Directors' report as at 31 December 2019

The Directors present their 46th Annual Report, together with the audited financial statements of the Bank of Valletta Group (the Group) and the Bank for the Financial Year (FY) ended 31 December 2019.

Principal Activities

The Bank of Valletta Group comprises Bank of Valletta p.l.c. (the Bank) and two subsidiary companies namely BOV Asset Management Limited (BOV AM) and BOV Fund Services Limited (BOV FS). The Group also has two equity-accounted investee companies, MAPFRE Middlesea p.l.c. and MAPFRE MSV Life p.l.c. The Group's principal activities are set out below.

The Group offers banking, financial and investment services and connected activities within the domestic Maltese market. The principal activities of the Bank comprise the following:

1) The receipt and acceptance of customers' monies for deposit in current, savings and term accounts which may be denominated in Euro and other major currencies,

2) The provision of loans and advances to a wide array of customers, and

3) The provision of investment services, covering a comprehensive suite of investment products and services that meet the customers' needs throughout their lifecycle, including stockbroking, advisory and discretionary portfolio management services.

The Group also provides a number of other services, including, bancassurance, corporate advisory, fund management, fund administration, and other services, such as 24-hour internet banking service, issuance of major credit cards, night safe facilities, automated teller machines, foreign exchange transactions, outward and inward payment transfers.

Pursuant to Article 177(2) of the Companies Act (Chapt. 386 of the Laws of Malta) the Directors declare that in mid-2019 the Bank embarked on (i) a transformation programme which revolves around the change of the Bank's core IT system to a state-of-the art Oracle platform (which was implemented on 1 January 2020) and (ii) an accelerated remediation plan.

(1) New Core Banking System

As announced in previous reports and communications, the Bank has announced a Core Banking Transformation programme to replace its information technology systems. It was the result of three years of commitment and hard work by its dedicated workforce to successfully conclude this ambitious transformation by 1 January 2020, as planned. Over the past year, BOV staff underwent intensive training and are now becoming more conversant with the new system. It is appropriate to keep in mind that such an extensive worldwide solution also needs an adaptation period both from a service perspective as well as ironing out functional issues. Throughout the changeover, the Bank also continued to deliver banking services to its customers, albeit reduced services by using cards through the ATM, ePOS and mobile locally and abroad during the changeover period.

With the implementation of the Core Banking Transformation programme, Bank of Valletta has achieved a critical cornerstone of the Group's strategy for 2020 and beyond. The new core banking system lays the foundation for a stronger bank and paves the way for the implementation of a comprehensive digitalisation strategy.

(2) Remediation Plan

This remediation plan envisages a full review and update of all customer files, the revamp of the Bank's risk appetite framework and its strategic planning process. The Bank has adopted industry best practice and chosen a risk based approach focusing efforts on potential risk.

The Bank registered a significant increase in administration expenses during the year relating primarily to the transformation programme and costs incurred ancillary with the change to the Bank's core IT system. The Bank is also working to instil a robust risk culture throughout the organisation, from the Board of Directors downwards.

The Parent Company

Bank of Valletta p.l.c. is licensed to carry out the business of banking and investment services in terms of the Banking Act,1994 (Chapter 371, Laws of Malta) and the Investment Services Act,1994 (Chapter 370, Laws of Malta). The Bank is an enrolled tied insurance intermediary of MAPFRE MSV Life p.l.c. under the Insurance Intermediaries Act, 2006 (Chapter 487, Laws of Malta).

The Bank offers the entire range of retail banking services as well as the sale of financial products such as units in collective investment schemes. The Bank also offers investment banking services, including underwriting and management of Initial Public Offerings (IPOs).

The Subsidiaries

BOV AM provides management services for collective investment schemes and portfolio management services for institutional

Directors' report as at 31 December 2019 (continued)

clients. BOV AM is a fully owned subsidiary of the Bank and has three regulatory functions: Asset Management, Risk Management and Compliance.

BOV FS is also a fully owned subsidiary of the Bank and is recognised as a fund administrator and licensed as a Company Services Provider by the Malta Financial Services Authority. BOV FS provides a comprehensive suite of services to fund managers and fund promoters, as well as a full suite of fund administration including fund accounting, shareholder registry services, regulatory reporting and corporate services.

Equity-Accounted Investees

MAPFRE MSV Life p.l.c. operates as a life assurance company licensed under the Insurance Business Act, 1998 (Chapter 403, Laws of Malta). MAPFRE Middlesea p.l.c. is engaged in the business of insurance, including group life assurance.

Strategic Initiatives of the Bank

During FY 2019, Bank of Valletta's strategy centred round the Vision 2020+, namely that of *"Making Bank of Valletta a safer and stronger bank for today and the future".*

This strategy was thus moulded into six strategic pillars:

1. Strong financial fundamentals to ensure long term stability and sustainability;
2. A Corporate Ethos based on integrity, fairness and transparency;
3. A business model based on prudence, sound governance and a secure and safe infrastructure;
4. A sustainable and equitable return to shareholders;
5. A superior customer experience based on customer centricity and on wider accessibility; and
6. Resourcing the organization for 2020 and beyond.

The Bank's strategy has been defined within the Risk Appetite Framework (RAF) approved by the Board during the year under review.

During the financial year under review, the Group has also continued with the restructuring of its business model, with the objective of lowering its risk profile through a de-risking programme aimed at turning Bank of Valletta into a lower risk and stronger Bank. The de-risking programme includes: (i) the winding down of certain business lines, namely the trusts and custody businesses; (ii) the re-dimensioning of other business lines notably the termination of thousands of customer relationships within the Bank's International Corporate Centre and International Personal Banking which no longer fit within the Bank's risk appetite; (iii) the revision of the Bank's risk appetite framework; (iv) the enhancement of risk policies such as the revision of the customer acceptance policy; and (v) comprehensive training programmes covering the entire organisation from the Board of Directors downwards.

Principal Risks and Uncertainties pursuant to Article 177 of the Companies Act, 1995 (Chapter 386, Laws of Malta)

The Directors are aware of the various risks faced by the Group as a result of its involvement in different business lines and operations. A number of measures are in place to ensure that such risks and uncertainties are maintained at acceptable levels and are in line with the Group's risk appetite and strategy of sustainable, long-term growth and profitability. In line with the Bank's Policy, the Risk Appetite Statement and Framework was reviewed and approved by the Board of Directors in December 2019. The document lays out the responsibilities of various stakeholders, including the Board of Directors and Senior Management, and establishes a number of qualitative and quantitative parameters for acceptable risk taking.

In line with the provisions of the Risk Appetite Statement and Framework, Senior Management is responsible for the day-to-day monitoring and control of risk taking, subject to the regular oversight of the Board of Directors through the Risk Management Committee. The overall structure is aimed at ensuring a sound risk culture supported by a performance management system that discourages excessive risk taking.

The key risks faced by the Group include credit risk, market risk, operational risk and liquidity risk. These, and other risks and uncertainties inherent in the business, require sound capital management to ensure adequacy against regulatory requirements and adverse events. With this in mind, the Group regularly sets out and reviews capital targets in line with actual and forecast business levels and monitors performance against such targets on a regular basis. A more detailed explanation of key risks and capital management is included within the Capital and Risk Management Report as well as Note 39 to the Financial Statements.

The Directors also recognize the fact that the Group may be subject to reputation and litigation risk as a result of its actions and operations. Conscious of the serious repercussions such risks may have on the Group's and the various stakeholders' wellbeing, both the Board of Directors and Senior Management exercise zero tolerance to conduct risk and aim to instil the highest levels of ethical behaviour through a number of appropriate policies, procedures and controls.

Operational Overview

A review of the business of the Group for the period ended 31 December 2019 and an indication of future developments are provided in the Chairman's Statement and the Chief Executive Officer's Commentary, which can be found in the front section of this Annual Report.

Directors' report as at 31 December 2019 (continued)

Dividends

The Directors propose a final gross dividend of €0.026 per share. The aggregate net dividend for the period is €0.017 per share, amounting to €10 million. The total dividend is analysed as follows:

	The Bank 2019 €
Gross	15,384,615
Tax at Source	5,384,615
Net	10,000,000

Board of Directors

The following Directors served on the Board during FY 2019:

Taddeo Scerri (Chairman)
Stephen Agius
Alan Attard (resigned on 1 January 2020)
Paul V Azzopardi (resigned 15 February 2020)
Miguel Borg
Diane Bugeja (appointed on 19 December 2019)
James Grech
Alfred Lupi
Mario Mallia (resigned on 27 December 2019)
Anita Mangion
Alfred Mifsud (appointed on 19 December 2019)
Antonio Piras
Joseph M Zrinzo (resigned on 1 September 2019)

Directors' Responsibilities

The Directors are required by the Companies Act, 1995 (Chapter 386, Laws of Malta) to prepare financial statements in accordance with International Financial Reporting Standards as adopted by the EU which give a true and fair view of the state of affairs of the Group and the Bank as at the end of the financial year and of the profit or loss of the Group and the Bank for the year then ended. In preparing the financial statements, the Directors should:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable; and
- prepare the financial statements on a going concern basis unless it is inappropriate to presume that the Group and the Bank will continue in business as a going concern.

The Directors are responsible for ensuring that proper accounting records are kept which disclose with reasonable accuracy at any time the financial position of the Group and the Bank, and which enable the Directors to ensure that the financial statements comply with the Banking Act, 1994 (Chapter 371, Laws of Malta) and the Companies Act, 1995 (Chapter 386, Laws of Malta) and with the requirements of Article 4 of the Regulation on the application of IFRS as adopted by the EU. This responsibility includes designing, implementing and maintaining such internal controls as the Directors determine necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error. The Directors are also responsible for safeguarding the assets of the Group and the Bank, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

After reviewing the Group's plans for the coming financial years, the Directors are satisfied that at the time of approving these financial statements, it is appropriate to continue adopting the going concern basis in preparing these financial statements.

Auditors

A resolution to re-appoint KPMG Malta jointly with KPMG LLP (United Kingdom) as statutory auditors of the Bank will be proposed at the forthcoming Annual General Meeting (AGM). KPMG Malta and KPMG LLP (United Kingdom) have expressed their willingness to remain in office.

Going concern – Listing Rule 5.62

The financial statements are prepared on a going concern basis. The Directors regard that pursuant to Listing Rule 5.62, this is appropriate, after due consideration of the Bank's profitability, liquidity, the statement of financial position, capital adequacy and solvency. Specifically, the Directors have prepared financial and capital plans for the next five years which show that the Bank is in a position to continue operating as a going concern for the foreseeable future. These plans take into account risks facing the Bank, including but not limited to, the potential crystallisation of known contingent liabilities.

Directors' report as at 31 December 2019 (continued)

Information Pursuant to Listing Rule 5.64

Authorised Share Capital

The Bank has an authorised share capital of €1,000 million divided into 1,000 million ordinary shares with a nominal value of €1.00 each.

Issued Share Capital

The issued shares of the Bank consist of one class of ordinary shares with equal voting rights attached.

During the Annual General meeting held on 9 May 2019, the shareholders approved a bonus share issue of 53,077,206 fully paid ordinary shares of a nominal value of €1.00 per share, representing 1 bonus share for every 10 shares held, thereby increasing the Bank's issued share capital from the previous 530,772,064 shares to 583,849,270 shares of €1.00 each share fully paid up, resulting in a paid up capital of €583,849,270.

Shareholding Structure

Clause 4.3 of the Bank's Memorandum of Association provides that, with the exception of existing large shareholders, presently the Government of Malta and UniCredit S.p.A., no person may at any time, whether directly or indirectly and in any manner whatsoever, acquire such number of shares in the Bank, as would in aggregate be in excess of 5% of the issued share capital of the Bank.

As at 31 December 2019, Malta Government Investments Limited had a shareholding in the Bank of 0.48% and National Development and Social Fund (NDSF) had a shareholding in the Bank of 2.88%. Both entities are fully owned by the Government.

Any shareholder holding in excess of 50% of the issued share capital of the Bank or if no such shareholder exists, the shareholder holding the highest number of shares not being less than 25% of the issued share capital, may appoint the Chairman. Qualifying Shareholders with 10% or more of the shares in issue are entitled to recommend one Director for every 10% holding.

The Directors confirm that as at 31 December 2019, shareholding in excess of 5% of the issued share capital of the Bank was held directly by:

Government of Malta	25.0%
UniCredit S.p.A.	10.2%

Appointment of Directors

The rules governing the appointment and replacement of the Bank's Directors are contained in Articles 24 to 31 of the Bank's Articles of Association. More details on the appointment and rotation process of Directors is found under the Corporate Governance Statement of Compliance, under principle 3.

An extraordinary resolution approved by the shareholders in general meeting is required to amend the Memorandum and Articles of Association.

Powers of Directors

The Board of Directors has the power to transact all business of whatever nature, not expressly reserved by the Memorandum and Articles of Association of the Bank, to be exercised by the Bank in general meeting or by any provisions contained in any provision contained in any applicable laws.

The shareholders in general meeting authorised the Board to exercise during the Prescribed Period, all the powers of the Bank to issue and allot shares up to an aggregate nominal amount equal to the Prescribed Amount. The Prescribed Period refers to a term of five years approved during an Extraordinary General Meeting held on 27 July 2017 and which term expires on the 26 July 2022. This authority is renewable for further periods of five years each.

Directors' Service Contracts

The Directors have service contracts with the Bank. More information on the Directors' service contracts can be found under the Remuneration Report.

Collective Agreements

The relative Collective Agreements regulate the compensation payable to employees in case of resignation, redundancy or termination of employment for other reasons.

It is hereby declared that as at 31 December 2019, information required under Listing Rules 5.64.5, 5.64.7 and 5.64.10 was not applicable to the Bank.

Directors' report as at 31 December 2019 (continued)

Amendments to the Memorandum of Association

The Bank's Memorandum of Association was revised during the period under review and approved by the Shareholders during the Annual General Meeting held on 9 May 2019.

1. Amendments to clauses 4.5 and 4.6 of the Memorandum of Association:

Pursuant to this revision to the Memorandum of Association, a large shareholder (namely any person who currently holds more than 5% of the Bank's issued share capital) being a bank, credit institution, financial institution, insurance company or licensed collective investment scheme, or licenced retirement fund shall be able to sell its large shareholding, namely any holding of more than 5% of the Bank's issued share capital, to any of the following institutions:

- banks
- credit institutions
- financial institutions
- insurance companies
- licensed collective investment schemes or
- licensed retirement funds

Pursuant to this amendment "licensed retirement funds" were included in the list of eligible institutions which are now able to acquire and hold a large shareholding in the Bank. This provision therefore allowed large shareholders who wished to dispose of their large shareholding, a broader segment in the market to whom they could sell and dispose of their shares as one holding, whilst at the time ensuring that only institutions which are subject to regulation and licensing could be the holders of a large shareholding in the Bank.

2. Amendments to Article 7 of the Articles of Association:

A new Article 7.3 was introduced to clarify and regulate the current practical state of affairs when shares issued by the Bank were held subject to usufruct. The amendment did not result in any changes from a practical point of view, but it was merely intended to formalise the process currently in place.

3. The inclusion of a new Article 27A of the Articles of Association and further amendments to the Articles of Association in connection with the insertion of Article 27A:

The inclusion of the new Article 27A addressed situations where, notwithstanding the efforts that may be made by the Nominations and Governance Committee to ensure that the Board of Directors of the Company had the necessary mix of skills and experience, there could arise situations where those efforts may not yield the appropriate mix and combination of skills; or where the regulator may require certain skills which may not be present on the Board.

In such situations, the Board can now react to ensure that the composition of the Board fulfils its ultimate aim. Accordingly, this new Article 27A empowered the Board of Directors to co-opt up to a maximum additional two Non-Executive Directors to sit on the Board of Directors of the Company (only in those instances where the nine Non-Executive Director positions were already filled, but the then current Board complement still does not have the composition required by regulation or in the opinion of the Nominations and Governance Committee, the Board still does not have the appropriate mix of collective skills, knowledge and experience).

Such co-opted Non-Executive Directors would be appointed for a three (3) year term which shall not be subject to rotation but shall be eligible for re-appointment.

A new provision regulating retiring directors was also introduced, specifying that Non-Executive Directors who reached seventy-five (75) years of age will no longer remain eligible for re-appointment or re-election once their term of office has expired.

Information pursuant to Listing Rule 5.70.1

There were no material contracts to which the Bank, or any one of its subsidiaries, was a party and in which anyone of the Bank's Directors was directly or indirectly interested.

Declaration pursuant to Investment Services Rule R4-5.3.5

Pursuant to the Malta Financial Services Authority (MFSA) Investment Services Rule R4-5.3.5 for Investment Services Providers and Standard Licence Conditions (SLCs) SLC 2.30, it is hereby declared that during the reporting period, there were no breaches of the MFSA Investment Services Rules, Standard Licence Conditions or other regulatory requirements.

Whistleblowing

The Bank has in place a Whistleblowing Policy aimed to encourage reporting of improper practices and suspected wrongdoing in a controlled manner which safeguards the confidentiality of the whistleblower. The nature of the disclosures made through the Whistleblowing process are reported to the Audit Committee.

Directors’ report as at 31 December 2019 (continued)

Information pursuant to the Sixth Schedule of the Companies Act, 1995 (Chapter 386, Laws of Malta)

Branches, Agencies and Centres

The Bank has the following Branches, Agencies and Centres around Malta and Gozo:

- 36 Branches offering both deposit taking and lending services
- 5 Business Centres
- 6 Investment Centres
- 4 Agencies offering deposit services only
- 1 Sub-Agency/Satellite Branch offering both deposit and lending services which reports to the “parent” branch

Besides the above local Branches, the Bank has four Representative Offices, one in Milan which was opened in 1996, one in Libya (temporarily closed) which was opened in 2002, one in Brussels, opened in 2012 and another one in London which was opened in 2018.

Research and Development

In light of the business sector in which it operates, the Bank does not consider research and development as a main area of activity.

Events occurring after the end of the accounting period

Appointment of new Chief Executive Officer (CEO) - With effect from 1 January 2020, the Bank has a new CEO, Mr Rick Hunkin, who replaced Mr Mario Mallia, the Bank’s former Chief Executive Officer. More information on the new CEO is found under section (xvii).

Non-Financial Disclosures

The following disclosures are made pursuant to Directive 2014/95/EU:

1. <u>Business Model</u>

Bank of Valletta operates a business model driven retail funding strategy which has over the years provided a highly stable funding source to support the Bank’s key business services to both personal and business customers.

The Bank’s suite of products and services has been developed in a way to ensure that the Bank’s customers are provided with a comprehensive range of solutions to meet their requirements as they progress through the different stages of their lifecycle. On the distribution side, the Bank’s strong branch network plays an important role in this model and remains a critical touchpoint for the Bank’s customers. In addition, the branch network has over the years been complemented with the introduction of a number of Investment Centres and a specialised Wealth Management Unit in order to provide our customers with convenient, professional and dedicated investment management and advisory services. On the other hand, through the Bank’s Corporate Centre, as well as a number of Business Centres, the Bank attends to the bespoke financing requirements of its business customers.

Despite the importance of the Bank’s physical customer touchpoints, the onset of technological developments has also driven the Bank to invest and deploy a number of key digital channels to strengthen the accessibility of its products and services to its customers. In fact, the introduction of internet banking, mobile banking and the newly launched BOV Pay portal, position the Bank at the very centre of its clients’ financial wellbeing where these touchpoints have today become the preferred channels through which customers prefer to transact.

2. <u>Environmental Friendly Measures</u>

Notwithstanding that the Bank does not pursue a formal policy relating to environmental measures, various environmental related initiatives were taken by the Bank during the reporting year. These initiatives are part of the Bank’s ongoing commitment to promote Green practices within the community and determination to decrease the carbon footprint led to various Green Initiatives and included installations of modern, energy efficient Heating Ventilation Air Conditioning (HVAC) systems, continuous disinfection and cleaning of ducting systems at various branches, replacement of lights to energy efficient Light Emitting Diodes (LED) light fittings, increased use of hybrid vehicles and installations of PV Cells which generated electrical energy and which resulted in lower electricity consumption costs. The Bank also participated in the annual global initiative Earth Hour by switching off the BOV Centre and Legal Office façade lights during the hour indicated, with the aim of reducing electricity consumption. The Bank also participated in the European Week for Waste Reduction. Waste Separation and Recycling of Electronic Waste was ongoing throughout the reporting period.

3. <u>Human Resources Matters</u>

The Bank is covered by a Collective Agreement which binds the relationship between the organisation and its employees. The prevailing Collective Agreement includes a number of Family Friendly measures ensuring employee matters are looked after, including but not limited to Flexible Work Arrangements, Adoption/Fostering Leave, Bereavement Leave, Community Work Leave, Employee Welfare and an Employee Wellness Allowance. Moreover, the Bank has in place a number of policies ensuring respect for human rights including

Directors' report as at 31 December 2019 (continued)

a Bullying Policy, a Sexual Harassment Policy, a Grievance Policy, Health and Safety Policy, a Code of Ethics and an Equality Policy. Related to the latter, the Bank has been awarded the Equality Mark, in recognition of the Bank's non-discriminatory approach to its workforce. Moreover, such policies ensure that employees have clear guidelines to follow if they feel they are not being fairly treated. No cases of discrimination were reported during 2019.

Employee Assistance Programme – This programme assists employees resolve personal or work related problems that hinder their ability to carry out responsibilities at work. The Bank, in conjunction with the Richmond Foundation, also offers its staff members free Mental Health Care related services. The Bank receives annual feedback from Richmond Foundation regarding the number of employees making use of these services, which information confirms that employees are well informed about these services and make use thereof when necessary.

4. <u>Anti-Corruption and Bribery Matters</u>

The Bank reiterates its zero tolerance stance towards financial crime, specifically including bribery and corruption. As part of its efforts to continuously increase controls in this area, thereby minimising risks to stakeholders, the economy and society in general, the Bank has during FY 2019 dedicated specific resources within its anti-financial crime function to control and mitigate bribery and corruption risk. Resources with experience in the area have also been recruited. The Bank has also approved a dedicated anti-bribery and corruption policy and has commenced work on procedures for its implementation, backed by a bank-wide training programme.

5. <u>Identification and Management of Principle Risks</u>

In conducting its day-to-day business activities, the Bank is exposed to different risk types. The sound management and control of such risks is important to ensure that the relative probability of risk event materialization is minimized to the greatest extent possible in the interest of institutional stakeholders.

Risk management and control is practised under the following configuration:

i) Top-level corporate governance: Board of Directors, various Board Committees such as the Risk Management Committee, Management Board, and other management committees such as the Asset and Liability Management Committee (ALCO);

ii) First line: revenue-generating business units – such ingrain frontline risk management internal control measures;

iii) Second line: this comprises various second-tier risk control and oversight functions such as Risk Management, Compliance, Anti-Financial Crime, Financial Control, and other backoffice support functions (e.g. quality control);

iv) Third line: independent assurance and constructive challenge by the Group Internal Audit;

The main risk types are outlined hereunder:

a) Credit risk: the risk of loss arising from default or credit quality deterioration of a customer or other counterparty to whom the Bank has either directly provided credit or in respect of whom it has assumed a contractual obligation.

   This risk is managed and controlled in various ways such as through the regular review of risk-averse credit policies, credit scoring systems, an internal risk rating system supplemented by an Early Warning System, a forward-looking expected loss model for quantifying provisions compliant with the IFRS 9 accounting regime, stress testing relating to credit risk, and various other measures. Examples of the latter include a four-eye approach in the sanctioning of credit facilities of significant magnitude, policies relating to forbearance and nonperforming loans, credit risk-related Key Risk Indicators in the Bank's Risk Appetite Framework, internal limits relating to single-name and sectoral concentration risk, and various other mitigants. Other developments are in the pipeline such as a risk-based pricing model.

b) Operational risk: The Group defines operational risk (OR), in line with the Basel framework, as the risk of losses arising from defects or failures in its internal processes, people, systems or external events, covering risk categories such as fraud, technological, cyber-risk, legal and conduct risk.

   Operational risk is inherent in all products, activities, processes and systems and is generated in all business and support areas. For this reason, all employees are responsible for managing and controlling the operational risks generated by their activities. The Group's goal in terms of operational risk management and control is focused on identifying, evaluating, and mitigating sources of risk, regardless of whether they have materialized or not. The analysis of exposure to operational risk helps determine the actions which should be taken to minimize the frequency and impact.

   In 2019, the Group's overall operational risk appetite was revised to low; this aims to protect the Bank's franchise, to support its strategic objectives, and ensure availability of services to support the local economy.

   As part of the strengthening of the Operational Risk Management Framework, the Bank has embarked, and is in advanced stage of deploying a dedicated Operational Risks IT solution which will enable the Group obtain a fuller and more precise view of risks in a timely manner, through the integration of risk and control assessment, risk event management, and metrics using a common set of risk taxonomy.

Directors' report as at 31 December 2019 (continued)

c) Market risk: in the main, the risk incurred as a result of changes in market factors that affect the value of positions mainly in the investment portfolio of securities. The Bank has its own Interest Rate Risk in the Banking Book (IRRBB) model to quantify risk arising under different shocks as prescribed by applicable regulatory dicta which is premised on two approaches: the Economic Value of Equity approach and the Earnings Based approach. A robust and prudent Treasury Management Policy ensures that responsible and well-informed risk-taking is practised by the Bank's Treasury function; such is complimented by independent arms-length analysis conducted by the Risk Management Department and submitted to ALCO and the Risk Management Committee from time to time. Inter alia, other important processes include the analysis of counterparty credit risk, credit valuation adjustment, and the development of a methodology to quantify equity risk on the part of the investment portfolio which is reported in the audited accounts at fair value (i.e. on a mark-to-market basis).

d) Liquidity risk: the risk that the BOV Group does not have the liquid financial resources to meet its obligations when they fall due, or can only obtain them at an unreasonably high cost.

Various liquidity risk management tools are used such maturity ladder gap analysis and the regular updating of key metrics. Inter alia, these include the Liquidity Coverage Ratio, the Net Stable Funding Ratio, the Loans-to-Deposit Ratio, the Maturity Transformation Metric and various others. Furthermore, over and above the Internal Liquidity Adequacy Assessment Process (ILAAP) which is thoroughly reviewed every year, the Bank conducts robust stress testing on liquidity at least on a semi-annual basis and which are supplemented by sensitivity analysis exercises from time to time. Other important elements with the liquidity risk management toolkit include the Contingency Funding Plan which is regularly updated and tested by means of simulation exercise and a prudent Liquidity Risk Policy which is also updated periodically.

e) Solvency risk: the risk of having insufficient capital to absorb unexpected losses and/or exceptional losses nascent from stress events. BOV has a regularly updated Capital Plan which is a key input in the institution's Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP is revised annually and ensures that there is enough capital not only to meet Pillar 1 risks – credit, operational, and market – but also other Pillar 2 risks such as IRRBB, concentration risk, equity risk, and others. Stress testing gauges the stressed capital position in terms of such key metrics as the stressed Common Equity Tier 1 capital and the stressed total Capital Adequacy Ratio; as a minimum this is done on a semi-annual basis. The Recovery Plan and the Resolution Plan respectively take even more adverse scenarios than the ICAAP as they are formulated under a gone concern perspective; such are also updated at least annually. Moreover, a proactive approach is practised relating to medium-term obligations nascent from the Minimum Requirement for own funds and Eligible Liabilities (MREL).

f) Regulatory compliance risk: the risk of non-compliance with legal and regulatory requirements as well as supervisory expectations which may result in administrative or disciplinary sanctions, or of material financial loss, due to failure to comply with the provisions governing the Group's activities. By ensuring that these rules are observed, the Group works to protect its customers, shareholders, counterparties and employees.

This is conducted in alignment with the Group strategy and Vision 2020+, which sets the Group's vision as operating a business model based on prudence and sound governance, and to continue strengthening the corporate ethos based on integrity, fairness and transparency.

(i) Financial Crime Compliance

The BOV group is committed to fight against financial crime and to set up and implement a programme to identify, understand and mitigate the financial crime risk. The financial crime risk encompasses:
a) money laundering and terrorist financing,
b) breaches of sanctions, and
c) bribery and corruption.

The Bank maintains a thorough AFC risk assessment in order to identify, understand, manage and mitigate inherent AFC risks. Risk mitigations measures are designed and implemented to control adequately and effectively those inherent risks. Inherent and residual risks are managed in line with the Bank's risk appetite.

BOV is always committed to be in compliance with all applicable laws and regulations regarding the fight against financial crime. The results of recommendations, provisions and sanctions by regulators for past shortcomings, together with the recommendations of in-house and external experts, form the basis for the current transformation programme aimed at leading BOV towards the highest industry standards of financial crime compliance.

(ii) Regulatory compliance

Complying with the regulatory obligations is not only the responsibility of the Compliance Department, but of all Group employees who must demonstrate compliance and integrity in their daily tasks. The management of compliance risks is based on a shared responsibility binding all business functions, the subsidiary companies and employees with in the internal control functions of the Group. All functions must integrate compliance with laws and regulations, the rules of good professional conduct and the Group's internal rules into their daily work. This consists of two main pillars - advisory and supervisory functions:

a) Advisory function – monitor regulatory developments, analyse the legislations that impact the Group, communicate the regulatory requirements to the impacted functions and provide guidance during implementation, and
b) Supervisory function - carry - out independent product and function oversight reviews on a risk-based compliance monitoring plan.

Directors' report as at 31 December 2019 (continued)

Group Compliance is an independent risk control function headed by the Group Chief Compliance Officer and constitutes the second line of defence for compliance risk. The Group Chief Compliance Officer is the designated Group Conflicts Officer. The Group Chief Compliance Officer reports to the Chief Executive Officer and has a direct escalation line to the Compliance and Crime Prevention Committee, which is a Board Committee.

Additionally, the Bank has a dedicated Money Laundering Reporting Officer and a Group Data Protection Officer.

g) Climate risk: The Bank is well aware of its environmental obligations as a responsible corporate citizen. Climate-change related risk drivers – whether physical or transition-led – are expected to act as factors that could aggravate the existing risks in the medium and long term. In a May 2019 European Central Bank publication it was stated that: "From a risk-management perspective, the lack of clear common definitions and data makes it difficult to measure the impact these risks have on individual banks, let alone compare them". Whilst it is still early days in this risk field, the Bank is not resting on its laurels. The publications of the Network for Greening the Financial System (NGFS) are on the institutional radar; so are those issued by the European Banking Authority (EBA) such as the press release issued in December 2019 entitled "EBA pushes for early action on sustainable finance". Taking a proactive approach, the Risk Management Department (RMD) reorganization which was in the pipeline as at reporting date, had already planned that a specific RMD unit will, with effect from 2020 be entrusted with proposing, formalizing, and developing the Bank's risk response to this emerging risk, one that is expected to gain importance in the coming years.

h) Key Performance Indicators (KPIs)

The Group has in place a set of key performance indicators (KPIs) that are quantifiable measures which ensure that material risks are kept within defined thresholds as formalized in the Risk Appetite Framework. A selection of key metrics is tabulated hereunder.

	CET 1	19.51%
Solvency	CAR	23.07%
	LCR	514.60%
Liquidity	NSFR	159.54%
Profitability	ROE*	6.2%

**Post Tax*

Various non-financial KPIs enable the Directors also to evaluate the risk profile exhibited on other risks such as reputational, compliance, anti-financial crime, operational, and risk culture.

The KPIs are reported on a regular basis in the Risk Dashboard which includes targets set to facilitate comparison between progress achieved towards attainment of strategic objectives and the actual risk profile exhibited viz.: 'within target', 'within tolerance', 'limit'.

Other than as disclosed in note 33 to the financial statements, there were no subsequent events which would have otherwise warranted an adjustment to or disclosure in these financial statements.

6. <u>COVID-19 Outbreak</u>

The events subsequent to the reporting date, notably the COVID-19 outbreak, will most likely have a substantial negative impact on both global and local economies. The existing capital buffers, together with measures made available by the regulatory authorities provide significant mitigation against the additional challenges of this unprecedented event. An adverse influence on 2020 performance is highly probable but a clear determination of the overall financial impact cannot be made at this early stage. There are uncertainties on both the duration of the crisis and the extent of the impact on the local economy as well as, the scale and effectiveness of mitigating measures provided by the local and EU authorities. The directors do not consider that any adjustments are required to the financial statements at this stage. The Bank has already taken steps and intends to launch further initiatives to continue to support the local economy as well as to help safeguard the well-being of its employees and its customers.

Statement by the Directors pursuant to Listing Rule 5.68

We, the undersigned, declare that to the best of our knowledge, the financial statements prepared in accordance with the applicable accounting standards, 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 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.

Approved by the Board of Directors and authorised for issue on 18 March 2020 and signed on its behalf by:

Taddeo Scerri
Chairman

Mr Rick Hunkin
Director and Chief Executive Officer