holdings plc, one of the world's top financial brands, and remains the largest company listed on the Malta Stock Exchange with a market capitalisation well in excess of €1.0 billion.

### Strategy

During this past decade the bank has undergone considerable change which has brought about a revolution within the local financial services sector. Over the years many milestones have been reached. These have included reaching exceptional levels of performance, introducing innovative products and services, the latest technology and systems, new work practices, and setting up a Global Call Centre in Swatar.

During the year under review the bank continued with its strategy, which is founded on seven global pillars, of building sustainable growth by focusing on its main customer groups. The bank aims to grow its business by providing excellent customer service, using our global distribution network to our customers' advantage, joining up our company in terms of technology and processes, and leveraging our world renowned brand, to make it easier for customers to do business with us.

In 2009 we were once again fortunate to have HSBC's Global Group Chief Executive, Mr Michael Geoghegan, visit us as part of his worldwide roadshow and update us on what is happening around the Group and what initiatives are being taken in the current economic environment.

HSBC Bank remains one of the most strongly capitalised and liquid banks in the world. Over 100 million customers worldwide entrust HSBC with US$1.2 trillion in deposits. HSBC has more deposits than loans and operates in 87 countries and territories worldwide.

We are committed to putting the customer at the centre of everything we do. We believe in building strong customer relationships that are sustainable and mutually beneficial. To achieve this we will continue investing in our staff, in the latest technology and systems, and in developing innovative products and services which offer greater customer convenience.

Our aim is to be the Best Bank in Malta, the Best Place to Work, Best Bank for Shareholders, and Best Bank in the Community.

## Corporate Sustainability

HSBC worldwide is known for its consistent leadership and commitment towards the societies where it operates. In Malta, HSBC remains very active in the improvement of education and the quality of life particularly of children in challenging circumstances; in environmental sustainability and in the preservation of the country's heritage.

HSBC is also a keen supporter of culture and the arts. The bank's association with annual concerts by the world renowned tenor Joseph Calleja, who in 2009 was accompanied by another music icon, Michael Bolton, is a fine example of this.

On the 19th March of every year, HSBC partners with other large corporates whose employees volunteer a day's work to carry out work in care homes. Throughout the year, HSBC also lends its support to the Malta Hospice Movement, the OASI Foundation and the Malta Diabetes Association and is the main sponsor of World's Children Day in Malta.

As the pillars of tomorrow's society, children are a responsibility which HSBC invests in through highly specialised educational and literacy projects, counselling services and recreational and rehabilitation programmes. HSBC continued its strong support for The Malta Community Chest Fund in its fund-raising events, and contributed significantly to the Rockestra concert and L-Istrina marathon.

HSBC Junior Achievement Young Enterprise Malta, the Scoops Programme, the Students Council at the University of Malta and Junior Chamber International are other beneficiaries of HSBC's financial assistance which encourages education at all levels, from secondary to tertiary and beyond.

Another important area where HSBC leads by example is with the environment. HSBC not only runs its operations in a carbon-neutral manner, it also funds environmental programmes and initiatives against climate change and contributes tangibly in the improvement of the Maltese environment. The latest commitment to plant 1,500 trees at the Maghtab site to mark the tenth anniversary of HSBC in Malta is another green credential for the bank, bringing the total number of trees planted by HSBC as part of Malta's afforestation programme to 25,000.

In 2009, HSBC renewed its support to the EkoSkola Programme, run in schools by Nature Trust (Malta) to encourage good environmental practices among students. The global programme, run jointly by HSBC and the Foundation for Environmental Education, is backed by a financial commitment from HSBC of US$2.5 million over three years. In Malta, HSBC is making available over US$40,000 to run the programme.

Through our own Maltese Climate Champions we also actively participate in the Climate Change Partnership Programme which the HSBC Group is funding worldwide, at a cost of US$100 million over five years. HSBC also supports initiatives to celebrate World Environment Day and the Clean Up the World campaign.

Maltese tenor Joseph Calleja and international music icon Michael Bolton delighted the crowds during an HSBC sponsored concert at Luxol Grounds, St. Andrews on 19 July 2009.

## Chairman's Statement (continued)

HSBC is a proud supporter of Malta's heritage and invests substantially in its preservation. HSBC is therefore the official patron of the National Museum of Fine Arts, where this year it funded the opening of the HSBC Vincenzo Bonello library, and renewed its support to Fondazzjoni Patrimonju Malti.

The HSBC philosophy is that a thriving society is critical to its future success as The World's Local Bank. That is why it invests in the fundamental building blocks for the development of its communities, with its support of children, the environment, heritage, culture and the arts.

In 2009, HSBC pledged over €330,000 in total for its Corporate Sustainability programme, partnering with and supporting entities which are doing a sterling job in keeping the vulnerable elements of society on their feet.

This is how HSBC remains committed to sustainability and strives to make a difference in the community.

### Board

During 2009 there was one change to the Board of Directors from those nominated by minority shareholders. Mr Victor Scicluna, who served on the Board for a number of years did not seek re-election and was replaced by Mr James Dunbar Cousin, a former senior HSBC executive who recently retired after a long and distinguished career with the bank.

I would like to convey my gratitude to Mr Scicluna for his loyal contribution to our organisation during these past years. I also warmly welcome Mr Dunbar Cousin, who I am certain will use his knowledge and vast experience for the benefit and future success of the bank.

I would also like to advise that Director Charles John Farrugia, who until recently acted as the bank's Head of Global Banking and Markets, has decided to retire from the organisation after many years of dedicated and professional service. However, it is with great satisfaction to note that Mr Farrugia has agreed to continue to serve as a Director of the bank in a non-executive capacity.

The Board has a distinctive mix of members who through their collective skills, vast knowledge and wealth of experience have managed to successfully guide the bank in these exceptionally difficult times. Besides myself as Chairman, the Board is composed of two expatriate Executive Directors who are also Chief Executive Officer and Chief Technology and Services Officer of the bank, one local Executive, four prominent Non-Executive Directors (who are all Maltese) and one overseas-based Director who is Head of International of HSBC Bank plc.

I look forward to continue working with these Directors and building on achievements for a successful future.

### Recognition

I am also delighted to be able to report that our previous Chief Executive Officer, Mr Shaun Wallis, was awarded The National Order of Merit from the Government of Malta in recognition for his achievements in supporting the Maltese economy. This is a remarkable honour and does HSBC proud at a time when the bank is celebrating its tenth anniversary of operations in Malta.

### Outlook

Whilst profitability at the bank will continue to be under pressure in the short term, I am confident that with the backing of the HSBC Group, our enduring commitment to liquidity, strong capital and a conservative approach to risk management, we are well-positioned to build on our many strengths and support our customers in driving future growth.

My gratitude and appreciation goes to the Board of Directors, Management and Staff of the bank for their ongoing contribution, diligence and commitment in delivering these results in 2009.

I also thank our Shareholders for their steadfast support and our Customers for their continued trust in our organisation.

Let us look forward to another decade of success.

Albert Mizzi, *Chairman*
22 February 2010

# Chief Executive Officer's Review


2009 has clearly been a challenging year for both the bank and its customers. It has been a year characterised by pressure on profitability as a consequence of a general slowdown in economic activity, continued low interest rates (which have resulted in significant margin compression) and ongoing volatility in equity and bond markets which have inevitably impacted our investment-related businesses.

In spite of difficult market conditions, HSBC Bank Malta has continued to deliver strong results for its shareholders where our profitability relative to history and peers remains attractive with a return on equity at 15.0 per cent. These results are a testament to the professionalism, commitment and hard work of our staff who performed admirably in demanding and complex circumstances.

## Performance

Profit before taxation for 2009 amounted to €71.2 million, a decrease of 25.9 per cent over the previous year. Given the well-documented global economic crisis and the exceptionally difficult market conditions, this is a good result.

The results were underpinned by a solid performance in the circumstances from all of our principal customer groups: Personal Financial Services; Commercial Banking; and Global Banking and Markets. Our subsidiary companies also delivered sound performances and made a significant contribution to profits.

The most significant drop in revenue related to interest income. During the year, interest receivable decreased by €76.5 million or 31.1 per cent when compared to prior year. While this was somewhat offset by less interest paid, overall net interest income decreased by 14.7 per cent. It is important to stress that interest income would have been further impacted had it not been for the proactive re-pricing of our commercial and personal lending portfolios to better reflect the market and its inherent risks and the higher cost of capital.

It is pleasing to note that thanks to maintaining a strict cost discipline, expenses decreased by 7.3 per cent during the year in spite of a 4.0 per cent increase embedded in the Collective Agreement for salaries. Our cost-to-income ratio stood at 52.5 per cent which whilst 4.5 per cent higher than prior year, was largely due of course to lower levels of income.

Loan impairments have, not unexpectedly, increased to €4.2 million. This increase is off an extremely low historic base and remains at relatively modest levels in comparison to the size of the overall lending book and benchmarks of other financial institutions around the world. This is a reflection of the continued prudent approach to lending within the bank and the close working relationship we have with our customers including those experiencing financial difficulties.

Profit attributable to shareholders was €45.9 million, which is respectable in the prevailing circumstances.

Total assets decreased to €5,117.8 million mainly due to lower lending activity to other financial institutions. New lending to customers was €662.2 million (a net increase of €114.2 million) which reflects our ongoing support to our customers and the local economy. Total liabilities decreased by €202.4 million during the year. The main reason for this is a reduction in institutional deposits. Customer deposits rose by over €70.0 million, which is a positive sign and demonstrates the trust our personal customers have in our organisation.

We remain very well capitalised. Our capital adequacy ratio is 11.8 per cent which is well in excess of the regulatory requirement of 8.0 per cent. We also remain very liquid with an assets-to-deposits ratio of 79.0 per cent.

## Chief Executive Officer's Review (continued)

In light of these commendable financial results the Board is recommending a final gross ordinary dividend of 8.0 euro cent per share.

### Personal Financial Services

The Personal Financial Services business provides a diverse range of products and services to over a quarter of a million customers. The diversification of this business proved to be a real strength in 2009. The low interest rate environment reduced margins on Savings products and this margin compression has resulted in a reduction in profits compared to 2008. However, the bank's retail business was open for business as usual and recorded growth in Mortgages and Loans to customers whilst maintaining responsible lending policies based largely on customer affordability. Despite fierce competition for Savings and numerous corporate bonds and equity issues, the bank's personal customer deposit base remained stable.

Wealth Management is a key area of growth and is centred on HSBC's unique Global Premier proposition which is aimed at the bank's customers who have investment needs both in Malta and overseas. Premier delivers superior service through dedicated relationship managers who are trained to make the most of Premier customers' money. The bank's Financial Planning Advisors have had a challenging time during 2009 due to volatility in the investment markets. The market environment required a balance between a more prudent approach towards the management of customer assets and active portfolio management.

HSBC's Trust business continues to be the market leader and we have more than doubled assets under management during the year. Our growing reputation in the Trust business provides a great opportunity to grow both from our existing customer base in Malta and from overseas customers, many of whom are introduced from the wider HSBC Group.

Insurance performance was robust in a challenging environment for investment and protection sales and sales volumes were ahead of prior year. Investment performance picked up during the second half of the year and this has enabled reserves to be strengthened.

### Commercial Banking

The Commercial banking business had a very successful year across all disciplines, despite the difficult market conditions and the deteriorating economy.

During 2009, the asset book was re-priced to better reflect risk, the increasing cost of capital and the scarcity of liquidity in the market in general. Although we have seen a reduction in requests for real estate lending, directly reflecting a slowdown in the sector and the economy, we have seen a continued increase in requests for working capital funding, primarily via invoice finance which continues to grow, and has delivered record profits in 2009.

The Leading International Business strategy continues to gather momentum and we were delighted to have signed a two year sponsorship deal with Malta Enterprise to support their overseas trade missions. Senior members of the Commercial Banking team joined Maltese business and Ministerial delegations to Poland, Czech Republic, Qatar, Libya and India. We are pleased that we have been able to play a pivotal role in promoting 'Malta Inc' to key current, and future


CEO Alan Richards addressing Premier customers during a seminar organised to celebrate HSBC Premier's 5 years in Malta.

trading partners, and have been able to ‘match-make’ between many of our Maltese and overseas clients.

We remain supportive of the micro and small business sectors and have seen growth in demand for our on-line Business Direct service. The €100 million Small Business Fund has continued to be used to support the key SME segment which will be an important catalyst for driving economic recovery.

We are anticipating a continued slowdown in the economy in the first half of 2010, but will continue to work closely with all of our commercial clients to provide help and support wherever we can.

### Global Banking and Markets

Global Banking and Markets continues to successfully deliver on its strategy to offer best in class services to our local and international customers. Drawing upon expertise, best practice and leading edge technologies from across HSBC Group, we are well positioned to play a pivotal role in the growth of Malta’s financial services sector.

The Treasury and Capital markets team has effectively managed the bank’s liquidity position and investments to ensure that the bank has escaped largely unscathed from the global financial crisis. The Global Banking and Markets team has focused its energy on providing an increasing range of hedging products which enable our customers to better protect against currency and interest rate risks.

Our Stockbroking subsidiary remains a leading player in the development of Malta’s capital markets. We have been appointed lead manager and registrar for a number of successful bond issues and have provided specialist corporate advisory services on cross-border transactions.

Both our Custody and Fund Administration businesses have enjoyed strong performances, winning new customer mandates as Malta becomes an increasingly important player in the global financial sector. These businesses draw support from HSBC’s global expertise and continue to invest in technology and staff training to help support the increasing growth in the number of funds choosing Malta as a domicile. HSBC Security Services (Malta) Ltd spearheaded the launch of the World Selection Fund in Malta – one of HSBC’s global products tailored to the needs of local investors.

Whilst 2009 was another challenging year for the fund management industry, HSBC Global Asset Management (Malta) Ltd maintained its focus on actively managing its bond and equity funds together with its individually managed portfolios. We have enjoyed particular success in corporate bond funds which have enjoyed strong returns as markets have stabilised. Our well qualified investment experts have access to the full research and analytical resources from across HSBC Group which is then tailored to support our local team of investment advisors.

The Global Banking and Markets division represents a key growth area for HSBC in Malta. We are confident that our local retail, private client, corporate and institutional customers will increasingly benefit from the services that we can offer as part of the HSBC Group. We will also play a key role in promoting Malta’s growth as a financial services centre.

### People

If I had to pick out one highlight for the year, it has been the way in which our staff have rallied round as a team to help manage the bank through the worst economic crisis in living memory. Our staff of course remain our greatest asset and we continue to invest in initiatives designed to make HSBC Bank Malta the best place to work. These initiatives include revisions to our performance pay system, improved career advancement opportunities, a renewed focus on talent management and ongoing training and development programmes. 2009 also saw a number of colleagues leave the organisation through a voluntary redundancy scheme and I would like to sincerely thank those leavers for their contribution to HSBC over the years.

As part of our talent management strategy we have a number of employees seconded on overseas assignments and we will continue with a rolling programme in 2010.

“Our people have been magnificent throughout 2009 in helping to manage the bank through the worst economic crisis in living memory.”

## Chief Executive Officer's Review (continued)

We have good relations with the trade unions and will continue to work with the unions to improve the working environment wherever possible.

I think it is fitting, to mention that Mr Charles John Farrugia, who until recently was our Head of Global Banking and Markets has retired from the bank after a long and distinguished career. I am delighted Mr Farrugia has agreed to remain on the Board of Directors and that we will continue to benefit from his experience and wise counsel in the years to come.

Our strong performance in a very difficult environment in 2009 is testament to the talent and dedication of the team at HSBC and I would like to thank them all for their contribution during such a difficult year.

### Awards

It is befitting that to mark its tenth anniversary of local operations, HSBC Bank Malta has been named Bank of the Year in Malta for 2009 by the prestigious Financial Times monthly publication *The Banker* in recognition for the best overall performance. Furthermore, HSBC Bank Malta also won the Global Finance awards for the categories 'Best Bank in Malta' and one of the 'World's Best Internet Banks'. *Global Custodian*, another leading international publication covering global securities services business, also honoured HSBC Bank Malta with an award for excellence.


Alan Richards, CEO HSBC Bank Malta receiving The Banker 2009 Bank of the Year Award from Stephen Timewell, Editor-in-Chief of The Banker (left) and British journalist and TV broadcaster Michael Buerk (right).

### Outlook

The unprecedented global financial and economic upheaval has clearly impacted the Maltese economy, although Malta has fared better than many of its European counterparts.

Whilst there are clear signs of markets stabilising internationally, the outlook for the Maltese economy and general impairment levels in 2010 remain challenging. We are not yet out of the woods and forecasts show that the economy will recover only slowly.

Our plans and priorities for 2010 have already been established and we will strive to better serve our customers, optimise revenue streams, continue to invest in our people, enhance our risk management policies and transform the bank through a number of significant infrastructure projects.

Competition is increasing and it is important that we continue to emphasise our competitive advantages in the local market as an international bank. We have to focus on those areas where we have a natural advantage thanks to our brand, unique international franchise, and Group technology and systems.

We also have to ride the wave of Malta's growing financial services sector as it develops and we are well placed to support this government-led initiative.

There is a lot to be done and 2010 will be another challenging year. However, we are in a position of real strength and well placed to achieve our goals and to remain Malta's leading provider of financial services.

Alan Richards, *Chief Executive Officer*
22 February 2010

# Chief Technology and Services Officer's Review


2009 was one of the most challenging years in living memory. Besides having to deal with the difficult market conditions, low interest rate environment and economic slowdown we were committed to ensure that we continued to invest in and lead through technology, to improve productivity and to deliver the efficient and high quality service for which we are renowned. This necessitated completing a number of projects, some of which were mandatory, continuing to automate our processes to extract operational efficiencies, and above all to provide a better customer experience in our day-to-day operations.

Throughout a time of unprecedented global turmoil we have managed to deliver sustained cost savings whilst improving productivity and process efficiency. All this was achieved through the professionalism and commitment of our employees, to whom I am truly grateful.

## Operations – Technology and Service Delivery

In line with one of the HSBC Group's global pillars of Leading through Technology, we have taken great strides forward in joining up with the rest of the HSBC Group. In 2009 we stepped up the pace on our journey of alignment under One HSBC: a Group-wide programme to standardise all systems, products and processes for the benefit of our customers, staff and shareholders. Being able to leverage off the capabilities and strengths of HSBC Group is a differentiating feature for HSBC Bank Malta. It gives us unparalleled opportunities to extract sustainable cost benefits and process efficiencies whilst benchmarking customer experience against world-class service standards. Standardisation and simplification is a cornerstone of this strategy to improve our productivity and increase our operational efficiencies: ensuring that we use Group systems to their full functionality so that we are delivering what our customers want at most convenience to them. In fact, benefits of this investment include the already launched Global Accounts View and Me2Me for our Premier customers, where they have the ability in a single "session" on Personal Internet Banking to view and transact on their accounts held with HSBC across the world – wherever and whenever they want.

Streamlining and automating our processes has been a strategic priority for 2009 and we have taken the opportunity to migrate some of our standard processes to HSBC Group Centres of Excellence. This brings to the bank locally the benefits of being part of a global Group: lower cost of production and global "best in class" processes and service standards. We will continue to take opportunities to migrate processes where we can achieve "best in class" standardised production efficiencies and customer service excellence whilst retaining robust controls.

Providing 24x7 service delivery channels is a key strategic imperative. We continued to invest in our Internet Banking service to ensure that we offer mainstream banking to our customers at a time that suits them. We have increased the number of core products that can be applied for and opened on line – providing customers with the fastest and most convenient service possible whilst delivering operational and cost efficiency for the bank. We will continue to invest in systems and re-engineer our processes so that our core products are immediately available for our customers on-line through Internet Banking.

Telephone Banking continues to be a key delivery channel for the bank and in 2009 we launched the provision of Life cover to our customers telephonically: providing immediate cover at our customers' convenience. We continued to invest in automating telephone banking services, enabling our customers to solve a number of their routine banking enquiries, such as balance information, at the touch of a button. Not only is this more convenient for our customers,

## Chief Technology and Services Officer's Review (continued)

but it also enhances the bank's operational efficiency. Importantly, it has also enabled our Call Centre agents to take a more proactive role in enhancing customer experience through undertaking financial reviews with our customers over the telephone – at a time that suits our customers rather than having to go to a branch. This way we are getting to know our customers better and supporting their value-added financial needs beyond the constraints of branch hours.

Throughout the year we continued to invest in our branch network in our ongoing pursuit of improving customer experience. We upgraded our facilities for Premier clients in eight of our branches and launched a Premier Centre at St. Julians Branch: all with dedicated staff to support our Premier clients. Similarly, as the Leading International Bank in Malta, we installed Business Banking Zones in all our branches to show that, in addition to our Business Banking Centre in Qormi, our branches are open for business to support our commercial customers with their transactional banking requirements.

The new Premier Centre at St. Julians Branch

Self Service Banking is a key tenet of our banking proposition and we have invested in our ATMs to ensure compliance with the Payment Services Directive that became effective on 1 November 2009. We have also commenced a rolling programme to upgrade our entire ATM stock over the next two years.

### Projects

To achieve our commitment to deliver world-class standards for our customers by investing in technology, improving productivity, delivering service quality excellence and robust controls, it is inevitable that we are involved in various projects: 2009 was no different.

These projects vary significantly in nature. In 2009, as part of the Group's One HSBC initiative, we have embarked upon a programme to migrate our core systems on to the Group's Gold Suite platform.

We also continued to promote Malta as a Centre of Excellence for Group mid-office processing work. In 2009 we migrated work to Malta to support HSBC businesses in Ireland and Bermuda.

2009 saw the implementation of the mandatory Payments Services Directive. Putting payments onto the same framework across Europe entailed very complex project work. The bank took an active role as part of the Group's European project team, co-ordinated through the United Kingdom and France. In line with all European HSBC operations, the bank was fully compliant with the new legislation and regulatory requirements as they became effective on 1 November.

Another regulatory requirement was the submission of our Internal Capital Adequacy Assessment Process report under Basel II capital requirements. This involved undertaking a number of stress testing exercises and scenario analysis on our capital requirements and liquidity levels and assessing all types of risk. I am pleased to confirm that our organisation is in robust shape and satisfies all the criteria of a sound financial institution, well placed to withstand stress conditions.

We are also constantly involved in projects of a local nature as part of our ongoing programme to enhance customer experience.

### Service and Operational Quality

Systems up-times, accuracy and speed of turnaround are of fundamental importance to sustaining our competitive advantage and standards of service excellence. In 2009 we achieved 99 per cent 24x7 systems up-times. Similarly, through all the change and pressures, we retained operational and financial integrity by maintaining the highest reputational standards in the financial services sector as evidenced by external and Group audits.

Delivering and enhancing our risk control mechanisms continued to be a key priority and in this respect we embarked upon a roll-out programme to introduce Chip & Pin technology to all the cards we issue to upgrade security and reduce fraud losses. Similarly we have put in place state-of-the-art mechanisms to counteract fraud in other areas of our operations such as our cards acquiring business. These initiatives have gone extremely well and, coupled with our Mobile Banking services which are increasingly popular with our customers as an alert mechanism for possible fraud attempts, the bank was able to significantly reduce operational losses in 2009.

### Our Technology and Support Services Team

While having the latest processes and state-of-the-art technology is beneficial, these would be futile without the knowledge, expertise and hard work of our staff. It is our people not our systems that drive our business forward. The success we have achieved would not have been possible otherwise.

HSBC Bank Malta employee Patrick Gauci was awarded the title of Local Hero by the HSBC Group for having detected and stopped a fraud transaction from taking place.

Our people have shown unparalleled strength, resilience, determination, and team spirit to drive the bank's technology, operational processes and support services forward to ensure the bank is more operationally efficient, delivering sustainable cost savings and maintaining robust service standards for our customers.

That is why in 2009 we continued to invest in our people, provided better career opportunities, implemented more family friendly policies and improved the working environment wherever we could. We also were delighted that more of our Group colleagues joined us as members of our teams offshore. This enabled us to give new opportunities to our Maltese staff to support our Business growth areas locally. Our aim is to make HSBC the Best Place to Work in Malta and the high engagement score in our recent Global people survey confirms that we are doing just that.

While we always work as a team and seek synergies by being joined up across the Group, it is also worth mentioning individual achievements where merited. Our sincere appreciation, therefore, goes to Patrick Gauci who was awarded the title of World's Local Hero by our Group Chief Executive, Mike Geoghegan, for the admirable work he did to detect and stop fraud. Patrick made all of us proud and truly deserved this recognition for displaying the highest level of commitment, personal impact and outstanding actions.

I would also like to thank all our staff for driving forward our environmental initiatives and reducing carbon emissions by over 8 per cent year on year and to those who participated in the HSBC Group Climate Change Programme. This is commendable and shows everyone that Malta is doing its part for a better world and sustainable future.

## Future Outlook

2010 is going to be very exciting and truly transformational. We have already embarked on a major change programme which will see us deliver a number of strategic initiatives requiring horizontal and collaborative commitment and ownership from all areas of the bank. The structural framework to achieve the desired outcomes and to ensure good governance has already been put in place. A Programme Director has been appointed and the various work stream leaders and project managers have been identified, drawing on the bank's top talent.

The successful completion of this dynamic change delivery programme will definitely leave a positive impact on how we function internally and how we deliver Group "best in class" propositions for our customers. We have a unique competitive advantage. By harnessing Group systems and Centres of Excellence we will be able to deliver this business transformation: reaping sustainable operational efficiencies whilst growing our income to deliver significantly more value added for our shareholders.

By connecting globally and acting locally we are well placed to strengthen our position as Malta's Leading Local and International Bank.

Sally Robson, *Chief Technology and Services Officer*
22 February 2010

# Board of Directors

**Albert Mizzi,** NON-EXECUTIVE CHAIRMAN
Age 82. Non-Executive Chairman of HSBC Bank Malta p.l.c. since June 1999. In 1946, joined family business Alf. Mizzi & Sons Ltd. and was Chairman for several years. In the 1960s he was heavily involved in private banking and appointed director of Medport. Established a number of Malta's important parastatal businesses: Air Malta, Sea Malta, Medserv, Mediterranean Insurance Brokers and Middle Sea Insurance. Following the setting up of Air Malta in 1973, he served as its Chairman for 19 years.

**Alan Richards,** DIRECTOR AND CHIEF EXECUTIVE OFFICER
Age 50. Director and Chief Executive Officer of HSBC Bank Malta p.l.c. since May 2008. Chairman of HSBC's Life Company, Stockbroking and Fund Management businesses in Malta. Prior to moving to Malta, he was Deputy Chief Executive Officer for HSBC Australia based in Sydney. Joined HSBC in 1984 as a graduate entrant and has also worked for HSBC in the United Kingdom, Hong Kong, Malaysia and Turkey.

**Sally Robson,** DIRECTOR AND CHIEF TECHNOLOGY AND SERVICES OFFICER
Age 51. Director and Chief Technology and Services Officer of HSBC Bank Malta p.l.c. since March 2006. A professional banker and a fellow of the Chartered Institute of Bankers. Joined the then Midland Bank plc in 1979. Since 1983 she has held a number of key managerial positions within the HSBC Group in the United Kingdom, with the last post held being that of Area Director for Greater Manchester.

**Anthony Mahoney,** NON-EXECUTIVE DIRECTOR
Age 47. Group General Manager, Deputy Chief Executive Officer, Continental Europe since February 2010. Joined Midland Bank (now HSBC Bank plc) in 1983 and has occupied various roles in the UK Bank and European organisation. He was appointed Chief Executive Officer, HSBC Bank plc, Malta branch in July 1997. In June 1999 he was promoted to Director and Chief Operating Officer, HSBC Bank Malta p.l.c. During this time he was Chairman of HSBC Home Loans (Malta) Limited, HSBC Fund Management (Malta) Limited, HSBC Life Assurance (Malta) Limited, HSBC Finance (Malta) Limited and HSBC Overseas Bank (Malta) Limited. In June 2008 he assumed the position of Head of International, HSBC Bank plc.

**Philip Farrugia Randon,** NON-EXECUTIVE DIRECTOR
Age 60. Director of HSBC Bank Malta p.l.c. since June 2004 and Non-Executive Director since May 2008. Graduated LL.D. in 1973 and joined the bank in 1974 as a legal adviser. Held the post of Company Secretary and the post of Head of Group Legal Department of HSBC Bank Malta p.l.c. for several years. Retired from the bank in May 2008.

**Charles John Farrugia,** EXECUTIVE DIRECTOR
Age 52. Director of HSBC Bank Malta p.l.c. since November 2004. Joined the bank in 1975. Was appointed Chief Dealer in 1995, Group Senior Treasury Manager in 1999 and Managing Director of HSBC Stockbrokers (Malta) Ltd in 2001. Held the post of Head of Global Banking and Markets of HSBC Bank Malta p.l.c. for several years. Retired from the bank in January 2010 and will continue to serve as a Non-Executive Director.

**Peter Paul Testaferrata Moroni Viani,** NON-EXECUTIVE DIRECTOR
Age 49. Non-Executive Director of HSBC Bank Malta p.l.c. since March 2001. Holds various executive positions and directorships within the Testaferrata Group of companies.

**Saviour sive Sonny Portelli,** NON-EXECUTIVE DIRECTOR
Age 65. Non-Executive Director of HSBC Bank Malta p.l.c. since October 2006. A senior Maltese businessman who is currently the Chairman of The Malta Council for Economic and Social Development. He shall be relinquishing his post of Chairman of GO plc on 10 March 2010 and will take up chairmanship of Air Malta plc.

**James Dunbar Cousin,** NON-EXECUTIVE DIRECTOR
Age 59. Appointed Non-Executive Director of HSBC Bank Malta p.l.c. on 1 April 2009. Joined Barclays Bank D.C.O. in 1968. Occupied various managerial roles within the branch network of Mid-Med Bank Limited. Subsequently, he occupied the roles of Executive Manager and later Head of Commercial Banking of HSBC Bank Malta p.l.c. Retired from the bank at the end of 2008.

**George Brancaleone,** COMPANY SECRETARY
Age 48. Company Secretary of HSBC Bank Malta p.l.c. since June 2004. Joined the bank in 1980 and graduated LL.D. in 1988. Company Secretary of various HSBC subsidiaries in Malta since 2001. Presently holds the post of Senior Manager at Audit, Compliance and Legal Department of HSBC Bank Malta p.l.c.

# Financial Review

## Summary of Financial Performance

### Group profit

During the year ended 31 December 2009, HSBC Bank Malta p.l.c. and its subsidiaries generated a profit before tax of €71.2 million. Although this represents a decline of 25.9 per cent compared to last year, this is a resilient performance in light of current market conditions.

Profit attributable to shareholders was €45.9 million, a decrease of €17.2 million over prior year figures.

Net operating income of €159.7 million represents a decline of €28.6 million over prior year. Net interest income declined by €18.1 million to €105.0 million.

Operating expenses were €83.8 million, a decrease of €6.6 million over prior year.

The group's cost to income ratio is 52.5 per cent from a prior year ratio of 48.0 per cent.

A fair value gain of €17.7 million on available-for-sale investment portfolio was reported in Other comprehensive income.

### Shareholder ratios

Earnings per share at 15.7 euro cent compare to 21.6 euro cent for the same period in 2008, with the pre-tax return on shareholders' funds at 23.2 per cent down from a prior year of 34.0 per cent.

The Directors propose a final gross dividend of 8.0 euro cent per share. This follows on the gross interim dividend of 7.7 euro cent paid in August 2009.

### Net interest income

Net interest income of €105.0 million represents a decline of 14.7 per cent compared to €123.0 million in the prior year adversely impacted by margin compression in the current low interest rate environment.

Despite a growth in Loans and advances to customers of €114.2 million or 3.7 per cent to €3,226.5 million, interest receivable on loans and advances to customers declined by €36.4 million or 19.9 per cent reflecting multiple reductions in the European Central Bank intervention rate since October 2008. Income from debt securities decreased by €7.8 million or 36.5 per cent to €13.6 million.

The cost of liabilities also fell by €58.4 million or 47.7 per cent but this was less than the decline in asset yields as spreads narrowed overall.

### Non-interest income

Non-interest income of €54.7 million represents a decline of 16.2 per cent or €10.6 million compared to €65.3 million in prior year affected significantly by the continuing downward pressure on the profitability of insurance and investment-related business which is impacted by the volatility in equity and bond markets.

Net fee and commission income at €32.4 million was slightly above 2008 levels of €31.8 million. Growth in lending, card issuance and usage fees, account services and retail brokerage activities were offset by declines in fees from remittances and subdued sentiment for retail investments.

The group uses the fair value designation for financial assets held by Life insurance operations amounting to €248.6 million. A positive movement of €26.7 million was recorded in the fair value of assets held to back insurance and investment contracts compared with a negative movement of €29.4 million in 2008. This reflected investment gains predominantly affecting the value of assets held in unit-linked and with profit funds. The positive movement in fair value is offset by a corresponding reduction in Net other operating income and an increase in Net insurance claims incurred and movement in policyholders' liabilities.

Life insurance activities generated a sound profit before tax of €11.7 million, down €4.7 million or 28.7 per cent compared to 2008 profit before tax of €16.4 million. Prior year's Net operating income did however include a non-recurring increase in Present value of in-force long-term insurance business following actuarial basis review of €3.8 million.

Gains on property revaluation and disposal amounting to €3.5 million reported in Net other operating income in 2008 did not recur during the current year.

### Operating expenses

Operating expenses of €83.8 million were €6.6 million or 7.3 per cent lower compared to the previous year with a cost to income ratio of 52.5 per cent compared to 48.0 per cent in 2008.

Employee compensation and benefits decreased by €6.2 million primarily due to the take up of voluntary early retirement schemes during the year which were provided for during 2008 and amounted to €5.6 million.

General and administrative expenses were slightly below prior year at €27.0 million reflecting the bank's focus on cost control.

Depreciation and amortisation charges were stable on prior year at €7.5 million.

## Net impairment

Performance was affected by €2.3 million increase in loan impairment charges which rose rapidly in the second half of 2009 from a low base as the consequences of the slowdown in the local economy impacted the lending portfolios.

Impairment reversals contributed €4.5 million to profitability. New impairment allowances of €7.4 million were raised and bad debt write-offs of €1.4 million were effected.

The quality of the overall loan book remains good with non-performing loans at 2.9 per cent of net loans (2008: 2.3 per cent).

## Taxation

The 2009 effective rate of tax was 35.6 per cent. Tax expense for 2009 amounted to €25.3 million.

## Assets

Total assets amounted to €5,117.8 million, 3.4 per cent lower than at 31 December 2008.

The proportion of assets deployed in Loans and advances to customers increased to 63.0 per cent from 58.8 per cent in 2008, while Loans and advances to banks declined to 14.6 per cent and Financial investments increased to 9.4 per cent of Total assets.

Net loans and advances to customers increased by €114.2 million supported by growth in both the personal and commercial sectors.

Advances to deposits ratio at 79.0 per cent is consistent with prior year end level of 77.5 per cent.

Short term liquid money market placements in the form of Loans and advances to banks decreased by €324.6 million to €747.7 million as a result of lower lending to other financial institutions.

The available-for-sale investment portfolio increased by €65.4 million to €470.1 million. This portfolio reported a fair value gain of €17.7 million as at 31 December 2009. The mark-up was credited to revaluation reserve, net of tax effect.

Life insurance business assets, are primarily designated as Financial assets at fair value through profit or loss. This portfolio reduced by €31.2 million to €248.6 million from a prior year end level of €279.7 million.

## Liabilities

Total liabilities decreased by €202.4 million to €4,811.2 million.

Amounts owed to customers increased by €70.0 million to €4,086.7 million compared to €4,016.6 million during the prior year in a period characterised by a number of bond issues and growing competitive pressures.

Amounts owed to banks decreased from a year opening level of €462.2 million to a year end closing level of €168.8 million reflecting a reduction in institutional deposits.

Funds under management by the group increased to a year end closing level of €419.0 million, up from an opening year level of €407.0 million.

Liabilities under insurance contracts issued increased by €40.3 million during the year to reach a year end level of €351.5 million.

## Shareholders' funds

Equity totalled €306.6 million at year end following dividend payments of €32.8 million during 2009.

The number of shareholders increased from 10,143 to 10,362 as at 31 December.

The capital adequacy ratio, on a Basel II basis, remained strong at 11.8 per cent and is in excess of regulatory capital requirements.

# Report of the Directors

## Results for 2009

The group reported a profit on ordinary activities before tax of €71.2 million for the year under review. The group's profit attributable to shareholders of the bank was €45.9 million.

A gross interim ordinary dividend of 7.7 euro cent was paid on 27 August 2009. The Directors have proposed a gross final dividend of 8.0 euro cent per ordinary share. The final dividend will be payable to shareholders on the bank's register as at 4 March 2010.

Further information about the results is provided in the group income statement on page 26.

## Principal activities

### Principal activities of parent company

The bank is authorised to carry on the business of banking under the Banking Act, 1994 as a credit institution. It is also an authorised dealer in terms of the Exchange Control Act and a licensed financial intermediary in terms of the Financial Markets Act, 1990. The bank also holds Category 3 and Category 4 Investment Services licenses issued by the Malta Financial Services Authority in terms of the Investment Services Act, 1994. These licenses authorise the bank to provide both investment services to third parties and trustee or custodian services for collective investment schemes.

The bank provides a comprehensive range of banking and financial related services.

The bank had the following subsidiaries at 31 December 2009: HSBC Life Assurance (Malta) Limited, HSBC Global Asset Management (Malta) Limited, HSBC Securities Services (Malta) Limited and HSBC Stockbrokers (Malta) Limited.

### Principal activities of subsidiaries

HSBC Life Assurance (Malta) Limited is authorised by the Malta Financial Services Authority to carry on business of insurance in Malta under the Insurance Business Act, 1998. HSBC Bank Malta p.l.c. is enrolled as a tied insurance intermediary for HSBC Life Assurance (Malta) Limited under the Insurance Act 2006.

HSBC Global Asset Management (Malta) Limited is the investment management arm of the bank. It manages a range of domestic and international funds, specialising in the development of structured capital secured investment products, and in the provision of tailor-made discretionary portfolio management services. The company offers both Open and Close ended types of funds and investments.

HSBC Securities Services (Malta) Limited is licensed under the Investment Services Act, 1994 and its main business activity is the provision of fund administration services to proprietary and third party investment funds. It also provides back office support to HSBC Bank Malta p.l.c. in the distribution of third party investment funds through the bank network.

HSBC Stockbrokers (Malta) Limited is a member of the Malta Stock Exchange and is regulated under the Investment Services Act, 1994 by the Malta Financial Services Authority. The company is principally engaged in providing stockbroking business on the Malta Stock Exchange and to arrange/support the listing of stocks and shares on the Exchange.

## Business review

A review of the business of the bank and its subsidiaries during the year under review and an indication of likely future developments are given in the 'Chief Executive Officer's Review' on pages 5 to 8 and 'Chief Technology and Services Officer's Review' on pages 9 to 11.

## Transactions in own shares

The bank holds units in a mutual fund which invests in the bank's shares. During the year, the bank indirectly disposed 11,523 own shares bringing the total number of shares indirectly held at 31 December 2009 to 50,052.

## Shareholder Register Information pursuant to Listing Rule 9.43

HSBC Bank Malta p.l.c. (the 'bank') authorised share capital is €141,000,000. The issued and fully paid up capital is €87,552,000 divided into 291,840,000 Ordinary Shares of a nominal value of 30.0 euro cent each. The issued share capital consists of one class of ordinary shares with equal voting rights attached and freely transferable.

HSBC Europe B.V. holds 70.03% of the bank's shares.

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

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

There is an Achievement Shares scheme in existence whereby employees in the GCB4 grade and higher can be awarded shares in HSBC Bank Holdings plc, depending on their performance. Share awards will be released to the individual after 3 years, provided participant remains continuously employed within the Group. During the 3-year period the employee has no voting rights whatsoever.

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

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

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

It is hereby declared that, as at 31 December 2009, the requirements pursuant to Listing Rules 9.43.7 and 9.43.10 did not apply to the bank.

## Shareholder Register Information

Directors' interest in the share capital of the company or in related companies at 31 December 2009:

| | |
|---|---|
| Albert Mizzi | 8,000 shares |
| Saviour sive Sonny Portelli | 4,700 shares |
| Philip Farrugia Randon | 6,400 shares |

Mr Charles John Farrugia has a non-beneficial interest of 7,511,587 ordinary shares in HSBC Bank Malta p.l.c. through the shareholding held by Amalgamated Investments Sicav p.l.c.

Mr Peter Paul Testaferrata Moroni Viani has a beneficial interest of 58,800 ordinary shares in HSBC Bank Malta p.l.c. through the shareholding of MacApps Limited, 40,000 ordinary shares through the shareholding of Capps Ltd, 40,000 ordinary shares through the shareholding of Viani Limited and 5,000 ordinary shares through the shareholding of Circles Limited. He also has a non-beneficial interest of 130,680 ordinary shares in HSBC Bank Malta p.l.c. through the shareholding of Santumas Shareholdings p.l.c.

There were no changes to Directors' interest from 31 December 2009 to 17 February 2010.

Shareholders holding five per cent (5%) or more of the equity capital at 17 February 2010:

| | |
|---|---|
| HSBC Europe B.V. | 70.03% |

Number of shareholders at 17 February 2010:

| | |
|---|---|
| One class of shares<br>(All shares have equal voting rights) | 10,396 shareholders |

# Report of the Directors (continued)

Number of shareholders analysed by range

| | 31 December 2009 | | 17 February 2010 | |
|---|---|---|---|---|
| Range of shareholding | Total shareholders | Shares | Total shareholders | Shares |
| 1 – 500 | 2,153 | 669,342 | 2,162 | 674,113 |
| 501 – 1,000 | 1,625 | 1,317,410 | 1,628 | 1,317,786 |
| 1,001 – 5,000 | 4,136 | 10,369,833 | 4,144 | 10,382,012 |
| 5,001 and over | 2,448 | 279,483,415 | 2,462 | 279,466,089 |

## Standard licence conditions

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

## Board of Directors

The Directors who served during the year are as follows:

Albert Mizzi (Chairman)
Alan Richards
Sally Robson
Anthony Mahoney
Philip Farrugia Randon
Charles John Farrugia
Victor Scicluna (resigned 1 April 2009)
Peter Paul Testaferrata Moroni Viani
Saviour sive Sonny Portelli
James Dunbar Cousin (appointed 1 April 2009)

## Senior management

As at 31 December 2009, the senior management of the group was composed of the following:

| | |
|---|---|
| Alan Richards | Chief Executive Officer |
| Sally Robson | Chief Technology and Services Officer |
| Charles John Farrugia | Head of Global Banking and Markets |
| Chris Bond | Designate Head of Global Banking and Markets |
| Richard Cottell | Head of Commercial Banking |
| Andrew Ripley | Head of Personal Financial Services |
| Alasdair Robertson | Head of Credit |
| Philip Farrugia | Head of Banking Services |
| Mark Sims | Head of Human Resources |
| John Sammut | Head of Audit, Compliance and Legal |
| Joseph Borg | Head of IT |
| David Demarco | Chief Financial Officer |
| Brian Tortell | Head of Marketing |
| Peter Calleya | Head of Strategic Planning |
| Josef Camilleri | Head of Public Affairs and CSR |
| Richard Philip Jones | Head of Insurance Services |
| Martin Scicluna | Head of Wealth Management |
| Charles Azzopardi | Head of Funds Administration |
| Ray Briffa | Head of Branch Banking and Direct Channels |
| Stephen Pandolfino | Deputy Head of Global Banking and Markets |
| Reuben Fenech | Head of Global Asset Management |
| Michel Cordina | Deputy Head of Commercial Banking |
| Nicolò Baldacchino Orland | Head of Customer Experience and Deputy Head of Service Delivery |

## Auditors

KPMG have expressed their willingness to continue in office. A resolution proposing the reappointment of KPMG as auditors of the bank will be submitted at the forthcoming Annual General Meeting.

## Statement by the Directors pursuant to Listing Rule 9.44c

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

Signed on behalf of the Board on 22 February 2010 by:

Albert Mizzi, *Chairman*

Alan Richards, *Chief Executive Officer*

# Statement of Compliance with the Principles of Good Corporate Governance

*As required by the Listing Rules of the Listing Authority, HSBC Bank Malta p.l.c. (the 'bank') hereby includes a Statement of Compliance which deals with the extent to which the bank has adopted the Code of Principles of Good Corporate Governance (the 'Principles') and the effective measures that the bank has taken to ensure compliance with these Principles.*

## Compliance with the Principles

Although the Principles are not mandatory, the Board of Directors (the 'Board') of the bank believes in their adoption, and has endorsed them except where there exist particular circumstances that warrant non-adherence thereto.

In line with the Principles, the Board's composition is a mixture of a non-executive Chairman, three executive Directors, five non-executive Directors, three of whom are deemed to be independent. All the Directors, individually and collectively, are of the appropriate calibre, with the necessary skills and experience to assist them in providing leadership, integrity and judgement in directing the bank. Furthermore, the roles of the Chief Executive Officer and the Chairman are separate.

## Internal control

The Board is ultimately responsible for the bank's system of internal control and for reviewing its effectiveness. Such procedures are designed to manage rather than to eliminate the risk of failure, to achieve business objectives and can only provide reasonable and not absolute assurance against material error, losses or fraud.

– Authority to operate the bank is delegated to the Chief Executive Officer within the limits set by the Board of the bank. Functional, operating and financial reporting standards are applicable within all entities of the HSBC Group. These are supplemented by operating standards set by the bank's management, as required.

– Systems and procedures are in place in the bank to identify, control and to report on the major risks including credit, changes in the market prices of financial instruments, liquidity, operational error and fraud. Exposure to these risks is monitored by the Asset and Liability Management Committee and by the Risk Management Committee.

– Comprehensive annual financial plans are prepared, reviewed and approved by the Board. Results are monitored and reports on progress compared with plan are prepared monthly. Financial accounting and reporting and certain management reporting standards have been established. Centralised functional control is exercised over all computer system developments and operations. Common systems are employed where possible for similar business processes.

– Responsibilities for financial performance against plans and for capital expenditure, credit exposures and market risk exposures are delegated with limits to line management. In addition, functional management in the bank has been given the responsibility to implement HSBC policies, procedures and standards in the areas of finance; legal and regulatory compliance; internal audit; human resources; credit; market risk; operational risk; computer systems and operations; property management; and for certain HSBC Group business and product lines.

– The internal audit function monitors compliance with policies and standards and the effectiveness of internal control structures within the bank and its subsidiaries. The work of the internal audit function focuses on areas of greatest risk as determined by a risk management approach.

– The bank's Compliance Department ensures that HSBC Bank Malta group complies with all the local and international regulatory obligations and HSBC Group standards and regulations.

Through the Audit Committee, the Board reviews the processes and procedures to ensure the effectiveness of the system of internal control of the bank and its subsidiaries, which are monitored by internal audit.

## Appointment/election of Directors

The Memorandum of Association of the bank specifically regulates the appointment of Directors. The Board consists of not more than nine Directors who are appointed/elected by the shareholders. Unless appointed for a shorter or longer period but not exceeding three years a Director shall hold office from the end of one Annual General Meeting to the end of the next. Every shareholder owning eleven per cent of the ordinary share capital is entitled to appoint one Director for each eleven per cent shareholding. The majority shareholder therefore has the right to appoint six Directors. Furthermore, any excess fractional shareholding not so utilised may be used to participate in the voting for the election of further Directors. Shareholders who own less than eleven per cent of the ordinary share capital participate in the election of the remaining three Directors.

The largest single shareholder (subject to a minimum thirty-three per cent holding of the ordinary issued share capital of the company), is entitled to appoint a Chairman from amongst the Directors appointed or elected to the Board. Every poll for the election of Directors is overseen by the bank's external auditors.

## Responsibilities of the Board

The Board meets quarterly to review and evaluate corporate strategy, major operational and financial plans, risk policy, financial performance objectives and monitor implementation and corporate performance within the parameters of all relevant laws, regulations and codes of best business practice.

The Board has delegated specific authority to the Chief Executive Officer to manage the activities of the bank within the limits set by it. In line with the nature and demands of the bank's business, the Board meets at least every quarter unless further meetings are required. Under the present circumstances the Board does not consider it necessary to appoint a committee to carry out a performance evaluation of its role as the Board's performance is always under the scrutiny of the shareholders and in line with Group standards.

Directors' Attendance at Board Meetings:

| *Members* | *Attended* |
|---|---|
| Albert Mizzi | 4 |
| Alan Richards | 4 |
| Sally Robson | 4 |
| Charles John Farrugia | 4 |
| Anthony Mahoney | 3 (out of 4) |
| Philip Farrugia Randon | 4 |
| Victor Scicluna (resigned 1 April 2009) | 1 (out of 1) |
| Peter Paul Testaferrata Moroni Viani | 4 |
| Saviour sive Sonny Portelli | 4 |
| James Dunbar Cousin (appointed 1 April 2009) | 3 (out of 3) |

Directors have access to independent legal advice at the bank's expense where the Board deems appropriate. The Board concentrates primarily on strategy, policy setting, business plans and financial information.

On joining the Board, a Director is provided with a handbook containing the main provisions of law, which regulate his office. The Director also attends a presentation made by the functional heads on the activities of their respective business units in the bank. The Directors also receive updates on changes, if any, to group's short term strategic and operational plans and quarterly updates by the Heads of Audit and Compliance, Credit and Marketing.

The Board considers appropriate schemes to recruit, retain and motivate high quality executive officers and management team. The bank continues to value diversity within its workforce. Several initiatives are being taken to further progress staff's development, amongst them Springboard, Navigator and Bridge to Success programmes.

## Directors' dealings

On joining the Board and regularly thereafter, Directors are informed and reminded of their obligations on dealing in securities of the bank within the parameters of law and the Listing Rules. A proper procedure of reporting advanced notices has been endorsed by the Board in line with the Principles, the Listing Rules and the internal code of dealing.

# Statement of Compliance with the Principles of Good Corporate Governance (continued)

## Committees

### Executive committee (EXCO)

The executive committee meets on a monthly basis to oversee the overall management of the bank. The Chief Executive Officer chairs this committee which is composed of the Chief Technology and Services Officer together with the top management of the bank.

### Asset and liability management committee (ALCO)

This committee reviews the financial risks of the group in Malta and ensures their prudent management: interest rate risk, liquidity and funding risk, foreign exchange risk, capital solvency, market sector risk and country risk. Furthermore, ALCO monitors the external environment and measures the impact on profitability of factors such as interest rate volatility, market liquidity, exchange rate volatility, monetary and fiscal policies and competitor banks activity.

The Chief Executive Officer has primary responsibility for ensuring efficient development of asset and liability management. Membership consists of senior executives with responsibility for the following functions: corporate banking, retail banking, treasury, financial control, marketing and credit. The ALCO, which is chaired by the Chief Executive Officer and deputised by the Chief Technology and Services Officer, meets once a month.

### Credit risk management committee

This committee reviews the credit risk management issues of the group in Malta. It meets on a monthly basis and is chaired by the Chief Executive Officer and deputised by the Chief Technology and Services Officer. Membership consists of senior executives with responsibility for the following functions: credit and risk management, corporate banking, retail banking, treasury, financial control, consumer finance and audit and compliance.

### Group risk management committee

This committee reviews the operational risks of the group in Malta: the identification, measurement, monitoring and controlling operational business risks and determines and agrees strategies and policies to mitigate these risks.

This committee which meets on a monthly basis is chaired by the Chief Technology and Services Officer and is composed of the Chief Financial Officer, the Chief Risk Officer, the Senior Internal Audit and Compliance Manager and the Heads of Banking Services, Commercial Banking, Personal Financial Services and Global Banking and Markets.

### Audit committee

This committee met five times during this year. Its terms of reference are modelled mainly on the recommendations in the Cadbury Report and are compliant with the Listing Rules. Additional terms of reference have been adopted by this committee to align with Group’s requirements. The primary purpose of this committee is to protect the interests of the bank’s shareholders and assist the directors in conducting their role effectively so that the bank’s decision-making capability and the accuracy of its reporting and financial results are maintained at a high level at all times.

The Audit committee, having been approved by the Listing Authority in terms of Listing Rule 8.72, scrutinises and monitors related party transactions. It considers the materiality and the nature of the related party transaction carried out by the bank to ensure that the arms’ length principle is adhered to at all times. Its members are Messrs Saviour sive Sonny Portelli (Chairman) and Peter Paul Testaferrata Moroni Viani who are independent non-executive directors and Dr Philip Farrugia Randon LL.D. who is a non-executive director. Executives of the bank are available to attend any of the meetings as directed by the committee. The Chief Executive Officer, the Chief Technology and Services Officer and a representative of the external auditors attend the meetings. In line with Listing Rule 8.62, the Head of Internal Audit is always present for its meetings and has a right of direct access to the Chairman of the committee at all times.

Mr Saviour sive Sonny Portelli was appointed by the Board in terms of Listing Rule 8.56a on the basis that he has a long and distinguished career in both public companies and private enterprise. Presently, Mr Portelli is also Chairman of the Malta Council for Economic and Social Development and Chairman of GO plc. Mr Portelli has served on the bank’s Board of Directors since October 2006 where his contributions have demonstrated that he is highly competent in accounting and au courant with accounting standards and practices and that he also possesses the qualities and experience required to discharge his duties as Chairman of this Committee.

In terms of Listing Rule 8.58.7, the Audit committee is responsible for developing and implementing a policy on the engagement of the external auditor to supply non-audit services. Since HSBC Holdings plc is a Securities Exchange Commission (SEC) registered company, non-audit services provided by the external auditor are regulated in terms of the SEC rules.

### Remuneration Committee (REMCO)

The remuneration committee established within HSBC Bank Malta p.l.c. is set up on a similar basis to its counterparts in the HSBC Group and hence is different in character from the 'remuneration committee' envisaged under the Code of Principles of Good Corporate Governance. Namely the Board does not appoint a committee to fix the remuneration packages of the individual Directors.

This remuneration committee meets primarily to review the compensation policy of HSBC Bank Malta p.l.c. and to make annual recommendations which are then sent to HSBC Bank plc for concurrence on pay review, salary increases and bonuses for key management personnel. It is presently chaired by Mr Albert Mizzi (independent non-executive Chairman) and comprises Messrs Peter Paul Testaferrata Moroni Viani, Saviour sive Sonny Portelli and Dr Philip Farrugia Randon LL.D. During 2009 one meeting was held by this committee.

## Shareholders

The principal contact with shareholders takes place via the annual and extraordinary general meetings. These meetings are called with sufficient notice and enable the use of proxies to attend, vote or abstain. Matters before an extraordinary general meeting are considered extraordinary business and sufficient explanation of the proposals is provided in advance of the meeting for proper evaluation by the shareholders.

Regular contact with shareholders is also maintained via company and media announcements.

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

## Corporate Sustainability

HSBC's Corporate Sustainability activities take place within the context of the Group wide strategy. In Malta the bank fulfils the Group's Corporate Sustainability strategy primarily through the three charitable funds:

– The HSBC Cares For Children Fund;

– The HSBC Cares For The Environment Fund; and

– The HSBC Cares For Malta's Heritage Fund.

These charitable funds deal with issues that concern the public in general: children in need, the environment and Malta's national heritage. They have succeeded in having an impact on a large majority of Maltese citizens and show the bank's strong commitment towards social investment.

## Going Concern

As required by Listing Rule 9.44e.13, upon due consideration of the bank's profitability and statement of financial position, capital adequacy and solvency, the Directors confirm the bank's ability to continue operating as a going concern for the foreseeable future.

Signed on behalf of the Board on 22 February 2010 by:

Albert Mizzi, *Chairman*

Alan Richards, *Chief Executive Officer*

## Remuneration Report

None of the Directors are employed with the bank on a definite service contract. Those Directors who are employed with the bank are so employed on an indefinite basis.

Directors' remuneration for the financial year under review:

| | € |
|---|---|
| – Directors' fees | 118,815 |
| – Directors' salaries and bonuses as full-time bank employees | 404,424 |

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

| | € |
|---|---|
| Albert Mizzi | 31,450 |
| Victor Scicluna | 10,484 |
| Peter Paul Testaferrata Moroni Viani | 21,550 |
| Saviour sive Sonny Portelli | 25,045 |
| Philip Farrugia Randon | 21,550 |
| James Dunbar Cousin | 8,736 |
| Total | 118,815 |

Directors' salaries and bonuses are being disclosed in aggregate rather than as separate figures for each Director as required by the Principles.

No Director is entitled to profit sharing, share options, pension benefits (other than performance-related bonus awards) or any other remuneration, directly from the bank.

Executive Directors may be entitled to HSBC Holdings plc share options as detailed in note 13 of the "Notes on the Accounts" and certain pension and early retirement benefits.

The Directors' fees are approved in aggregate by shareholders at the Annual General Meeting. Those Directors who are employed with the bank are not paid any fees for their directorship.

## Directors' responsibility for the Financial Statements

The Companies Act, 1995 requires the Directors of HSBC Bank Malta p.l.c. (the 'bank') to prepare financial statements for each financial period which give a true and fair view of the financial position of the bank and the group as at the end of the financial period and of the profit or loss of the bank and the group for that period in accordance with the requirements of International Financial Reporting Standards as adopted by the EU.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy, at any time, the financial position of the bank and the group and to enable them to ensure that the financial statements have been properly prepared in accordance with the provisions of the Companies Act, 1995 and the Banking Act, 1994.

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

The Directors, through oversight of management, are responsible to ensure that the bank establishes and maintains internal control to provide reasonable assurance with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

Management is responsible, with oversight from the Directors, to establish a control environment and maintain policies and procedures to assist in achieving the objective of ensuring, as far as possible, the orderly and efficient conduct of the group's business. This responsibility includes establishing and maintaining controls pertaining to the bank's objective of preparing financial statements as required by the Companies Act, 1995 and managing risks that may give rise to material misstatements in those financial statements. In determining which controls to implement to prevent and detect fraud, management considers the risks that the financial statements may be materially misstated as a result of fraud.

Signed on behalf of the Board of Directors by:

Albert Mizzi, *Chairman*

Alan Richards, *Chief Executive Officer*

# Income Statements for the year 1 January 2009 to 31 December 2009

| | | Group | | Bank | |
|---|---|---|---|---|---|
| | | **2009** | 2008 | **2009** | 2008 |
| | *Note* | **€000** | €000 | **€000** | €000 |
| Interest receivable and similar income | | | | | |
| – on loans and advances, balances with Central Bank of Malta and Treasury Bills | 6 | **155,408** | 224,031 | **155,401** | 223,907 |
| – on debt and other fixed income instruments | 6 | **13,630** | 21,479 | **11,535** | 21,376 |
| Interest payable | 7 | **(64,068)** | (122,466) | **(65,319)** | (124,623) |
| **Net interest income** | | **104,970** | 123,044 | **101,617** | 120,660 |
| Fees and commissions receivable | | **34,259** | 34,332 | **31,148** | 28,498 |
| Fees and commissions payable | | **(1,895)** | (2,567) | **(1,637)** | (1,955) |
| **Net fee and commission income** | 8 | **32,364** | 31,765 | **29,511** | 26,543 |
| Dividend income | 9 | **43** | 69 | **10,581** | 1,504 |
| Trading profits | 10 | **7,221** | 7,802 | **7,221** | 7,802 |
| Net income from insurance financial instruments designated at fair value through profit or loss | 12 | **26,717** | (29,407) | **–** | – |
| Net gains on sale of available-for-sale financial assets | 11 | **1,268** | 2,787 | **1,184** | 2,725 |
| Net earned insurance premiums | 12 | **52,878** | 58,032 | **–** | – |
| Net other operating income | 12 | **(2,232)** | 31,779 | **892** | 3,749 |
| **Total operating income** | | **223,229** | 225,871 | **151,006** | 162,983 |
| Net insurance claims incurred and movement in policyholders' liabilities | 12 | **(63,570)** | (37,570) | **–** | – |
| **Net operating income** | 12 | **159,659** | 188,301 | **151,006** | 162,983 |
| Employee compensation and benefits | 13 | **(49,252)** | (55,477) | **(46,680)** | (52,991) |
| General and administrative expenses | | **(27,047)** | (27,743) | **(25,599)** | (26,168) |
| Depreciation | | **(6,322)** | (5,951) | **(6,301)** | (5,920) |
| Amortisation | | **(1,148)** | (1,238) | **(1,041)** | (1,011) |
| **Net operating income before impairment charges and provisions** | | **75,890** | 97,892 | **71,385** | 76,893 |
| Net impairment | 14 | **(4,429)** | (1,907) | **(4,232)** | (1,907) |
| Net provisions for liabilities and other charges | | **(265)** | 102 | **(237)** | 103 |
| **Profit before tax** | 15 | **71,196** | 96,087 | **66,916** | 75,089 |
| Tax expense | 16 | **(25,329)** | (32,972) | **(22,261)** | (25,706) |
| **Profit for the year** | | **45,867** | 63,115 | **44,655** | 49,383 |
| **Profit attributable to shareholders** | | **45,867** | 63,115 | **44,655** | 49,383 |
| **Earnings per share** | 17 | **15.7c** | 21.6c | **15.3c** | 16.9c |

# Statements of Comprehensive Income for the year 1 January 2009 to 31 December 2009

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| **Profit attributable to shareholders** | **45,867** | 63,115 | **44,655** | 49,383 |
| **Other comprehensive income** | | | | |
| Available-for-sale investments: | | | | |
| – change in fair value | **17,693** | (9,635) | **16,132** | (9,673) |
| – change in fair value transferred to profit or loss | **(1,268)** | (1,348) | **(1,184)** | (1,287) |
| – income taxes | **(5,749)** | 3,844 | **(5,232)** | 3,836 |
| **Other comprehensive income for the year, net of tax** | **10,676** | (7,139) | **9,716** | (7,124) |
| **Total comprehensive income for the year, net of tax** | **56,543** | 55,976 | **54,371** | 42,259 |

# Statements of Financial Position at 31 December 2009

| | | Group | | Bank | |
|---|---|---|---|---|---|
| | | **2009** | 2008 | **2009** | 2008 |
| | *Note* | **€000** | €000 | **€000** | €000 |
| **Assets** | | | | | |
| Balances with Central Bank of Malta, Treasury Bills and cash | *18* | **172,671** | 130,682 | **172,670** | 130,681 |
| Cheques in course of collection | | **10,764** | 9,308 | **10,764** | 9,308 |
| Financial assets held for trading | *19* | **11,746** | 11,823 | **11,964** | 12,057 |
| Financial assets designated at fair value through profit or loss | *20* | **248,553** | 279,714 | **–** | – |
| Financial investments | *21* | **478,975** | 429,912 | **380,275** | 412,016 |
| Loans and advances to banks | *22* | **747,657** | 1,072,306 | **747,582** | 1,072,269 |
| Loans and advances to customers | *23* | **3,226,477** | 3,112,240 | **3,226,477** | 3,112,240 |
| Shares in subsidiary companies | *24* | **–** | – | **35,707** | 35,707 |
| Intangible assets | *25* | **60,691** | 64,256 | **1,741** | 1,797 |
| Property and equipment | *26* | **65,397** | 70,684 | **65,470** | 70,731 |
| Investment property | *27* | **14,588** | 14,050 | **11,665** | 11,647 |
| Assets held for sale | *28* | **10,604** | 9,168 | **10,604** | 9,317 |
| Current tax recoverable | | **6,164** | 2,966 | **4,516** | 2,164 |
| Deferred tax assets | *33* | **9,053** | 15,916 | **8,766** | 15,726 |
| Other assets | *29* | **20,712** | 25,824 | **7,931** | 8,425 |
| Prepayments and accrued income | *30* | **33,748** | 47,239 | **30,006** | 44,598 |
| **Total assets** | | **5,117,800** | 5,296,088 | **4,726,138** | 4,948,683 |
| **Liabilities** | | | | | |
| Financial liabilities held for trading | *19* | **11,044** | 11,381 | **11,046** | 12,375 |
| Amounts owed to banks | *31* | **168,771** | 462,185 | **168,771** | 462,185 |
| Amounts owed to customers | *32* | **4,086,669** | 4,016,632 | **4,146,295** | 4,073,875 |
| Provision for current tax | | **207** | 688 | **–** | – |
| Deferred tax liabilities | *33* | **18,851** | 17,600 | **–** | – |
| Liabilities to customers under investment contracts | *34* | **16,853** | 15,122 | **–** | – |
| Liabilities under insurance contracts issued | *35* | **351,513** | 311,250 | **–** | – |
| Other liabilities | *36* | **35,479** | 36,734 | **32,221** | 33,883 |
| Accruals and deferred income | *37* | **33,422** | 53,930 | **33,068** | 53,839 |
| Provisions for liabilities and other charges | *38* | **577** | 312 | **514** | 277 |
| Subordinated liabilities | *39* | **87,827** | 87,777 | **87,827** | 87,777 |
| **Total liabilities** | | **4,811,213** | 5,013,611 | **4,479,742** | 4,724,211 |
| **Equity** | | | | | |
| Share capital | *40* | **87,552** | 87,552 | **87,552** | 87,552 |
| Revaluation reserve | *41* | **25,825** | 15,149 | **25,030** | 15,314 |
| Retained earnings | *41* | **193,210** | 179,776 | **133,814** | 121,606 |
| **Total equity** | | **306,587** | 282,477 | **246,396** | 224,472 |
| **Total liabilities and equity** | | **5,117,800** | 5,296,088 | **4,726,138** | 4,948,683 |
| **Memorandum items** | | | | | |
| Contingent liabilities | *42* | **119,449** | 129,925 | **119,472** | 129,948 |
| Commitments | *43* | **923,900** | 1,110,572 | **923,900** | 1,110,572 |

The financial statements on pages 26 to 88 were approved by the Board of Directors on 22 February 2010 and signed on its behalf by:

Albert Mizzi, *Chairman*

Alan Richards, *Chief Executive Officer*

# Statements of Changes in Equity for the year 1 January 2009 to 31 December 2009

| | Note | *Share capital* €000 | *Revaluation reserve* €000 | *Retained earnings* €000 | *Total equity* €000 |
|---|---|---|---|---|---|
| *Group* | | | | | |
| At 1 January 2009 | | **87,552** | **15,149** | **179,776** | **282,477** |
| Profit for the year | | **–** | **–** | **45,867** | **45,867** |
| **Other comprehensive income** | | | | | |
| Available-for-sale investments: | | | | | |
| – change in fair value, net of tax | | **–** | **11,500** | **–** | **11,500** |
| – change in fair value transferred to profit or loss, net of tax | | **–** | **(824)** | **–** | **(824)** |
| **Total other comprehensive income** | | **–** | **10,676** | **–** | **10,676** |
| **Total comprehensive income for the year** | | **–** | **10,676** | **45,867** | **56,543** |
| **Transactions with owners, recorded directly in equity** | | | | | |
| Share-based payments | | **–** | **–** | **384** | **384** |
| Dividends | *45* | **–** | **–** | **(32,817)** | **(32,817)** |
| **Total contributions by and distributions to owners** | | **–** | **–** | **(32,433)** | **(32,433)** |
| **At 31 December 2009** | | **87,552** | **25,825** | **193,210** | **306,587** |
| At 1 January 2008 | | 84,976 | 24,614 | 166,702 | 276,292 |
| Profit for the year | | – | – | 63,115 | 63,115 |
| **Other comprehensive income** | | | | | |
| Available-for-sale investments: | | | | | |
| – change in fair value, net of tax | | – | (6,263) | – | (6,263) |
| – change in fair value transferred to profit or loss, net of tax | | – | (876) | – | (876) |
| Release of revaluation reserve on disposal of properties, net of tax | | – | (2,326) | 2,326 | – |
| **Total other comprehensive income** | | – | (9,465) | 2,326 | (7,139) |
| **Total comprehensive income for the year** | | – | (9,465) | 65,441 | 55,976 |
| **Transactions with owners, recorded directly in equity** | | | | | |
| Increase in paid-up value | | 2,576 | – | (2,576) | – |
| Share-based payments | | – | – | 858 | 858 |
| Dividends | *45* | – | – | (50,649) | (50,649) |
| **Total contributions by and distributions to owners** | | 2,576 | – | (52,367) | (49,791) |
| At 31 December 2008 | | 87,552 | 15,149 | 179,776 | 282,477 |

## Statements of Changes in Equity for the year 1 January 2009 to 31 December 2009 (continued)

| | Note | *Share capital* €000 | *Revaluation reserve* €000 | *Retained earnings* €000 | *Total equity* €000 |
|---|---|---|---|---|---|
| *Bank* | | | | | |
| At 1 January 2009 | | **87,552** | **15,314** | **121,606** | **224,472** |
| Profit for the year | | **–** | **–** | **44,655** | **44,655** |
| **Other comprehensive income** | | | | | |
| Available-for-sale investments: | | | | | |
| – change in fair value, net of tax | | **–** | **10,485** | **–** | **10,485** |
| – change in fair value transferred to profit or loss, net of tax | | **–** | **(769)** | **–** | **(769)** |
| **Total other comprehensive income** | | **–** | **9,716** | **–** | **9,716** |
| **Total comprehensive income for the year** | | **–** | **9,716** | **44,655** | **54,371** |
| **Transactions with owners, recorded directly in equity** | | | | | |
| Share-based payments | | **–** | **–** | **370** | **370** |
| Dividends | *45* | **–** | **–** | **(32,817)** | **(32,817)** |
| **Total contributions by and distributions to owners** | | **–** | **–** | **(32,447)** | **(32,447)** |
| **At 31 December 2009** | | **87,552** | **25,030** | **133,814** | **246,396** |
| At 1 January 2008 | | 84,976 | 24,764 | 122,317 | 232,057 |
| Profit for the year | | – | – | 49,383 | 49,383 |
| **Other comprehensive income** | | | | | |
| Available-for-sale investments: | | | | | |
| – change in fair value, net of tax | | – | (6,288) | – | (6,288) |
| – change in fair value transferred to profit or loss, net of tax | | – | (836) | – | (836) |
| Release of revaluation reserve on disposal of properties, net of tax | | – | (2,326) | 2,326 | – |
| **Total other comprehensive income** | | – | (9,450) | 2,326 | (7,124) |
| **Total comprehensive income for the year** | | – | (9,450) | 51,709 | 42,259 |
| **Transactions with owners, recorded directly in equity** | | | | | |
| Increase in paid-up value | | 2,576 | – | (2,576) | – |
| Share-based payments | | – | – | 805 | 805 |
| Dividends | *45* | – | – | (50,649) | (50,649) |
| **Total contributions by and distributions to owners** | | 2,576 | – | (52,420) | (49,844) |
| At 31 December 2008 | | 87,552 | 15,314 | 121,606 | 224,472 |

# Statements of Cash Flows for the year 1 January 2009 to 31 December 2009

| | Note | Group 2009 €000 | Group 2008 €000 | Bank 2009 €000 | Bank 2008 €000 |
|---|---|---|---|---|---|
| **Cash flows from operating activities** | | | | | |
| Interest, commission and premium receipts | | **265,609** | 314,862 | **206,526** | 248,029 |
| Interest, commission and claims payments | | **(103,916)** | (145,954) | **(83,838)** | (125,827) |
| Payments to employees and suppliers | | **(80,017)** | (79,468) | **(75,910)** | (75,013) |
| Operating profit before changes in operating assets/liabilities | | **81,676** | 89,440 | **46,778** | 47,189 |
| Decrease/(increase) in operating assets: | | | | | |
| Trading instruments | | **36,917** | (32,825) | **391** | 33 |
| Reserve deposit with Central Bank of Malta | | **4,575** | 61,306 | **4,575** | 61,306 |
| Loans and advances to customers and banks | | **174,561** | (471,985) | **174,774** | (471,985) |
| Treasury Bills | | **(32,931)** | 80,531 | **(48,690)** | 80,531 |
| Other receivables | | **(3,814)** | (4,867) | **(2,983)** | (4,876) |
| Increase/(decrease) in operating liabilities: | | | | | |
| Customer accounts and amounts owed to banks | | **51,665** | 2,379 | **53,076** | (8,316) |
| Other payables | | **7,728** | 5,213 | **359** | 3,801 |
| Net cash from/(used in) operating activities before tax | | **320,377** | (270,808) | **228,280** | (292,317) |
| Tax paid | | **(26,879)** | (38,876) | **(21,167)** | (30,498) |
| Net cash from/(used in) operating activities | | **293,498** | (309,684) | **207,113** | (322,815) |
| **Cash flows used in investing activities** | | | | | |
| Dividends received | | **387** | 49 | **8,628** | 982 |
| Interest received from financial investments | | **16,115** | 23,884 | **15,444** | 23,825 |
| Proceeds from sale and maturity of financial investments | | **187,399** | 88,551 | **180,805** | 86,156 |
| Proceeds on sale of property and equipment and intangible assets | | **2,097** | 9,755 | **1,949** | 9,750 |
| Purchase of financial investments | | **(218,285)** | (83,733) | **(132,135)** | (67,953) |
| Purchase of property and equipment, investment property and intangible assets | | **(4,174)** | (7,556) | **(4,112)** | (7,454) |
| Purchase of shares in subsidiary companies | | **–** | – | **–** | (6,166) |
| Net cash (used in)/from investing activities | | **(16,461)** | 30,950 | **70,579** | 39,140 |
| **Cash flows used in financing activities** | | | | | |
| Dividends paid | | **(32,817)** | (50,649) | **(32,817)** | (50,649) |
| Issue of subordinated loan stock | | **–** | 30,000 | **–** | 30,000 |
| Subordinated loan stock issue costs | | **–** | (226) | **–** | (226) |
| Net cash used in financing activities | | **(32,817)** | (20,875) | **(32,817)** | (20,875) |
| **Increase/(decrease) in cash and cash equivalents** | | **244,220** | (299,609) | **244,875** | (304,550) |
| Effect of exchange rate changes on cash and cash equivalents | | **6,911** | (22,840) | **6,911** | (22,840) |
| Net increase/(decrease) in cash and cash equivalents | | **237,309** | (276,769) | **237,964** | (281,710) |
| | | **244,220** | (299,609) | **244,875** | (304,550) |
| Cash and cash equivalents at beginning of year | | **304,595** | 604,204 | **299,572** | 604,122 |
| **Cash and cash equivalents at end of year** | *46* | **548,815** | 304,595 | **544,447** | 299,572 |

# Notes on the Accounts

## 1 Reporting entity

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

The consolidated financial statements of the bank as at and for the year ended 31 December 2009 comprise the bank and its subsidiaries (together referred to as the 'group' and individually as 'group entities').

## 2 Basis of preparation

**a** *Statement of compliance*

These financial statements have been drawn up in accordance with International Financial Reporting Standards as adopted by the EU ('the applicable financial reporting framework'). All references in these financial statements to IAS, IFRS or SIC/IFRIC interpretations refer to those adopted by the EU.

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

**b** *Basis of measurement*

The financial statements have been prepared on the historical cost basis except for certain intangible assets measured at the present value of in-force long-term assurance business, and the following are measured at fair value:

- Derivative financial instruments;
- Financial instruments at fair value through profit or loss;
- Available-for-sale financial assets; and
- Property.

**c** *Functional and presentation currency*

The financial statements are presented in euro (€), which is the group's functional currency.

**d** *Use of estimates and assumptions*

The preparation of financial statements in conformity with the applicable financial reporting framework requires the use of estimates and assumptions about future conditions. The use of available information and application of judgement are inherent in the formation of estimates, actual results in the future may differ from those reported.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Information about significant areas of estimation, uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described in notes 4, 25 and 52.

## 3 Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements, and have been applied consistently by group entities.

### a *Basis of consolidation*

#### i *Subsidiaries*

Subsidiaries are entities controlled by the bank. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

#### ii *Transactions eliminated on consolidation*

Intra-group balances and income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

### b *Financial instruments*

#### i *Non-derivative financial instruments*

Non-derivative financial instruments are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below:

*Cash and cash equivalents*

Cash and cash equivalents comprise cash balances and deposits with contractual maturity of less than three months. Loans and advances to banks and Amounts owed to banks that are repayable on demand or have a contractual maturity of three months or less and which form an integral part of the group's cash management are included as a component of cash and cash equivalents for the purpose of the cash flow statement. Subsequent to initial recognition cash equivalents are measured at amortised cost.

*Trading assets and trading liabilities*

Treasury bills, debt securities, equity shares and short positions in securities are classified as held for trading if they have been acquired principally for the purpose of selling or repurchasing in the near term, or they form part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. These financial assets or financial liabilities are recognised on trade date when the group enters into contractual arrangements with counterparties to purchase or sell securities, and are normally derecognised when either sold (assets) or extinguished (liabilities). Subsequently, their fair values are remeasured, and all gains and losses from changes therein are recognised in profit or loss in Trading profits as they arise.

*Financial instruments designated at fair value*

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

- eliminates or significantly reduces valuation or recognition inconsistencies that would otherwise arise from measuring financial assets or financial liabilities, or recognising gains and losses on them, on different bases. Under this criterion, the only class of financial instruments designated by the group is financial assets and financial liabilities under investment contracts.

  Liabilities to customers under linked contracts are determined based on the fair value of the assets held in the linked funds, with changes recognised in profit or loss. Liabilities to customers under other types of investment contracts would be measured at amortised cost. If no designation was made for the assets relating to the customer liabilities they would be classified as available-for-sale and the changes in fair value would be recorded directly in equity. These financial instruments are managed on a fair value basis and management information is also prepared on this basis. Designation at fair value of the financial assets and liabilities under investment contracts allows the changes in fair values to be recorded in profit or loss and presented in the same line.

# Notes on the Accounts (continued)

## 3 Significant accounting policies *(continued)*

### b *Financial instruments (continued)*

#### i *Non-derivative financial instruments (continued)*

Financial instruments designated at fair value (continued)

- applies to groups of financial assets, financial liabilities or combinations thereof that are managed, and their performance evaluated, on a fair value basis in accordance with a documented risk management or investment strategy, and where information about the groups of financial instruments is reported to management on that basis. Under this criterion certain financial assets held to meet liabilities under insurance contracts are the main class of financial instruments so designated. The group has documented risk management and investment strategies designed to manage such assets at fair value, taking into consideration the relationship of assets to liabilities in a way that mitigates market risks. Reports are provided to management on the fair value of the assets.

The fair value designation, once made, is irrevocable. Designated financial assets and financial liabilities are recognised when the group enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and are normally derecognised when sold (assets) or extinguished (liabilities). Subsequently, the fair values are remeasured, and gains and losses from changes therein are recognised in Net income from insurance financial instruments designated at fair value through profit or loss.

Treasury bills, debt securities and equity shares intended to be held on a continuing basis, other than those designated at fair value, are classified as available-for-sale or held-to-maturity.

*Available-for-sale*

Available-for-sale financial assets are subsequently remeasured 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 assets are sold, cumulative gains or losses previously recognised in other comprehensive income are recognised in profit or loss as Net gains on sale of available-for-sale financial assets.

*Held-to-maturity*

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the group positively intends, and is able, to hold until maturity. Held-to-maturity investments are subsequently measured at amortised cost using the effective interest method, less any impairment losses.

*Loans and advances to banks and customers*

Loans and advances to banks and customers are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and advances are recognised when the cash is advanced to the borrowers. They are subsequently measured at amortised cost using the effective interest method, less impairment losses.

#### ii *Derivative financial instruments*

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

## 3 Significant accounting policies *(continued)*

**b** *Financial instruments (continued)*

*iii Derecognition of financial assets and liabilities*

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

- substantially all the risks and rewards of ownership have been transferred; or
- substantially all the risks and rewards have neither been retained nor transferred but control is not retained.

Financial liabilities are derecognised when they are extinguished, that is when the obligation is discharged, cancelled or expires.

*iv Offsetting financial assets and financial liabilities*

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

*v Repurchase transactions*

The group enters into purchases of investments under agreement to resell substantially identical investments at a certain date in the future at a fixed price. Investments purchased subject to commitments to resell at future dates are not recognised. The amounts paid are recognised in loans and advances to either banks or customers. The receivables are shown as collateralised by the underlying security. Investments sold under repurchase agreements continue to be recognised in the statement of financial position and are measured in accordance with the accounting policy for either assets held for trading or available-for-sale as appropriate. The proceeds from sale of the investments are reported as liabilities to either banks or customers.

The difference between the sale and repurchase consideration is recognised using the effective interest method over the period of the transactions and is included in interest.

**c** *Investment in subsidiaries*

Investment in subsidiaries is shown in the separate statement of financial position at cost less any impairment losses.

**d** *Intangible assets*

Intangible assets include software and the present value of in-force long-term insurance business.

Software acquired by the group is initially measured at cost and subsequently stated net of accumulated amortisation and impairment losses. Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is recognised in profit or loss as incurred.

Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful life of software, from the date it is available for use. The estimated useful life of software ranges between 3 – 5 years.

For the accounting policy governing the present value of in-force long-term insurance business see note 3i (iv).

**e** *Property and equipment*

*i Owned assets*

Property and equipment are initially measured at cost. Freehold and long leasehold properties are revalued to fair value on the basis of their existing use. Revaluations are performed by a professionally qualified architect with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the reporting date. Any surpluses arising on revaluation are credited to a revaluation reserve. Any deficiencies resulting from decreases in value are deducted from this reserve to the extent that it is sufficient to absorb them, with any excess charged to profit or loss.

Items of property and equipment are stated net of accumulated depreciation and any impairment losses.

Gains and losses on disposal of an item of property and equipment are determined by comparing the proceeds from disposal with the carrying amount of property and equipment and are recognised net in profit or loss within Net operating income. When revalued assets are sold, the amounts included in the revaluation surplus reserve are transferred to retained earnings.

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

**e** *Property and equipment (continued)*

*ii Finance and operating leases*

Leases in terms of which the group assumes substantially all the risks and rewards of ownership are classified as finance leases.

When the group is a lessee under finance leases, the leased assets are capitalised and included in property and equipment and the corresponding liability to the lessor is included in Other liabilities. A finance lease and its corresponding liability are recognised initially at the fair value of the asset or, if lower, the present value of the minimum lease payments. Finance charges payable are recognised in Net interest income over the period of the lease based on the interest rate implicit in the lease so as to give a constant rate of interest on the remaining balance of the liability.

All other leases are classified as operating leases. When the group is the lessee, leased assets are not recognised on the statement of financial position. Rentals payable and receivable under operating leases are accounted for on a straight-line basis over the periods of the leases and are included in General and administrative expenses and Net other operating income respectively.

*iii Subsequent costs*

The cost of replacing part of an item of property and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the group and its cost can be measured reliably. The carrying amount of the replaced part is derecognised. The costs of the day-to-day servicing of property and equipment are recognised in profit or loss as incurred.

*iv Depreciation*

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment. Land is not depreciated. The estimated useful lives for the current and comparative period are as follows:

| | |
|---|---|
| – long leaseholds, freehold buildings and improvements | 50 years |
| – short leaseholds and improvements to rented property | over term of lease |
| – equipment, furniture and fittings | 3 – 10 years |

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

**f** *Investment property*

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

Investment properties are included in the statement of financial position at fair value with changes therein recognised in profit or loss in the period of change. Fair values are determined by independent professional valuers who apply recognised valuation techniques.

**g** *Impairment*

*i Financial assets not at fair value through profit or loss*

At each reporting date an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated as the difference between the financial asset's acquisition cost (net of any principal repayments and amortisation) and the current fair value (less any previous impairment loss recognised in profit or loss).

All impairment losses are recognised in the profit or loss. Any cumulative loss in respect of an available-for-sale financial asset recognised previously in equity is removed from other comprehensive income and transferred to profit or loss.

Losses for impaired loans are recognised promptly when there is objective evidence that impairment of a loan or portfolio of loans has occurred.

## 3 Significant accounting policies *(continued)*

### g *Impairment (continued)*

#### *i Financial assets not at fair value through profit or loss (continued)*

There are two basic methods of calculating impairment losses, those calculated on individual loans and those losses assessed on a collective basis. Impairment losses are recorded as charges to the profit or loss. The carrying amount of impaired loans on the statement of financial position is reduced through the use of impairment allowances accounts. Losses expected as a result of future events, no matter how likely, are not recognised in profit or loss.

#### *ii Calculation of recoverable amount*

At each reporting date, the group assesses on a case-by-case basis whether there is any objective evidence that a loan is impaired. This procedure is applied to all accounts that are considered individually significant. In determining impairment losses on these loans, the following factors are considered:

- the group's aggregate exposure to the customer;
- the viability of the customer's business model and their capability to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;
- the amount and timing of expected receipts and recoveries;
- the extent of other creditors' commitments ranking ahead of, or pari passu with, the group and the likelihood of other creditors continuing to support the customer;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realisable value of security (or other credit risk mitigants) and likelihood of successful repossession; and
- the likely deduction of any costs involved in recovery of amounts outstanding.

Impairment losses are calculated by discounting the expected future cash flows of a loan at its original effective interest rate, and comparing the resultant present value with the loan's carrying amount.

Impairment is assessed on a collective basis in two circumstances:

- to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment; and
- for homogeneous groups of loans that are not considered individually significant.

Individually assessed loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective loss. This reflects impairment losses incurred at the balance sheet date which will only be individually identified in the future.

The collective impairment allowance is determined after taking into account:

- historical loss experience in portfolios of similar risk characteristics (for example, by industry sector, loan grade or product);
- the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against the loss on an individual loan; and
- management's experienced judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

The period between a loss occurring and its identification is identified by local management for each identified portfolio.

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

- When appropriate empirical information is available, the group utilises roll rate methodology. This methodology employs a statistical analysis of historical trends of delinquency and default to estimate the likelihood that loans will progress through the various stages of delinquency and ultimately prove irrecoverable. The estimated loss is the difference between the present value of expected future cash flows, discounted at the original effective interest rate of the portfolio, and the carrying amount of the portfolio. Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss.

## 3 Significant accounting policies *(continued)*

### g *Impairment (continued)*

*ii Calculation of recoverable amount (continued)*

– In other cases, when the portfolio size is small or when information is insufficient or not sufficiently reliable to adopt a roll rate methodology, the group adopts a formulaic approach which allocates progressively higher percentage loss rates the longer a customer's loan is overdue. Loss rates are calculated from the discounted expected future cash flows from a portfolio.

In normal circumstances, historical experience provides the most objective and relevant information from which to assess inherent loss within each portfolio. In certain circumstances, historical loss experience provides less relevant information about the inherent loss in a given portfolio at the reporting date, for example, where there have been changes in economic, regulatory or behavioural conditions, such that the most recent trends in the portfolio risk factors are not fully reflected in the statistical models. In these circumstances, such risk factors are taken into account when calculating the appropriate level of impairment allowances by adjusting the impairment allowances derived solely from historical loss experience.

Roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

*iii Non-financial assets*

The carrying amounts of the group's non-financial assets, other than investment property and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in profit or loss.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists.

The recoverable amount of non-financial assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

*iv Reversals of impairment*

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

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. For financial assets measured at amortised cost and available-for-sale financial assets that are debt securities, the reversal is recognised in profit or loss. For available-for-sale financial assets that are equity securities, the reversal is recognised directly in other comprehensive income.

An impairment loss on non-financial assets is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

*v Loan write-offs*

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery of these amounts and, for collateralised loans, when the proceeds from realising the security have been received.

## 3 Significant accounting policies *(continued)*

**h** *Assets held for sale*

Non-current assets that are expected to be recovered primarily through sale rather than through continuing use are classified as held for sale. Immediately before classification as held for sale, the assets are remeasured in accordance with the group's accounting policies. Thereafter generally the assets are measured at the lower of their carrying amount and fair value less cost to sell. Impairment losses on initial classification as held for sale and subsequent gains or losses on remeasurement are recognised in profit or loss. Gains are not recognised in excess of any cumulative impairment loss.

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**i** *Insurance and investment contracts*

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

Insurance contracts are accounted for as follows:

*i Premiums*

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

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

*ii Claims and reinsurance recoveries*

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

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

*iii Liabilities under insurance contracts*

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

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

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

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

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

The present value of in-force long-term insurance business is determined by discounting future cash flows expected to emerge from business currently in force, using appropriate assumptions in assessing factors such as future mortality, lapse rates and levels of expenses and a risk discount rate that reflects the risk premium attributable to the respective long-term insurance business. Movements in the present value of in-force long-term insurance business are included in Net other operating income on a gross of tax basis.

## Notes on the Accounts (continued)

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

**i** *Insurance and investment contracts (continued)*

*v Investment contracts*

Investment contracts are those contracts where there is no significant insurance risk.

Customer liabilities under unit-linked investment contracts and the linked financial assets are designated at fair value through profit or loss, and the movements in fair value are recognised in profit or loss in Net income from insurance financial instruments designated at fair value through profit or loss.

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

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

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

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

**j** *Provisions*

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a current legal or constructive obligation as a result of past events, and a reliable estimate can be made of the amount of the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

**k** *Financial guarantee contracts*

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

Financial guarantee liabilities are initially recognised at their fair value, and the initial fair value is amortised over the life of the financial guarantee. The financial guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment when a payment under the guarantee has become probable. Financial guarantees are included within Amounts owed to customers.

**l** *Interest income and expense*

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

The calculation of the effective interest rate includes all fees and points paid or received, transaction costs, and discounts or premiums that are an integral part of the effective interest rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability.

Interest on impaired financial assets is recognised using the original effective interest rate.

## 3 Significant accounting policies *(continued)*

**m** *Non-interest income*

*i Net fee and commission income*

Fee income is recognised as follows:

- on the execution of a significant act when the significant act has been completed; and
- as the services are provided except where the fee is charged to cover the cost of a continuing service to, or risk borne for, the customer, or is interest in nature. In these cases, the fee is recognised on an appropriate basis over the relevant period.

Income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate and recorded in Net interest income.

Other fees and commission expense, which relates mainly to transaction and service fees are expensed as the services are received.

*ii Dividend income*

Dividend income is recognised on the date the entity's right to receive income is established which in the case of quoted securities is usually the ex-dividend date.

*iii Net income from insurance financial instruments designated at fair value*

Net income from financial instruments designated at fair value includes:

- all gains and losses from changes in the fair value of financial assets and financial liabilities designated at fair value through profit or loss; and
- interest income and expense and dividend income arising on these financial instruments.

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**n** *Employee benefits*

*i Defined contribution plan*

The group contributes towards the State pension defined contribution plan in accordance with local legislation and to which it has no commitment beyond the payment of fixed contributions. Obligations for contributions are recognised as an expense in profit or loss as they fall due.

*ii Termination benefits*

Termination benefits are recognised as an expense when the group is demonstrably committed, without realistic possibility of withdrawal, to a formal detailed plan to either terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognised as an expense if the group has made an offer encouraging voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably.

*iii Share-based payment transactions*

Share-based payment arrangements in which the group receives goods or services as consideration for equity instruments in the ultimate parent company are accounted for as equity-settled share-based payment transactions, regardless of how the equity instruments are obtained by the group.

The grant date fair value of share-based payment awards granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period that the employees unconditionally become entitled to the awards. The amount recognised as an expense is adjusted to reflect the number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date.

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

**o** *Foreign currencies*

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange prevailing on the date of transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange ruling at the reporting date. Non-monetary assets and liabilities that are measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined. Foreign currency differences arising on retranslation are recognised in profit or loss except for differences arising on retranslation of available-for-sale equity instruments, which are recognised directly in equity.

**p** *Income tax*

Income tax expense comprises current and deferred tax. Income tax expense is recognised in profit or loss except to the extent that it relates to items recognised directly in equity or in other comprehensive income.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised for unused tax losses and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

**q** *Segmental reporting*

The group's operating segments are organised into three customer groups, Personal Financial Services (PFS), Commercial Banking (CMB) and Global Banking and Markets (GBM). The group's chief decision maker regularly reviews operating activity by customer group. The group's operating segments were determined to be customer groups because the chief decision maker uses information on customer group segments in order to make decisions about allocating resources and assessing performance. The group's chief decision maker is the Executive committee (EXCO).

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

**r** *Future accounting developments*

The Directors anticipate that the adoption of other IFRS that were in issue at the date of authorisation of these financial statements will have no material impact on the financial statements of the group in the period of initial application.

**4 Financial instruments and risk management**

**a** *Use of financial instruments*

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

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

The principal categories of risk are credit risk, market risk and liquidity risk. These categories of risk in relation to life insurance business are described in note 4(e) and excluded from group figures disclosed in notes 4(b) to 4(d).

The group's accounting policies are directed towards the establishment of fair values for its assets and liabilities, for measurement or disclosure purposes, in light of these risks.

## 4 Financial instruments and risk management *(continued)*

### b *Credit risk*

#### *i Credit risk management*

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from lending, trade finance and treasury business. It also arises when issuers of debt securities are downgraded and as a result the value of group's holdings of these assets fall. The group has standards, policies and procedures dedicated to control and monitor the risk arising from all such activities.

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

Special attention is paid to problematic loans. Specialist units are established by the group to provide customers with support in order to help them avoid default wherever possible.

a Collateral and other credit enhancements

Collateral can be an important mitigant of credit risk. Nevertheless, it is group's policy to establish that loans are within the customer's capacity to repay rather than to over rely on security. In certain cases, depending on the customer's standing and the type of product, facilities may be unsecured.

The group is required to implement guidelines on the acceptability of specific classes of collateral or credit risk mitigation, and determine suitable valuation parameters. Such parameters are expected to be conservative, reviewed regularly and supported by empirical evidence. Security structures and legal covenants are required to be subject to regular review to ensure that they continue to fulfil their intended purpose and remain in line with local market practice.

At balance sheet date the principal type of collateral held consisted of immovable properties. Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Financial investments are generally unsecured.

b Credit quality of loans and advances

Group's credit risk rating processes are designed to highlight exposures which require closer management attention because of their greater probability of default and potential loss. Risk ratings are reviewed regularly and amendments, where necessary, are implemented promptly. The credit quality of unimpaired loans is assessed by reference to the Group's standard credit rating system.

#### *ii Credit exposure*

Maximum exposure to credit risk

The group's maximum exposure to credit risk on and off balance sheet financial instruments, before taking account of any collateral held or other credit enhancements can be classified in the following categories:

- Financial assets recognised on balance sheet comprise Balances with Central Bank of Malta, treasury bills and cash, cheques in course of collection, financial assets at fair value through profit or loss, financial investments, loans and advances and acceptances and endorsments. The maximum exposure of these Financial assets to credit risk, equals their carrying amount.
- Financial guarantees granted. The maximum exposure to credit risk is the full amount that the group would have to pay if the guarantees are called upon.
- Loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities. The maximum exposure to credit risk is the full amount of the committed facilities.

## Notes on the Accounts (continued)

### 4 Financial instruments and risk management *(continued)*

**b** *Credit risk (continued)*

*ii Credit exposure (continued)*

Concentration of credit risk exists when a number of counterparties are engaged in similar activities, or operate in the same industry sector and so their ability to meet contractual obligations is similarly affected by certain conditions.

The following industry concentrations are considered significant for Loans and advances to customers:

| | 2009 | 2008 |
|---|---|---|
| | €000 | €000 |
| *Group/Bank* | | |
| Agriculture | **4,568** | 4,440 |
| Fishing | **4,417** | 1,890 |
| Mining and quarrying | **2,634** | 8,849 |
| Manufacturing | **134,891** | 156,693 |
| Electricity, gas and water supply | **72,303** | 65,524 |
| Construction | **390,176** | 419,090 |
| Wholesale and retail trade; repairs | **360,423** | 351,282 |
| Hotels and restaurants; excluding related construction activities | **204,153** | 196,571 |
| Transport, storage and communication | **131,673** | 138,241 |
| Financial intermediation | **7,070** | 8,582 |
| Real estate, renting and business activities | **188,330** | 180,081 |
| Public administration | **101,446** | 57,842 |
| Education | **2,061** | 3,044 |
| Health and social work | **25,445** | 26,321 |
| Community, recreational and personal service activities | **14,688** | 16,173 |
| Household and individuals | **1,627,153** | 1,519,738 |
| Gross loans and advances to customers | **3,271,431** | 3,154,361 |

Debt securities and Treasury Bills by rating agency (S&P Rating Agency) designation:

| | *Treasury Bills* | *Debt securities* | *Total* |
|---|---|---|---|
| | €000 | €000 | €000 |
| *Group* | | | |
| **At 31 December 2009** | | | |
| AAA | **–** | **25,733** | **25,733** |
| AA- to AA+ | **–** | **42,032** | **42,032** |
| A- to A+ | **64,633** | **271,915** | **336,548** |
| Lower than A- | **–** | **31,379** | **31,379** |
| Unrated | **–** | **8,894** | **8,894** |
| | **64,633** | **379,953** | **444,586** |
| At 31 December 2008 | | | |
| AAA | – | 22,740 | 22,740 |
| AA- to AA+ | – | 39,895 | 39,895 |
| A- to A+ | 14,895 | 329,494 | 344,389 |
| Lower than A- | – | 10,054 | 10,054 |
| Unrated | – | 8,880 | 8,880 |
| | 14,895 | 411,063 | 425,958 |

## 4 Financial instruments and risk management *(continued)*

### b *Credit risk (continued)*

#### *iii Credit quality of financial assets*

The following tables provide a detailed analysis of the credit quality of the group's lending portfolio:

a Distribution of loans and advances by credit quality

| | *Loans and advances to customers* | *Loans and advances to banks* | *Loans and advances to customers* | *Loans and advances to banks* |
|---|---|---|---|---|
| | **2009** | **2009** | 2008 | 2008 |
| | **€000** | **€000** | €000 | €000 |
| *Group/Bank* | | | | |
| Gross loans and advances: | | | | |
| – neither past due nor impaired | **3,008,761** | **747,582** | 2,908,856 | 1,072,269 |
| – past due but not impaired | **153,843** | **–** | 157,621 | – |
| – impaired | **108,827** | **–** | 87,884 | – |
| | **3,271,431** | **747,582** | 3,154,361 | 1,072,269 |

b Distribution of loans and advances neither past due nor impaired

The credit quality of the portfolio of loans and advances that were neither past due nor impaired at 31 December 2009 can be assessed by reference to group's standard credit grading system. The following information is based on that system:

| | *Loans and advances to customers* | *Loans and advances to banks* | *Loans and advances to customers* | *Loans and advances to banks* |
|---|---|---|---|---|
| | **2009** | **2009** | 2008 | 2008 |
| | **€000** | **€000** | €000 | €000 |
| *Group/Bank* | | | | |
| Satisfactory risk | **2,658,322** | **747,582** | 2,606,749 | 1,072,269 |
| Watch list and special attention | **220,168** | **–** | 185,242 | – |
| Sub-standard but not impaired | **130,271** | **–** | 116,865 | – |
| | **3,008,761** | **747,582** | 2,908,856 | 1,072,269 |

c Loans and advances which were past due but not impaired

Related credit losses which may arise are partly covered by collective impairment allowances.

| | *Loans and advances to customers* | |
|---|---|---|
| | **2009** | 2008 |
| | **€000** | €000 |
| *Group/Bank* | | |
| Past due up to 29 days | **88,645** | 98,451 |
| Past due 30 – 59 days | **25,191** | 36,182 |
| Past due 60 – 89 days | **22,715** | 11,419 |
| Past due 90 – 179 days | **4,456** | 3,488 |
| Past due over 180 days | **12,836** | 8,081 |
| | **153,843** | 157,621 |

Renegotiated loans that would otherwise be past due or impaired totalled €85,798,000 (2008: €75,858,000).

## Notes on the Accounts (continued)

### 4 Financial instruments and risk management *(continued)*

**b** *Credit risk (continued)*

*iii Credit quality of financial assets (continued)*

d Individually impaired gross loans by industry sector

| | Loans and advances to customers | |
|---|---|---|
| | **2009** | 2008 |
| | **€000** | €000 |
| *Group/Bank* | | |
| Personal banking | **21,137** | 16,944 |
| Commercial and corporate | **78,559** | 61,633 |
| Other | **9,131** | 9,307 |
| | **108,827** | 87,884 |

*iv Movement in allowance accounts for loans and advances to customers*

| | Individually assessed allowances | Collective allowances | Individually assessed allowances | Collective allowances |
|---|---|---|---|---|
| | **2009** | **2009** | 2008 | 2008 |
| | **€000** | **€000** | €000 | €000 |
| *Group/Bank* | | | | |
| At 1 January | **28,365** | **13,756** | 32,942 | 13,604 |
| Additions | **8,524** | **–** | 3,742 | 152 |
| Reversals | **(2,885)** | **(1,331)** | (6,778) | – |
| Discount unwind | **(1,475)** | **–** | (1,539) | – |
| Exchange | **–** | **–** | (2) | – |
| At 31 December | **32,529** | **12,425** | 28,365 | 13,756 |

*v Settlement risk*

The group's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to failure of a company to honour its obligations to deliver cash, securities or other assets as contractually agreed.

For certain types of transactions the group mitigates this risk by conducting settlements through a settlement/clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations.

**c** *Liquidity risk*

Liquidity risk is the risk that the group does not have sufficient financial resources to meet its financial obligations when they fall due or will have to do so at excessive cost. This risk can arise from mismatches in timing of cash flows.

The objective of the group's liquidity and funding management is to ensure that all foreseeable funding commitments and deposit withdrawals can be met when due. It is the group's objective to maintain a diversified and stable funding base with the objective of enabling the group to respond quickly and smoothly to unforeseen liquidity requirements.

## 4 Financial instruments and risk management *(continued)*

### c *Liquidity risk (continued)*

The group's liquidity and funding management process includes:

- projecting cash flows by considering the level of liquid assets necessary in relation thereto;
- monitoring balance sheet liquidity ratios against internal and regulatory requirements;
- maintaining a diverse range of funding sources with adequate back-up facilities;
- managing the concentration and profile of debt maturities;
- monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensure a satisfactory overall funding mix; and
- maintaining liquidity and funding contingency plans. These plans identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systematic or other crises while minimising adverse long-term implications for the business.

Current accounts and savings deposits payable on demand or at short notice form a significant part of the group's funding. The group places considerable importance on maintaining the stability of these deposits.

*Cash flows payable by the group under financial liabilities by remaining contractual maturities*

| | *Due within 3 months* | *Due between 3 and 12 months* | *Due between 1 and 5 years* | *Due after 5 years* | *Gross nominal outflow* |
|---|---|---|---|---|---|
| | **€000** | **€000** | **€000** | **€000** | **€000** |
| *Group* | | | | | |
| **At 31 December 2009** | | | | | |
| Amounts owed to banks | **168,127** | **578** | **10** | **375** | **169,090** |
| Amounts owed to customers | **2,901,317** | **948,737** | **275,263** | **–** | **4,125,317** |
| Subordinated liabilities | **1,339** | **3,109** | **17,795** | **102,011** | **124,254** |
| Other financial liabilities | **32,711** | **859** | **553** | **–** | **34,123** |
| | **3,103,494** | **953,283** | **293,621** | **102,386** | **4,452,784** |
| Loan commitments | **696,258** | **15,700** | **129,851** | **68,839** | **910,648** |
| At 31 December 2008 | | | | | |
| Amounts owed to banks | 450,947 | 15,501 | 60 | 606 | 467,114 |
| Amounts owed to customers | 2,728,795 | 1,123,587 | 233,048 | – | 4,085,430 |
| Subordinated liabilities | 2,224 | 2,224 | 17,795 | 106,460 | 128,703 |
| Other financial liabilities | 29,303 | 2,527 | 1,464 | – | 33,294 |
| | 3,211,269 | 1,143,839 | 252,367 | 107,066 | 4,714,541 |
| Loan commitments | 765,899 | 23,067 | 201,005 | 104,188 | 1,094,159 |

## Notes on the Accounts (continued)

**4 Financial instruments and risk management** *(continued)*

**c** *Liquidity risk (continued)*

| | Due within 3 months | Due between 3 and 12 months | Due between 1 and 5 years | Due after 5 years | Gross nominal outflow |
|---|---|---|---|---|---|
| | **€000** | **€000** | **€000** | **€000** | **€000** |
| *Bank* | | | | | |
| **At 31 December 2009** | | | | | |
| Amounts owed to banks | **168,127** | **578** | **10** | **375** | **169,090** |
| Amounts owed to customers | **2,941,711** | **969,086** | **275,263** | **–** | **4,186,060** |
| Subordinated liabilities | **1,339** | **3,109** | **17,795** | **102,011** | **124,254** |
| Other financial liabilities | **29,438** | **859** | **553** | **–** | **30,850** |
| | **3,140,615** | **973,632** | **293,621** | **102,386** | **4,510,254** |
| Loan commitments | **696,258** | **15,700** | **129,851** | **68,839** | **910,648** |
| At 31 December 2008 | | | | | |
| Amounts owed to banks | 450,947 | 15,501 | 60 | 606 | 467,114 |
| Amounts owed to customers | 2,784,702 | 1,126,162 | 233,048 | – | 4,143,912 |
| Subordinated liabilities | 2,224 | 2,224 | 17,795 | 106,460 | 128,703 |
| Other financial liabilities | 26,452 | 2,527 | 1,464 | – | 30,443 |
| | 3,264,325 | 1,146,414 | 252,367 | 107,066 | 4,770,172 |
| Loan commitments | 765,899 | 23,067 | 201,005 | 104,188 | 1,094,159 |

The balances in the above table will not agree directly to the amounts in the financial position as the table incorporates all cash flows, on an undiscounted basis, related to both principal as well as those associated with all future coupon payments. Furthermore, loan commitments are not recognised on the Statements of Financial Position.

Assets available to meet these liabilities, and to cover outstanding commitments, include balances with Central Bank of Malta, Treasury Bills and cash, cheques in course of collection, loans to banks and to customers and marketable debt securities and undrawn credit lines.

The group would meet unexpected net cash outflows by accessing additional funding sources such as interbank lending, or by selling securities such as Treasury Bills or debt securities.

**d** *Market risk*

Market risk is the risk that movements in market risk factors, including foreign exchange rates, interest rates and market prices will reduce the group's income or the value of its portfolios.

The objective of the group's market risk management is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with the group's status as a premier provider of financial products and services.

The group manages market risk through risk limits approved by HSBC Holdings plc. Limits are set by product and risk type with market liquidity being a principal factor in determining the level of limits set.

The group's interest rate exposures comprise those originating in its treasury activities and those originating in other banking activities. The primary source of interest rate risk originating in other banking activities arises from the employment of non-interest liabilities such as shareholders' equity and current accounts, as well as fixed rate loans and liabilities other than those generated by treasury business. The group's ALCO assesses the interest rate risks which arise in the business. The primary objective of such interest rate risk management is to limit potential adverse effects of interest rate movements on Net interest income.

## 4 Financial instruments and risk management *(continued)*

### d *Market risk (continued)*

#### i *Fair value and price verification control*

Where certain financial instruments are carried on the group's balance sheet at fair values, the valuation and the related price verification processes are subject to independent validations. The determination of fair values is therefore a significant element in the reporting of the group's global market activities.

Certain of the group's financial assets and liabilities are carried at cost or amortised cost and not at fair value.

a Investments – Debt and other fixed income instruments held-to-maturity

This category of asset is carried at amortised cost and amounts to €8,894,000 as at 31 December 2009 (2008: €25,240,000). Fair value based on quoted market prices at the balance sheet date without deduction for transaction costs amounts to €8,952,000 as at 31 December 2009 (2008: €25,160,000).

b Investments – Equity and other non-fixed income instruments available-for-sale

Certain unlisted equity investments are carried at cost and amount to €354,000 as at 31 December 2009 (2008: €459,000). There is no market for these investments and there have not been any recent transactions that provide evidence of the current fair value. Discounted cash flow techniques do not provide a reliable measure of the fair value of these investments.

c Loans and advances to banks and customers

This category of asset is reported net of impairment allowances to reflect the estimated recoverable amounts. As at 31 December 2009 the group's carrying amount was €3,974,059,000 (2008: €4,184,509,000).

The Loans and advances to customers category of asset amounts to €3,226,477,000 (2008: €3,112,240,000). This carrying value approximates to fair value in the case of loans which are repriceable at the group's discretion. These loans constitute a significant element of the total loan portfolio.

The Loans and advances to banks category of asset amounts to €747,582,000 (2008: €1,072,269,000). For Loans and advances to banks within the 'less than one year' maturity band, fair value is taken to be the amount carried at reporting date. As at 31 December 2009, 91 per cent of Loans and advances to banks had a contractual repricing within the 'less than three months' band. Interest rates on these loans and advances reflect current market rates, and therefore the carrying amount approximates to fair value.

d Assets held for sale

Assets acquired in satisfaction of debt amounting to €8,772,000 as at 31 December 2009 (2008: €7,519,000) consist mainly of repossessed immovable property measured at the lower of cost and their forced sales value.

e Amounts owed to banks and customers

This category of liability is carried at amortised cost and amounts to €4,255,440,000 as at 31 December 2009 (2008: €4,478,817,000). Of this liability, 86 per cent has contractual repricing within the 'less than three months' band, 5 per cent reprices within the 'between three months and one year' band whilst 9 per cent reprices within the 'between one year and five years' band. For demand deposits and deposits maturing within one year, fair value is taken to be the amount payable on demand at reporting date.

f Subordinated liabilities

This category of liability is carried at amortised cost. Fair value based on quoted market prices at reporting date without deduction for transaction costs amounts to €91,250,000 as at 31 December 2009 (2008: €89,800,000).

# Notes on the Accounts (continued)

## 4 Financial instruments and risk management *(continued)*

### d *Market risk (continued)*

#### *ii Bases of valuing financial assets and liabilities measured at fair value*

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilised. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, HSBC will source alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable.

| | *Valuation techniques* | | | |
|---|---|---|---|---|
| | *Quoted market price* | *Using observable inputs* | *With significant unobservable inputs* | |
| | Level 1 | Level 2 | Level 3 | Total |
| | **€000** | **€000** | **€000** | **€000** |
| *Group* | | | | |
| **At 31 December 2009** | | | | |
| **Assets** | | | | |
| Financial assets held for trading | **–** | **11,746** | **–** | **11,746** |
| Financial assets designated at fair value through profit or loss | **248,553** | **–** | **–** | **248,553** |
| Financial investments: available-for-sale | **467,339** | **2,742** | **–** | **470,081** |
| **Liabilities** | | | | |
| Financial liabilities held for trading | **–** | **11,044** | **–** | **11,044** |
| Liabilities to customers under investment contracts | **16,853** | **–** | **–** | **16,853** |

| | *Valuation techniques* | | | |
|---|---|---|---|---|
| | *Quoted market price* | *Using observable inputs* | *With significant unobservable inputs* | |
| | Level 1 | Level 2 | Level 3 | Total |
| | €000 | €000 | €000 | €000 |
| *Group* | | | | |
| At 31 December 2008 | | | | |
| **Assets** | | | | |
| Financial assets held for trading | 391 | 11,432 | – | 11,823 |
| Financial assets designated at fair value through profit or loss | 279,714 | – | – | 279,714 |
| Financial investments: available-for-sale | 398,894 | 5,778 | – | 404,672 |
| **Liabilities** | | | | |
| Financial liabilities held for trading | – | 11,381 | – | 11,381 |
| Liabilities to customers under investment contracts | 15,122 | – | – | 15,122 |

## 4 Financial instruments and risk management *(continued)*

**d** *Market risk (continued)*

*ii Bases of valuing financial assets and liabilities measured at fair value (continued)*

| | *Valuation techniques* | | | |
|---|---|---|---|---|
| | *Quoted market price* | *Using observable inputs* | *With significant unobservable inputs* | |
| | Level 1 | Level 2 | Level 3 | Total |
| | **€000** | **€000** | **€000** | **€000** |
| *Bank* | | | | |
| **At 31 December 2009** | | | | |
| **Assets** | | | | |
| Financial assets held for trading | **–** | **11,964** | **–** | **11,964** |
| Financial investments: available-for-sale | **368,639** | **2,742** | **–** | **371,381** |
| **Liabilities** | | | | |
| Financial liabilities held for trading | **–** | **11,046** | **–** | **11,046** |

| | *Valuation techniques* | | | |
|---|---|---|---|---|
| | *Quoted market price* | *Using observable inputs* | *With significant unobservable inputs* | |
| | Level 1 | Level 2 | Level 3 | Total |
| | €000 | €000 | €000 | €000 |
| *Bank* | | | | |
| At 31 December 2008 | | | | |
| **Assets** | | | | |
| Financial assets held for trading | 391 | 11,666 | – | 12,057 |
| Financial investments: available-for-sale | 380,998 | 5,778 | – | 386,776 |
| **Liabilities** | | | | |
| Financial liabilities held for trading | – | 12,375 | – | 12,375 |

# Notes on the Accounts (continued)

## 4 Financial instruments and risk management *(continued)*

### d *Market risk (continued)*

*iii Value at risk (VAR)*

One of the principal tools used by the group to monitor and limit market risk exposure is VAR. VAR is a technique that estimates potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence.

The VAR models used by the group are predominantly based on historical simulation. The historical simulation models derive plausible future scenarios from historical market rate time series, taking account of inter-relationships between different markets and rates, for example, between interest rates and foreign exchange rates.

The historical simulation models used by the group incorporate the following features:

- potential market movements are calculated with reference to data from the last two years;
- historical market rates and prices are calculated with reference to foreign exchange rates and commodity prices, interest rates, equity prices and the associated volatilities;
- VAR is calculated to a 99 per cent confidence level; and
- VAR is calculated for a one-day holding period.

Although a valuable guide to risk, VAR should always be viewed in the context of its limitations, for example:

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a one-day holding period assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a one-day holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99 per cent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence; and
- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

The group recognises these limitations by augmenting its VAR limits with other position and sensitivity limit structures.

The VAR for the group was as follows:

| | **2009** | 2008 |
|---|---|---|
| | **€000** | €000 |
| At 31 December | **942** | 1,176 |
| Average | **1,015** | 559 |
| Minimum | **734** | 328 |
| Maximum | **1,289** | 1,176 |

The VAR at 31 December 2009 fell compared with 31 December 2008. The major cause of this was a reduction in risk positions arising from the Group's balance sheet management activities.

## 4 Financial instruments and risk management *(continued)*

### d *Market risk (continued)*

#### iv *Sensitivity of net interest income*

A principal part of all group's management of market risk is to monitor the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling). For simulation modelling, the business uses a combination of scenarios relevant to local businesses and local markets and standard scenarios which are required throughout the group.

The table below sets out the impact on future net income/net assets of an incremental 50 basis points parallel fall or rise in all yield curves worldwide on the first day of the following year based on current financial position/risk profiles:

| | *Impact on profit for the year* | *Impact on net assets* | *Impact on profit for the year* | *Impact on net assets* |
|---|---|---|---|---|
| | **2009** | **2009** | 2008 | 2008 |
| | **€000** | **€000** | €000 | €000 |
| *Group* | | | | |
| + 50 basis points | **6,056** | **2,984** | 6,019 | 3,713 |
| - 50 basis points | **(11,643)** | **(8,571)** | (6,019) | (3,713) |

#### v *Currency concentration*

| | *Euro* | *Other currencies* | *Total* | *Euro* | *Other currencies* | *Total* |
|---|---|---|---|---|---|---|
| | **2009** | **2009** | **2009** | 2008 | 2008 | 2008 |
| | **€000** | **€000** | **€000** | €000 | €000 | €000 |
| *Group* | | | | | | |
| **Assets** | | | | | | |
| Balances with Central Bank of Malta, Treasury Bills and cash | **170,662** | **2,009** | **172,671** | 128,543 | 2,139 | 130,682 |
| Cheques in course of collection | **10,063** | **701** | **10,764** | 8,444 | 864 | 9,308 |
| Financial assets held for trading | **9,093** | **2,653** | **11,746** | 6,357 | 5,466 | 11,823 |
| Financial assets designated at fair value through profit or loss | **183,308** | **65,245** | **248,553** | 216,874 | 62,840 | 279,714 |
| Financial investments | **444,066** | **34,909** | **478,975** | 370,198 | 59,714 | 429,912 |
| Loans and advances to banks | **199,705** | **547,952** | **747,657** | 546,284 | 526,022 | 1,072,306 |
| Loans and advances to customers | **3,195,339** | **31,138** | **3,226,477** | 3,085,245 | 26,995 | 3,112,240 |
| Other assets | **218,158** | **2,799** | **220,957** | 245,991 | 4,112 | 250,103 |
| **Total assets** | **4,430,394** | **687,406** | **5,117,800** | 4,607,936 | 688,152 | 5,296,088 |

# Notes on the Accounts (continued)

## 4 Financial instruments and risk management *(continued)*

### d *Market risk (continued)*

#### v *Currency concentration (continued)*

| | Euro 2009 €000 | Other currencies 2009 €000 | Total 2009 €000 | Euro 2008 €000 | Other currencies 2008 €000 | Total 2008 €000 |
|---|---|---|---|---|---|---|
| *Group* | | | | | | |
| **Liabilities and equity** | | | | | | |
| Financial liabilities held for trading | **9,009** | **2,035** | **11,044** | 5,829 | 5,552 | 11,381 |
| Amounts owed to banks | **161,550** | **7,221** | **168,771** | 429,801 | 32,384 | 462,185 |
| Amounts owed to customers | **3,484,990** | **601,679** | **4,086,669** | 3,431,309 | 585,323 | 4,016,632 |
| Liabilities to customers under investment contracts | **16,853** | **–** | **16,853** | 15,122 | – | 15,122 |
| Liabilities under insurance contracts issued | **351,513** | **–** | **351,513** | 311,250 | – | 311,250 |
| Subordinated liabilities | **87,827** | **–** | **87,827** | 87,777 | – | 87,777 |
| Other liabilities | **83,990** | **4,546** | **88,536** | 103,542 | 5,722 | 109,264 |
| Total equity | **306,587** | **–** | **306,587** | 282,477 | – | 282,477 |
| **Total liabilities and equity** | **4,502,319** | **615,481** | **5,117,800** | 4,667,107 | 628,981 | 5,296,088 |

| | Euro 2009 €000 | Other currencies 2009 €000 | Total 2009 €000 | Euro 2008 €000 | Other currencies 2008 €000 | Total 2008 €000 |
|---|---|---|---|---|---|---|
| *Bank* | | | | | | |
| **Assets** | | | | | | |
| Balances with Central Bank of Malta, Treasury Bills and cash | **170,661** | **2,009** | **172,670** | 128,542 | 2,139 | 130,681 |
| Cheques in course of collection | **10,063** | **701** | **10,764** | 8,444 | 864 | 9,308 |
| Financial assets held for trading | **9,093** | **2,871** | **11,964** | 6,357 | 5,700 | 12,057 |
| Financial investments | **346,579** | **33,696** | **380,275** | 353,252 | 58,764 | 412,016 |
| Loans and advances to banks | **199,630** | **547,952** | **747,582** | 546,247 | 526,022 | 1,072,269 |
| Loans and advances to customers | **3,195,339** | **31,138** | **3,226,477** | 3,085,245 | 26,995 | 3,112,240 |
| Other assets | **173,847** | **2,559** | **176,406** | 197,343 | 2,769 | 200,112 |
| **Total assets** | **4,105,212** | **620,926** | **4,726,138** | 4,325,430 | 623,253 | 4,948,683 |
| **Liabilities and equity** | | | | | | |
| Financial liabilities held for trading | **9,009** | **2,037** | **11,046** | 5,829 | 6,546 | 12,375 |
| Amounts owed to banks | **161,550** | **7,221** | **168,771** | 429,801 | 32,384 | 462,185 |
| Amounts owed to customers | **3,542,083** | **604,212** | **4,146,295** | 3,485,730 | 588,145 | 4,073,875 |
| Subordinated liabilities | **87,827** | **–** | **87,827** | 87,777 | – | 87,777 |
| Other liabilities | **61,257** | **4,546** | **65,803** | 82,284 | 5,715 | 87,999 |
| Total equity | **246,396** | **–** | **246,396** | 224,472 | – | 224,472 |
| **Total liabilities and equity** | **4,108,122** | **618,016** | **4,726,138** | 4,315,893 | 632,790 | 4,948,683 |

## 4 Financial instruments and risk management *(continued)*

**e** *Insurance risk*

The insurance risk of the group represents that faced by the life insurance subsidiary company. The principal insurance risk is that the actual claims and benefit payments may exceed the carrying amount of the insurance liabilities. The group manages its insurance risks through the application of formal underwriting, reinsurance and claims procedures designed to ensure compliance with regulations.

The following table provides an analysis of the insurance risk exposures by type of business:

| | *Group* | |
|---|---|---|
| | **2009** | 2008 |
| | **€000** | €000 |
| Life insurance (non-linked) | | |
| Insurance contracts with discretionary participation feature | **224,988** | 204,174 |
| Term assurance and other long-term contracts | **37,669** | 47,414 |
| Total non-linked | **262,657** | 251,588 |
| Life (linked) | **88,856** | 59,662 |
| Investment contracts | **16,853** | 15,122 |
| **Total insurance liabilities** | **368,366** | 326,372 |

*Present value of in-force long-term insurance business ('PVIF')*

The group life insurance business is accounted for using the embedded value approach, which, inter alia, provides a comprehensive framework for the evaluation of insurance and related risks.

The following table shows the effect on the PVIF of reasonably possible changes in the main economic assumptions across the life insurance business:

| | | *PVIF Impact* | |
|---|---|---|---|
| | | **2009** | 2008 |
| **Assumptions** | **Movement** | **€000** | €000 |
| As published | | | |
| Risk free rate | +100 basis points | **2,897** | 2,061 |
| Risk free rate | -100 basis points | **(822)** | (484) |
| Risk adjusted discount rate | +100 basis points | **(1,061)** | (788) |
| Risk adjusted discount rate | -100 basis points | **1,171** | 858 |
| Expenses inflation | +100 basis points | **(327)** | (310) |
| Expenses inflation | -100 basis points | **298** | 285 |
| Lapse rate | +100 basis points | **(452)** | (255) |
| Lapse rate | -100 basis points | **479** | 269 |

The group's life insurance business is exposed to a range of financial risks, including market risk, credit risk and liquidity risk. The nature and management of these risks is described below.

*i Market risk*

a Interest rate risk

Life insurance business is exposed to interest rate risk when there is a mismatch in terms of duration or yields between assets and liabilities. The group manages the interest rate risk arising from its insurance underwriting business by matching estimated future cash outflows to be paid to policyholders by expected cash flows from assets. The pool of investments backing liabilities is managed within strict duration limits that ensure that the net effect of interest rate changes on assets and liabilities is manageable.

Interest rate risk is also assessed by measuring the impact of defined movements in interest yield curves on the profits after tax and net assets of the insurance underwriting business.

## Notes on the Accounts (continued)

**4 Financial instruments and risk management** *(continued)*

**e** *Insurance risk (continued)*

*i Market risk (continued)*

b Equity price risk

The group manages the equity risk arising from its holdings of equity securities by setting limits on the maximum market value of equities that the insurance underwriting business may hold. Equity risk is also monitored by estimating the effect of predetermined movements in equity prices on the profit, and total net assets of the insurance underwriting business.

An immediate and permanent movement in interest yield curves and equity prices as at reporting date would have the following impact on the profit for the year and net assets at that date:

| | **2009** | | 2008 | |
|---|---|---|---|---|
| | *Impact on profit for the year* | *Impact on net assets* | *Impact on profit for the year* | *Impact on net assets* |
| | **€000** | **€000** | €000 | €000 |
| +100 basis points shift in yield curves | **(210)** | **(210)** | 1,000 | 1,000 |
| -100 basis points shift in yield curves | **(281)** | **(281)** | 67 | 67 |
| +10 per cent increase in equity prices | **368** | **368** | 749 | 749 |
| -10 per cent increase in equity prices | **(546)** | **(546)** | (1,996) | (1,996) |

*ii Credit risk*

The group's life insurance underwriting business is exposed to credit risk in respect of its investment portfolios and reinsurance transactions. The Investment Committee is responsible for the quality and performance of the investment portfolios and follows a credit process involving delegated approval authorities and credit procedures, the objective of which is to build and maintain risk assets of high quality.

The following table presents the analysis of debt securities and Treasury Bills within insurance business by rating agency (S & P Rating Agency) :

| | *Treasury Bills* | *Debt securities* | *Total* |
|---|---|---|---|
| | **€000** | **€000** | **€000** |
| **At 31 December 2009** | | | |
| AAA | **–** | **20,228** | **20,228** |
| AA- to AA+ | **–** | **16,486** | **16,486** |
| A- to A+ | **5,981** | **131,960** | **137,941** |
| Lower than A- | **–** | **11,510** | **11,510** |
| Unrated | **–** | **12,045** | **12,045** |
| | **5,981** | **192,229** | **198,210** |
| At 31 December 2008 | | | |
| AAA | – | 19,938 | 19,938 |
| AA- to AA+ | – | 9,869 | 9,869 |
| A- to A+ | 22,369 | 65,535 | 87,904 |
| Lower than A- | – | 11,028 | 11,028 |
| Unrated | – | 12,520 | 12,520 |
| | 22,369 | 118,890 | 141,259 |

## 4 Financial instruments and risk management *(continued)*

### e *Insurance risk (continued)*

*iii Liquidity risk*

It is an inherent characteristic of almost all insurance contracts that there is uncertainty over the amount and the timing of settlement of claims liabilities that may arise, and this leads to liquidity risk. As part of the management of this exposure, estimates are prepared for most lines of life insurance business of cash flows expected to arise from insurance funds at reporting date.

The following table shows the expected maturity of insurance liabilities at 31 December 2009:

| | *Due within 3 months* | *Due between 3 and 12 months* | *Due between 1 and 5 years* | *Due after 5 years* | *Gross nominal outflow* |
|---|---|---|---|---|---|
| | **€000** | **€000** | **€000** | **€000** | **€000** |
| **At 31 December 2009** | | | | | |
| Liabilities to customers under investment contracts | **–** | **–** | **1,753** | **15,100** | **16,853** |
| Liabilities under insurance contracts issued | **440** | **–** | **66,284** | **282,034** | **348,758** |
| At 31 December 2008 | | | | | |
| Liabilities to customers under investment contracts | – | – | 1,380 | 13,742 | 15,122 |
| Liabilities under insurance contracts issued | 53 | 777 | 59,670 | 250,359 | 310,859 |

*All sensitivity analysis disclosed in this note are illustrative only and employ simplified scenarios. Effects may not be linear and therefore the results cannot be extrapolated. They do not allow for the effect of management actions taken to mitigate these effects, nor do they take account of any other behavioural aspects.*

## 5 Capital management and allocation

HSBC's capital management approach is driven by its strategy taking into account the regulatory, economic and commercial environment in which it operates. HSBC's capital management policy is to maintain a strong capital base to support the development of its business and to meet regulatory capital requirements at all times.

Capital management is monitored by ALCO. An annual group capital plan is prepared and approved by the Board with the objective of maintaining both the optimal amount of capital and the mix between the different components of capital. The group recognises the impact on shareholder returns by the level of equity capital employed and seeks to maintain a prudent balance between the advantages and flexibility afforded by a strong capital position and the higher returns on equity from increased leverage.

The Malta Financial Services Authority supervises the group on a consolidated basis and, as such, receives information on the capital adequacy of, and sets capital requirements for, the group as a whole.

In implementing the EU's directives which regulate capital requirements, the Malta Financial Services Authority requires each bank and banking group to maintain an individually prescribed ratio of total capital to risk-weighted assets.

The group's capital base is divided in two tiers, as defined in the Own Funds of Credit Institutions Authorised Under the Banking Act 1994 BR03:

- Original own funds comprise share capital, retained earnings and reserves created by appropriations of retained earnings. The book value of intangible assets are deducted in arriving at original own funds calculations.
- Additional own funds comprise qualifying subordinated loan capital, collective impairment allowances, and unrealised gains arising on the fair valuation of financial instruments held as available-for-sale. Additional own funds also include reserves arising from the revaluation of properties.

## Notes on the Accounts (continued)

**5 Capital management and allocation** *(continued)*

The group's risk and capital management policy is based on the Basel II framework which is structured on three pillars. These have been adopted by the Malta Financial Services Authority by way of banking rules as follows:

– Pillar 1- BR04 (Capital Requirements of Credit Institutions Authorised Under the Banking Act 1994) defines the minimum capital resouces requirements for credit, counterparty, market and operational risks. These requirements are expressed in terms of Risk Weighted Assets. The group has adopted the Standardised Approach in determining the material risks on its banking operations and operational risk.

  Banking operations are categorised as either trading book or banking book and risk-weighted assets are determined accordingly. Banking book risk-weighted assets are measured by means of a hierarchy of risk weightings classified according to the nature of each asset and counterparty, taking into account any eligible collateral or guarantees. Banking book contingent liabilities and commitments giving rise to credit, foreign exchange or interest rate risk are assigned weights appropriate to the category of the counterparty, taking into account any eligible collateral or guarantees. Trading book risk-weighted assets are determined by taking into account market related risks such as foreign exchange, interest rate and equity position risks and counterparty risk.

  Operational risk capital requirements are calculated under the Standardised Approach, as a percentage of the average of the last three financial years' gross revenues.

– Pillar 2- BR12 (The Supervisory Review Process of Credit Institutions Authorised Under the Banking Act 1994) involves both the credit institution and the regulator taking a view whether the credit institution should hold additional capital against risks not covered in pillar 1. The objective of the Rule is to ensure that credit institutions have sufficient capital to support all material risks which their business exposes them to and aims to reinforce the link between risk and capital. An integral part of pillar 2 process is the Internal Capital Adequacy Assessment Process ('ICAAP') which is the credit institution's self-assessment of the levels of capital that it needs to hold. The general framework for the technical development of the ICAAP submission was approved by the Board in July 2009, followed by a supervisory review during the last quarter. The results of the ICAAP show that the group maintains a comfortable level of excess capital and substantial liquidity that ensures the flexibility and resources needed to achieve the long term strategic objectives of the group even under market stress situations.

– Pillar 3- BR7 (Publication of Annual Report and Audited Financial Statements of Credit Institutions Authorised Under the Banking Act 1994) is related to market discipline and aims to make credit institutions more transparent by requiring them to publish specific, prescribed details of their risks, capital and risk management under the Basel II framework. The group is considered a significant local subsidiary of HSBC Holdings plc and in terms of article 23 of the Rule exempted from full risk disclosure requirements under pillar 3. HSBC publishes pillar 3 disclosures as a separate document on the Group Investor Relations website.

| | *Group* | | | |
|---|---|---|---|---|
| | *Face value* | *Weighted amount* | *Face value* | *Weighted amount* |
| | **2009** | **2009** | 2008 | 2008 |
| | **€000** | **€000** | €000 | €000 |
| Balances with Central Bank of Malta, Treasury Bills and cash | **172,671** | **–** | 130,682 | – |
| Cheques in course of collection | **10,764** | **10,764** | 9,308 | 9,308 |
| Loans and advances to banks | **747,657** | **150,049** | 1,072,272 | 214,454 |
| Loans and advances to customers | **3,226,477** | **2,100,147** | 3,125,996 | 1,974,942 |
| Debt securities and equities | **381,862** | **80,285** | 413,826 | 100,051 |
| Investment in insurance company | **28,578** | **28,578** | 28,578 | 28,578 |
| Property and equipment and investment property | **77,051** | **77,051** | 53,735 | 53,735 |
| Other assets | **44,067** | **36,926** | 69,408 | 51,226 |
| Prepayments and accrued income | **33,748** | **29,872** | 44,852 | 35,861 |
| | **4,722,875** | **2,513,672** | 4,948,657 | 2,468,155 |
| Contingent liabilities and commitments | **1,145,952** | **183,385** | 1,240,497 | 281,059 |
| **Credit and counterparty risk** | | **2,697,057** | | 2,749,214 |

## 5 Capital management and allocation *(continued)*

| | Group | | | |
|---|---|---|---|---|
| | *Face value* | *Weighted amount* | *Face value* | *Weighted amount* |
| | **2009** | **2009** | 2008 | 2008 |
| | **€000** | **€000** | €000 | €000 |
| **Credit and counterparty risk** | | **2,697,057** | | 2,749,214 |
| **Operational risk** | | **304,276** | | 304,652 |
| **Market risk** | | **23,596** | | 34,700 |
| **Total risk weighted assets** | | **3,024,929** | | 3,088,566 |
| **Own funds** | | | | |
| **Original own funds** | | | | |
| Share capital | **87,552** | | 87,552 | |
| Retained earnings | **143,526** | | 137,694 | |
| Intangible assets | **(1,803)** | | (1,914) | |
| | **229,275** | | 223,332 | |
| **Additional own funds** | | | | |
| Revaluation reserve | **25,825** | | 15,131 | |
| Collectively assessed allowances | **12,425** | | 13,756 | |
| Subordinated liabilities | **87,827** | | 87,777 | |
| | **126,077** | | 116,664 | |
| **Total own funds** | **355,496** | | 339,996 | |
| **Capital adequacy ratio** | | **11.75%** | | 11.00% |

| | Bank | | | |
|---|---|---|---|---|
| | *Face value* | *Weighted amount* | *Face value* | *Weighted amount* |
| | **2009** | **2009** | 2008 | 2008 |
| | **€000** | **€000** | €000 | €000 |
| Balances with Central Bank of Malta, Treasury Bills and cash | **172,670** | **–** | 130,681 | – |
| Cheques in course of collection | **10,764** | **10,764** | 9,308 | 9,308 |
| Loans and advances to banks | **747,582** | **150,049** | 1,072,269 | 214,454 |
| Loans and advances to customers | **3,226,477** | **2,100,147** | 3,125,996 | 1,974,942 |
| Debt securities and equities | **380,275** | **78,698** | 412,016 | 98,249 |
| Shares in subsidiary companies | **35,707** | **35,707** | 35,707 | 35,707 |
| Property and equipment and investment property | **77,135** | **77,135** | 82,378 | 82,378 |
| Other assets | **44,141** | **30,499** | 47,298 | 29,709 |
| Prepayments and accrued income | **30,006** | **29,239** | 44,598 | 35,377 |
| | **4,724,757** | **2,512,238** | 4,960,251 | 2,480,124 |
| Contingent liabilities and commitments | **1,145,952** | **183,385** | 1,240,520 | 281,070 |
| **Credit and counterparty risk** | | **2,695,623** | | 2,761,194 |
| **Credit and counterparty risk** | | **2,695,623** | | 2,761,194 |
| **Operational risk** | | **301,805** | | 293,500 |
| **Market risk** | | **23,596** | | 34,700 |
| **Total risk weighted assets** | | **3,021,024** | | 3,089,394 |

## Notes on the Accounts (continued)

### 5 Capital management and allocation *(continued)*

| | *Bank* | | | |
|---|---|---|---|---|
| | *Face value* | *Weighted amount* | *Face value* | *Weighted amount* |
| | **2009** | **2009** | 2008 | 2008 |
| | **€000** | **€000** | €000 | €000 |
| **Own funds** | | | | |
| **Original own funds** | | | | |
| Share capital | **87,552** | | 87,552 | |
| Retained earnings | **133,814** | | 121,606 | |
| Intangible assets | **(1,741)** | | (1,797) | |
| | **219,625** | | 207,361 | |
| **Additional own funds** | | | | |
| Revaluation reserve | **25,030** | | 15,296 | |
| Collectively assessed allowances | **12,425** | | 13,756 | |
| Subordinated liabilities | **87,827** | | 87,777 | |
| | **125,282** | | 116,829 | |
| **Total own funds** | **345,267** | | 324,190 | |
| **Capital adequacy ratio** | | **11.42%** | | 10.49% |

### 6 Interest receivable and similar income

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| On loans and advances to banks | **6,915** | 34,710 | **6,915** | 34,710 |
| On loans and advances to customers | **146,361** | 182,757 | **146,354** | 182,633 |
| On balances with Central Bank of Malta | **1,009** | 3,412 | **1,009** | 3,412 |
| On Treasury Bills | **1,123** | 3,152 | **1,123** | 3,152 |
| | **155,408** | 224,031 | **155,401** | 223,907 |
| On debt and other fixed income instruments | **15,864** | 23,983 | **13,650** | 23,924 |
| Amortisation of net premiums | **(2,234)** | (2,504) | **(2,115)** | (2,548) |
| | **13,630** | 21,479 | **11,535** | 21,376 |
| | **169,038** | 245,510 | **166,936** | 245,283 |
| Interest receivable and similar income from: | | | | |
| – Group companies | **6,920** | 34,446 | **6,920** | 34,446 |
| – subsidiary companies | **–** | – | **2** | 5 |

Discount unwind on impaired loans and advances to customers included in interest receivable on loans and advances to customers amounted to €1,475,000 (2008: €1,539,000).

## 7 Interest payable

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| On amounts owed to banks | **1,304** | 8,152 | **1,304** | 8,152 |
| On amounts owed to customers | **58,249** | 111,131 | **59,500** | 113,288 |
| On subordinated liabilities | **4,503** | 3,167 | **4,503** | 3,167 |
| On finance leases | **12** | 16 | **12** | 16 |
| | **64,068** | 122,466 | **65,319** | 124,623 |
| Interest payable to: | | | | |
| – Group companies | **1,210** | 7,160 | **1,210** | 7,160 |
| – subsidiary companies | **–** | – | **1,251** | 2,157 |

## 8 Net fee and commission income

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| Net fee and commission income that is not an integral part of the effective interest rate on: | | | | |
| – financial assets or liabilites not at fair value through profit or loss | **21,572** | 19,640 | **21,572** | 19,640 |
| – trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals and other institutions | **9,509** | 10,942 | **4,774** | 3,833 |
| – other | **1,283** | 1,183 | **3,165** | 3,070 |
| | **32,364** | 31,765 | **29,511** | 26,543 |
| Net fee and commission income from: | | | | |
| – Group companies | **1,094** | 727 | **802** | 552 |
| – subsidiary companies | **–** | – | **3,534** | 3,643 |

Net fee and commission income include €3,071,000 (2008: €2,159,000) derived from investment services activities.

## 9 Dividend income

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| Available-for-sale financial assets | **2** | 29 | **2** | 29 |
| Financial assets held for trading | **41** | 40 | **41** | 40 |
| Subsidiary companies | **–** | – | **10,538** | 1,435 |
| | **43** | 69 | **10,581** | 1,504 |

# Notes on the Accounts (continued)

## 10 Trading profits

| | **2009** | 2008 |
|---|---|---|
| | **€000** | €000 |
| *Group/Bank* | | |
| Profit on foreign exchange activities | **7,063** | 7,932 |
| Net gains/(losses) on financial instruments at fair value through profit or loss | **158** | (130) |
| | **7,221** | 7,802 |

## 11 Net gains on sale of available-for-sale financial assets

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| Net gains on disposal | **–** | 1,439 | **–** | 1,439 |
| Net revaluation gains transferred from equity | **1,268** | 1,348 | **1,184** | 1,286 |
| | **1,268** | 2,787 | **1,184** | 2,725 |

## 12 Net operating income

Net operating income of €159,659,000 (2008: €188,301,000) includes net income from Life insurance business analysed as follows:

| | *Group* | |
|---|---|---|
| | **2009** | 2008 |
| | **€000** | €000 |
| Net fee and commission income | **302** | 156 |
| Net income from insurance financial instruments designated at fair value through profit or loss | **26,717** | (29,407) |
| Net earned insurance premiums | **52,878** | 58,032 |
| Net other operating income | **(3,296)** | 28,016 |
| | **76,601** | 56,797 |
| Net insurance claims incurred and movement in policyholders' liabilities | **(63,570)** | (37,570) |
| | **13,031** | 19,227 |

**a** *Net earned insurance premiums*

| | *Group* | |
|---|---|---|
| | **2009** | 2008 |
| | **€000** | €000 |
| **Life insurance** | | |
| Gross earned premium | **55,898** | 60,851 |
| Reinsurance paid | **(3,020)** | (2,819) |
| | **52,878** | 58,032 |

## 12 Net operating income *(continued)*

**b** *Net insurance claims incurred and movement in policyholders' liabilities*

| | *Group* | | | | | |
|---|---|---|---|---|---|---|
| | *Gross* | *Reinsurance* | *Net* | *Gross* | *Reinsurance* | *Net* |
| | **2009** | **2009** | **2009** | 2008 | 2008 | 2008 |
| | **€000** | **€000** | **€000** | €000 | €000 | €000 |
| **Life insurance** | | | | | | |
| Claims paid | **18,847** | **(600)** | **18,247** | 18,082 | (17) | 18,065 |
| Change in technical provision | **39,068** | **5,721** | **44,789** | 20,839 | (773) | 20,066 |
| Change in claims provision | **1,785** | **(1,251)** | **534** | 311 | (872) | (561) |
| | **59,700** | **3,870** | **63,570** | 39,232 | (1,662) | 37,570 |

## 13 Employee compensation and benefits

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| Wages, salaries and allowances | **44,185** | 45,289 | **41,735** | 42,991 |
| Defined contribution social security costs | **2,403** | 2,517 | **2,303** | 2,401 |
| Retirement benefits | **2,073** | 6,358 | **2,073** | 6,358 |
| Share-based payments | **591** | 1,313 | **569** | 1,241 |
| | **49,252** | 55,477 | **46,680** | 52,991 |
| | ***Number*** | *Number* | ***Number*** | *Number* |
| Average number of employees | | | | |
| – executive and senior managerial | **256** | 260 | **237** | 244 |
| – other managerial, supervisory and clerical | **1,281** | 1,355 | **1,240** | 1,299 |
| – others | **51** | 56 | **51** | 56 |
| | **1,588** | 1,671 | **1,528** | 1,599 |

In order to align the interests of staff with those of shareholders, share options in ordinary shares of the ultimate parent company are offered to group employees under all-employee share plans and achievement shares awarded to group middle management and above, under discretionary incentive plans. The company offered two types of share option schemes to its employees.

Under the HSBC Holdings savings-related share option plans, options are offered at nil consideration at an exercise price discounted at a rate of 20 per cent of the market value immediately preceding the date of invitation. The options are exercisable either on the first, third or fifth anniversary of the commencement of the relevant savings contract.

Options awarded up to 31 December 2004 under the discretionary HSBC Holdings Group Share Option Plan were offered for nil consideration and granted at market value and are normally exercisable between the third and tenth anniversaries of the date of grant, subject to vesting conditions.

Shares in HSBC Holdings plc awarded under the discretionary HSBC Holdings Group Achievement Share Scheme are offered at nil consideration. Shares are released to individuals after three years provided they remain employed by the Group. There is no performance condition attached to these awards. For those receiving share awards, additional awards will be made during the three year life of the award, representing equivalent value to dividends reinvested in shares. At the end of the three year period, the value of the award will have grown in line with HSBC's total shareholder return over the same period.

## Notes on the Accounts (continued)

### 13 Employee compensation and benefits *(continued)*

| | *Group* | | | |
|---|---|---|---|---|
| | *Options* | *Weighted average exercise price (€)* | *Options* | *Weighted average exercise price (€)* |
| | **2009** | **2009** | 2008 | 2008 |
| **Savings related Share Option Plans** | | | | |
| Outstanding at 1 January | **237,623** | **8.51** | 330,277 | 8.57 |
| Granted during the year | **218,509** | **8.61** | 193,096 | 10.35 |
| Effect of rights issue | **51,664** | **8.54** | – | – |
| Exercised during the year | **(11,130)** | **6.02** | (189,990) | 6.26 |
| Closed during the year | **(399,907)** | **8.55** | (95,760) | 9.76 |
| Outstanding at 31 December | **96,759** | **9.71** | 237,623 | 8.51 |
| Exercisable at 31 December | **22,066** | **6.67** | 17,452 | 6.16 |

| | *Group* | | | |
|---|---|---|---|---|
| | *Options* | *Weighted average exercise price (€)* | *Options* | *Weighted average exercise price (€)* |
| | **2009** | **2009** | 2008 | 2008 |
| **Group Share Option Plans** | | | | |
| Outstanding at 1 January | **545,200** | **7.95** | 597,539 | 10.37 |
| Reinstated during the year | **54,736** | **7.42** | 19,050 | 7.26 |
| Effect of rights issue | **79,765** | **8.77** | – | – |
| Exercised during the year | **(59,661)** | **6.91** | (71,389) | 7.11 |
| Outstanding at 31 December | **620,040** | **8.70** | 545,200 | 7.95 |
| Exercisable at 31 December | **225,102** | **7.78** | 221,550 | 7.11 |

The options outstanding at reporting date had a contractual life of between one and five years.

The weighted average share price and exercise price are denominated in pounds sterling and disclosed in euro equivalent using the exchange rates prevailing at reporting date.

*Fair value of share option schemes*

Fair values of share options awarded under all-employee share option plans in 2009, measured at the date of grant of the option, are calculated using a Black-Scholes model.

The expected life of options depends on the behaviour of option holders, which is incorporated into the option model consistent with historic observable data. The fair values calculated are inherently subjective and uncertain due to the assumptions made and the limitations of the model used. The significant weighted average assumptions used to estimate the fair value of the options granted in 2009 were as follows:

| | *1 year savings-related share option schemes* | *3 year savings-related share option schemes* | *5 year savings-related share option schemes* |
|---|---|---|---|
| Risk-free interest rate (%) | 0.70 | 2.10 | 2.40 |
| Expected volatility (%) | 50.00 | 35.00 | 30.00 |
| Expected life (years) | 1 | 3 | 5 |

The risk-free interest rate was determined from the UK gilts zero-coupon yield curve. Expected volatility is estimated by considering both historic average share price volatility and implied volatility for traded options over HSBC shares of similar maturity to those of the employee options. Expected life is not a single input parameter but a function of various behavioural assumptions. Expected dividend yield was determined to be 4.5 per cent per annum, in line with consensus analyst options.

## 14 Net impairment

| | Group | | Bank | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| **Write-downs** | | | | |
| Investments | | | | |
| – available-for-sale equity instruments | **(197)** | – | **–** | – |
| Loans and advances to customers | | | | |
| – specific allowances | **(7,384)** | (3,742) | **(7,384)** | (3,742) |
| – collective allowances | **–** | (152) | **–** | (152) |
| – bad debts written off | **(1,380)** | (2,504) | **(1,380)** | (2,504) |
| | **(8,764)** | (6,398) | **(8,764)** | (6,398) |
| **Reversals of write-downs** | | | | |
| Loans and advances to customers | | | | |
| – specific allowances | **2,885** | 4,188 | **2,885** | 4,188 |
| – collective allowances | **1,331** | – | **1,331** | – |
| – bad debts recovered | **316** | 303 | **316** | 303 |
| | **4,532** | 4,491 | **4,532** | 4,491 |
| Net impairment | **(4,429)** | (1,907) | **(4,232)** | (1,907) |

## 15 Profit before tax

| | **2009** | 2008 |
|---|---|---|
| | **€000** | €000 |
| *Group/Bank* | | |
| Profit before tax is stated after charging: | | |
| Directors' emoluments | | |
| – fees | **119** | 128 |
| – other emoluments | **404** | 772 |
| | **523** | 900 |

Profit before tax for the group is also stated after charging auditors' fees €166,000, other assurance services €8,000, tax advisory services €10,000 and other non-audit services €3,000.

# Notes on the Accounts (continued)

## 16 Tax expense

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| The charge for income tax, which is based on the taxable profit for the year at a rate of 35%, comprises: | | | | |
| – current | **23,200** | 28,589 | **20,768** | 26,449 |
| – deferred | **2,129** | 4,383 | **1,493** | (743) |
| | **25,329** | 32,972 | **22,261** | 25,706 |

The tax on profit on ordinary activities and the result of accounting profit multiplied by the applicable tax rate are reconciled as follows:

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| Profit on ordinary activities before tax | **71,196** | 96,087 | **66,916** | 75,089 |
| Tax at the applicable rate of 35% | **24,919** | 33,630 | **23,420** | 26,281 |
| Tax effect of non-taxable income | **(19)** | (80) | **–** | (58) |
| Tax effect of profits taxed at different rates | **–** | (824) | **(1,750)** | (824) |
| Tax effect of non-deductible expenses | **157** | 174 | **140** | 171 |
| Tax effect of depreciation charges not deductible by way of capital allowances | **347** | 347 | **347** | 346 |
| Tax effects of property sales tax consequences | **(55)** | – | **65** | – |
| Tax effect of taxable temporary differences not previously recognised | **20** | (234) | **78** | (169) |
| Tax effect of additional deductions | **(40)** | (41) | **(39)** | (41) |
| Tax on profit on ordinary activities | **25,329** | 32,972 | **22,261** | 25,706 |

## 17 Earnings per share

The calculation of earnings per share of the group and the bank is based on the profit attributable to shareholders of the bank as shown in the profit or loss, divided by the number of shares in issue as at 31 December 2009.

## 18 Balances with Central Bank of Malta, Treasury Bills and cash

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| Balances with Central Bank of Malta | **83,029** | 88,420 | **83,029** | 88,420 |
| Malta Government Treasury Bills | **64,633** | 14,895 | **64,633** | 14,895 |
| Cash | **25,009** | 27,367 | **25,008** | 27,366 |
| | **172,671** | 130,682 | **172,670** | 130,681 |

Balances with Central Bank of Malta include a reserve deposit requirement in terms of Regulation (EC) No. 1745/2003 of the European Central Bank. The average reserve deposit requirement as at year end was €78,392,000 in respect of the group and bank (2008: €82,966,000).

## 19 Financial instruments held for trading

| | Group | | Bank | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| **Financial assets held for trading** | | | | |
| Equity and other non-fixed income instruments | **–** | 391 | **–** | 391 |
| Derivative financial instruments | **11,746** | 11,432 | **11,964** | 11,666 |
| | **11,746** | 11,823 | **11,964** | 12,057 |
| Derivative financial instruments held with: | | | | |
| – Group companies | **3,612** | 3,986 | **3,612** | 3,986 |
| – subsidiary companies | **–** | – | **218** | 234 |
| **Financial liabilities held for trading** | | | | |
| Derivative financial instruments | **11,044** | 11,381 | **11,046** | 12,375 |
| Derivative financial instruments held with: | | | | |
| – Group companies | **7,274** | 6,971 | **7,274** | 6,971 |
| – subsidiary companies | **–** | – | **2** | 994 |

**a** *Equity and other non-fixed income instruments*

The equity and other non-fixed income instruments held for trading are listed on the Malta Stock Exchange and are analysed as follows:

| | **2009** | 2008 |
|---|---|---|
| | **€000** | €000 |
| *Group/Bank* | | |
| Issued by other issuers | | |
| – local others | **–** | 391 |
| | **–** | 391 |

**b** *Derivative financial instruments*

| | *Notional* | *Fair value assets* | *Fair value liabilities* | *Notional* | *Fair value assets* | *Fair value liabilities* |
|---|---|---|---|---|---|---|
| | **2009** | **2009** | **2009** | 2008 | 2008 | 2008 |
| | **€000** | **€000** | **€000** | €000 | €000 | €000 |
| *Group* | | | | | | |
| **Interest rate derivatives** | | | | | | |
| Over the counter products | | | | | | |
| – interest rate swaps purchased | **167,662** | **7,140** | **–** | 82,584 | 3,641 | – |
| – interest rate swaps written | **167,662** | **–** | **7,098** | 82,584 | – | 3,589 |
| **Currency derivatives** | | | | | | |
| Over the counter products | | | | | | |
| – foreign exchange contracts | **82,759** | **2,112** | **1,452** | 95,510 | 3,013 | 3,014 |
| – foreign exchange options purchased | **20,356** | **484** | **–** | 54,030 | 3,354 | – |
| – foreign exchange options written | **20,356** | **–** | **484** | 54,030 | – | 3,354 |
| **Equity derivatives** | | | | | | |
| Over the counter products | | | | | | |
| – equity index options purchased | **25,205** | **2,010** | **–** | 34,804 | 1,424 | – |
| – equity index options written | **25,205** | **–** | **2,010** | 34,804 | – | 1,424 |
| | | **11,746** | **11,044** | | 11,432 | 11,381 |

# Notes on the Accounts (continued)

## 19 Financial instruments held for trading *(continued)*

**b** *Derivative financial instruments (continued)*

| | *Notional* | *Fair value assets* | *Fair value liabilities* | *Notional* | *Fair value assets* | *Fair value liabilities* |
|---|---|---|---|---|---|---|
| | **2009** | **2009** | **2009** | 2008 | 2008 | 2008 |
| | **€000** | **€000** | **€000** | €000 | €000 | €000 |
| *Bank* | | | | | | |
| **Interest rate derivatives** | | | | | | |
| Over the counter products | | | | | | |
| – interest rate swaps purchased | **167,662** | **7,140** | **–** | 82,584 | 3,641 | – |
| – interest rate swaps written | **167,662** | **–** | **7,098** | 82,584 | – | 3,589 |
| **Currency derivatives** | | | | | | |
| Over the counter products | | | | | | |
| – foreign exchange contracts | **93,122** | **2,330** | **1,454** | 108,604 | 3,247 | 4,008 |
| – foreign exchange options purchased | **20,356** | **484** | **–** | 54,030 | 3,354 | – |
| – foreign exchange options written | **20,356** | **–** | **484** | 54,030 | – | 3,354 |
| **Equity derivatives** | | | | | | |
| Over the counter products | | | | | | |
| – equity index options purchased | **25,205** | **2,010** | **–** | 34,804 | 1,424 | – |
| – equity index options written | **25,205** | **–** | **2,010** | 34,804 | – | 1,424 |
| | | **11,964** | **11,046** | | 11,666 | 12,375 |

## 20 Financial assets designated at fair value through profit or loss

| | *Group* | |
|---|---|---|
| | **2009** | 2008 |
| | **€000** | €000 |
| Debt, Treasury Bills and other fixed income instruments | **101,097** | 125,173 |
| Equity and other non-fixed income instruments | **147,456** | 154,541 |
| | **248,553** | 279,714 |

**a** *Debt, Treasury Bills and other fixed income instruments*

| | *Group* | |
|---|---|---|
| | **2009** | 2008 |
| | **€000** | €000 |
| Issued by public bodies | | |
| – local government | **53,899** | 71,502 |
| – foreign government | **13,934** | 17,640 |
| Issued by other issuers | | |
| – local banks | **729** | 111 |
| – foreign banks | **9,965** | 12,702 |
| – others local | **5,300** | 6,994 |
| – others foreign | **17,270** | 16,224 |
| | **101,097** | 125,173 |
| Listing status | | |
| – listed on the Malta Stock Exchange | **60,661** | 80,007 |
| – listed elsewhere | **40,436** | 43,181 |
| – local unlisted | **–** | 1,985 |
| | **101,097** | 125,173 |

## 20 Financial assets designated at fair value through profit or loss *(continued)*

**a** *Debt, Treasury Bills and other fixed income instruments (continued)*

| | *Group* | |
|---|---|---|
| | **2009** | 2008 |
| | **€000** | €000 |
| At 1 January | **125,173** | 150,216 |
| Exchange adjustments | **4** | (11) |
| Acquisitions | **9,466** | 76,217 |
| Disposals/Redemptions | **(35,008)** | (103,356) |
| Changes in fair value | **1,462** | 2,107 |
| At 31 December | **101,097** | 125,173 |

**b** *Equity and other non-fixed income instruments*

| | *Group* | |
|---|---|---|
| | **2009** | 2008 |
| | **€000** | €000 |
| Issued by other issuers | | |
| – others local | **35,470** | 34,895 |
| – others foreign | **111,986** | 119,646 |
| | **147,456** | 154,541 |
| Listing status | | |
| – listed on the Malta Stock Exchange | **14,528** | 13,110 |
| – listed elsewhere | **132,928** | 141,431 |
| | **147,456** | 154,541 |
| At 1 January | **154,541** | 125,479 |
| Exchange adjustments | **565** | 490 |
| Acquisitions | **25,886** | 108,351 |
| Disposals | **(54,491)** | (42,392) |
| Changes in fair value | **20,955** | (37,387) |
| At 31 December | **147,456** | 154,541 |

# Notes on the Accounts (continued)

## 21 Financial investments

| | Group | | Bank | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| **Debt and other fixed income instruments** | | | | |
| – available-for-sale | **468,172** | 401,909 | **371,014** | 385,805 |
| – held-to-maturity | **8,894** | 25,240 | **8,894** | 25,240 |
| **Equity and other non-fixed income instruments** | | | | |
| – available-for-sale | **1,909** | 2,763 | **367** | 971 |
| | **478,975** | 429,912 | **380,275** | 412,016 |

**a** *Debt and other fixed income instruments available-for-sale*

| | Group | | Bank | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| Issued by public bodies | | | | |
| – local government | **256,063** | 186,769 | **200,614** | 186,292 |
| – foreign government | **30,115** | 10,441 | **2,334** | 5,122 |
| Issued by other issuers | | | | |
| – foreign banks | **146,673** | 165,751 | **141,026** | 164,808 |
| – local others | **488** | – | **–** | – |
| – foreign others | **34,833** | 38,948 | **27,040** | 29,583 |
| | **468,172** | 401,909 | **371,014** | 385,805 |
| Amounts include: | | | | |
| – issued by Group companies | **–** | 1,005 | **–** | 1,005 |
| Listing status | | | | |
| – listed on the Malta Stock Exchange | **256,551** | 186,769 | **200,614** | 186,292 |
| – listed elsewhere | **209,246** | 210,333 | **168,025** | 194,706 |
| – foreign unlisted | **2,375** | 4,807 | **2,375** | 4,807 |
| | **468,172** | 401,909 | **371,014** | 385,805 |
| At 1 January | **401,909** | 401,225 | **385,805** | 401,225 |
| Exchange adjustments | **2,738** | (9,137) | **2,735** | (9,137) |
| Amortisation | **(2,247)** | (1,226) | **(2,128)** | (1,270) |
| Acquisitions | **218,283** | 83,733 | **132,133** | 67,953 |
| Disposals/Redemptions | **(170,315)** | (64,112) | **(163,721)** | (64,112) |
| Changes in fair value | **17,804** | (8,574) | **16,190** | (8,854) |
| At 31 December | **468,172** | 401,909 | **371,014** | 385,805 |

Debt instruments with a carrying amount of €54,516,000 (2008: €105,449,000) have been pledged against the provision of credit lines by the Central Bank of Malta. At 31 December 2009, no balances were outstanding against these credit lines.

**b** *Debt and other fixed income instruments held-to-maturity*

| | **2009** | 2008 |
|---|---|---|
| | **€000** | €000 |
| *Group/Bank* | | |
| Issued by other issuers | | |
| – foreign banks | **–** | 8,512 |
| – local others | **8,894** | 8,881 |
| – foreign others | **–** | 7,847 |
| | **8,894** | 25,240 |

## 21 Financial investments *(continued)*

**b** *Debt and other fixed income instruments held-to-maturity (continued)*

| | **2009** | 2008 |
|---|---|---|
| | **€000** | €000 |
| *Group/Bank* | | |
| Listing status | | |
| – listed on the Malta Stock Exchange | **8,894** | 10,279 |
| – listed elsewhere | **–** | 14,961 |
| | **8,894** | 25,240 |
| At 1 January | **25,240** | 47,030 |
| Exchange adjustments | **169** | (3,086) |
| Amortisation | **13** | 4 |
| Redemptions | **(16,528)** | (18,708) |
| At 31 December | **8,894** | 25,240 |

**c** *Equity and other non-fixed income instruments available-for-sale*

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| Issued by other issuers | | | | |
| – local others | **1,896** | 2,251 | **354** | 459 |
| – foreign others | **13** | 512 | **13** | 512 |
| | **1,909** | 2,763 | **367** | 971 |
| Listing status | | | | |
| – listed elsewhere | **1,542** | 1,792 | **–** | – |
| – local unlisted | **354** | 459 | **354** | 459 |
| – foreign unlisted | **13** | 512 | **13** | 512 |
| | **1,909** | 2,763 | **367** | 971 |
| At 1 January | **2,763** | 8,270 | **971** | 3,753 |
| Exchange adjustments | **(75)** | (46) | **(75)** | (46) |
| Acquisitions | **–** | 540 | **–** | 539 |
| Disposals | **(551)** | (4,831) | **(551)** | (2,436) |
| Write-down | **(197)** | – | **–** | – |
| Changes in fair value | **(31)** | (1,170) | **22** | (839) |
| At 31 December | **1,909** | 2,763 | **367** | 971 |

# Notes on the Accounts (continued)

## 22 Loans and advances to banks

| | Group | | Bank | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| Repayable on call and at short notice | **45,130** | 8,590 | **45,055** | 8,553 |
| Term loans and advances | **702,527** | 1,063,716 | **702,527** | 1,063,716 |
| | **747,657** | 1,072,306 | **747,582** | 1,072,269 |
| Amounts include: | | | | |
| – due from Group companies | **734,734** | 1,066,679 | **734,734** | 1,066,679 |

## 23 Loans and advances to customers

| | **2009** | 2008 |
|---|---|---|
| | **€000** | €000 |
| *Group/Bank* | | |
| Repayable on call and at short notice | **489,719** | 524,230 |
| Term loans and advances | **2,781,712** | 2,630,131 |
| Gross loans and advances to customers | **3,271,431** | 3,154,361 |
| Allowances for uncollectability | **(44,954)** | (42,121) |
| Net loans and advances to customers | **3,226,477** | 3,112,240 |
| Allowances for uncollectability | | |
| – individually assessed allowances | **32,529** | 28,365 |
| – collectively assessed allowances | **12,425** | 13,756 |
| | **44,954** | 42,121 |

The balance of individually assessed allowances at reporting date includes €15,932,000 (2008: €14,792,000) in respect of interest in suspense which has been netted off against interest receivable.

## 24 Shares in subsidiary companies

| *Bank* Name of company | *Incorporated in* | *Nature of business* | *Equity interest* | **2009** | 2008 |
|---|---|---|---|---|---|
| | | | % | **€000** | €000 |
| HSBC Life Assurance (Malta) Limited | Malta | Life insurance | **99.99** | **28,578** | 28,578 |
| HSBC Global Asset Management (Malta) Limited | Malta | Portfolio management services | **99.99** | **5,940** | 5,940 |
| HSBC Securities Services (Malta) Limited | Malta | Fund Administration services | **99.98** | **1,166** | 1,166 |
| HSBC Stockbrokers (Malta) Limited | Malta | Stockbroking services | **99.99** | **23** | 23 |
| | | | | **35,707** | 35,707 |

## 25 Intangible assets

| | Group | | Bank | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| Software | **1,912** | 2,014 | **1,741** | 1,797 |
| Present value of in-force long-term insurance business | **58,779** | 62,242 | **–** | – |
| | **60,691** | 64,256 | **1,741** | 1,797 |

**a** *Software*

| | Group | | Bank | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| **Cost** | | | | |
| At 1 January | **11,001** | 9,477 | **9,665** | 8,220 |
| Additions | **1,046** | 1,524 | **985** | 1,445 |
| Disposals | **(5)** | – | **(5)** | – |
| **At 31 December** | **12,042** | 11,001 | **10,645** | 9,665 |
| **Depreciation** | | | | |
| At 1 January | **8,987** | 7,749 | **7,868** | 6,857 |
| Charge for the year | **1,148** | 1,238 | **1,041** | 1,011 |
| Disposals | **(5)** | – | **(5)** | – |
| **At 31 December** | **10,130** | 8,987 | **8,904** | 7,868 |
| **Carrying amount at 1 January** | **2,014** | 1,728 | **1,797** | 1,363 |
| **Carrying amount at 31 December** | **1,912** | 2,014 | **1,741** | 1,797 |

**b** *Present value of in-force long-term insurance business*

| | Group | |
|---|---|---|
| | **2009** | 2008 |
| | **€000** | €000 |
| At 1 January | **62,242** | 34,382 |
| Addition from current year new business | **5,427** | 21,853 |
| Movement from in-force business | **(8,890)** | 6,007 |
| **At 31 December** | **58,779** | 62,242 |

The following are the key assumptions used in the computation of PVIF:

| | Group | |
|---|---|---|
| | **2009** | 2008 |
| Risk free rate | **Euro swap curve** | 4.50% |
| Risk adjusted discount rate | **8.00%** | 8.00% |
| Expenses inflation | **French inflation swap curve modified for Malta** | 3.25% |
| Lapse rate | **Different rates for different products** | 11.00% |

# Notes on the Accounts (continued)

## 26 Property and equipment

| | *Land and buildings* | *Computer equipment* | *Others* | *Total* |
|---|---|---|---|---|
| | **€000** | **€000** | **€000** | **€000** |
| *Group* | | | | |
| **Cost/revaluation** | | | | |
| At 1 January 2009 | **48,703** | **18,303** | **47,743** | **114,749** |
| Acquisitions | **57** | **2,157** | **895** | **3,109** |
| Disposals | **(2,040)** | **(1,859)** | **(491)** | **(4,390)** |
| **At 31 December 2009** | **46,720** | **18,601** | **48,147** | **113,468** |
| **Depreciation** | | | | |
| At 1 January 2009 | **2,349** | **13,654** | **28,062** | **44,065** |
| Charge for the year | **558** | **1,513** | **4,251** | **6,322** |
| Disposals | **(18)** | **(1,857)** | **(441)** | **(2,316)** |
| **At 31 December 2009** | **2,889** | **13,310** | **31,872** | **48,071** |
| **Carrying amount at 1 January 2009** | **46,354** | **4,649** | **19,681** | **70,684** |
| **Carrying amount at 31 December 2009** | **43,831** | **5,291** | **16,275** | **65,397** |
| **Cost/revaluation** | | | | |
| At 1 January 2008 | 52,378 | 17,824 | 46,849 | 117,051 |
| Acquisitions | 2,135 | 1,825 | 2,072 | 6,032 |
| Disposals | (5,810) | (1,346) | (1,178) | (8,334) |
| At 31 December 2008 | 48,703 | 18,303 | 47,743 | 114,749 |
| **Depreciation** | | | | |
| At 1 January 2008 | 1,796 | 12,502 | 24,933 | 39,231 |
| Charge for the year | 570 | 1,497 | 3,884 | 5,951 |
| Disposals | (17) | (345) | (755) | (1,117) |
| At 31 December 2008 | 2,349 | 13,654 | 28,062 | 44,065 |
| Carrying amount at 1 January 2008 | 50,582 | 5,322 | 21,916 | 77,820 |
| Carrying amount at 31 December 2008 | 46,354 | 4,649 | 19,681 | 70,684 |

| | *Group* | |
|---|---|---|
| | **2009** | 2008 |
| | **€000** | €000 |
| **Carrying amount of land and buildings occupied for own activities** | **43,831** | 46,354 |

| | *Land and buildings* | *Computer equipment* | *Others* | *Total* |
|---|---|---|---|---|
| | **€000** | **€000** | **€000** | **€000** |
| *Bank* | | | | |
| **Cost/revaluation** | | | | |
| At 1 January 2009 | **48,689** | **17,874** | **46,499** | **113,062** |
| Acquisitions | **57** | **2,157** | **895** | **3,109** |
| Disposals | **(2,040)** | **(1,856)** | **(488)** | **(4,384)** |
| **At 31 December 2009** | **46,706** | **18,175** | **46,906** | **111,787** |

## 26 Property and equipment *(continued)*

| | *Land and buildings* | *Computer equipment* | *Others* | *Total* |
|---|---|---|---|---|
| | **€000** | **€000** | **€000** | **€000** |
| *Bank* | | | | |
| **Depreciation** | | | | |
| At 1 January 2009 | **2,133** | **13,282** | **26,916** | **42,331** |
| Charge for the year | **558** | **1,492** | **4,251** | **6,301** |
| Disposals | **(18)** | **(1,856)** | **(441)** | **(2,315)** |
| **At 31 December 2009** | **2,673** | **12,918** | **30,726** | **46,317** |
| **Carrying amount at 1 January 2009** | **46,556** | **4,592** | **19,583** | **70,731** |
| **Carrying amount at 31 December 2009** | **44,033** | **5,257** | **16,180** | **65,470** |
| **Cost/revaluation** | | | | |
| At 1 January 2008 | 52,364 | 17,403 | 45,524 | 115,291 |
| Acquisitions | 2,135 | 1,812 | 2,062 | 6,009 |
| Disposals | (5,810) | (1,341) | (1,087) | (8,238) |
| At 31 December 2008 | 48,689 | 17,874 | 46,499 | 113,062 |
| **Depreciation** | | | | |
| At 1 January 2008 | 1,580 | 12,155 | 23,699 | 37,434 |
| Charge for the year | 570 | 1,470 | 3,880 | 5,920 |
| Disposals | (17) | (343) | (663) | (1,023) |
| At 31 December 2008 | 2,133 | 13,282 | 26,916 | 42,331 |
| Carrying amount at 1 January 2008 | 50,784 | 5,248 | 21,825 | 77,857 |
| Carrying amount at 31 December 2008 | 46,556 | 4,592 | 19,583 | 70,731 |

| | *Bank* | |
|---|---|---|
| | **2009** | 2008 |
| | **€000** | €000 |
| **Carrying amount of land and buildings occupied for own activities** | **44,033** | 46,556 |

The carrying amount of land and buildings that would have been included in the financial statements had these assets been carried at cost less depreciation is €16,426,000 (2008: €18,949,000) for the group and the bank.

## 27 Investment property

| | *Fair Value* | *Cost* | *Fair Value* | *Cost* |
|---|---|---|---|---|
| | **2009** | **2009** | 2008 | 2008 |
| | **€000** | **€000** | €000 | €000 |
| *Group* | | | | |
| **Freehold land and buildings** | | | | |
| At 1 January | **14,050** | **8,553** | 12,885 | 8,553 |
| Additions | **18** | **18** | – | – |
| Fair value adjustments | **520** | **–** | 1,165 | – |
| At 31 December | **14,588** | **8,571** | 14,050 | 8,553 |

# Notes on the Accounts (continued)

## 27 Investment property *(continued)*

| | *Fair Value* | *Cost* | *Fair Value* | *Cost* |
|---|---|---|---|---|
| | **2009** | **2009** | 2008 | 2008 |
| | **€000** | **€000** | €000 | €000 |
| *Bank* | | | | |
| **Freehold land and buildings** | | | | |
| At 1 January | **11,647** | **6,473** | 10,482 | 6,473 |
| Additions | **18** | **18** | – | – |
| Fair value adjustments | **–** | **–** | 1,165 | – |
| At 31 December | **11,665** | **6,491** | 11,647 | 6,473 |

During the year ended 31 December 2009, €671,000 (2008: €689,000) was recognised as rental income in the income statement relating to investment property for the group and €503,000 (2008: €533,000) for the bank. The rental income of the bank was received from a Group company.

## 28 Assets held for sale

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| Assets acquired in satisfaction of debt | **8,772** | 7,519 | **8,772** | 7,668 |
| Other | **1,832** | 1,649 | **1,832** | 1,649 |
| | **10,604** | 9,168 | **10,604** | 9,317 |

Repossessed properties are made available for sale in an orderly fashion, with the proceeds used to reduce or repay the outstanding indebtedness. The group does not generally occupy repossessed properties for its business use. In the main, repossessed property consisted of immovable property.

## 29 Other assets

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| Acceptances and endorsements | **2,212** | 4,233 | **2,212** | 4,233 |
| Reinsurance assets | **12,140** | 16,952 | **–** | – |
| Other | **6,360** | 4,639 | **5,719** | 4,192 |
| | **20,712** | 25,824 | **7,931** | 8,425 |
| Amounts include: | | | | |
| – due from Group companies | **1,894** | 1,815 | **1,894** | 1,815 |

## 30 Prepayments and accrued income

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| Accrued income | **32,562** | 46,215 | **28,828** | 43,579 |
| Prepayments | **1,186** | 1,024 | **1,178** | 1,019 |
| | **33,748** | 47,239 | **30,006** | 44,598 |
| Amounts include: | | | | |
| – due from Group companies | **531** | 11,271 | **482** | 11,239 |
| – due from subsidiary companies | **–** | – | **285** | 288 |

## 31 Amounts owed to banks

| | 2009 | 2008 |
|---|---|---|
| | **€000** | €000 |
| *Group/Bank* | | |
| Term deposits | **157,817** | 440,405 |
| Repayable on demand | **10,954** | 21,780 |
| | **168,771** | 462,185 |
| Amounts include: | | |
| – due to Group companies | **163,904** | 342,399 |

## 32 Amounts owed to customers

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| Term deposits | **1,995,524** | 2,286,470 | **2,016,423** | 2,295,696 |
| Repayable on demand | **2,091,145** | 1,730,162 | **2,129,872** | 1,778,179 |
| | **4,086,669** | 4,016,632 | **4,146,295** | 4,073,875 |
| Amounts include: | | | | |
| – due to Group companies | **899** | 971 | **899** | 971 |
| – due to subsidiary companies | **–** | – | **59,626** | 57,243 |

## 33 Deferred tax

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| Deferred tax liabilities and (assets) are attributable to the following: | | | | |
| – excess of capital allowances over depreciation | **852** | 936 | **842** | 928 |
| – allowances for uncollectibility | **(14,066)** | (13,770) | **(13,997)** | (13,770) |
| – property sales tax consequences | **7,023** | 6,953 | **6,672** | 6,664 |
| – fair value movements on investments | **(305)** | (6,030) | **(731)** | (6,148) |
| – value of in-force life insurance business | **20,573** | 21,785 | **–** | – |
| – fair value movement on policyholders' investments | **(2,698)** | (4,771) | **–** | – |
| – other | **(1,581)** | (3,419) | **(1,552)** | (3,400) |
| | **9,798** | 1,684 | **(8,766)** | (15,726) |

| | *Group* | | | |
|---|---|---|---|---|
| | *At 1 January 2009* | *Recognised in income* | *Recognised in equity* | *At 31 December 2009* |
| | **€000** | **€000** | **€000** | **€000** |
| Movement in temporary differences relating to: | | | | |
| – excess of capital allowances over depreciation | **936** | **(84)** | **–** | **852** |
| – allowances for uncollectibility | **(13,770)** | **(296)** | **–** | **(14,066)** |
| – property sales tax consequences | **6,953** | **2** | **6** | **7,023** |
| – fair value movements on investments | **(6,030)** | **154** | **5,781** | **(305)** |
| – value of in-force life insurance business | **21,785** | **(1,212)** | **–** | **20,573** |
| – fair value movement on policyholders' investments | **(4,771)** | **1,929** | **–** | **(2,698)** |
| – other | **(3,419)** | **1,636** | **198** | **(1,581)** |
| | **1,684** | **2,129** | **5,985** | **9,798** |

# Notes on the Accounts (continued)

## 33 Deferred tax *(continued)*

| | *Group* | | | |
|---|---|---|---|---|
| | *At 1 January 2008* | *Recognised in income* | *Recognised in equity* | *At 31 December 2008* |
| | €000 | €000 | €000 | €000 |
| Movement in temporary differences relating to: | | | | |
| – excess of capital allowances over depreciation | 995 | (61) | 2 | 936 |
| – allowances for uncollectibility | (15,833) | 2,063 | – | (13,770) |
| – property sales tax consequences | 7,498 | (558) | 13 | 6,953 |
| – fair value movements on investments | (2,158) | 50 | (3,922) | (6,030) |
| – value of in-force life insurance business | 12,034 | 9,751 | – | 21,785 |
| – fair value movement on policyholders' investments | 60 | (4,781) | (50) | (4,771) |
| – other | (1,788) | (2,081) | 450 | (3,419) |
| | 808 | 4,383 | (3,507) | 1,684 |

| | *Bank* | | | |
|---|---|---|---|---|
| | *At 1 January 2009* | *Recognised in income* | *Recognised in equity* | *At 31 December 2009* |
| | **€000** | **€000** | **€000** | **€000** |
| Movement in temporary differences relating to: | | | | |
| – excess of capital allowances over depreciation | **928** | **(86)** | **–** | **842** |
| – allowances for uncollectibility | **(13,770)** | **(227)** | **–** | **(13,997)** |
| – property sales tax consequences | **6,664** | **2** | **6** | **6,672** |
| – fair value movements on investments | **(6,148)** | **154** | **5,263** | **(731)** |
| – other | **(3,400)** | **1,650** | **198** | **(1,552)** |
| | **(15,726)** | **1,493** | **5,467** | **(8,766)** |

| | *Bank* | | | |
|---|---|---|---|---|
| | *At 1 January 2008* | *Recognised in income* | *Recognised in equity* | *At 31 December 2008* |
| | €000 | €000 | €000 | €000 |
| Movement in temporary differences relating to: | | | | |
| – excess of capital allowances over depreciation | 997 | (69) | – | 928 |
| – allowances for uncollectibility | (15,833) | 2,063 | – | (13,770) |
| – property sales tax consequences | 7,209 | (558) | 13 | 6,664 |
| – fair value movements on investments | (2,159) | (106) | (3,883) | (6,148) |
| – other | (1,762) | (2,073) | 435 | (3,400) |
| | (11,548) | (743) | (3,435) | (15,726) |

The group's deferred tax assets and liabilities on the balance sheet have not been off-set to the extent that there is no legally enforceable right of set-off with the tax authorities.

## 34 Liabilities to customers under investment contracts

| | Group | |
|---|---|---|
| | **2009** | 2008 |
| | **€000** | €000 |
| At 1 January | **15,122** | 18,947 |
| Premiums received | **141** | 1,385 |
| Accounts balances paid on surrender and other termination during the year | **(710)** | (910) |
| Changes in unit prices and other movements | **2,300** | (4,300) |
| At 31 December | **16,853** | 15,122 |

## 35 Liabilities under insurance contracts issued

| | Group | |
|---|---|---|
| | *Gross* | *Gross* |
| | **2009** | 2008 |
| | **€000** | €000 |
| **Life insurance (non-linked)** | | |
| Provisions for policyholders | **260,187** | 250,467 |
| Outstanding claims | **2,470** | 1,121 |
| **Total non-linked** | **262,657** | 251,588 |
| **Life insurance (linked)** | | |
| Provisions for policyholders | **88,572** | 59,614 |
| Outstanding claims | **284** | 48 |
| **Total linked** | **88,856** | 59,662 |
| **Total liabilities under insurance contracts** | **351,513** | 311,250 |

| | Group | | | |
|---|---|---|---|---|
| | *Non-linked business* | *Linked business* | *All business* | *All business* |
| | *Provisions for policy-holders* | *Provisions for policy-holders* | *Outstanding claims* | *Total* |
| | **2009** | **2009** | **2009** | **2009** |
| | **€000** | **€000** | **€000** | **€000** |
| At 1 January | **250,467** | **59,614** | **1,169** | **311,250** |
| Claims in respect of new business | **–** | **–** | **3,410** | **3,410** |
| Movement for the year | **9,720** | **28,958** | **(1,227)** | **37,451** |
| Previous year claims paid | **–** | **–** | **(598)** | **(598)** |
| At 31 December | **260,187** | **88,572** | **2,754** | **351,513** |

## Notes on the Accounts (continued)

### 35 Liabilities under insurance contracts issued *(continued)*

| | *Group* | | | |
|---|---|---|---|---|
| | *Non-linked business* | *Linked business* | *All business* | *All business* |
| | *Provisions for policy-holders* | *Provisions for policy-holders* | *Outstanding claims* | *Total* |
| | 2008 | 2008 | 2008 | 2008 |
| | €000 | €000 | €000 | €000 |
| At 1 January | 217,237 | 72,034 | 1,672 | 290,943 |
| Claims in respect of new business | – | – | 1,995 | 1,995 |
| Movement for the year | 33,230 | (12,420) | (1,393) | 19,417 |
| Previous year claims paid | – | – | (1,105) | (1,105) |
| At 31 December | 250,467 | 59,614 | 1,169 | 311,250 |

### 36 Other liabilities

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| Bills payable | **10,605** | 12,153 | **10,605** | 12,153 |
| Cash collateral for commitments | **124** | 1,021 | **124** | 1,021 |
| Obligations under finance leases | **268** | 404 | **268** | 404 |
| Acceptances and endorsements | **2,212** | 4,233 | **2,212** | 4,233 |
| Other | **22,270** | 18,923 | **19,012** | 16,072 |
| | **35,479** | 36,734 | **32,221** | 33,883 |

### 37 Accruals and deferred income

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| Accrued interest | **17,134** | 33,848 | **17,471** | 34,404 |
| Other | **16,288** | 20,082 | **15,597** | 19,435 |
| | **33,422** | 53,930 | **33,068** | 53,839 |
| Amounts include: | | | | |
| – due to Group companies | **2,552** | 1,762 | **2,417** | 1,681 |
| – due to subsidiary companies | **–** | – | **337** | 556 |

### 38 Provisions for liabilities and other charges

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| At 1 January | **312** | 414 | **277** | 380 |
| Provisions made during the year | **265** | 91 | **237** | 91 |
| Provisions reversed during the year | **–** | (193) | **–** | (194) |
| At 31 December | **577** | 312 | **514** | 277 |

## 39 Subordinated liabilities

| | 2009 | 2008 |
|---|---|---|
| | **€000** | €000 |
| *Group/Bank* | | |
| 4.60% subordinated unsecured loan stock 2017 | **58,022** | 57,992 |
| 5.90% subordinated unsecured loan stock 2018 | **29,805** | 29,785 |
| | **87,827** | 87,777 |

## 40 Share capital

| | 2009 | 2008 |
|---|---|---|
| | **€000** | €000 |
| **Authorised** | | |
| 470,000,000 Ordinary shares of 30c each | **141,000** | 141,000 |
| **Issued and fully paid up** | | |
| 291,840,000 Ordinary shares of 30c each | **87,552** | 87,552 |

## 41 Reserves

*Revaluation reserve*

The revaluation reserve comprises the surplus arising on the revaluation of the group's freehold and long leasehold properties and the cumulative net change in fair values of available-for-sale financial assets held by the group, net of deferred taxation. The revaluation reserve is not available for distribution.

## 42 Contingent liabilities

| | *Group Contract amount* | | *Bank Contract amount* | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| Guarantees and assets pledged as collateral security | | | | |
| – guarantees | **95,820** | 97,505 | **95,843** | 97,528 |
| – standby letters of credit | **23,629** | 32,420 | **23,629** | 32,420 |
| | **119,449** | 129,925 | **119,472** | 129,948 |
| Amounts include: | | | | |
| – in favour of Group companies | **6,934** | 9,566 | **6,934** | 9,566 |
| – in favour of subsidiary companies | **–** | – | **23** | 23 |

# Notes on the Accounts (continued)

## 43 Commitments

| | Contract amount | |
|---|---|---|
| | **2009** | 2008 |
| | **€000** | €000 |
| *Group/Bank* | | |
| Documentary credits | **13,250** | 16,411 |
| Undrawn formal standby facilities, credit facilities and other commitments to lend | **910,648** | 1,094,159 |
| Uncalled share capital in other companies | **2** | 2 |
| | **923,900** | 1,110,572 |
| Amounts include: | | |
| – in favour of Group companies | **–** | 70 |

## 44 Capital and lease commitments

**a** *Capital commitments*

Capital commitments are made up of:

| | **2009** | 2008 |
|---|---|---|
| | **€000** | €000 |
| *Group/Bank* | | |
| Intangible assets | **133** | 379 |
| Property and equipment | **497** | 393 |
| | **630** | 772 |

**b** *Operating leases*

Total future minimum lease payments under non-cancellable operating leases not provided for:

| | **2009** | 2008 |
|---|---|---|
| | **€000** | €000 |
| *Group/Bank* | | |
| Less than one year | **2,286** | 2,163 |
| Between one year and five years | **5,219** | 5,347 |
| More than five years | **4,304** | 4,967 |
| | **11,809** | 12,477 |

**c** *Finance leases*

Finance lease payments, both principal and finance charge, are payable as follows:

| | **2009** | 2008 |
|---|---|---|
| | **€000** | €000 |
| *Group/Bank* | | |
| Less than one year | **190** | 289 |
| Between one year and five years | **105** | 153 |
| More than five years | **–** | – |
| Total minimum lease payments | **295** | 442 |
| Finance charges | **(27)** | (38) |
| Present value of minimum lease payments | **268** | 404 |

## 45 Dividends

| | Bank | | | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **% per share** | % per share | **€000** | €000 |
| **Gross of income tax** | | | | |
| % per 30c share | | | | |
| – prior year's final | **32** | 49 | **28,016** | 43,192 |
| – interim | **26** | 40 | **22,472** | 34,729 |
| | **58** | 89 | **50,488** | 77,921 |
| | **Euro cent per share** | Euro cent per share | **€000** | €000 |
| **Net of income tax** | | | | |
| euro cent per 30c share | | | | |
| – prior year's final | **6.24** | 9.62 | **18,210** | 28,075 |
| – interim | **5.01** | 7.74 | **14,607** | 22,574 |
| | **11.25** | 17.36 | **32,817** | 50,649 |

The Directors have proposed a final gross ordinary dividend of 8.0 euro cent (2008: 9.6 euro cent) per share. The final dividend will be payable to shareholders on the bank's register as at 4 March 2010.

## 46 Cash and cash equivalents

| | Group | | Bank | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| **Balances of cash and cash equivalents are analysed below:** | | | | |
| Cash | **25,009** | 27,367 | **25,008** | 27,366 |
| Balances with Central Bank of Malta (excluding reserve deposit) | **4,638** | 5,454 | **4,638** | 5,454 |
| Financial assets designated at fair value through profit or loss | **4,356** | 4,985 | **–** | – |
| Loans and advances to banks | **683,010** | 713,481 | **682,999** | 713,444 |
| Amounts owed to banks | **(168,198)** | (446,692) | **(168,198)** | (446,692) |
| **Per statements of cash flows** | **548,815** | 304,595 | **544,447** | 299,572 |
| Adjustment to reflect balances with contractual maturity of more than three months | **372,904** | 632,956 | **128,643** | 358,227 |
| **Per statements of financial position** | **921,719** | 937,551 | **673,090** | 657,799 |

## Notes on the Accounts (continued)

### 46 Cash and cash equivalents *(continued)*

| | Group | | Bank | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| **Analysed as follows:** | | | | |
| Cash and balances with Central Bank of Malta (excluding reserve deposit) | **29,647** | 32,821 | **29,646** | 32,820 |
| Malta Government Treasury Bills | **64,633** | 14,895 | **64,633** | 14,895 |
| Financial assets designated at fair value through profit or loss | **248,553** | 279,714 | **–** | – |
| Loans and advances to banks | **747,657** | 1,072,306 | **747,582** | 1,072,269 |
| Amounts owed to banks | **(168,771)** | (462,185) | **(168,771)** | (462,185) |
| | **921,719** | 937,551 | **673,090** | 657,799 |

### 47 Segmental information

**a** *Class of business*

| | *Personal Financial Services* | | *Commercial Banking* | | *Global Banking and Markets* | | *Group Total* | |
|---|---|---|---|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 | **€000** | €000 | **€000** | €000 |
| *Group* | | | | | | | | |
| **Net interest income** | | | | | | | | |
| – External | **30,821** | 7,283 | **60,493** | 62,887 | **13,656** | 52,874 | **104,970** | 123,044 |
| – Inter-segment | **24,041** | 58,094 | **(11,255)** | (9,993) | **(12,786)** | (48,101) | **–** | – |
| | **54,862** | 65,377 | **49,238** | 52,894 | **870** | 4,773 | **104,970** | 123,044 |
| **Net non-interest income** | | | | | | | | |
| – External | **26,554** | 35,230 | **16,496** | 16,570 | **11,639** | 13,457 | **54,689** | 65,257 |
| – Inter-segment | **1,480** | 2,995 | **–** | – | **(1,480)** | (2,995) | **–** | – |
| | **28,034** | 38,225 | **16,496** | 16,570 | **10,159** | 10,462 | **54,689** | 65,257 |
| **External Operating expenses** | | | | | | | | |
| – Employee compensation and benefit | **(32,475)** | (37,857) | **(14,254)** | (15,088) | **(2,523)** | (2,532) | **(49,252)** | (55,477) |
| – General and administrative expenses | **(19,303)** | (19,238) | **(5,738)** | (6,083) | **(2,006)** | (2,422) | **(27,047)** | (27,743) |
| – Depreciation | **(4,463)** | (4,307) | **(1,843)** | (1,625) | **(16)** | (19) | **(6,322)** | (5,951) |
| – Amortisation | **(755)** | (910) | **(330)** | (298) | **(63)** | (30) | **(1,148)** | (1,238) |
| | **(56,996)** | (62,312) | **(22,165)** | (23,094) | **(4,608)** | (5,003) | **(83,769)** | (90,409) |
| External Net impairment | **(2,578)** | (1,017) | **(1,654)** | (890) | **(197)** | – | **(4,429)** | (1,907) |
| External Net provisions for liabilities and other charges | **(20)** | 146 | **(217)** | (43) | **(28)** | (1) | **(265)** | 102 |
| **Profit before tax** | **23,302** | 40,419 | **41,698** | 45,437 | **6,196** | 10,231 | **71,196** | 96,087 |

## 47 Segmental information *(continued)*

**a** *Class of business (continued)*

| | *Personal Financial Services* | | *Commercial Banking* | | *Global Banking and Markets* | | *Group Total* | |
|---|---|---|---|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 | **€000** | €000 | **€000** | €000 |
| **Assets** | | | | | | | | |
| Segment total assets | **2,129,646** | 1,974,137 | **1,682,729** | 1,667,774 | **1,305,425** | 1,654,177 | **5,117,800** | 5,296,088 |
| Average total assets | **2,051,891** | 1,882,670 | **1,675,252** | 1,606,429 | **1,479,801** | 1,606,489 | **5,206,944** | 5,095,588 |
| **Total Equity** | **113,280** | 114,874 | **159,636** | 153,929 | **33,671** | 13,674 | **306,587** | 282,477 |

**b** *Geographical segments*

The group's activities are carried out within Malta. There are no identifiable geographical segments or other material concentrations.

## 48 Related party transactions

During the course of banking operations, the group conducted business transactions with entities owned by the ultimate parent and its subsidiaries on an arm's length basis.

Executive Directors participate in the HSBC Group share option plans (see note 13).

**a** *Transactions, arrangements and agreements involving Directors and others*

Particulars of transactions, arrangements and agreements entered into with Directors, connected persons and companies controlled by them and with key management personnel of HSBC Bank Malta p.l.c.:

| | *Group* | | *Bank* | |
|---|---|---|---|---|
| | *Balance at end of year* | *Balance at end of year* | *Balance at end of year* | *Balance at end of year* |
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| **Directors, connected persons and companies controlled by them** | | | | |
| Loans | **119,777** | 109,228 | **119,777** | 109,228 |
| Credit card transactions | **27** | 21 | **27** | 21 |
| Guarantees | **5,968** | 1,764 | **5,968** | 1,764 |
| Commitments to lend | **55,297** | 43,430 | **55,297** | 43,430 |
| **Senior executive management** | | | | |
| Loans | **2,053** | 1,816 | **1,942** | 1,692 |
| Credit card transactions | **54** | 50 | **49** | 50 |

The above banking facilities are part of long-term commercial relationships and were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

# Notes on the Accounts (continued)

## 48 Related party transactions *(continued)*

**b** *Compensation to Directors and key management personnel*

| | Group | | Bank | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€000** | €000 | **€000** | €000 |
| Short-term employee benefits | **3,454** | 3,316 | **3,058** | 3,006 |
| Post-employment benefits | **238** | 208 | **238** | 208 |
| Other long-term benefits | **17** | 3 | **17** | 3 |
| Termination benefits | **348** | 204 | **348** | 204 |
| Share-based payments | **134** | 206 | **130** | 193 |
| | **4,191** | 3,937 | **3,791** | 3,614 |

Details of Directors' fees and emoluments are stated in note 15.

**c** *Transactions with other related parties*

Information relating both to transactions with HSBC Holdings plc and its subsidiaries as well as with subsidiary companies of HSBC Bank Malta p.l.c. are stated in the 'Notes on the Accounts' where the following are disclosed.

Note 6 – interest receivable and similar income
Note 7 – interest payable
Note 8 – net fee and commission income
Note 9 – dividend income
Note 13 – employee compensation and benefits
Note 19 – financial instruments held for trading
Note 21 – financial investments
Note 22 – loans and advances to banks
Note 24 – shares in subsidiary companies
Note 27 – investment property
Note 29 – other assets
Note 30 – prepayments and accrued income
Note 31 – amounts owed to banks
Note 32 – amounts owed to customers
Note 37 – accruals and deferred income
Note 42 – contingent liabilities
Note 43 – commitments

Included in Interest receivable and similar income (note 6) and in Interest payable (note 7), the group recognised interest amounting to €6,887,000 and €1,022,000 respectively, on advances and deposits placed with an intermediate parent.

Furthermore, expenditure relating to transactions with HSBC Holdings plc and its subsidiaries amounting to €6,242,000 (2008: €4,565,000) for the group and €5,570,000 (2008: €4,324,000) for the bank are included within general and administrative expenses.

## 49 Trust and custody activities

The group provides trust and custody services to individuals, trusts, retirement benefit plans and other institutions, whereby it holds and manages assets or invests funds received in various financial instruments at the direction of the customer. The group receives fee income for providing these services. Trust assets and assets held in custody are not assets of the group and are not recognised in the statements of financial position. The group is not exposed to any credit risk relating to such placements, as it does not guarantee these investments.

At 31 December 2009, the total assets held by the group on behalf of customers were €2,718,297,000 (2008: €2,587,745,000).

## 50 Registered office and ultimate parent company

The addresses of the registered and principal offices of the bank and its subsidiary companies included in the consolidated financial statements can be found in a separate statement which is filed at the Registrar of Companies in accordance with the provisions of the Fourth Schedule to the Companies Act, 1995.

The ultimate parent company of HSBC Bank Malta p.l.c. is HSBC Holdings plc, which is incorporated and registered in England. The registered address is 8 Canada Square, London E14 5HQ, United Kingdom. Copies of the HSBC Holdings plc *Annual Review 2009* and *Annual Report and Accounts 2009* may be obtained from its registered office from 30 March 2010 or viewed on www.hsbc.com.

## 51 Investor compensation scheme

In accordance with the provisions of the Investor Compensation Scheme Regulations, 2003 issued under the Investment Services Act, 1994, licence holders are required to transfer a variable contribution to an Investor Compensation Scheme Reserve and place the equivalent amount with a bank, pledged in favour of the Scheme. Alternatively licence holders can elect to pay the amount of variable contribution directly to the Scheme.

HSBC Bank Malta p.l.c. and HSBC Stockbrokers (Malta) Limited have elected to pay the amount of the variable contribution directly to the Scheme.

## 52 Accounting estimates and judgements

The Directors considered the development, selection and disclosure of the group's critical accounting policies and estimates and the application of these policies and estimates. Estimates and judgements are continually evaluated and are based on historical and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

*Critical accounting judgement in applying accounting policies*

*i Impairment losses on loans and advances*

The group reviews its loan portfolio to assess impairment on an ongoing basis as relevant generic data is observed concerning risks associated with groups of loans with similar risk characteristics (see note 3(g)(i)). As a result, the group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans, before the decrease is actually identified with an individual loan in that portfolio. The evidence may include observable data indicating that there has been an adverse change in the relative economic situation of an asset group or in the credit status of borrowers in a group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

# Notes on the Accounts (continued)

## 52 Accounting estimates and judgements *(continued)*

*Critical accounting judgement in applying accounting policies (continued)*

*ii Policyholder claims and benefits*

The determination of the liabilities under long-term insurance contracts is dependent on estimates made by the group. Estimates are made as to the expected number of deaths for each of the years in which the group is exposed to risk. The group bases these estimates on standard industry and national mortality tables that reflect recent historical mortality experience, adjusted where appropriate to reflect the group's own experience. The estimated number of deaths determines the value of the benefit payments and the value of the valuation premiums. The main source of uncertainty is that epidemics such as AIDS, SARS, pandemic flu and wide-ranging lifestyle changes, such as in eating, smoking and exercise habits, could result in future mortality being significantly worse than in the past for the age groups in which the group has significant exposure to mortality risk.

Estimates are also made as to future investment income arising from the assets backing long-term insurance contracts. These estimates are based on current market returns as well as expectations about future economic and financial developments.

For long-term insurance contracts with fixed and guaranteed terms and with discretionary participation features, estimates of future deaths, voluntary terminations, investment returns and administrative expenses form the assumptions used for calculating the liabilities during the life of the contract. A margin for risk and uncertainty is added to these assumptions. New estimates are made each subsequent year to reflect the current long-term outlook.

*iii Fair value of derivatives*

The fair value of financial instruments that are not quoted in active markets are determined by using valuation techniques. Where valuation techniques (for example models) are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are certified before they are used, and models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data, however areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates. Changes in assumption about these factors could affect reported fair value of financial instruments.

*iv Impairment of available-for-sale equity instruments*

The group determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, the group evaluates among other factors, the normal volatility in share price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financial cash flows.

*v Held-to-maturity investments*

The group follows the application guidance in IAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. This classification requires significant judgement. In making this judgement, the group evaluates its intention and ability to hold such investments to maturity. If the group fails to keep these investments to maturity other than for specific circumstances, for example, selling an insignificant amount close to maturity, it will be required to reclassify the entire class as available-for-sale. The investments would therefore be measured at fair value not amortised cost.

# Report of the Independent Auditors to the Members of HSBC Bank Malta p.l.c.

## Report on the financial statements

We have audited the financial statements of HSBC Bank Malta p.l.c. (the 'bank') and of the group of which the bank is the parent, as set out on pages 26 to 88, which comprise the statements of financial position as at 31 December 2009 and the statements of comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### Directors' responsibility for the financial statements

As explained more fully in the Directors' Responsibilities Statement set out on page 25, the directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the EU, the Companies Act, 1995 (Chapter 386, Laws of Malta), and the Banking Act, 1994 (Chapter 371, Laws of Malta), and, as regards the financial statements of the group, Article 4 of the IAS Regulation. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### Auditors' responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. This report, including the opinion, has been prepared for and only for the bank's members as a body in accordance with Article 179 of the Companies Act, 1995 (Chapter 386, Laws of Malta) and Article 31 of the Banking Act, 1994 (Chapter 371, Laws of Malta), and may not be appropriate for any other purpose.

In addition, we read the other information contained in the Annual Report 2009 and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent material misstatements of fact or material inconsistencies with the financial statements.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

### Opinion on financial statements

In our opinion, the financial statements:

– give a true and fair view of the group's and the bank's financial position as at 31 December 2009, and of their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU; and

– have been properly prepared in accordance with the Companies Act, 1995 (Chapter 386, Laws of Malta), the Banking Act, 1994 (Chapter 371, Laws of Malta), and, as regards the financial statements of the group, Article 4 of the IAS Regulation.

# Report of the Independent Auditors to the Members of HSBC Bank Malta p.l.c. (continued)

## Report on other legal and regulatory requirements

### Matters on which we are required to report by the Banking Act, 1994 (Chapter 371, Laws of Malta)

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 thereof;

– the bank's financial statements are in agreement with the books of account; and

– to the best of our knowledge and belief and, on the basis of the explanations given to us, the financial statements give the information required by law in force in the manner so required.

### Matters on which we are required to report by exception by the Companies Act, 1995 (Chapter 386, Laws of Malta) ('the Act'), other than those reported upon above

We have nothing to report in respect of the following matters where the Act requires us to report to you if, in our opinion:

– the information given in the Directors' Report for the financial year for which the financial statements are prepared is not consistent with the financial statements; or

– certain disclosures of Directors' remuneration specified by the Act are not made.

### Report required by Listing Rule 8.38 issued by the Listing Authority in Malta on the Directors' Statement of Compliance with the Code of Principles of Good Corporate Governance (the 'Principles') outlined in Appendix 8.1 to Chapter 8 (Continuing Obligations) of the Listing Rules (the 'Appendix')

Listing Rule 8.36 requires an Issuer whose securities are admitted to trading on a Regulated Market operating in Malta to prepare a corporate governance statement. In addition, as an Issuer registered in Malta, Listing Rule 8.36b requires that the bank endeavours to adopt the Principles and to prepare a report explaining how it has complied with the provisions of the Appendix.

Our responsibility as independent auditors of the bank, is laid down by Listing Rule 8.38, which requires us to issue a report on the Directors' Statement of Compliance with the Principles, which is set out in pages 20 to 23.

We review the Directors' Statement of Compliance and report as to whether this statement provides the disclosures required by Listing Rules 8.37 and 8.38 as obtaining prior to the coming into effect of Circular 01/2010 issued to all Company Secretaries and Stockbroking Firms, by the Listing Authority (Malta Financial Services Authority), which circular came into effect on 11 January 2010. We are not required to, and we do not, consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risks and control procedures, nor on the ability of the group to continue in operational existence.

In our opinion, the Directors' Statement of Compliance set out in pages 20 to 23 provides the disclosures required by the aforementioned Listing Rules 8.37 and 8.38 as obtaining prior to the coming into effect of Circular 01/2010 issued to all Company Secretaries and Stockbroking Firms, by the Listing Authority (Malta Financial Services Authority), which circular came into effect on 11 January 2010.

*Noel Mizzi (Partner) for and on behalf of*

KPMG
*Registered Auditors*
Portico Building
Marina Street
Pietà PTA 9044
Malta

22 February 2010

# Group Income Statements and Statements of Comprehensive Income: Five-Year Comparison

## Group Income Statements

| | **2009** | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|---|
| | **€000** | €000 | €000 | €000 | €000 |
| Interest receivable and similar income | **169,038** | 245,510 | 237,580 | 188,388 | 167,445 |
| Interest payable | **(64,068)** | (122,466) | (111,342) | (78,996) | (63,655) |
| **Net interest income** | **104,970** | 123,044 | 126,238 | 109,392 | 103,790 |
| Net non-interest income | **54,689** | 65,257 | 72,453 | 66,634 | 56,070 |
| Operating expenses | **(83,769)** | (90,409) | (83,672) | (80,007) | (74,691) |
| Net impairment | **(4,429)** | (1,907) | (42) | 422 | 331 |
| Net provisions for liabilities and other charges | **(265)** | 102 | (340) | (16) | 2 |
| **Profit before tax** | **71,196** | 96,087 | 114,637 | 96,425 | 85,502 |
| Tax expense | **(25,329)** | (32,972) | (38,322) | (33,944) | (29,448) |
| **Profit for the year** | **45,867** | 63,115 | 76,315 | 62,481 | 56,054 |
| **Profit attributable to shareholders of the bank** | **45,867** | 63,115 | 76,315 | 62,451 | 56,038 |
| **Profit attributable to minority interest** | **–** | – | – | 30 | 16 |
| **Earnings per share** | **15.7c** | 21.6c | 26.1c | 21.4c | 19.1c |

Earnings per share for comparative periods have been restated as a result of share split and bonus issue effected on 1 April 2005 and 18 April 2006 respectively.

## Group Statements of Comprehensive Income

| | **2009** | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|---|
| | **€000** | €000 | €000 | €000 | €000 |
| Profit attributable to shareholders of the bank | **45,867** | 63,115 | 76,315 | 62,451 | 56,038 |
| **Other comprehensive income** | | | | | |
| Available-for-sale investments: | | | | | |
| – change in fair value | **17,693** | (9,635) | (10,677) | (5,977) | 2,712 |
| – change in fair value transferred to profit or loss | **(1,268)** | (1,348) | (3,537) | (6,340) | (2,806) |
| Freehold and long leasehold properties – revaluation | **–** | – | 9,789 | – | – |
| Income taxes | **(5,749)** | 3,844 | 3,800 | 4,325 | 3,790 |
| **Other comprehensive income for the year, net of tax** | **10,676** | (7,139) | (625) | (7,992) | 3,696 |
| **Total comprehensive income for the year, net of tax** | **56,543** | 55,976 | 75,690 | 54,459 | 59,734 |

## Group Statements of Financial Position: Five-Year Comparison

| | **2009** | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|---|
| | **€000** | €000 | €000 | €000 | €000 |
| **Assets** | | | | | |
| Balances with Central Bank of Malta, Treasury Bills and cash | **172,671** | 130,682 | 472,136 | 304,144 | 179,644 |
| Cheques in course of collection | **10,764** | 9,308 | 3,103 | 24,540 | 22,658 |
| Financial assets held for trading | **11,746** | 11,823 | 15,980 | 24,216 | 9,101 |
| Financial assets designated at fair value through profit and loss | **248,553** | 279,714 | 275,695 | 261,999 | 216,937 |
| Financial investments | **478,975** | 429,912 | 456,525 | 391,656 | 522,944 |
| Loans and advances to banks | **747,657** | 1,072,306 | 631,018 | 596,459 | 379,413 |
| Loans and advances to customers | **3,226,477** | 3,112,240 | 2,822,315 | 2,623,169 | 2,366,838 |
| Intangible assets | **60,691** | 64,256 | 36,110 | 25,388 | 21,973 |
| Property and equipment | **65,397** | 70,684 | 77,820 | 66,648 | 69,290 |
| Investment property | **14,588** | 14,050 | 12,885 | 7,959 | 2,239 |
| Assets held for sale | **10,604** | 9,168 | 11,922 | 9,266 | 11,456 |
| Current tax recoverable | **6,164** | 2,966 | 2,596 | 1,877 | 4,414 |
| Deferred tax assets | **9,053** | 15,916 | 11,553 | – | – |
| Other assets | **20,712** | 25,824 | 25,855 | 24,955 | 20,268 |
| Prepayments and accrued income | **33,748** | 47,239 | 39,576 | 33,983 | 29,974 |
| **Total assets** | **5,117,800** | 5,296,088 | 4,895,089 | 4,396,259 | 3,857,149 |
| **Liabilities** | | | | | |
| Financial liabilities held for trading | **11,044** | 11,381 | 15,043 | 24,792 | 9,434 |
| Amounts owed to banks | **168,771** | 462,185 | 87,142 | 294,264 | 52,800 |
| Amounts owed to customers | **4,086,669** | 4,016,632 | 4,039,492 | 3,436,873 | 3,184,751 |
| Debt securities in issue | **–** | – | – | – | 28 |
| Provision for current tax | **207** | 688 | 11,043 | – | – |
| Deferred tax liabilities | **18,851** | 17,600 | 12,361 | 10,729 | 8,952 |
| Liabilities to customers under investment contracts | **16,853** | 15,122 | 18,947 | 21,321 | 19,327 |
| Liabilities under insurance contracts issued | **351,513** | 311,250 | 290,943 | 239,390 | 200,967 |
| Other liabilities | **35,479** | 36,734 | 32,303 | 32,183 | 39,029 |
| Accruals and deferred income | **33,422** | 53,930 | 53,147 | 42,271 | 35,022 |
| Provisions for liabilities and other charges | **577** | 312 | 414 | 75 | 58 |
| Subordinated liabilities | **87,827** | 87,777 | 57,962 | – | – |
| **Total liabilities** | **4,811,213** | 5,013,611 | 4,618,797 | 4,101,898 | 3,550,368 |
| Equity attributable to shareholders | **306,587** | 282,477 | 276,292 | 294,361 | 306,017 |
| Minority interest | **–** | – | – | – | 764 |
| **Total equity** | **306,587** | 282,477 | 276,292 | 294,361 | 306,781 |
| **Total liabilities and equity** | **5,117,800** | 5,296,088 | 4,895,089 | 4,396,259 | 3,857,149 |
| **Memorandum items** | | | | | |
| Contingent liabilities | **119,449** | 129,925 | 129,972 | 138,779 | 119,993 |
| Commitments | **923,900** | 1,110,572 | 1,148,034 | 1,064,288 | 934,582 |

## Group Statements of Cash Flows: Five-Year Comparison

| | **2009** | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|---|
| | **€000** | €000 | €000 | €000 | €000 |
| Net cash from/(used in) operating activities | **293,498** | (309,684) | 343,005 | (22,241) | 135,935 |
| **Cash flows used in investing activities** | | | | | |
| Dividends received | **387** | 49 | 228 | 172 | 217 |
| Interest received from financial investments | **16,115** | 23,884 | 21,011 | 26,399 | 27,484 |
| Proceeds from sale and maturity of financial investments | **187,399** | 88,551 | 195,078 | 207,061 | 133,252 |
| Proceeds on sale of property and equipment and intangible assets | **2,097** | 9,755 | 61 | 186 | 615 |
| Purchase of financial investments | **(218,285)** | (83,733) | (278,768) | (88,169) | (86,956) |
| Purchase of property and equipment, investment property and intangible assets | **(4,174)** | (7,556) | (9,981) | (5,383) | (6,650) |
| Proceeds on sale of shares in subsidiary company | **–** | – | – | 1,048 | – |
| Net cash (used in)/from investing activities | **(16,461)** | 30,950 | (72,371) | 141,314 | 67,962 |
| **Cash flows used in financing activities** | | | | | |
| Dividends paid | **(32,817)** | (50,649) | (93,677) | (67,827) | (66,446) |
| Maturity of debt securities in issue and subordinated loan stock | **–** | – | – | (28) | (46,387) |
| Issue of subordinated loan stock | **–** | 30,000 | 58,234 | – | – |
| Issue of units to minority interest | **–** | – | – | 212 | 748 |
| Subordinated loan stock issue costs | **–** | (226) | (302) | – | – |
| Net cash used in financing activities | **(32,817)** | (20,875) | (35,745) | (67,643) | (112,085) |
| **Increase/(decrease) in cash and cash equivalents** | **244,220** | (299,609) | 234,889 | 51,430 | 91,812 |

# Group Accounting Ratios: Five-Year Comparison

| | **2009** | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|---|
| | **%** | % | % | % | % |
| Net interest income and other operating income to total assets | **3.1** | 3.6 | 4.1 | 4.0 | 4.1 |
| Operating expenses to total assets | **1.6** | 1.7 | 1.7 | 1.8 | 1.9 |
| Cost to income ratio | **52.5** | 48.0 | 42.1 | 45.5 | 46.7 |
| Profit before tax to total assets | **1.4** | 1.8 | 2.3 | 2.2 | 2.2 |
| Profit before tax on equity | **23.2** | 34.0 | 41.5 | 32.8 | 27.9 |
| Profit after tax to equity | **15.0** | 22.3 | 27.6 | 21.2 | 18.3 |

| | **2009** | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|---|
| Shares in issue (millions) | **291.8** | 291.8 | 291.8 | 291.8 | 73.0 |
| Net assets per 30 euro cent share (cents)* | **105.0** | 96.8 | 94.7 | 100.9 | 105.1 |
| Earnings per 30 euro cent share (cents)* | **15.7** | 21.6 | 26.1 | 21.4 | 19.1 |
| Dividend per 30 euro cent share (cents)* | | | | | |
| – gross | **17.3** | 26.7 | 49.4 | 35.9 | 34.9 |
| – net | **11.2** | 17.4 | 32.1 | 23.3 | 22.8 |
| Dividend cover | **1.4** | 1.2 | 0.8 | 0.9 | 0.8 |

** Ratios for 2005 have been restated to reflect the number of shares in issue.*

# Group Financial Highlights in US dollars

| | 2009 | 2008 |
|---|---|---|
| | US$000 | US$000 |
| **Income statements** | | |
| Net operating income | **230,069** | 271,342 |
| Operating expenses | **(120,711)** | (130,279) |
| Net impairment reversals | **(6,382)** | (2,748) |
| Net provisions for liabilities and other charges | **(382)** | 147 |
| **Profit before tax** | **102,594** | 138,462 |
| Tax expense | **(36,499)** | (47,513) |
| **Profit for the year** | **66,095** | 90,949 |
| **Profit attributable to shareholders of the bank** | **66,095** | 90,949 |
| **Statements of Financial Position** | | |
| **Assets** | | |
| Balances with Central Bank of Malta, Treasury Bills and cash | **248,819** | 188,313 |
| Cheques in course of collection | **15,511** | 13,413 |
| Financial assets held for trading | **16,926** | 17,037 |
| Financial assets at fair value through profit or loss | **358,165** | 403,068 |
| Financial investments | **690,203** | 619,503 |
| Loans and advances to banks | **1,077,374** | 1,545,193 |
| Loans and advances to customers | **4,649,353** | 4,484,738 |
| Intangible assets | **87,456** | 92,593 |
| Property and equipment | **94,237** | 101,856 |
| Investment property | **21,021** | 20,246 |
| Assets held for sale | **15,280** | 13,211 |
| Current tax recoverable | **8,882** | 4,274 |
| Deferred tax assets | **13,045** | 22,935 |
| Other assets | **29,846** | 37,212 |
| Prepayments and accrued income | **48,631** | 68,071 |
| **Total assets** | **7,374,749** | 7,631,663 |
| **Liabilities and equity** | | |
| Financial liabilities held for trading | **15,914** | 16,400 |
| Amounts owed to banks | **243,199** | 666,009 |
| Amounts owed to customers | **5,888,890** | 5,787,967 |
| Provision for current tax | **298** | 991 |
| Deferred tax liabilities | **27,164** | 25,362 |
| Liabilities to customers under investment contracts | **24,285** | 21,791 |
| Liabilities under insurance contracts issued | **506,530** | 448,511 |
| Other liabilities | **51,125** | 52,933 |
| Accruals and deferred income | **48,161** | 77,713 |
| Provisions for liabilities and other charges | **832** | 450 |
| Subordinated liabilities | **126,559** | 126,487 |
| Share capital | **126,162** | 126,162 |
| Revaluation reserve | **37,214** | 21,830 |
| Retained earnings | **278,416** | 259,057 |
| **Total liabilities and equity** | **7,374,749** | 7,631,663 |

The US Dollar Exchange of same date was €1 = US$1.4410. Comparative results have also been translated at these rates.

# Branches and Offices

## MALTA OFFICES

**Registered Office/Head Office**
233 Republic Street, Valletta VLT 1116
Tel: 2597 0000 Fax: 2380 4923

**Personal Financial Services**
Personal Financial Services Centre
80 Mill Street, Qormi QRM 3101
Tel: 2380 1895 Fax: 2380 4537

**Premier Centre**
**Wealth Management Office**
Personal Financial Services Centre
80 Mill Street, Qormi QRM 3101
Tel: 2148 9100 Fax: 2380 2219

**Business Banking Centre**
80 Mill Street, Qormi QRM 3101
Tel: 2380 1895 Fax: 2380 4532

**International Banking Centre**
Business Banking Centre
80 Mill Street Qormi
Tel: 2380 1895 Fax: 2380 2676

**Trade Services**
Operations Centre
80 Mill Street, Qormi QRM 3101
Tel: 2380 1828 Fax: 2380 4535

**Operations Centre**
80 Mill Street, Qormi QRM 3101
Tel: 2380 0000 Fax: 2380 4923

**Card Products Division**
Operations Centre
80 Mill Street, Qormi QRM 3101
Tel: 2380 2380 Fax: 2380 4924

**Contact Centre**
Operations Centre
80 Mill Street, Qormi QRM 3101
Tel: 2380 2380 Fax: 2149 0613

**Legal Office**
116 Archbishop Street
Valletta VLT 1114
Tel: 2597 2406 Fax: 2597 2417

Contracts Centre
32 Merchants Street, Valletta VLT 1173
Tel: 2597 3382 Fax: 2597 3306

Inheritance Unit
1st Floor, 32 Merchants Street
Valletta VLT 1173
Tel: 2380 3360/1/2/3/4
Fax: 2380 3365

### BRANCHES AND AUTOMATED OFFICES

**Attard**
34 Mosta Road ATD 1434
Tel: 2380 2380 Fax: 2141 6786

**Balzan**
Bertu Fenech Square BZN 1032
Tel: 2380 2380 Fax: 2380 1190

**Birkirkara**
1 Naxxar Road BKR 9049
Tel: 2380 2380 Fax: 2334 1690

**Birżebbuġa**
2 Birżebbuġa Road BBG 1508
Tel: 2380 2380 Fax: 2361 4790

**Buġibba**
Bay Square SPB 2511
Tel: 2380 2380 Fax: 2334 7390

**Cospicua**
50 Pilgrimage Street BML 1580
Tel: 2380 2380 Fax: 2293 4090

**Fgura**
Council of Europe Square FGR 1254
Tel: 2380 2380 Fax: 2361 8790

**Floriana**
Development House FRN 9010
Tel: 2380 2380 Fax: 2597 8990

**Gudja** *(Agency)*
1 Main Street GDJ 1201
Tel: 2380 2380 Fax: 2169 5607

**Gżira**
196 The Strand GZR 1023
Tel: 2380 2380 Fax: 2324 3990

**Hamrun**
121 St. Joseph Road HMR 1017
Tel: 2380 2380 Fax: 2597 2390

**Luqa**
143 Carmel Street LQA 1319
Tel: 2380 2380 Fax: 2361 5090

**Luqa** *(Bureau)*
Malta International Airport, LQA 9400
Welcomers' Hall
Tel: 2380 2380 Fax: 2180 1938

Airside Arrivals Area *(Automated Office)*

**Marsascala**
St. Anthony Street MSK 9057
Tel: 2380 2380 Fax: 2163 6860

**Marsaxlokk** *(Automated Office)*
55 Xatt is-Sajjieda MXK 1302

**Mellieħa**
6 Gorg Borg Olivier Street MLH 1027
Tel: 2380 2380 Fax: 2334 6890

**Mosta**
63 Constitution Street MST 9058
Tel: 2380 2380 Fax: 2334 6190

**Msida**
52 Msida Seafront MSD 9043
Tel: 2380 2380 Fax: 2597 8590

**Msida, University of Malta**
Room 6, Ground Floor
Humanities Building MSD 2080
Tel: 2380 2380 Fax: 2133 1377

**Naxxar**
Victory Square NXR 1705
Tel: 2380 2380 Fax: 2334 5990

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12 Antoine De Paule Square PLA 1261
Tel: 2380 2380 Fax: 2361 1390

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Tel: 2380 2380 Fax: 2380 5490

**Rabat**
12 Saqqajja Square RBT 1190
Tel: 2380 2380 Fax: 2334 5890

**San Ġwann**
198 Naxxar Road SGN 9030
Tel: 2380 2380 Fax: 2324 7590

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St. George's Road STJ 3202
Tel: 2380 2380 Fax: 2324 2090

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St. Paul's Street SPB 3419
Tel: 2380 2380 Fax: 2334 6490

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Tel: 2380 2380 Fax: 2380 2790

**Sliema**
High Street SLM 1549
Tel: 2380 2380 Fax: 2324 6090

**Sliema**
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Tel: 2380 2380 Fax: 2324 8090

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Tel: 2380 2381 Fax: 2324 6046

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Tel: 2380 2380 Fax: 2324 8894

**Tarxien**
Main Street TXN 2556
Tel: 2380 2380 Fax: 2293 1290

**Valletta**
32 Merchants Street VLT 1173
Tel: 2380 2380 Fax: 2597 3320

**Żabbar**
19 Sanctuary Street ZBR 1010
Tel: 2380 2380 Fax: 2361 4290

**Żebbuġ**
254 Main Street ZBG 1304
Tel: 2380 2380 Fax: 2293 4490

**Żejtun**
25th November Avenue ZTN 2018
Tel: 2380 2380 Fax: 2361 5690

**Żurrieq**
38 High Street ZRQ 1318
Tel: 2380 2380 Fax: 2361 7890

## GOZO OFFICES

**Victoria**
90 Republic Street VCT 1017
Tel: 2380 2380 Fax: 2293 7192

**Victoria ShareShop**
90 Republic Street VCT 1016
Tel: 2293 7103 Fax: 2293 7192

**Nadur** *(Agency)*
18 St. Peter & St. Paul Square
NDR 1010
Tel: 2380 2380 Fax: 2155 0952

**Xagħra** *(Agency)*
8th September Avenue XRA 1011
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Tel: 2380 2380 Fax: 2155 6313

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Valletta VLT 1116
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HSBC Bank Malta p.l.c.
233 Republic Street
Valletta VLT 1116, Malta
Telephone: 356 2597 0000
Customer Service: 356 2380 2380
Facsimile: 356 2380 4923