

# NEMEA BANK ANNUAL REPORT 2014



## NEMEA BANK IN A FEW WORDS

- Nemea's spearhead product, now entering its second phase of development, is the revolutionary nip – the Nemea Instant Payment, enabling transfer of money globally in real time and for free, providing private individuals, corporations and institutions with vast value added
- Nemea is a modern pan-European bank licensed to provide banking and investment services to the 31 EU and EEA countries with an aggregate home market of over 500 million people and a total GDP of EUR 13 trillion
- Nemea does not run a network of traditional physical branch offices but offers its products and services exclusively online
- The Bank focuses on serving internationally oriented individual clients of two core segments – the Gen X and Y young students and professionals, the global citizens of the future and the cosmopolitan entrepreneurs, executives and professionals, people leading international lives
- Nemea is strategically located in Malta, an EU member state that is the middle point between Europe, Africa and Middle East, forming the vast EMEA region of more than 1.5 billion people

## NEMEA REVOLUTIONISES GLOBAL PAYMENTS





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## YEAR IN REVIEW

- The financial year from 1 January to 31 December 2014, the sixth financial period of the Bank, was a transformative year for the Bank, ending a long period of static preparation, when the first phase of the retail web bank was published live, triggering a new phase of growth.

### 2014

- A new website was launched in February, which was further developed following the launch of the first phase of the retail web bank on 07-07-14 and the development of new products and services
- Current, savings and term deposit account products were launched and offered to both individual and business clients as personal and business cash management tools
- Client service and communications was extended to offer full client support in English, Spanish, French, Finnish and Greek
- Nemea's spearhead product – the Nemea Instant Payment – was launched to peer-to-peer users
- Traditional SEPA and other SWIFT payment products were launched
- As a result of the launch of the web bank and deposit products, the deposit base was multiplied six-fold from €2,858 thousand in 2013 to €17,952 thousand in 2014. Subsequently, the balance sheet tripled, from €8,536 thousand to €24,145 thousand in December 2013 and December 2014 respectively. Nemea's profit before tax increased by 440%, from €65 thousand to €349 thousand for the year ended 31 December 2013 and 31 December 2014 respectively
- The Bank doubled its staff from 11 to 23, incorporating new responsibility segments such as risk management, finance and accounting, marketing and communications, SEO, sales and client services, all of which were required to take the Bank forward from a development to a growth phase
- The Bank initiated the acquisition of consumer loans in the last quarter of 2014, enabling a satisfactory lending margin that also translated into maintaining very competitive offers on savings and term deposit accounts
- A number of corporate and investment banking cases were successfully concluded, focusing on real estate-related cases
- The Bank acted as an investment manager of an alternative investment fund

## LETTER TO STAKEHOLDERS

Nemea Bank has closed its sixth and best financial period so far. The Bank launched the first phase of its online retail bank in the beginning of the second half of the year, and has been growing ever since. The previously static preparative phase ended and transformed into a phase of growth overnight, with the size of the balance sheet tripling during the second half of the year, and doubling again during the first quarter of 2015. Nemea's progression into full client operations was accompanied by the development of corporate social responsibility efforts to underscore the Bank's social commitment. In spite of increasing costs due to the Bank's growth, such as the doubling of the staff count, the Bank was able to return a clear profit that was its best so far. The long, patient build-up and development of the online banking portal, in line with the Bank's original business plan came to fruition, and 2014 ended as the best year on record for the Bank, despite the fact that the Bank only reaped the rewards of the new online platform for less than half a year.

### **General operating environment: regulatory rage continues, banks stifled and prevented from lending, Europe showing very limited signs of progress away from the infernal spiral of deflation**

In terms of the general operating environment, there was little difference between the years 2013 and 2014, with the general economic environment remaining stagnant and Europe having firmly decided to shoot at its own feet through ever-increasing financial services regulation – the “regulatory rage” as many reputable financial publications call it – as opposed to clear action to stimulate supply and growth. It is clearer than ever before that ‘banker bashing’ has become an excuse by politicians, bureaucrats and regulators to avoid taking courageous decisions to put the European economy back on its feet. Having observed this for the past 5-6 years, with the wrong type and direction of regulation becoming ever stronger, one wonders, when will those, who so eagerly try to point fingers to the banks, look into the mirror with a more critical eye of themselves. It would appear that it is rather the extremely badly managed, unsustainable and structurally outdated public economies and countries that have kept Europe wading through mud, rather than the banks. In several instances, decisions taken by regulators have even intentionally prevented banks from exercising their key economic function by tightening capital requirements and continuously increasing the risk weights of assets, while politicians confusingly keep shouting: “Why don't banks increase their lending?” This irresponsible regulatory overdrive and lack of direction is costing Europe far too much, and it is high time that those stifling banks' ability to fulfill their economic function start bearing their own responsibilities – this includes regulators and other technocrats who are the engine behind each attempt to tax and regulate everything that moves insofar as stopping banks from moving at all.

As we stated in our review last year, and with this extremely antagonistic regulatory evolution maintaining its course, we state once more: In our opinion, banks, which are already under intense pressure as a result of the recessionary environment that is now

even heading towards deflation, are also having to cope with the artificial impediments being created by politicians, regulators and central bankers, making the burden for banks rather excessive to bear – a pure burden without any benefit whatsoever in return, being a rather asymmetric, negative state of affairs. This is not a critique of regulation as a tool for positive guidance, but it is little wonder that industry experts are talking about enormous fatigue caused by what is certainly undue regulatory burden. It therefore does not come as a surprise that certain quarters are also talking about the emergence of a very aggressive front to counter a regulatory evolution that has gone too far into a totally wrong direction.



Mika Lehto and Heikki Niemelä

**The golden rule in regulation: Tighten at the top of the cycle, loosen at the bottom**

Isn't it obvious that in difficult economic circumstances, any regulation should be loosened to a practical minimum rather than tightened to the very maximum? Wouldn't this help the banking sector to fulfill its economic function of maturity transformation, that is, transforming short-term customer deposits into long-term corporate and private household loans to finance investment, rather than to suffocate all of it? In this process of maturity transformation, the increase in regulatory requirements for liquidity is also acting in a very counterproductive manner, requiring banks to hold ever-larger portions of their portfolios in very liquid form, rather than funneling such funds as loans to finance back to the underlying economies for sustainable growth. One can easily ask: which will generate more growth and prosperity, lending to those in need of funds, or the practice of hoarding excessive cash balances? Neither the management of banks nor the regulation thereof should be based on fear and weakness, trapping everything in liquid form, but on confidence in the future, in the eventual economic growth that will emerge from vision and the right stimulus.

As has been seen so many times, trying to prevent any causes that led to the previous excesses or imbalances in the economic cycle from re-emerging through extreme regulation never works: the causes of the next economic "bubble" never tend to be the same ones as those of the previous cycle, and almost always tend not to be seen or detected in time by most people; as if they were, they could be prevented from boiling over in time through appropriate action in the first place. As this is not the case, why

spend so much time, energy and taxpayers' money in trying to kill something that has already been endured and is in the past, and simultaneously strangle and stifle any future growth by tying down the whole financial services sector along the way, rather than to show any sign of 'enlightened guidance and supervision', guiding the markets in a pragmatic manner to cut off excess but not by killing off the everyday business as is happening today? It is naïve to think that by regulating everything the world will somehow become more 'governable' and that any crises would suddenly be eliminated for good. This kind of regulatory evolution can only lead from weakness to weakness, as is unfortunately clearly in evidence at present, and there is absolutely nothing good that can emerge from it.

Europe has great potential, but that potential can only be tapped through smart supply-side stimulus, measures that incentivize business and the creation of jobs, and intelligent regulation that boosts confidence rather than shackles ideas and innovation. Without incentive and good rewards for innovation, risk taking and success, no one will innovate, take intelligent risks or be able to succeed, and without those elements no economic machine will churn and pull the underlying societies from their depths and put them back on the track of growth.

### **Launch of our web bank**

After several years of delays, in mid-2014, we were finally able to launch the first version of our retail web bank that is running on our proprietary Hydra core banking system. The launch of the web bank brings to a close a very unlucky period of systems development, characterized by a disastrous performance by a major banking systems vendor in the early years of the project. These delays held us back from launching our growth phase earlier. The new web bank is the product of a strategic decision to develop our core systems platform in-house, to ensure full control of the most vital infrastructure of the Bank. It is the work of the next generation in-house development team that, through leadership and competence, had already developed a basic online banking platform by early 2014 for public consumption. It took several more months to have the client authentication module delivered by an external software vendor and thoroughly test it, so that the web bank we are using today was launched on 07-07-14.

Ever since the launch of the initial version of the web bank, the Bank has experienced a steady growth, which, from the earliest indications, is merely an initial ripple of many great things to come. This has been very positive.

Our experience with IT systems has really proven that core banking systems are a core competence for a bank, especially when every element of financial services is dematerialized, virtual, and digital: if one is not in full control of one's own systems and the development they constantly require, not much can be done in this business. Even if it is always a challenge to build strong platforms from scratch, it is essential for long-term success, and this is what we have certainly experienced: a bank intended to operate online without its online platform, and without control of the development of its own platform, would be a bank without any future, without any possibility for success. So practically we have never had any real choice but to build everything on our own.

To reach our goals, the development team more than doubled, from 4 people at the end of 2013, to 9 people by the end of 2014. Its growth will continue in 2015. But it is significant to note that the core and internet banking platform was initially built up by a very small team of 4-5 people, showing that things are possible and quality work does

not require enormous teams and resources, if people are energetic, passionate and know what they are doing.

In July 2014, the first live version of the web bank was launched, containing basic features such as the Nemea account (the default current account) and a range of well-rewarding fixed term accounts with maturities between 1 month and 5 years directed to savers, as well as the NIP – the revolutionary Nemea Instant Payment as explained elsewhere in this annual report, and traditional payment types such as the European SEPA and other SWIFT-based interbank payments.

After the initial launch, other products such as a savings account were launched in the course of the autumn, and the work continued on the next version of the internal Hydra back office that was eventually released in February 2015.

Both the website and the web bank were offered as from launch in four languages: English, Finnish, French and Spanish. They are being offered in the Eurozone countries of such languages: English in general and in particular for Malta, Ireland and Cyprus (Greek has been introduced as from March 2015), Finnish for Finland (currently passively without any active promotion), French for Belgium (French-speaking Brussels and the southern Walloon region of Belgium), France and Luxembourg, and Spanish for Spain. More languages and countries will follow in 2015, with Greek having been introduced before the date of this annual report in March 2015, and the Dutch version being launched with the new website as well, and the Italian version being in the pipeline.

### **Alternative investment fund management**

During 2014, the Bank continued to manage the Nemea Credit Opportunities Fund that kept producing a steady double-digit yield to its investors, including the Bank. The Fund grew slightly due to the returns it produced as well as due to a few new investments, also including one in early 2015. The Fund was originally launched in 2012 and has already generated a very good performance track. The fund details were also included in the Thomson Reuters service in 2014 for a better institutional visibility.

### **Sources of revenue**

Before launching its web bank, the Bank had previously started an online term deposit product in 2013 that was not very actively promoted, as the focus was on the delivery of a proper web bank at the time. The pre-web bank online deposit was only occasionally promoted in local newspaper ads in Malta. Only upon the launch of the web bank in July 2014, was an active online promotion on the Internet initiated in selected countries to increase brand awareness, account opening and the term deposit products. This resulted in a growing flow of funds to both the new current account and term deposit accounts that are mainly offered in the euro currency.

While the Bank will be developing and launching its own lending products on the Hydra platform soon, with a focus on consumer loans, it collaborates with other entities in acquiring and investing in such consumer loans, enabling a satisfactory lending margin that can also be shared with the Bank's clients by offering them a good return on their term savings, thus benefitting both parties. Without a good risk-adjusted yield on its investments, the Bank would not be able to offer attractive rates for its depositors.

While the Bank's consumer business model was not yet in full swing in 2014, some core elements thereof were launched as explained above in this letter, and the active investment process of the accrued deposit funds was kicked off. Just before we sent this letter for publication, in March 2015, the Bank also launched the first version of its business bank online, enabling both a fully electronic client registration process unlike any other bank, as well as full access to a business web bank. The Bank has already previously accepted business clients through the manual paper-based client registration process, but the volumes of business clients will increase significantly with the streamlined online process that will also make online promotion of the business product possible.

While the online retail banking activities have been gradually launched since mid-2014, the Bank has also lent funds and arranged financing for some corporate clients in mainly real estate-related projects, generating additional fee and interest income.

## Results

The net operating income grew from EUR 1,126 thousand in 2013 to EUR 1,908 thousand in 2014, which enabled the year to be closed at a net profit after tax of EUR 349 thousand despite of a growing cost base. The profit was the best recorded by the Bank so far.

For the financial year 2014, the Bank generated a profit before tax of EUR 349 thousand, an increase of EUR 284 thousand over 2013 figure of EUR 65 thousand (an increase of 4% over 2014), out of net operating income of EUR 1,908 thousand (2013: 1,126 thousand), an increase of 70% on the previous year. These results were a significant improvement over the previous year, and would have been yet much stronger had the web bank been live already earlier in the year. The goals for 2014 were to be further down the road in terms of the operation of our online banking platform and to be able to launch and operate such new businesses, and generate additional significant revenue streams therefrom, something that was started during 2014. The net result, after tax expense, amounted to a positive EUR 223 thousand, resulting in a ROE of 4.45%, an increase of 3.69% over the previous year's ROE of 0.7%.

The Bank always aims at technically distributing the entire net profit to its parent company in line with the Maltese practice between parent company and its operating subsidiary, and a sufficient part thereof would be reinvested into the Bank's capital. The Maltese tax credit system, however, requires the distribution of the entire profit to the parent company, for the tax burden to be minimized and for the maximum amount of funds to be reinvested into growth, as otherwise a very significant part of the profits would be lost for nothing at all in return. It is therefore an integral part of our dividend policy to act in line with the requirements of the Maltese tax credit system for internationally oriented companies in order to benefit from it. So, for technical purposes, the Bank has to always distribute 100% of its profits for the year to its parent before reinvesting a sufficient part thereof.

Driven by the steady increase in loan and deposit funding, total assets almost tripled during the second half of the year and grew by 183% to EUR 24,145 thousand (2013: EUR 8,536 thousand). The deposit stock grew to EUR 17,952 thousand (2013: EUR 2,858 thousand), indicating an increase of 528% when compared to 2013, and loans to clients increased to EUR 14,137 thousand (2013: EUR 3,596 thousand), or 305%. While previously, the Bank practically funded all of its operations from its own funds, since the summer of 2014, the deposit funding has been steadily increasing, and the normal bank balance sheet leverage has largely taken shape, a major transformation from the

largely unlevered state before that. After the web bank went live, we were able to witness a material balance sheet growth and the CAD ratios fell proportionally to more “normal” levels generally seen at commercial banks. While it might be satisfying to some, in the middle of the continued crisis, to say that in terms of CAD ratios, the Bank was probably one of the proportionally better capitalized banks in an environment, where strong Tier 1 and total capital ratios are highly appreciated, in our view, we as a bank had been in a less optimal situation with next to no leverage, where we could not use and leverage our balance sheet in a more efficient manner that is typical for a commercial bank. Finally, as from mid-2014, we started seeing a different development in that respect with the decreasing CAD ratios that were previously at abnormally high levels.

### **Human resources**

Over the course of the year under review, our staff more than doubled from 11 to 23 persons.

At the end of the year, there were 23 employees at the Bank, in addition to the Board of Directors, actively contributing to the setup of the Bank’s operations. Entering a new phase of development, the Bank strengthened its team and resources in several areas: Systems Development, Risk Management, Finance & Accounting, Marketing & Communications, Sales, SEO/Inbound Marketing, and Client Services.

We have seen that finding skilled and competent employees who fit the company spirit and culture is continuously one of the greatest challenges. We will continue to look for the kind of talent we need for our operations both locally and beyond the shores of Malta, and it is likely that the staff will become more and more international, when both native staff serving clientele in different countries and languages where we operate, as well as for some specialized positions, for which the supply for competent staff is extremely limited in Malta given its small size in general and the financial services sector in particular, if such talent exists at all in certain areas.

In 2015, the team is expected to grow at least in the areas of Finance, Treasury, Legal & Compliance, Systems Development/IT, Sales, Card Operations and Client Service, and the staff numbers are projected to substantially increase during the year.

### **Our contribution to nurturing talent and ideas**

As the Bank has progressed from its initial preparative phase into a full-blown client operation, it has endeavored to increase its stewardship and support of civic goals that promote its founding ethos and driving mission: nurturing talent and great ideas. Over the past year, Nemea Bank undertook corporate social responsibility initiatives in two key sectors: fostering a spirit of entrepreneurship and promoting talented artists in the cultural sphere.

For the second year running, the Bank actively contributed towards the “L’Idée en or” project in Belgium. Organized by the popular Belgian media house Sudpresse, L’Idée en or encourages young entrepreneurs in Belgium’s Wallonia region to come forward and promote their ideas and ventures. The best project is awarded a financial prize of €25,000 to further develop their project. This year’s winners were Thibant Gilquin, 26, and Helen Hoyois, 24, from Mons, Belgium, who proposed an innovative project called “Do Eat”. Nemea’s participation included contributing to the final prize, the publication of articles promoting creativity and innovation on Sudpresse, and participation in the competition’s jury.

Nemea Bank also continued to play its part in nurturing talent in the arts by renewing its commitment and support for young Maltese tenor Cliff Zammit Stevens, who held his 6<sup>th</sup> annual summer concert in Mdina, Malta, on August 28. Cliff was joined on stage by the young British pianist Ian Tindale and Swedish mezzo Annie Fredriksson so that the Bank's support bore a distinct pan-European flavor. We plan to take our support to the arts to an even higher level in 2015 with the organization of the very first Nemea Concert in September.

### **Events after the closing of the financial period**

The year 2015 has commenced encouragingly, with the deposit base and balance sheet doubling in size over during the first quarter of the year. The improved website, including an online registration of business clients as a new feature, as well as the corporate web bank, have been launched just before the publication of this annual report. New languages such as Greek and Dutch have been added, and further languages are in the pipeline, including Italian and German. The Bank has increased resourcing in the payment card project and expects to launch its first debit card product this year, thus enabling the Bank to move from the status of a "second bank" offering savings products to the "primary bank" enabling the clients to use Nemea as their daily primary bank in all of their on and offline purchases, payments and other transactions.

### **An encouraging outlook for 2015**

This year, we expect the growth that started last summer to strengthen significantly. As stated above, we have just launched the first version of the corporate web bank, and the next generation website including an online client registration process for business clients as well. The improved website with additional languages and the online service for business clients will increase both the coverage of additional geographic segments and client types, leading to an increased flow of new clients. New products such as the payment card, expected to be launched during the second half of the year, and the first consumer loan product expected to come out later this year as well, will increase the business and profitability of the Bank. The expansion of the Nemea Instant Payment into a true online payment method not only for individuals in a P2P context but as a business payment method in a B2C and B2B context, will really start realizing the potential of the NIP product into an international payment method, added with the currency accounts and currency exchange service for a truly global product to be launched on the Hydra platform. The potential of the 'NIP button' as an online payment method side by side with well-known card brands is a very interesting scenario with an extremely significant growth potential. The launch of these new products during 2015 will give us strong tools for growth and profitability of the business, and we will expect to multiply our size over the course of the year. While multiplying in size may sound very significant and risky to some, one has to take into account that as a bank we are still very small, so only by multiplying in size can we start growing into a more meaningful scale and scope as a financial services provider. At the same time, we are well equipped to manage any risks relating to the growing volume and complexity of our operation, be it in terms of operational, credit or market risk, as the risk management approach is intrinsic in our culture and not only a duty of our Risk Management function but part of everybody's work on a daily basis. So overall, we expect to see a very interesting and inspiring 2015 ahead, with a very substantial growth by all measures.

Since the beginning of our project to establish this Bank, we have always had ambitious goals and objectives. Despite all the challenges faced, we never give up and always achieve our long-term objectives, and that means hard work for decades to come. Now, when the first phase of our proprietary core and internet banking platform is live, we have started redeeming our promises in terms of our business model, and the existence of that platform, running a live operation, is a proof that our persistence and patience pays off, and that the choices we have made have been the right ones. Our unwavering determination, persistent hard work and patience to never give up before achieving our goals have taken us forward and will take us so much further. We have the right vision, the right objectives, the right tools and skills and an increasingly better team to get there. As for any enterprise, success never comes without hardships and challenges, and one is never worthy of any success without mastering and enduring any such hardships, but our true entrepreneurial work and effort will take us there. That is something we have never doubted, even if the challenges experienced have temporarily taken a lot of our energy, time and effort and often without any reward or immediate compensation. At the same time, the recent achievement of certain critical milestones in terms of our online operation, and the incredible opportunity ahead, give us inspiration, strength and stamina to continue on our path towards the unchanged objectives.

And while we expect our businesses, people and presence to grow and diversify, we will also increasingly pay attention to the nurturing, application of and respect for the Nemean values and culture, expecting every Nemean to live and breathe them, as our culture and values will be the key glue in holding everything together, guiding our people to behave, act and represent themselves in the Nemea way, up to our standards of excellence in everything they do and towards everyone they meet. Innovation, intelligence, incentive and integrity must show in all aspects of our work and activity, maintaining our innovative approach, being incentivized to act and take initiatives forward, developing, evolving things, having the intelligence to think through things, listen, use common sense and be of high integrity in everything we do. Abiding by these things will be a source of pride for all of us.

We thank our colleagues and our team for their commitment, dedication and contribution as well as the support and positive collaboration we have experienced with our other key stakeholders, and we are looking forward to a successful 2015 both with the new members of the team and those who have been loyal and trustworthy since the earliest phases of this journey. Now, with our proprietary platform in place, and a steady flow and movement of operations, we are in a stronger position than ever before to capture the growth opportunity ahead, especially when and if the general economy recovers, but even without it, and to produce such fruitful results that are in the interests of all of our stakeholders.



Heikki Niemelä  
Co-Chairman



Mika Lehto  
Co-Chairman





## 1 STRATEGY, BUSINESS, PERFORMANCE AND RESPONSIBILITY

This section presents the Bank's strategy and business, and discusses its performance. The Bank's role vis-à-vis its employees and the society at large as part of its corporate responsibility are also explored.



## STRATEGY AND STRUCTURE

Nemea Bank is a modern pan-European provider of banking and investment services, serving a discerning, international client base of individuals based in the countries of the EU/EEA area. Nemea Bank does not operate a traditional network of physical branches but distributes its services exclusively online providing superior accessibility, efficiency and convenience to its clients. The NIP, Nemea Instant Payment, a free real-time online global money transfer is the planned spearhead service of the Bank.

### **What we do**

Our planned strategy is simple:

- We will offer the NIP, the Nemea Instant Payment, a free global online money transfer as core service;
- This service is complemented with a growing number of premium quality banking, investment and later insurance services that are offered with style, substance, speed, security and good value for money; and
- Our operations generate funds, which we invest for additional return, and we earn interest, fee, commission and premium income from our products and services to generate income and profits.

The strategy remains unchanged and shall be executed in phases. The service is currently offered in English and will be increased to provide different products and facilities. Information and services are to be provided in other languages including French, Spanish and Finnish. The deposit product will be expanded to an internet banking facility, enabling internal transfers between clients as well as transfers to and from third party banks through the SWIFT and SEPA networks.

### **Who are our clients**

Initially, we will offer our retail banking services mainly to private individuals, and the most likely early adaptor segment therein that are "global citizens", internationally oriented people, both Generation X, Y and Z young students and professionals, and international executives, professionals, entrepreneurs and other high net worth individuals, forming a "smile curve". In later phases, we will focus more on merchants, corporations and institutions as our clients.

### **Expansion of our client segments**

**Phase 1:** Private Individuals. Our initial target market consists of private individuals who often are frustrated with the risks, delays and costs of international money transfers. Initially, we will facilitate mainly international money transfers between individual clients e.g. friends and family members, and between consumers, who have entered into a direct transaction with each either online or offline.

Requests to open accounts are being made online, and are opened further to the completion of the full due diligence process. Eventually, a client pack will be

introduced that will include, a card being debit, credit or otherwise, and optional features, if the client has selected a premium pack.

**Phase 2:** Small and Medium-Sized Businesses. The growing client base, requests from consumers, active communications, and the economic benefits will attract online merchants, consumer services companies, and public entities like municipalities and government agencies to open accounts with us, and start receiving payments securely, in real-time and for free.

**Phase 3:** Corporations. Finally, multinational industrial, financial, and service companies will also want to benefit from the time and cost savings made possible with secure, real-time, and free money transfers, and will join the party.

Service examples: global cash pooling, dynamic limit and risk management, real-time reporting, automated collecting, budgeting and planning tools.

### **Our products for retail clients**

The description below reflects the planned products and services for retail banking initiated in 2012, developed in 2013 and 2014 and are presently being expanded even further in a phased manner:

**Payments and Money Transfers.** The key service is the secure, real-time, and free global money transfer NIP, the Nemea Instant Payment, which allows clients to deal with their payment and money transfer needs free of charge. The Bank also offers its clients a range of traditional payment and money transfer options, such as SEPA and international interbank payments.

**Accounts.** We offer three types of accounts, namely current, savings and term deposit accounts. All deposit accounts are opened online through the client's current account, which serves as a client's online banking platform from which all services are opened and managed. Currently, money can be transferred to our bank from a bank account held at a third party bank. With the launch of planned card payment products, Nemea Bank will transform from a savings bank to a primary bank for daily transactions.

**Credits and Loans.** We are focusing on the development of smaller consumer credit schemes, both for individuals and businesses, that are relatively short-term in nature. Consumer credit is non-collateralized and based on the creditworthiness of the client i.e. sufficient income and/or financial assets, clean credit record, etc. At a later stage, we will consider extending our offering further to cover other consumer loan products, such as mortgages and car loans, while the consumer loan segment is deemed highly attractive with sound risk-reward ratios.

**Payment Cards.** We are presently developing our first globally recognised debit card product, to be launched in late 2015. We plan to offer further targeted debit and credit card products to our clients at a later stage.

**Mutual Funds.** We will subsequently offer, initially, third-party mutual fund products in money market instruments, bonds, equities, and mixed funds through our website. They will be best of breed products provided by leading fund managers.

**Securities.** We will subsequently offer the facility to buy, sell and trade equities, fixed income, derivatives, currency, and commodity products through best-of-breed online brokerage facility as part of our service.

### **Distribution**

Our products and services are offered exclusively online, as online distribution of financial services maximises user convenience, security, speed, confidentiality, 24/7 availability, and cost efficiency. During 2014, we launched a refurbished website and expanded on the online banking facility. In 2015, we will roll out a new, fully responsive website with comprehensive client services in English, Spanish, French, Dutch, Greek, Finnish and Italian, including a new online corporate registration platform.

### **Geography**

We are a pan-European bank planning to serve clients based in all 31 countries of the European Union / European Economic Area. In the long term, we plan to expand our offering into a global one in gradual steps.

### **Client benefits**

Immediate benefits for all clients will be obvious: savings in time and money and increased ease and convenience.

For organisations, the opportunity to globally consolidate cash positions in real-time and receive and make payments for free lowers transaction costs, increases interest and investment income, reduces working capital requirements and the cost of capital, and thus improves profitability.

In addition, the added convenience and ease offered to clients leads to an enhanced client experience, enhanced risk management, decrease in errors, lower credit losses, and a sophisticated image. This, in return, results in greater client satisfaction and thus creates stakeholder value.

### **Economics**

Despite offering free global money transfers, the objective of the Bank is to create superior shareholder value. It earns money on the invested funds and generates income by offering value added products and services. Combined with low cost structure and prudent risk management, it results in healthy profitability. Profitability with sustainable and controlled growth creates a valuable franchise.



**Our vision**

Our long-term vision is to become recognised as a leading global provider of banking, investment and insurance services.

**Our mission**

Our mission is to make banking faster, cheaper, easier, more convenient and accessible.

### **Paradigm change in banking**

There are no “free real-time global money transfer services” offered by any party. Global money transfer services are either delayed, not free or not available online. We will be the first international bank to offer this service.

**Online equals real-time.** We integrate the terms of “real-time” and “online” into one and make it reality – this really is not the case in most online financial services. There is an enormous variety of online financial services, but, in fact, very few of them are actually real-time, offering the users of such services to have the transaction executed at the same time as a transaction is confirmed or an order given. Delays are largely caused by traditional banking systems running on batch processing, being in technical conflict with the requirements for real-time transaction processing.

**Global retail banking.** We break the paradigm of retail banking, traditionally being inherently local. This we do by extending centrally manufactured products and services as a global offering available everywhere online, with gradually introduced language and feature adjustments to facilitate the local needs and requirements of our clients. This will lead to genuinely global retail banking, rendering the physical location of a bank or a need for that meaningless. We do not believe in the need for local retail banking other than the Bank’s ability to serve the client with his/her own language, which can also be facilitated online, but see retail banking as a global business.

### **Commoditisation and globalisation**

We believe that the majority of financial products are globally homogeneous and commodity-like. Thus, cost control is as elementary as quality in financial services. Winning banks will be lowest cost/highest quality producers with a strong brand.

Local “brick and mortar” banks and insurance branches have served consumers and small businesses since modern banking and insurance started to evolve. The future of finance, however, lies online. Today, financial products and services are offered mostly in digital form. They represent value without the presence of a physical commodity. We believe that, in the future, most digital products and services will be globally delivered over the internet.

### **Competitive positioning**

We will be a global payment network, and a modern pan-European bank.

Given this definition for positioning, in comparison with other industry players, we will be positioned to compete with traditional global banks and eventually with bancassurance groups (broad service scope/cost disadvantage plus other current challenges) and e-money institutions (limited service scope/similar cost structure).

Besides direct competition in bancassurance, competition is expected from a wide variety of retail goods and service providers in related or overlapping fields. Companies with traditional business processes suffer from the cost disadvantage, while pure online businesses often lack the knowhow, processes, systems and skills to run a fully fledged bank and/or global bancassurance operation.

## Operational structure

In 2014, the Bank has operated as a single business unit. Its key development was the launch of the first phase of its online retail bank which has allowed it to offer retail clients a comprehensive banking service, including the registration and ongoing use of current, savings and term deposit accounts.

While the initial focus has been on the retail bank serving individual clients, in 2015 the Bank will launch an online business bank serving business clients, offering businesses to submit all documentation and maintain their account online.

In the medium to long-term, the operations of the Bank will be directed towards four 'banks within the Bank', starting with the finalisation of the retail bank:

- Retail Bank serving individual retail clients,
- Business Bank serving business clients,
- Private Bank serving individual high net worth clients, and
- Corporate & Investment Bank serving corporate, institutional and government clients.

The Bank's offering and client segmentation is consistent and in line with its integrated business model.

### Retail Bank

The Retail Bank is at the core of the Bank's offering, being built around the NIP to serve internationally-oriented individual clients in their daily banking needs: payments and accounts. Cards will be introduced towards the end of 2015 and loan products a bit later, while being delayed by several years vis-à-vis the original plans. The banking service will be gradually complemented with premium investment products.

### Business Bank

The business banking segment will focus on serving mainly smaller businesses like individual merchants and SMEs in terms of their payment transaction and cash management needs. The Nemea Instant Payment product will provide our business clients with superior benefits in terms of receiving and transmitting funds in real time, globally and for free, leading to exceptional savings and advantages in working capital pooling. Our business cash management products provide our clients with attractive yields on their liquidity form both for immediately accessible and term deposit funds.

### Private Bank

The Private Bank's services will be designed for modern high net worth and affluent individuals leading international lives, who are often entrepreneurs or entrepreneurial families benefiting from the integrated service Nemea Bank can offer, combining value-adding services both to the business and its owners at a personal level.

### Corporate & Investment Bank

The corporate and investment banking business will focus on serving entrepreneurially driven companies with international operations or ambitions within the European SME segment, serving them through the integrated approach combining financing, advice and investment to help realize their ambitions. The services provided by the Private Bank to the entrepreneur, business owner and his or her family complement the services of the CIB proposed to the company, forming an integrated setting for both the company and the people behind it.

The operations of the CIB will be gradually initiated and their development driven by client demand. The CIB will also serve institutional investor clients and public bodies.

In this area, as a new development for catering both for the Bank's Asset Management business, serving both Private Banking and Institutional Clients, Nemea Group licensed its first umbrella structure of Maltese Professional Investor Funds, or PIFs, and is presently running a single sub-fund within this model.

### **The integrated approach**

The synergies potentially resulting from both cross-selling potential of the integrated business model (e.g. retail distribution of investment products manufactured by the CIB, or serving company financing needs owned by Private Bank clients) as well as infrastructural scale benefits (unified product and service manufacturing platform) between the Bank's businesses create additional sustainable future earnings opportunities, on top of their individual growth rates. To the Bank, the integrated approach means meeting client needs without expecting clients to worry about its internal organizational structures.

Another advantage of the integrated approach is that it helps the Bank to create synergies on cost and funding. The Bank shares infrastructure and services between parts of its business, eliminating redundant structures, management and control functions. All the businesses will operate under one brand, increasing the efficiency of brand building efforts.

### **Growth through sustainable, client-driven revenue streams**

The composition and structure of the Bank's businesses is defined by the client-driven needs. The optimal basis for building a high quality, sustainable earnings stream is a business mix that reflects these needs and responds to them, starting from the setup of the Retail Bank. Since the Bank takes this carefully planned approach, the Bank can grow without needing to change its strategic positioning or competitive profile.

While the Bank's focus will be on organic growth, possible future acquisitions should accelerate and complement growth, and they must have an obvious strategic and cultural fit, while being financially attractive to shareholders.

## **Managing Nemea Bank's business**

### **Focus on profitable growth**

The Bank's shareholders expect the Bank to achieve profitable growth. As described in this section, fulfilling this expectation requires Nemea Bank to establish a set of earning streams that are based on true client benefits, build a strong and growing client base and maintain its unique assets and capabilities that are hard for competitors to copy.

Efficiency in managing financial resources and risks is a prerequisite for all three of these requirements. By making continuous efficiency improvement – achieving the same or a better result or service with fewer resources - a permanent task, the Bank enforces significant discipline in the way it manages costs. This helps to optimise spending across different economic and business cycles in such a way that it creates value for both clients and shareholders.

### Balance sheet management and funding framework

The Bank will increase its balance sheet gradually. The Bank's retail businesses are mainly intended to be funded by client deposits. The Corporate & Investment Bank's (CIB) businesses are planned to be partly term-funded, based on an assessment of the quality and liquidity of their assets by the Bank's treasury function.

### Board and management structure

The management and oversight structure of Nemea Bank is the responsibility of the Board of Directors (BoD).

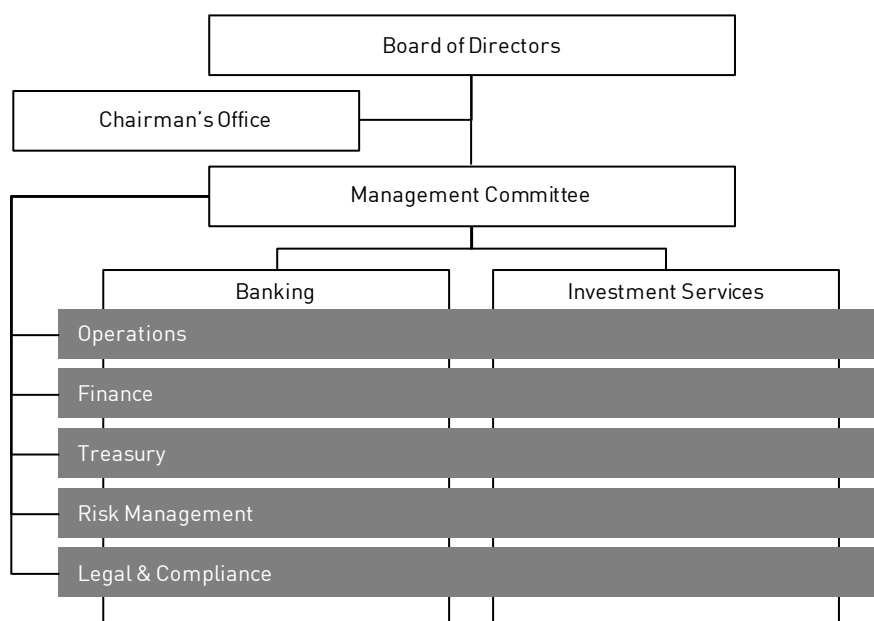
#### Board of Directors

The BoD is the more senior body, with ultimate responsibility for the strategy and management of the Bank, as well as the supervision of operative management. The BoD also defines the Bank's risk framework, principles and overall risk-taking capacity. It also comprises a member that is fully independent.

#### Chairman's Office

The Chairman's Office of the BoD (which consists of the two Co-Chairmen of the BoD) has an active oversight and control over the operational management team of the Bank, the implementation of strategy and the Bank's business results.

The following chart illustrates the Bank's current operational and management structure.



#### Management Committee

As the Bank grows, the management team will be expanded, giving effect step-by-step to the full-blown Management Committee.

## THE CREATION OF NEMEA – FROM AN IDEA TO AN INSTITUTION

“Despite the advances in modern technology, the transfer of money has been slow, expensive and inconvenient.” It was the summer of 2006 and we discussed one of our favourite topics – the future of finance. We drilled down to the very basics of banking and finance, considering the very basic elements of the infrastructure of global finance. At the core, banks do basically three things: they take deposits and extend loans, and to facilitate this, they make and receive payments. Looking into the international framework for payments, be they domestic or international cross-border payments, we could see vast inefficiencies both in terms of time and money, causing generation of negative value and waste to the users of such payment services. Our experience could certainly be shared by many: basically everybody having ever made payments has been frustrated by the cost of making payments or the time required for the funds to reach the beneficiary, or both. Payments form the backbone of finance, and are a core element of the international financial infrastructure. How could they be so inefficient? We could immediately see that there is a vast opportunity to create value for everybody making payments – in concrete terms of time, money and convenience.

As money has in many ways been and will be ever more virtual instead of being a physical good, we felt that transferring money should not be slow, it should not cause any delay – it should basically take no time at all. It should be real-time. Why should it take any time at all to transfer a virtual good around the world, if it practically does not take any time to send an email or talk or chat with another person physically being half the world apart? We felt that here, the world must have a service similar to email and those offering free global online calls and chats. Money must be transferable instantly, without delay, around the globe, and for free. It is just like electricity instantly available in the network, by just plugging in the plug, or water flowing in the pipes, accessible by just turning the tap: a basic commodity, costing little or nothing per unit.

Nemea Instant Payment, the nip, was born. Transfer money globally in real time and for free. Simple as that. At the same time very simple and a complete paradigm change. But why has nobody done that before? Many could, but incumbent banks had and have vast amounts of revenue from payment services at stake directly and indirectly in terms of free float of funds, something they have not been willing to cannibalize. We, without any such legacies and with the inevitable development taking towards our chosen direction, did not have any such loss at stake but only the opportunity to be the pioneer and make this happen: a fantastic opportunity to create value for everybody moving money.

How could we do that, given the geographic borders, regulatory differences, different payment systems and so on? Well, how can an email reach its recipient, or how can an internet protocol-based call or chat message reach its recipient? The answer is already in the question, and it is intrinsically very simple, even if it may involve some sophisticated technology to make it happen. We run our proprietary, fully secured payments network on the internet, and any payments are processed within our system

in the same way international internet protocol calls or messages are processed within their providers' systems. It is at the same time secure and global, instant and always accessible, regardless of the time and geographic location of the originator or the beneficiary. It is the new era of payments, where there are no longer delays and no longer costs in making payments. Simply put, it is the revolution of payments. The network is always there and the payment is always here – it is always instant.

### **Immediate benefits of the nip**

The nip forms a very clear and strong value proposition, benefiting everyone using it, including private individuals, institutions and companies. One could immediately see a number of benefits in using this product, for example:

- Immediate benefits for all clients will be obvious: savings in time and money and increased ease and convenience.
- For organizations, the opportunity to globally consolidate cash positions in real-time and receive and make payments for free lowers transaction costs, increases interest and investment income, reduces working capital requirements and the cost of capital, and thus improves profitability.

In addition, the added convenience and ease offered to clients leads to an enhanced client experience, enhanced risk management, decrease in errors, lower credit losses, and a sophisticated image. This, in return, results in greater client satisfaction and thus creates stakeholder value.

### **Expansion of client segments**

**Nemea was created around the nip concept**, planning to gradually expanding across products and services and across client segments, starting with the payment and other basic retail banking products for individual clients, expanding into investment services and insurance in the future in terms of business areas, and into corporate and institutional business in terms of additional client segments.

### **Vast potential realised through systematic execution of logical and consistent strategy**

In brief, the opportunity presented by the nip is enormous, potentially cutting billions of euros of waste in terms of lost time and money in international payments. After the nip, payments finally are as they should have been a long time ago: free and real time.

### **Long-term execution of strategy leads to gradual fulfilment of vision and mission**

Our logical, consistent and pragmatic strategy will help us to work step-by-step towards realizing our vision of becoming a leading international financial services provider and our mission of making global financial services faster, cheaper, easier, more convenient and accessible, creating vast value to all stakeholders in the process, primarily our clients.

It is a long and fascinating journey ahead, and we have only just started it. By the way, Nemea was named after the first of the 12 labours of the mythical hero Hercules. There are many more fascinating challenges ahead.

## RISK FACTORS

Certain risks, including those described below, can impact Nemea Bank's ability to carry out its business strategies and directly affect its earnings. As a consequence, the revenues and operating profit of the Bank vary from period-to-period and revenues and operating profit for any particular period will not be indicative of future results.

### **Risk factors related to Nemea Bank's business activity**

Performance in the financial services industry depends on the economic climate – negative developments can adversely affect Nemea Bank's business activities.

The financial services industry prospers in conditions of economic growth, stable geopolitical conditions, capital markets that are transparent, liquid and buoyant and positive investor sentiment. An economic downturn, inflation or a severe financial crisis in various forms such as the European sovereign bond crisis that emerged in 2010, may negatively affect Nemea Bank's revenues and it may be unable to immediately adjust all its costs to the resulting deterioration in market or business conditions.

A market downturn can be precipitated by geopolitical events, changes in monetary or fiscal policy, trade imbalances, natural disasters, pandemics, civil unrest, war or terrorism. Because financial markets are global and highly interconnected, even local and regional events can have widespread impact well beyond the countries in which they occur. A crisis could develop, regionally or globally, as a result of disruption in emerging markets, which are particularly susceptible to macro-economic and geopolitical developments, or as a result of the failure of a major market participant. If Nemea Bank's presence and business in emerging economies increases, it becomes more exposed to these risks.

Adverse and extreme developments of this kind may affect Nemea Bank's businesses in a number of ways, and may have further adverse effect on the Bank's businesses, current or future:

- a general reduction in business activity and market volumes affects fees, commissions and margins from market-making and client-driven transactions and activities;
- a market downturn is likely to reduce the volume and valuations of assets Nemea Bank manages on behalf of clients, reducing its asset and performance-based fees;
- reduced market liquidity limits trading and arbitrage opportunities and impedes Nemea Bank's ability to manage risks, impacting both trading income and performance-based fees;
- assets Nemea Bank holds for its own account as investments or trading positions could continue to fall in value;
- impairments and defaults on credit exposures and on trading and investment positions could increase, and losses may be exacerbated by falling collateral values; and

- if individual countries impose restrictions on cross-border payments or other exchange or capital controls, Nemea Bank could suffer losses from enforced default by counterparties, be unable to access its own assets, or be impeded in – or prevented from – managing its risks.

Given the prospective trading inventory, trading activities and the counterparty credit risks in its businesses, the Bank is expected to be dependent upon its risk management and control processes to avoid or limit potential losses.

Risk-taking is a major part of the business of a financial services provider. Nemea Bank is likely to earn a part of its revenues from market-making and proprietary trading in cash and derivatives markets. Credit is an integral part of many of Nemea Bank's activities. This will include lending, underwriting and derivatives businesses and positions.

Interest rates, equity prices, foreign exchange levels and other market fluctuations can adversely affect its earnings. Some losses from risk-taking activities are inevitable but, to be successful over time, Nemea Bank must balance the risks it takes with the returns it generates. It must therefore diligently identify, assess, manage and control its risks, not only in normal market conditions but also as they might develop under more extreme ("stressed") conditions, when concentrations of exposure can lead to severe losses. Nemea Bank's approach to risk management and control and its tools and processes for market and credit risk control, including country risk, are described in Risk, Treasury and Capital Management section of this annual report.

The Bank may not always be able to prevent losses arising from extreme and sudden market dislocations that are not anticipated by its risk measures and systems and affect inventory positions and therefore lead to serious losses. Value at Risk (VaR), a statistical measure for market risk, is derived from historical market data, and thus, by definition, cannot reliably predict losses. Stress loss and concentration controls, and the dimensions in which Nemea Bank aggregates risk to identify potentially highly correlated exposures, help to make potential loss estimates.

Nemea Bank aims at constantly strengthening its risk management and risk control frameworks, but the Bank could suffer losses in future if:

- it does not fully identify the risks in its portfolio, in particular risk concentrations and correlated risks;
- its assessment of the risks identified, or its response to negative trends, proves to be inadequate or incorrect;
- markets move in ways that are unexpected – in terms of their speed, direction, severity or correlation – and Nemea Bank's ability to manage risks in the resultant environment is therefore restricted;
- third parties to whom Nemea Bank has or will have credit exposure or whose securities it holds for its own account are severely affected by events not anticipated by Nemea Bank's models and the Bank accordingly suffers defaults and impairments beyond the level implied by its risk assessment; and
- collateral or other security that may be provided by its counterparties proves inadequate to cover their obligations at the time of their default.

Nemea Bank will also manage risk on behalf of its clients in its asset and wealth management businesses. Its performance in these activities could be harmed by the same factors. If clients suffer losses or the performance of their assets held with the

Bank is not in line with relevant benchmarks against which clients assess investment performance, Nemea Bank may suffer reduced fee income and a decline in assets under management or withdrawal of mandates.

Investment positions – such as equity holdings that may be made as a part of strategic or operational investment initiatives, for revenue generation, held in support of the Bank's business activities, and seed investments made at the inception of funds managed by Nemea Bank – may also be affected by market risk factors. These investments, however, are often not liquid and are generally intended or required to be held beyond a normal trading horizon. They are subject to a distinct control framework (described in Risk, Treasury and Capital Management section of this annual report). Deteriorations in the fair value of these positions would have a negative impact on Nemea Bank's earnings.

**Liquidity and funding management are critical to Nemea Bank's ongoing performance**

A substantial part of Nemea Bank's funding requirement is expected to be met using short-term unsecured funding sources, including wholesale and retail deposits and the issuance of other short-term instruments. If this situation were to change, Nemea Bank could be forced to liquidate assets, in particular from its trading portfolio, to meet maturing liabilities or deposit withdrawals. Nemea Bank might be forced to sell them at discounts that could adversely affect its profitability and its business franchises.

**Nemea Bank's capital strength is important to support its client franchise**

Nemea Bank's capital position measured by the BIS capital ratios is strong, while at the same time the balance sheet has been unleveraged during the preparatory phase. Capital ratios are determined by risk-weighted assets – balance sheet, off-balance sheet and market positions, measured and risk-weighted according to regulatory criteria – and eligible capital. Nemea Bank's capital ratios could come under pressure due to financial losses, or due to an increase in risk-weighted assets. For instance, substantial market volatility, a widening of credit spreads (the major driver of Nemea Bank's VaR) or a change in regulatory treatment of positions in various assets could result in a rise in risk-weighted assets and thereby reduce Nemea Bank's capital ratios.

**Operational risks may affect Nemea Bank's business**

Nemea Bank's businesses are dependent on the Bank's ability to process a substantial number of transactions across diverse markets and possibly in different currencies, in addition to being subject to the many different legal and regulatory regimes of these countries. Nemea Bank's operational risk management and control systems and processes, which are described in the operational risk section of Risk, Treasury and Capital Management of this annual report, are designed to ensure that the risks associated with the Bank's activities including those arising from process error, failed execution, unauthorized trading, fraud, systems failure and failure of security and physical protection are appropriately controlled. If these internal controls fail or prove ineffective in identifying and remedying such risks, Nemea Bank could suffer operational failures that might result in losses.

**Legal claims and regulatory risks arise in the conduct of Nemea Bank's business**

In the ordinary course of its business, Nemea Bank is subject to regulatory oversight and liability risk. It may be involved in claims, disputes and legal proceedings and regulatory investigations where Nemea Bank is active, including Malta, the EU at large,

and other jurisdictions. Such proceedings may expose Nemea Bank to substantial monetary damages and legal defense costs, injunctive relief, criminal and civil penalties and the potential for regulatory restrictions on Nemea Bank's businesses. The outcome of such matters, if any, cannot be predicted, and they could adversely affect Nemea Bank's future business.

**Nemea Bank might be unable to identify or capture revenue or competitive opportunities, or retain and attract qualified employees**

The financial services industry is characterized by intense competition, continuous innovation, detailed (and sometimes fragmented) regulation and ongoing consolidation. Nemea Bank faces competition at the level of local markets and individual business lines, and from international financial institutions. Barriers to entry in individual markets are being eroded by new technology. Nemea Bank expects these trends to continue and competition to increase in the future.

The competitive strength and position of Nemea Bank could be eroded if the Bank is unable to identify market trends and developments, does not respond to them by devising and implementing adequate business strategies or is unable to attract or retain the qualified people needed to carry them out.

Nemea Bank seeks to reward its employees appropriately based on competitive compensation schemes. Given the competitiveness of the financial industry, however, the possibility cannot be excluded that key employees will be attracted by competitors and decide to leave Nemea Bank, or that Nemea Bank may be less successful in attracting qualified employees.

**Nemea Bank's reputation is key to its business**

Nemea Bank's reputation is critical in maintaining its relationships with clients, shareholders, regulators and the general public. The reputation of the Bank can be damaged, for instance, by misconduct by its employees, by activities of business partners over which Nemea Bank has limited or no control, by severe or prolonged financial losses or by uncertainty about its financial soundness and its reliability. This could result in client attrition in different parts of Nemea Bank's business and could negatively impact its financial performance. The Bank's reputation is therefore a key factor in its risk management efforts.

**Risk factors and internet security**

Financial and internet services both call for effective risk management. Combining the two makes security issues a key factor in determining the success of the Bank. The Bank has a non-compromising approach to security and uses industry leading, state-of-the-art security processes and systems. Security systems include intrusion prevention system (IPS), physical firewalls, secure sites, strong authentication, cryptography, clustering and mirroring, disaster recovery, and real-time backups.

One critical risk relating to internet security is phishing and other forms of identity theft, where a commonplace means to practice phishing for the criminals is to present themselves as a bank or a representative of a bank, phishing for personal identification codes and other private and confidential information to access a bank's services and use somebody else's, whose access codes have been phished, accounts to steal the funds on them. The Bank informs all of its clients that it never asks for such information given to it neither by email, phone or similar unsecured manner.

Another critical risk is the increase of identity theft, where criminals present themselves as some other persons, dead or alive, whose identities they have stolen,

and modified details e.g. by using forged or digitally altered documents, or scanned copies thereof, to open accounts, and use financial products and services, e.g. applying for a loan with a false identity, and never repaying such loans. Managing such risk is a common challenge to all banks, especially when larger and larger part of business is conducted online, only being based on a non face-to-face identification, where more and more secure identification tools are being developed and employed.

**Nemea Bank's international online presence will expose the Bank to other risks**

Nemea Bank technically provides its products and services to 30 EU/EEA countries, and will earn income and hold assets and liabilities in different currencies and may thus be subject to different legal, tax and regulatory regimes.

Nemea Bank's ability to execute its international strategy depends on obtaining and maintaining local regulatory approvals where required in addition to the Bank having been passported its banking and investment services in the 30 EU and EEA countries. This includes the approval of acquisitions or other transactions and the ability to obtain the necessary licenses to operate in a local market. Changes in local tax laws or regulations may affect the ability or the willingness of Nemea Bank's clients to do business with the Bank, or the viability of the Bank's strategies and business model.

Because Nemea Bank prepares its accounts in euros, while a part of its assets, liabilities, revenues and expenses may in the course of its business be denominated in other currencies, changes in foreign exchange rates may have an effect on its reported income. Nemea Bank's approach to management of this currency risk is explained in the corporate currency management system in Risk, Treasury and Capital Management section of this annual report.

## MEASUREMENT AND ANALYSIS OF PERFORMANCE

Nemea Bank's performance is measured and reported in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS), the Companies Act (1995) and the Banking Act (1994) of Malta. The following discussion and analysis of Nemea Bank's results provide a commentary on the underlying operational performance of the business, with a focus on continuing operations.

### **Factors affecting Nemea Bank's financial position and results of operations in 2014**

The key factor affecting the business and results of the Bank during 2014 was the continued delay in the delivery of the banking system, thus preventing the Bank from properly executing its business plan, causing a loss of revenues and a mismatch between income and cost bases, but through prudent management of costs and successful results of certain client businesses, the year resulted in a profit.

### **Performance measures**

Nemea Bank assesses its performance against a set of four measures that have been designed to measure the delivery of continuously improving returns to its shareholders.

On average, through periods of varying market conditions, Nemea Bank, when fully operational vis-à-vis its business plan, will:

- seek to increase the value of its firm by achieving a sustainable, after-tax return on equity of a minimum of 15%;
- manage business group and business unit cost / income ratios at levels that compare well with competitors. The cost / income ratio target is limited to the banking & investment services businesses.
- target a double-digit percentage growth for (diluted) earnings per share (EPS); and
- aim to achieve a clear growth trend in net new money for all banking and investment services businesses (deposits and client assets under management).

On this basis, performance indicators 2014 show:

- return on equity for year 2014 at 4.45% (2013 at 0.68%);
- earnings per share of EUR 0.04 (2013 EUR 0.007 per share); and
- a cost / income ratio for the financial businesses of 82% (94% in 2013).

## FINANCIAL RESULTS

During the year under review the Bank continued collecting deposits from both local and foreign clients while it continued to increase its client base in Corporate and Investment Banking, which has still been the Bank's main source of income. 2014 was also the year when the Bank continued to capitalize on the developing of its core and internet banking system as well as the continued setting up of the basic operational infrastructure in anticipation of the launch of the business model.

### Operating income

Total operating income was EUR 1,907,947 in 2014 (2013: EUR 1,125,583). Net interest income was EUR 102,076 (2013: EUR 213,995). Net fee and commission income reached EUR 1,585,047 (2013: EUR 686,596). Trading income amounted to EUR 89,040 (2013: EUR 96,317). Other income amounted to EUR 131,784 (2013: EUR 128,675).

### Operating expenses

Total operating expenses were EUR 1,558,803 in 2014 (2013: EUR 1,060,908).

Personnel expenses amounted to EUR 678,617 in 2014 (2013: EUR 468,560) of which national insurance contributions amounted to EUR 31,782 (2013: EUR 20,157). Other personnel expenses reached EUR 27,005 (2013: EUR 20,313). Personnel-related expenses were 43.5% of total costs (2013: 44.2%).

General and administrative expenses were EUR 684,091 in 2014 (2013: EUR 458,192). Professional fees normally include legal fees and IT and other outsourcing expenses. General and administrative expenses were 43.89% of total costs (2013: 43.2%).

The share of license and regulatory license fees including depositors' compensation scheme was EUR 51,643 in 2014 (2013: EUR 44,120). The share was 3.3% of total costs (2013: 4.2%).

Depreciation and amortisation was EUR 164,278 in 2014 (2013: EUR 134,156), representing 10.5% of total costs (2013: 12.6%).

### Tax

The current year tax charge of EUR 126,466 (2013: EUR 26,902) is resulting from current tax payable of EUR 102,302 and a movement in deferred tax of (EUR 24,163) which is mainly being driven by unrealised trading income and differences between the net book value of the tangible assets and their respective tax written down values.

### Net result

Net profit after tax and amortisation for the financial year ended 31 December 2014 was EUR 222,678 (2013: EUR 37,773).

## **Dividend**

The Board of Directors are proposing a final dividend of EUR 216,436 for the financial year ended 31 December 2014 (none for the year ended 31 December 2013).

## BALANCE SHEET AND OFF-BALANCE SHEET

Nemea Bank's total assets stood at EUR 24,144,957 as at 31 December 2014 (2013: EUR 8,535,627).

### Lending and borrowing

#### Lending

Loans and advances to banks were EUR 4,670,392 as at 31 December 2014 (2013: EUR 1,335,983). Loans and advances to customers stood at EUR 15,579,246 as at 31 December 2014 (2013: EUR 4,933,375).

#### Borrowings

There were no borrowings as at 31 December 2014 (none as at 31 December 2013).

The Bank has taken deposits amounting to EUR 17,951,516 as at 31 December 2014 (2013: EUR 2,857,507).

#### Repurchase agreements and securities borrowing / lending

There were neither any repurchase agreements nor any securities borrowed/lent as at 31 December 2014 (none as at 31 December 2013).

#### Trading portfolio

As at 31 December 2014, trading assets amounted to EUR 886,200 (2013: EUR 797,160). There were no investments in debt instruments as at 31 December 2014.

#### Replacement values

In 2014, the Bank did not hold any derivative instruments (none in 2013).

#### Other assets / liabilities

Property, plant and equipment was EUR 154,311 as at 31 December 2014 (2013: EUR 123,754), mainly driven by office infrastructure and data center investments. Intangible assets, mainly office software and banking system were EUR 150,676 as at 31 December 2014 (2013: EUR 136,026).

#### Equity

As at 31 December 2014, the equity attributable to Nemea Bank shareholders stood at EUR 5,785,922 (2013: EUR 5,563,244). The increase from the end of 2013 reflects the attributable profit of EUR 222,678 for 2014 (2013: EUR 37,773).

#### Capital adequacy

The Bank's Capital Adequacy Ratio stood at 32% as at 31 December 2014 (63% as at 31 December 2013), with both total CAD and Tier 1 ratio being the same due to the lack of any other capital instruments employed other than equity capital.

**Risk concentrations**

Nemea Bank's main concentrations of risk are disclosed in detail in the note 28 of the financial statements "Concentrations of Risk".

The importance and the potential impact of such risk concentrations to Nemea Bank (with respect to liquidity, capital resources or market and credit risk support), including off-balance sheet structures, is also described in Risk, Treasury and Capital Management section of this report.

## CASH FLOWS

As at 31 December 2014, the level of cash and cash equivalents was EUR 5,778,868 (2013: EUR 1,633,292).

### **Operating activities**

Net cash flows generated from operating activities were EUR 4,355,061 in 2014 (EUR (1,026,397) net cash flows used in operating activities in 2013). Cash flow from operating activities (before changes in operating assets and liabilities and income taxes paid) totalled to EUR 406,511 in 2014 (EUR (656,343) cash flow operating activities in 2013).

### **Investing activities**

Investing activities generated a net cash outflow of EUR 209,486 in 2014 (EUR 236,571 cash inflow in 2013). This was mainly made up of the purchases of property, plant and equipment and intangible assets.

### **Financing activities**

In 2014 and 2013, no cash flows were generated from financing activities.

## EMPLOYEES

Nemea Bank relies on the expertise and commitment of its employees to deliver the solutions and the quality of service demanded by its clients. The Bank invests in developing and motivating its employees, whether they are new hires, seasoned employees, key talent or senior managers.

### Staffing

#### The Nemea Bank workforce

The number of people employed was twenty two as at 31 December 2014, three of which worked in management-level positions.

In 2014, all of Nemea Bank personnel were based in Malta.

#### Recruiting staff

Recruiting efforts aim at hiring highly qualified people in order to lay solid foundation to reach the Bank's ambitious objectives.

At Nemea, an individual's ability to contribute to the performance of his or her team and business area help determine success. Employees are nurtured and work in a positive, encouraging and inspiring environment that is diverse and international, with the Nemea culture acting as the thread to join everybody together as parts of the common living organism. Employees are challenged and stimulated, asked to challenge, and given the opportunity to contribute to the development of creative and value-adding solutions for clients – and their ability to do so will be directly connected to their ability to innovate, initiate and excel in finding creative, unique and practical ways to help them realize their objectives. Nemea Bank is committed to providing the tools and opportunities to advance its staff's learning and career development as rapidly as possible. Nemea never suppresses talent but aims at leveraging it to the full – both to personal and company's satisfaction and fulfillment.

From your first day staff members are guided by senior team members and colleagues, who will help them expand their understanding of the company's products and services, its business areas, and markets in general.

Nemea helps develop leaders both through formal training and on-the-job learning. Nemea helps employees build a strong career. Nemea mentors its best talent to help develop skills, behavior and insights to enable staff members to attain their and our goals and beyond.

#### Developing and sustaining a diverse workforce

Nemea Bank considers diversity to include the recognition and appreciation of multiple backgrounds, cultures and perspectives. Nemea Bank promotes diversity in its operations. Diversity will be integrated into Nemea Bank's working practices, such as recruiting, performance management and talent development. Diversity is an important part of Nemea Bank's culture.

The Bank's people come from various countries and with diverse backgrounds: each bringing their unique perspective to make Nemea Bank a remarkably diverse and stimulating place to work.

Nemea Bank employees immediately find themselves immersed in the company of like-minded people: people with intellect, talent, entrepreneurial spirit, drive to achieve and succeed and vision for future, willing to make their own mark.

### **Employee retention**

A number of factors influence employee retention. These include compensation, and incentives, performance management and learning and development opportunities. Nemea Bank manages these elements at all levels. The retention of key staff is also tracked.

### **Performance management**

The skills, expertise and ambition of Nemea Bank employees, together with a business culture that values meritocracy, are essential to achieving results for both clients and Nemea Bank alike. Performance management processes aimed to be conducted throughout the year support staff development, reinforce the Bank's core values and help ensure employees have the skills necessary to implement the long-term strategy of taking advantage of the global trends underlying our business strategies.

As Nemea Bank believes employee-manager dialog underpins good performance management and demonstrable performance is the basis for meritocracy. All employees are intended to participate in a performance management process that assesses individual achievements against specific objectives. The performance measurement and management (PMM) process specifies expectations for behavior and actions according to (and increasing with) experience and rank. As an example of this, evaluations for all employees include a "client focus" element, although the specific requirements to successfully fulfill this vary significantly according to their function or role.

The PMM assessment is one element defining individual incentive awards, with top performers receiving proportionately higher rewards. The total amount of money granted in incentive awards is determined by the financial performance of the Bank and its individual businesses.

### **Compensation and incentives**

To support its integrated business strategy, Nemea Bank endeavors to foster an entrepreneurial and performance-oriented culture. Compensation is linked to performance.

### **Learning and development**

#### **Leadership development**

Nemea Bank invests in the career and skill development of its people. Leadership development activities target high potential employees across the Bank. Senior people at Nemea Bank play a direct role in teaching and mentoring key talent.

#### **Business training**

Employees have access to professional and personal skill development opportunities. As business or regulatory needs require, additional educational initiatives are developed to meet the training need. The promotion of cross-business collaboration is one example.

**Commitment**

Nemea Bank's corporate values form the foundation of what the Bank does and how it does it. These values are integrated into the commercial decision-making process, management techniques and ways in which people interact with one another during the daily course of business. The implementation of this vision is underpinned by Nemea Bank's ethical beliefs of diversity, integrity and privacy, and corporate responsibility. Entrepreneurial leadership, partnership and meritocracy are the core competencies that help Nemea Bank succeed. And client focus is Nemea Bank's ultimate purpose.

## CORPORATE RESPONSIBILITY

As an international financial services provider, one of Nemea Bank's main purposes is to create long-term value. Nemea Bank believes this can be best achieved by providing clients with value-added products and services and by promoting a corporate culture that adheres to high ethical standards. The Bank also firmly believes that, for any business, long-term value creation is also dependent on what it does above and beyond what laws and regulations require. It is why Nemea Bank dedicates itself to creating a working environment based on the values of equal opportunity, diversity and meritocracy.

### **Environment**

Nemea Bank acknowledges that climate change represents one of the most significant environmental challenges of current times. It will have wide-ranging effects on ecosystems, societies and economies worldwide.

### **Corporate responsibility governance**

The Board of Directors (BoD) assesses how to meet the evolving expectations of Nemea Bank's stakeholders in relation to the Bank's corporate conduct. If the BoD concludes that there is a gap between what stakeholders expect and what Nemea Bank practices – and that this gap represents either a risk or an opportunity to the Bank – it suggests appropriate actions to be taken by the Bank.

### **Corporate responsibility: training and raising awareness**

It is important that employees are aware of Nemea Bank's corporate responsibility efforts and processes. The Bank provides general information published and on its website.

Training is also integral to the more specialized areas of environmental management and anti-money laundering (AML).

### **Contributing to society – preventing money laundering, corruption and terrorist financing**

Extensive and constant efforts to prevent money laundering, corruption and terrorist financing are important contributions to society. The integrity of the financial system is the responsibility of all those involved in it. Nemea Bank takes its duties extremely seriously.

Nemea Bank's Anti-Money Laundering Officer leads its efforts to fight money laundering, corruption and the financing of terrorism. Its key task is to help employees to recognize and then manage and report suspicious activities – in a way that neither treats all clients as criminals nor unduly hinders normal business. While doing so, the Bank also remains completely committed to the respect and protection of its clients' privacy, a cornerstone of the Bank's philosophy.

The best way to achieve such goals is through a spirit of partnership across the Bank – between those who manage client relationships and the risk managers and controllers who support them. Employees will be focused on really getting to know clients, understanding their needs and their business – and then asking questions when things do not make sense. To assist employees in their "customer due diligence" (CDD) skills, the effective ongoing monitoring and the identification of new trends in suspicious behavior, employees will be undertaking training courses, both in the form of on-line training and seminars.

To prevent money laundering and terrorist financing, Nemea Bank takes a risk-oriented approach that is tailored to its different business lines and their particular risks and exposures. This includes establishing consistent criteria by which a business relationship should be judged "higher-risk" from an AML perspective. Nemea Bank will also be utilizing advanced technology to assist the Bank in the identification of transaction patterns or unusual dealings.

### **Nemea Bank and the environment**

The Bank remains committed to integrating environmental considerations into all its business activities. It has an environmental policy in place to e.g. emphasize the importance of paperless office to save natural resources as well as to limit any unnecessary energy consumption and business travel.

### **Corporate responsibility in Nemea Bank guidelines and policies**

The importance Nemea Bank attaches to responsible corporate behavior is reflected in the various documents and policies defining the rules and principles the Bank applies to the behavior of its employees. These guidelines define the way Nemea Bank does business and the Bank regularly monitors compliance.

The Bank and its employees should conduct themselves in a manner that is above reproach, as preserving Nemea Bank's integrity is vital to its most valuable asset – its reputation.

The Bank has a code of conduct and ethics, which sets forth the policies and practices that it expects all of its employees to follow. The code outlines the required standards of fairness, honesty and integrity in a general manner. It is the basis for all Nemea Bank policies.

### **Conflicts of interest**

Nemea Bank is committed to ensuring fair treatment of all its stakeholders, while recognizing that conflicts of interest cannot always be avoided. The Bank has therefore established guiding principles outlining its approach to properly identifying and managing conflicts of interest.

### **Information security**

Nemea Bank adheres to the highest standards of information security. It meets legal and regulatory requirements related to information security, satisfying the obligations it has to clients, employees and shareholders.



## 2 RISK, TREASURY AND CAPITAL MANAGEMENT

This report outlines principles by which we manage and control risk, run our Treasury and manage capital and liquidity.



## RISK MANAGEMENT AND CONTROL

### Risk management and control principles

Taking, managing and controlling risk is core to Nemea Bank's business. The aim is not, therefore, to eliminate all risks but to achieve an appropriate balance between risk and return. When in full operation, Nemea Bank's approach to risk management and control is based on five principles:

- **business management throughout the Bank is accountable** for all the risks assumed or incurred by their business operations and is responsible for the continuous and active management of risk exposures to ensure that risk and return are balanced;
- **an independent control process** is an integral part of the Bank's structure – its goal is to provide an objective check on risk-taking activities and to support senior management in achieving appropriate alignment of the interests of all stakeholders including shareholders, clients and employees;
- **comprehensive, transparent and objective risk disclosure** to senior management, the Board of Directors (BoD), shareholders, regulators, rating agencies and other stakeholders is an essential component of the risk control process;
- **earnings protection** is based on limiting the scope for adverse variations in earnings and exposure to stress events – controls are applied at the level of individual exposures and portfolios in each business and to risk in aggregate, across all businesses and major risk types, relative to the Bank's risk capacity (the level of risk Nemea Bank is capable of absorbing, based on its anticipated earnings power); and
- **protection of Nemea Bank's reputation** ultimately depends on the effective management and control of the risks incurred in the course of business.

The principles are the foundation upon which the more detailed risk management and control frameworks are built. These frameworks comprise both qualitative elements, including policies and authorities, and quantitative components including limits. They are continually adapted and enhanced as Nemea Bank's business and the market environment evolve.

### Risk management and control responsibilities

The **BoD** has a strategic and supervisory function. It is responsible for the Bank's fundamental approach to risk, for approving the risk principles and for determining risk capacity and risk appetite.

The **Chairman's Office** acts as the Risk Council of the BoD. In this capacity, it oversees the risk profile of the Bank on behalf of the BoD and oversees implementation of the risk management and control principles.

The **Risk Officer (RO)** has overall responsibility for the development, implementation and enforcement of Nemea Bank's risk principles. This includes establishing risk control frameworks, formulating risk policies and determining methodologies for measurement and assessment of risk.

The Finance department is responsible for transparency in the financial performance of Nemea Bank and its business groups, including high quality and timely reporting and disclosure in line with regulatory requirements, corporate governance standards and global best practice. The Finance department is responsible for implementation of the risk principles in the areas of capital management, liquidity, funding and tax.

The **Head of Legal and Compliance** is responsible for implementing the risk principles in the areas of legal and compliance.

The **Head of each business area** will have overall responsibility for the business group and its management, and is accountable for its results and risks.

**All employees**, but in particular those involved in risk decisions, must make Nemea Bank's reputation an overriding concern. Responsibility for Nemea Bank's reputation cannot be delegated or syndicated.

### The risk control process

There are five key elements in the independent risk control process that is planned to be run when the Bank is in full operation, while appropriate risk controls have been effected at all stages of development:

- **risk policies** to implement the risk principles, reflecting Nemea Bank's risk capacity and risk appetite, and consistent with evolving business requirements and international best practice. Nemea Bank's risk policies are principle-based, specifying minimum requirements, high-level controls and standards, and broad authorities and responsibilities – they are never a substitute for the exercise of sound business judgment but, rather a guide and determine actions and decisions;
- **risk identification** through continuous monitoring of portfolios, assessment of risks in new businesses and complex or unusual transactions, and ongoing review of the risk profile in the light of market developments and external events;
- **risk measurement** using methodologies and models which are independently verified and approved;
- **risk control** by monitoring and enforcing compliance with risk principles, policies and limits, and with regulatory requirements; and
- transparent **risk reporting** to stakeholders, and to management at all levels, on all relevant aspects of the approved risk control framework, including limits.

The Bank is developing control processes around the establishment of new businesses, and the execution of complex or unusual transactions. These processes involve the business, and potentially all the control functions – risk control, legal, compliance, treasury, finance, tax and logistics, as necessary. The objective is to ensure that all critical elements are addressed across disciplines. A key aspect is whether transactions can be booked in a way that will permit appropriate ongoing risk management, measurement, control and reporting.

### Risk categories

Business risks are the risks associated with a chosen business strategy – it is business management's responsibility to respond to fundamental changes in the economic

environment and the competitive landscape. Business risks are not subject to independent risk control but will be factored into the Bank's planning and budgeting process and the assessment of Nemea Bank's risk capacity and overall risk exposure.

The primary and operational risks inherent in business activities are subject to independent risk control.

Primary risks are:

- **credit risk** – the risk of loss resulting from the failure of a client or counterparty to meet its contractual obligations. It arises on traditional banking products, such as loans and commitments, and on derivatives and similar transactions. A form of credit risk also arises on securities and other obligations in tradable form. Their fair values are affected by changing expectations about the probability of failure to meet obligations as well as actual failures. Where these instruments are held in connection with a trading activity, Nemea Bank controls the risk as market risk;
- **market risk** – the risk of loss resulting from changes in market variables of two broad types: general market risk factors and idiosyncratic components. General market risk factors include interest rates, exchange rates, equity market indices, commodity prices and general credit spreads. Idiosyncratic components are specific to individual names and affect the values of their securities and other obligations in tradable form, and derivatives referenced to those names. Investment positions may also be affected by market risk factors but they are often not liquid and are generally intended or required to be held beyond a normal trading horizon. For these reasons they are subject to a different control framework; and
- **liquidity and funding risk** – the risk that Nemea Bank might be unable to meet its payment obligations when due, or to borrow funds in the market on an unsecured or secured basis at an acceptable price to fund actual or proposed commitments.

**Operational risk** is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external causes, whether deliberate, accidental or natural. Operational risks must be monitored, and are controlled and mitigated to the extent possible and desirable.

### Quantitative controls

In principle, for risks that are quantifiable, Nemea Bank will be measuring potential loss at three levels – expected loss, statistical loss and stress loss.

**Expected loss** is the loss that is expected to arise on average over time in connection with an activity. It is an inherent cost of such activity, and must be factored into business plans. For financial instruments carried at fair value, expected loss is reflected in valuations and deducted directly from revenues.

**Statistical loss** measures, such as Value at Risk ("VaR"), estimate the amount by which actual loss in a portfolio can exceed expected loss over a specified time horizon, measured to a specified level of confidence (probability).

**Stress loss** is the loss that could arise from extreme events, typically beyond the confidence level of the statistical loss estimate, and is normally a scenario-based measure.

Concentration controls complement portfolio risk measures. Controls are generally applied where the Bank identifies that positions in different financial instruments or different portfolios are affected by changes in the same risk factor or group of correlated factors and there is the potential for significant loss in the event of extreme but plausible adverse developments. Nemea Bank's concentration controls include credit limits for individual clients, counterparties and counterparty groups, ceilings on exposure to all but the best-rated countries, limits on potential loss from changes in general market risk factors, and thresholds on single name exposures in the trading portfolio.

The primary day-to-day quantitative controls are intended to govern normal periodic adverse results and prevent severe losses as a result of stress events. The identification of stress events and scenarios to which Nemea Bank will be vulnerable and an assessment of their potential impact – in particular the danger of aggregated losses from a single event through concentrated exposures – is a critical component of the risk control process. Risk measures and controls rely on a combination of past experience, available external data, and judgments about likely future developments. Each new stress event is in some way unique, and thus no risk measure can provide complete protection against every possible scenario. Equally, each stress event offers new insights into ways of enhancing risk measures and controls, whether specific to an individual portfolio or risk type or a more generic extension from a particular experience.

### **"Earnings-at-risk" and "Capital-at-risk"**

To complement the day-to-day operating controls, Nemea Bank has developed and will be implementing two concepts – "Earnings-at-risk" and "Capital-at-risk" – to assess aggregate risk exposure across risk types and businesses against its financial resources. These measures assess Nemea Bank's ability to absorb the potential loss inherent in its business in the current economic cycle, across all business lines, and from all major sources, including primary risks, operational risks and business risks.

**Earnings-at-risk** focuses on Nemea Bank's ability to absorb losses from current earnings, while **capital-at-risk** considers more extreme losses and their potential to lead to a breach of minimum regulatory capital requirements or, ultimately, to insolvency. **Capital-at-risk** is an input to the capital management process.

**Earnings-at-risk** is planned to be an integral part of the risk control and is monitored by the senior management and the Chairman's Office as part of the regular risk reporting cycle. The concept reflects Nemea Bank's view that the first and primary resource to absorb losses is a firm's earnings stream. **Earnings-at-risk** has three elements – risk capacity, risk exposure and risk appetite.

**Risk capacity** is the level of risk Nemea Bank considers itself capable of absorbing, based on its earnings power, without damage to its dividend paying ability, its strategic plans and, ultimately, its reputation and ongoing business viability. It is based on a combination of budgeted / forecast and historical revenues and costs, adjusted for performance-related compensation, and dividends and related taxes.

**Risk exposure** is an estimate of potential loss based on current and prospective risk limits and risk positions across major risk categories – primary risks, operational risk and business risk. It is assessed against a severe but plausible constellation of events over a one-year time horizon to a 95% confidence level – in effect to assess the impact of a "once in 20 years" event. The measure builds on the statistical loss measures used in the day-to-day operating controls as far as possible, extending their time horizons

where necessary, with adjustments and supplements determined by management to reflect known coverage gaps, measurement weaknesses and potential events. The results are combined to reflect potential correlations between the various risk categories under the severe scenarios envisaged.

A comparison of risk exposure with risk capacity serves as a basis for determining the appropriateness of current or proposed risk limits, and Nemea Bank's ability to pay a cash dividend out of its earnings. It is also one of the tools available to management to guide decisions on adjustments to the risk profile.

**Risk appetite** is established by the BoD, who set an upper bound on aggregate risk exposure in the form of a "risk exposure ceiling". It is appropriate that risk exposure should be less than risk capacity.

As with any model, Earnings-at-risk is heavily dependent on the many assumptions (including the chosen confidence level) and estimates that are necessarily entailed in determining the inputs and generating the output, not least because risk exposure includes a combination of statistical and more judgmental elements. Measured risk exposure must be understood in this context. Risk capacity and risk exposure are, furthermore, dynamic measures, affected significantly by the external environment which will impact, for example, correlations between risk categories, the liquidity of Nemea Bank's positions, the potential to reduce or hedge them at reasonable prices, and Nemea Bank's funding costs.

**Capital-at-risk** builds off the Earnings-at-risk concept but assesses the potential for losses to exceed earnings capacity and erode capital. For Capital-at-risk, the analysis of risk exposure is essentially the same as for Earnings-at-risk but measured at two higher confidence levels – the first in relation to Nemea Bank's minimum regulatory capital requirement, and the second in terms of solvency.

The Capital-at-risk measure of aggregate risk exposure is an important consideration in the assessment of capital adequacy.

Like Earnings-at-risk, Capital-at-risk relies on the day-to-day risk control measures and will potentially underestimate aggregate exposure if these measures do not fully capture the risks.

### **Qualitative controls**

Although measurement of risk is clearly important, quantification does not always tell the whole story, and not all risks are quantifiable. Due diligence, sound judgment, common sense and an appreciation of a wide range of potential outcomes – including a willingness to challenge assumptions – are key components of a strong risk culture for both risk management and risk control.

## RISK CONCENTRATIONS

A concentration of risk exists where positions in financial instruments are affected by changes in the same risk factor or group of correlated factors, and the exposure could, in the event of extreme but plausible adverse developments, result in significant losses. The identification of risk concentrations necessarily entails judgment about potential future developments, which cannot be predicted with certainty. In determining whether a concentration of risk exists, risk controllers consider a number of elements, both individually and in combination. They include the shared characteristics of the instruments; the size of the position; the sensitivity of the position to changes in risk factors and the volatility of those factors; the liquidity of the markets in which the instruments are traded and the availability and effectiveness of hedges or other potential risk mitigants; and the risk reward profile of the positions. If a risk concentration is identified, it is assessed to determine whether it should be reduced or the risk should be mitigated, and the available means to do so. Identified concentrations are subject to increased monitoring.

There is clearly a possibility that losses could arise on asset classes and positions other than those considered, if the correlations that emerge in a stressed environment differ markedly from those envisaged by the Bank. The Bank has exposures to a number of securities in its portfolios. It is exposed to credit spread and default risk of fixed income instruments, to idiosyncratic risk on both equities (while no equity exposure currently held) and fixed income assets, and to country risk. Nemea Bank does not currently foresee the likelihood of material losses on such positions but the possibility cannot be ruled out.

## CREDIT RISK

Credit risk is the risk of financial loss resulting from failure by a client or counterparty to meet its contractual obligations to Nemea Bank. This can be caused by factors directly related to the counterparty, such as business or management problems, or from failures in the settlement process, for example on a foreign exchange transaction, where the Bank honors its obligation but the counterparty fails to deliver the counter-value (settlement risk). Alternatively, it can be triggered by economic or political difficulties in the country in which the counterparty is based or where it has substantial assets (country risk).

### **Sources of credit risk**

Credit risk is inherent in traditional banking products – loans, commitments to lend and contingent liabilities, such as letters of credit – and in "traded products" – derivative contracts such as forwards, swaps and options, repurchase agreements (repos and reverse repos), and securities borrowing and lending transactions. The risk control processes applied to these products are fundamentally the same, although the accounting treatment varies – they can be carried at amortized cost or fair value, depending on the type of instrument and, in some cases, the nature of the exposure.

Many of the business activities of the Bank will be creating credit risk. It offers individual and business clients a variety of credit products, although the majority of credit risks are well secured against financial collateral or other assets. The Bank will be giving high net worth individuals (HNWI), corporate, institutional, intermediary and alternative asset management clients access to the full range of credit and capital markets instruments across all product classes, and engaging with other professional counterparties in its trading and risk management activities.

### **Credit risk control organization and governance**

Effective credit risk control is critical to Nemea Bank's safety and soundness. The credit risk control framework is based on the risk management and control principles, supported by credit policies. It has both qualitative and quantitative elements. When entering a fully operational phase, Nemea Bank is establishing processes to ensure that risks are identified, assessed, pre-approved where necessary, and continuously monitored and reported. Measures and limits are applied to the credit risk of individual counterparties and counterparty groups, and the quality and diversification of portfolios and sub-portfolios are assessed, a key objective being to control risk concentrations.

The Risk Committee assesses the creditworthiness of individual counterparties and the adequacy and effectiveness of any security or credit hedges, and evaluating credit risk in portfolios, sub-portfolios and other aggregations, including country risk.

The Chairman's Office will delegate appropriate authority to the senior management. Further delegations will be made to credit officers in the business groups. The level of credit authority delegated to holders depends on their seniority and experience and

varies according to the quality of the counterparty and any associated security. These authorities will encompass all aspects of the approval of credit risk, including settlement risk, and the determination of allowances, provisions and credit valuation adjustments for any impaired claims.

## **Credit risk control**

### **Limits and controls**

The primary objective of quantitative controls is to avoid, as far as possible, undue credit risk concentrations. Concentrations of credit risk exist if clients are engaged in similar activities, or are located in the same geographical region or have comparable economic characteristics such that their ability to meet contractual obligations would be similarly affected by changes in economic, political or other conditions. The Bank will be establishing limits to constrain exposure to individual counterparties and counterparty groups and at portfolio and sub-portfolio levels, wherever risk concentrations are identified, including exposure to specific industries and countries, where appropriate.

At the level of the individual counterparty and counterparty group, risk officers will establish limits for all types of banking and traded products exposure, which cover not only the current outstanding amount and replacement values of contractual obligations but also contingent commitments and the potential future development of exposure on traded products. Credit engagements may not be entered into without the appropriate approvals and limits.

Limits will be applied in a variety of forms to portfolios or sectors, where necessary, to restrict risk concentrations or areas of higher risk, or to control the rate of portfolio growth. In particular for higher risk engagements, the impact of variations in default rates and asset values is assessed using stress scenarios, taking into account risk concentrations. Stress loss limits will be applied to portfolios where considered necessary, including limits on exposures to all but the best-rated countries.

In establishing these controls, including the related authorities and approval processes, a distinction is made between those exposures which are to be held to maturity ("take and hold" exposures) and those which will be held only in the short term, pending distribution or risk transfer ("temporary exposures"). An example of temporary exposure is syndicated lending where the bulk of the original commitment will be distributed to other financial institutions or investors. For all exposures, the credit quality and cash flow generation capacity of the counterparty over the full term of the obligation are at the heart of the credit assessment. For temporary exposures, market liquidity and Nemea Bank's distribution capabilities will be also key considerations in the approval process.

### **Risk mitigation**

Nemea Bank employs risk mitigation techniques for most of its credit portfolios, typically by taking security in the form of financial collateral (cash or marketable securities) or other assets, or through risk transfers or the purchase of credit protection.

Taking security is the most common form of risk mitigation. Valuation standards are applied in assessing the mitigating effect of security. In lending to affluent private clients (Lombard lending) the pledge of securities or cash is required. The Bank will also be taking financial collateral in the form of marketable securities in much of its over-the-counter (OTC) derivatives activity and in its securities financing (securities

lending / borrowing and repurchase / reverse repurchase) business. Where financial collateral is taken, haircuts are generally applied to the market value, reflecting the quality, liquidity, volatility – and in some cases complexity – of the individual instruments. Exposures and collateral positions are continuously monitored, and margin calls and closeout procedures are enforced when the market value of collateral falls below predefined levels relative to the exposure. Collateral concentrations within individual client portfolios and across clients are also monitored where relevant and may affect the discount applied to specific collateral. For property financing, a mortgage over the relevant property is taken to secure the claim, considering the ability of the borrower to service the debt from income, and in accordance with Nemea Bank's policy on loan to value ratios.

OTC derivatives business will be conducted almost without exception under bilateral master agreements, which generally allow for the close out and netting of all transactions in the event of default by the other party. Nemea Bank may also enter into two-way collateral agreements with market participants, under which either party can be required to provide collateral in the form of cash or marketable securities when exposure exceeds a pre-defined level. The OTC derivatives business with lower-rated counterparties is generally conducted under one-way collateral agreements where the counterparty provides collateral to Nemea Bank. Under these kinds of agreements, only cash or very liquid collateral will be accepted. The Bank will maintain standards for netting and collateral agreements, including assurance that contracts are legally enforceable in insolvency in the relevant jurisdictions.

Nemea Bank will also make use of credit hedging, in the form of risk transfers, securitizations and purchase of credit protection, as part of its active management of credit risk to reduce concentrated exposures to individual names or sectors or in specific portfolios. Most of this credit hedging will be achieved by transferring underlying credit risk to high-grade market counterparties using single name credit default swaps, executed under bilateral netting agreements and generally also under collateral agreements. Credit-pooling vehicles will also be used to transfer risk to outside investors via credit-linked notes. In the internal risk reporting processes, the gross exposure before hedging as well as net exposure will be tracked. The benefit of credit hedges is only recognized in credit risk measures if they cover future exposure increases to a high level of confidence, and offer protection against a wide range of credit events, including failure to pay, bankruptcy and insolvency, restructuring and repudiation, and moratorium. Proxy hedges (credit protection on a different but correlated name) and index or macro hedges are not recognized.

The effectiveness of credit protection bought from a counterparty depends on the ability of the counterparty to meet any claim. Exposure to credit protection providers is monitored as part of overall credit exposure. Where there is significant correlation between the counterparty and the hedge provider (so-called "wrong-way risk") Nemea Bank's policy will be to not recognize any benefit in credit risk measures.

### **Reporting**

An essential element of the credit risk control process is transparent and objective risk reporting.

The credit risk control will be responsible for risk reporting covering both exposure to individual counterparties from all products and activities, and portfolio risks. It will also supply information to a central unit providing consolidated reports of counterparty and portfolio risk and country risk to senior management, the Chairman's Office, the Board of Directors (BoD) and regulators where applicable.

## Credit risk measurement

Credit risk measurement is an essential component of the credit risk control framework. The measurement of credit exposure from a loan which is fully drawn is straightforward. By contrast, the estimation of credit exposure on a traded product, the value of which varies with changes in market variables, interim cash flows and the passage of time, is more complex and requires the use of models. The assessment of portfolio risk also entails estimations of the likelihood of defaults occurring, of the associated loss ratios if they do, and of default correlations between counterparties.

Nemea Bank has developed tools to support the quantification of credit risk of individual counterparties, applying the three generally accepted parameters: probability of default, loss given default and exposure at default. Models will also be used to derive portfolio risk measures – expected loss, statistical loss and stress loss.

In line with Nemea Bank's internal governance standards and the requirements of the new regulatory capital framework (Basel III), the development and maintenance of models will conform to global standards, and the models and their components will be subject to independent verification before implementation. Models must comply with established measurement standards to ensure consistency and allow meaningful aggregation of credit risk across all businesses, and will be reviewed and updated on an ongoing basis

## Credit risk parameters

Three parameters are used to measure and control individual counterparty credit risk:

- the "**probability of default**", which is an estimate of the likelihood of the client or counterparty defaulting on its contractual obligations. This probability is assessed using rating tools tailored to the various categories of counterparties. Besides their use for credit risk measurement, ratings will be an important element in setting credit risk authorities;
- the likely recovery ratio on the defaulted claims, which is a function of the type of counterparty and any credit mitigation or support (such as security or guarantee), from which the "**loss given default**" is determined;
- the current exposure to the counterparty and its possible future development, from which potential "**exposure at default**" is derived. For traded products such as OTC derivatives, the exposure at default is not a definitive number – it must be derived by modeling the range of possible outcomes. In measuring individual counterparty exposure against credit limits, the Bank considers the "maximum likely exposure" measured to a high confidence level over the full life of all outstanding obligations, whereas in aggregating exposures to different counterparties for portfolio risk measurement, the expected exposure to each counterparty at a given time horizon (usually one year) generated by the same model is used.

These parameters are the basis for most internal measures of credit risk. The Bank is proceeding to commence the implementation of the Basel III regime.

## Expected loss

Credit losses must be expected as an inherent cost of doing business. But the occurrence of credit losses is erratic in both timing and amount, and those that arise usually relate to transactions entered into in previous accounting periods. In order to reflect the fact that future credit losses are implicit in today's portfolio, Nemea Bank uses the concept of "expected loss".

Expected credit loss is a statistically based concept which is used to estimate the annual costs that are expected to arise, on average, from positions in the current portfolio that become impaired. The expected loss for a given credit facility is a function of the three components described above – probability of default, loss given default and exposure at default. The expected loss figures for individual counterparties are aggregated to derive the expected credit loss for the whole portfolio.

Expected loss is the foundation of credit risk quantification in all portfolios. It is an input to the valuation or pricing of some products, and the determinant of credit risk costs charged to the business in the management accounts, which differs from the credit loss expense reported under International Financial Reporting Standards as adopted by the European Union (IFRS). Expected loss is also the starting point for the measurement of portfolio statistical loss and stress loss.

### **Statistical loss**

Nemea Bank uses a statistical model – Credit Value at Risk (“Credit VaR”) – to estimate the largest potential loss on the portfolio over one year measured to a specified level of confidence. The shape of the modeled loss distribution is driven by systematic default relationships amongst counterparties within and between segments. The results of this analysis provide an indication of the level of risk in the portfolio, and the way it develops over time. It is also an important input to the overall risk measures Earnings-at-risk and Capital-at-risk.

### **Stress loss**

Stress loss is a scenario-based measure, which complements the statistical model. It is used to assess potential loss in various extreme but plausible scenarios in which it is assumed that one or more of the three key credit risk parameters deteriorates substantially according to a pattern that is typical for the chosen scenario. Stress tests will be run regularly, and on an ad hoc basis as necessary, in order to identify adverse portfolio situations, particularly risk concentrations. All scenario results are monitored, and for certain portfolios and segments, stress loss is subject to limits.

### **Composition of credit risk**

The measures of credit risk differ, depending on the purpose for which exposures are aggregated – financial accounting under IFRS, determination of regulatory capital, or Nemea Bank’s own internal management view, i.e. the way credit portfolio risk is managed.

As explained in the Credit risk measurement section, Nemea Bank will also be measuring, and generally applying limits to, credit exposure to individual counterparties and counterparty groups and measuring risk across counterparties at various portfolio and sub-portfolio levels. In these calculations the Bank will also be considering the potential development of replacement values of traded products over time as market risk factors change, interim payments are made and transactions mature, all of which can significantly alter the risk exposure profile over time. These potential developments are not reflected in the tables opposite and below, which reflect only the current exposures.

Total gross credit exposure amounted to EUR 23,512,663 as at 31 December 2014 (2013: EUR 8,131,827) inclusive of loans and advances to customers, loans and advances to banks, and other assets (Note 28 to Financial Statements).

### Settlement risk

Settlement risk arises in transactions involving exchange of value when the Bank must honor its obligation to deliver without first being able to determine that the counter-value has been received.

### Country risk

The Bank will be assigning ratings to all countries to which it has exposure. Sovereign ratings express the probability of occurrence of a country risk event that would lead to impairment of Nemea Bank's claims. The default probabilities and the mapping to the ratings of the major rating agencies will be the same as for counterparty rating classes (as described under "Probability of default").

### Country risk exposure

There was no exposure to emerging market countries during both 2014 and 2013.

### Impairment and default – distressed claims

Nemea Bank has classifications for distressed claims.

A loan carried at amortized cost is considered to be "**past due**" when a significant payment has been missed. It is classified as "non-performing" where payment of interest, principal or fees is overdue by more than 90 days and there is no firm evidence that the claim will be settled by later payments or the liquidation of collateral; or when insolvency proceedings have commenced against the borrower; or when obligations have been restructured on concessionary terms.

Any claim, regardless of accounting treatment, is classified as "**impaired**" if Nemea Bank considers it probable that it will suffer a loss on that claim as a result of the obligor's inability to meet its obligations according to the contractual terms, and after realization of any available collateral. "Obligations" in this context include interest payments, principal repayments or other payments due, for example under an OTC derivative contract or a guarantee.

The recognition of impairment in the financial statements depends on the accounting treatment of the claim. For products carried at amortized cost, impairment is recognized through the creation of an allowance or provision, which is charged to the statement of comprehensive income as credit loss expense. For products recorded at fair value, impairment is recognized through a credit valuation adjustment, which is charged to the income statement through the net trading income line.

The Bank has policies and processes to ensure that the carrying values of impaired claims are determined in compliance with IFRS on a consistent and fair basis, especially for those impaired claims for which no market estimate or benchmark for the likely recovery value is available. The credit controls applied to valuation and workout are the same for both amortized cost and fair-valued credit products. Each case is assessed on its merits, and the workout strategy and estimation of cash flows considered recoverable are independently approved by the credit risk control organization.

Portfolios of claims carried at amortized cost with similar credit risk characteristics are also assessed for collective impairment. A portfolio is considered impaired on a collective basis if there is objective evidence to suggest that it contains impaired obligations but the individual impaired items cannot yet be identified.

The assessment of collective impairment differs depending on the nature of the underlying obligations. In Nemea Bank's retail businesses, where delayed payments are likely to be routinely seen, Nemea Bank will be reviewing individual positions for impairment only after they have been in arrears for a certain time. To cover the time lag between the occurrence of an impairment event and its identification, collective loan loss allowances are established, based on the expected loss measured for the portfolio over the average period between trigger events and their identification for individual impairments. Collective loan loss allowances of this kind are not required for corporate and investment banking businesses because individual counterparties and exposures are continuously monitored and impairment events are identified at an early stage.

Additionally, for all portfolios, Nemea Bank will assess each quarter – or on an ad hoc basis if necessary – whether there has been any previously unforeseen development, which might result in impairments, which cannot be immediately identified individually. Such events could be stress situations such as a natural disaster or a country crisis, or they could result from structural changes in, for example, the legal or regulatory environment. To determine whether an event-driven collective impairment exists, a set of global economic drivers will be regularly assessed for the most vulnerable countries and, on a case-by-case basis, the impact of specific potential impairment events since the last assessment is reviewed. Again, the expected loss parameters of the affected sub-portfolios are the starting point for determining the collective impairment, adjusted as necessary to reflect the severity of the event in question.

#### **Past due but not impaired loans**

Past due but not impaired loans have suffered missed payments but are not considered impaired because Nemea Bank expects ultimately to collect all amounts due under the contractual terms of the loans or with equivalent value.

#### **Impaired loans, allowances and provisions**

As at 31 December 2014, total impaired assets amounted to EUR 51,599 (2013: 19,782).

Nemea Bank will seek to liquidate collateral in the form of financial assets in the most expeditious manner, at prices considered fair. This may require that it purchases assets for its own account, where permitted by law, pending orderly liquidation.

#### **Credit loss expense**

Nemea Bank's financial statements are prepared in accordance with IFRS, under which credit loss expense charged to the statement of comprehensive income in any period is the sum of net allowances and direct write-offs minus recoveries arising in that period, i.e. the credit losses actually incurred. By contrast, for internal management reporting, credit loss expense is based on the expected loss concept described under "Credit risk measurement".

#### **Rating system design and estimation of credit risk parameters**

##### **Probability of default**

Nemea Bank will be assessing the likelihood of default of individual counterparties using rating tools tailored to the various counterparty segments. The performance of rating tools, including their predictive power with regard to default events, is regularly validated and model parameters are adjusted as necessary.

External ratings, where available, will be used to benchmark Nemea Bank's internal default risk assessment. The ratings of the major rating agencies are linked to the internal rating classes based on the long-term average 1-year default rates for each external grade. Observed defaults per agency rating category vary year-on-year, especially over an economic cycle, and therefore the Bank does not expect the actual number of defaults in its equivalent rating band in any given period to equal the rating agency average. Nemea Bank will be monitoring the long-term average default rates associated with external rating classes.

In the corporate & institutional business, rating tools will be differentiated by broad segments, including banks, sovereigns, corporates, funds, hedge funds, commercial real estate and a number of more specialized businesses. The design of these tools will follow a common approach. The selection and combination of relevant criteria (financial ratios and qualitative factors) will be determined through a structured analysis by credit officers with expert knowledge of each segment, supported by statistical modeling techniques where sufficient data is available.

The banking portfolio will include exposures to a range of enterprises, both large and small- to medium-sized ("SMEs") and the rating tools will vary accordingly. For segments where sufficient default data is available, rating tool development will primarily be based on statistical models. Typically, these "score cards" consist of several criteria combining financial ratios with qualitative and behavioral factors, which have proven good indicators of default in the past, are accepted by credit officers and are easy to apply. For smaller risk segments with few observed defaults a more expert-based approach will be chosen. For the commercial real estate segment and for Lombard lending, which is part of the retail segment, the probability of default will be derived from simulation of potential changes in the creditworthiness of the counterparty and the value of the collateral and the probability that it will fall below the loan amount.

Default expectations for the residential mortgage segment will be based on the internal default and loss history, where the major differentiating factor is the loan to value ratio – the amount of the outstanding obligation expressed as a percentage of the value of the collateral.

#### **Loss given default**

Loss given default or loss severity represents Nemea Bank's expectation of the extent of loss on a claim should default occur. It is expressed as percentage loss per unit of exposure and typically varies by type of counterparty, type and seniority of claim, and availability of collateral or other credit mitigation. Loss given default estimates cover loss of principal, interest and other amounts due (including work-out costs), and also consider the costs of carrying the impaired position during the workout process.

In the corporate & institutional business, where defaults are rare events, loss given default estimates will be based on expert assessment of the risk drivers (country, industry, legal structure, collateral and seniority), supported by empirical evidence from internal loss data and external benchmark information where available. In the banking portfolio, loss given default differs by counterparty and collateral type and is statistically estimated using internal loss data. For the residential mortgage portfolio, a further differentiation is derived using simulation methods based on loan to value ratios.

**Exposure at default**

Exposure at default represents the amounts Nemea Bank expects to be owed at the time of default.

For outstanding loans, the exposure at default will be the drawn amount or face value. For loan commitments and for contingent liabilities, it includes any amount already drawn plus the further amount, which is expected to be drawn at the time of default, should it occur. This calculation is based on a "credit conversion factor", a fixed percentage per product type derived from historical experience of drawings under commitments by counterparties within the year prior to their default.

For traded products, the estimation of exposure at default is more complex, since the current value of a contract or portfolio of contracts can change significantly over time and may, at the time of a future default, be considerably higher or lower than the current value. For repurchase and reverse repurchase agreements and for securities borrowing and lending transactions, the net amount which could be owed to or by the Bank will be assessed, taking into account the impact of market moves over the time it would take to close out all transactions ("close-out exposure"). Exposure at default on OTC derivative transactions is determined by modeling the potential evolution of the replacement value of the portfolio of trades with each counterparty over the lifetime of all transactions – "potential credit exposure" – taking into account legally enforceable close-out netting agreements where applicable.

For all traded products, the exposure at default will be derived from the same Monte Carlo simulation of potential market moves in all relevant risk factors, such as interest rates and exchange rates, based on estimated correlations between the risk factors. This will ensure a scenario-consistent estimation of exposure at default across all traded products at counterparty and portfolio level. The randomly simulated sets of risk factors are then used as inputs to product specific valuation models to generate valuation paths, taking into account the impact of maturing contracts and changing collateral values, including the ability to call additional collateral.

The resultant distribution of future valuation paths will support various exposure measures. All portfolio risk measures will be based on the expected exposure profile. By contrast, in controlling individual counterparty exposures the Bank will limit the potential "worst case" exposure over the full tenor of all transactions, and therefore applies the limits to the "maximum likely exposure" generated by the same simulations, measured to a specified high confidence level.

Cases where there is material correlation between factors driving counterparty's credit quality and the factors driving the future path of traded products exposure – "wrong-way risk" – will require special treatment. In such cases, the potential credit exposure generated by the standard model is overridden by a calculation from a customized exposure model that explicitly takes this correlation into account. For portfolios where this risk is inherently present, for instance for a hedge funds portfolio, Nemea Bank will be establishing special controls to capture these wrong-way risks.

## MARKET RISK

Market risk is the risk of loss from changes in market variables. There are two broad categories of variables – general market risk factors and idiosyncratic components. General market risk factors are variables which are driven by macroeconomic, geopolitical and other market-wide considerations, independent of any instrument or single name. They include the level, slope or shape of yield curves (interest rates), the levels of equity market indices and exchange rates, prices of energy, metals and commodities, and the general level of credit spreads – the yield paid by borrowers above that on risk-free securities. Associated volatilities and correlations between risks factors – which may be unobservable or only indirectly observable – are also considered to be general market risk factors. Idiosyncratic components are those that cannot be explained by general market moves – broadly, elements of the prices of debt and equity instruments and derivatives (including derivative securities and basket products) linked to them that result from factors and events specific to individual names.

Nemea Bank will be disclosing its market risk in terms of statistical loss using its proprietary Value at Risk (“VaR”) model, but internally also applies stress measures and a variety of concentration and other quantitative and qualitative controls.

### Sources of market risk

Nemea Bank will be taking on both general and idiosyncratic market risks in its trading activities, and some non-trading businesses create general market risks.

#### Trading

Most of Nemea Bank’s trading activity will take place on the corporate and institutional side of the business. It includes market-making, facilitation of client business and proprietary position taking in the cash and derivative markets for equities, fixed income, interest rates, foreign exchange, energy, metals and commodities.

The fixed income trading area of fixed income, currencies and commodities (FICC) will carry inventory, including exposures to residential and commercial real estate, corporate and consumer credit, and municipal loan markets.

Exposure to movements in the level and shape of yield curves is expected to arise in the corporate and institutional trading activities. Exposure to directional interest rate movements varies depending on client flows and traders’ views of the markets. It is often these variations that drive changes in the level of the VaR, although the impact of any position or change in position depends on the composition of the whole portfolio at the time.

The Bank will be active in equity markets. Equity risk is the other major contributor to the market risk, partly from index-based transactions but also from individual stocks, giving rise to idiosyncratic as well as general market risk. A significant component of equity VaR will be event risk from proprietary positions, which are taken, for example,

to capture arbitrage opportunities or price movements resulting from mergers and acquisitions.

Nemea Bank will trade in currencies, and to a lesser extent it may trade in energy, metals and commodities, but the contribution from these activities to overall market risk is generally expected to be relatively small.

Trading businesses are subject to a variety of market risk limits within which traders will be managing their risks according to their view of the market, employing a variety of hedging and risk mitigation strategies. Senior management and risk controllers may, however, give instructions for risk to be reduced, even when limits are not exceeded, if particular positions or the general levels of exposure are considered inappropriate. Hedging and mitigation strategies will then be discussed and agreed with trading management.

### **Non-trading**

In the corporate and investment banking, significant non-trading interest rate risk and all non-trading foreign exchange risks are captured, controlled and reported under the same risk management and control framework as trading risk.

In the other business areas, exposures to general market risk factors – primarily interest rates and exchange rates – also arise from non-trading activities. Market risks are generally transferred to the Treasury, who manage the positions as part of their overall portfolios within their allocated limits. The largest items are the interest rate risks in banking. All risk transfers will take place according to approved transfer pricing mechanisms. Market risks that are retained by the other businesses are not expected to be significant relative to the Bank's overall risk, and all exposures will be subject to market risk measures and controls. With the exception of structural currency exposures, all non-trading currency and commodity positions will be subject to market risk regulatory capital and are therefore generally captured in VaR, although such positions do not contribute significantly to overall VaR.

Treasury will also assume market risk from its balance sheet and capital management responsibilities. Treasury will be financing non-monetary balance sheet items such as bank property and equity investments; it also manages interest rate and foreign exchange risks resulting from the deployment of the Bank's equity, from structural foreign exchange positions and from non-euro revenues and costs. The market risk limits that will be allocated to Treasury will cover both the risks resulting from these responsibilities, and those transferred from other business groups. The limits will allow the flexibility to pre-hedge or delay hedging if desired, both to manage large flows and to take advantage of market movements.

Exposure to single names arising from debt instruments, such as loans, which are not originated or acquired as part of a trading activity will be controlled under the credit risk framework. Neither idiosyncratic nor credit spread risk on these instruments is captured under the market risk framework.

In corporate & investment banking, the Bank will be hedging an increasing proportion of its credit exposure. Specific hedges, such as credit default swaps on the same name, are reflected in credit risk measures, but other types of hedge may also be used for exposure management – for example, credit indices or proxy hedges on other names. Hedges of this type are treated as open positions for risk control purposes and are captured under the market risk framework.

## **Risk control organization, governance and structure**

The board of directors, acting as the risk committee is responsible for development of the market risk control framework. It will be the primary responsibility of traders to identify the risks inherent in their activities, including those arising from new businesses and products, and from structured transactions. Independent controllers will be responsible for ensuring that identified risks are completely and accurately captured in risk measurement systems and appropriately constrained by portfolio and concentration controls. They will also be responsible for assessing the reasonableness of reported risk.

Market risk authority delegations may be made to market risk officers in the business areas. For trading businesses, standard transactions within approved business lines and limits will not be requiring prior risk control approval. Rather, risk management and risk control authority holders approve the retention of positions or give instructions for risk to be reduced based on subsequent review. Large transactions such as security underwritings and transactions creating less liquid risks – particularly structured and complex transactions – will, however, require pre-approval, as do temporary increases in limits to accommodate new transactions or positions.

Standard forms of market risk measures, limits and controls will be applied to portfolios and risk concentrations. Other forms of measurement and control will be developed, where necessary, for individual risk types, particular books and specific exposures. The quantitative controls will be complemented by qualitative controls geared to the prompt identification, assessment, measurement and monitoring of market risks. Risks that are not well reflected by standard measures will be subject to additional controls, potentially including transaction level pre-approval and specific limits.

The Bank's policy will require that models used for valuation or which feed risk positions to risk control systems are subject to independent verification.

Reporting is an important component of the qualitative framework and Nemea Bank therefore will be implementing processes requiring regular reporting to senior management and the Chairman's Office and Board of Directors (BoD).

Utilizations of most limits, including all major portfolio and concentration limits, will be reported daily and all excesses will be investigated. Daily reports, including commentary, on material risk positions will be provided to senior management and CRO. Monthly and quarterly reports, including both quantitative and qualitative information, will also be prepared to senior management, the Chairman's Office and the BoD.

## **Risk measures**

Nemea Bank will be implementing two major portfolio measures of market risk – VaR and stress loss – complemented by concentration risk measures and supplementary controls.

Concentration limits will be tailored to the nature of the activities and the risks they create. They therefore differ between, for example, the corporate and institutional business, where the risks are most varied and complex, and Treasury, which will be carrying market risk in a limited range of risk types and not generally in complex instruments.

Supplementary limits will be established on portfolios, sub-portfolios, asset classes or products for specific purposes where standard limits are not considered to provide

comprehensive control. These "operational limits" will be intended to address concerns about, for example, market liquidity or operational capacity. They may also be applied to complex products for which not all model input parameters are observable, and which thus create difficulties in valuation and risk measurement. Operational limits can take a variety of forms including values (market, nominal or notional) or risk sensitivities.

### **Value at Risk (VaR)**

VaR is a statistically based estimate of the potential loss on the current portfolio from adverse movements in both general and idiosyncratic market risk factors. The same VaR model is used for internal risk control (including limits) and as the basis for determining market risk regulatory capital requirements.

Nemea Bank will be measuring VaR using a 10-day time horizon for internal risk measurement and control, and as the basis for market risk regulatory capital, and based on a 1-day horizon for information purposes and for backtesting. VaR is derived from a distribution of potential losses. It expresses the amount that might be lost over the specified time horizon as a result of changes in market variables, but only to a certain level of confidence (99%) and there is therefore a specified statistical probability (1%) that actual loss over the period could be greater than the VaR estimate. Backtesting allows for an assessment of the reliability of the VaR model.

VaR shall be calculated at the end of each trading day, based on positions recorded at that time. Retrospective adjustments to valuations, affecting risk positions, may be booked some days later, particularly at period ends. VaR is not subsequently restated to reflect these later adjustments to positions.

VaR models are based on historical data and thus implicitly assume that market moves over the next 10 days or one day will follow a similar pattern to those that have occurred in the historical period being considered in the calibration of the risk models. For general market risk, the Bank will be using a look-back period of five years – a period which generally captures the cyclical nature of financial markets and is likely to include periods of both high and low volatility. The Bank will be calibrating the risk models directly to these historical changes and using the calibrated models to simulate risk factor changes, a method known as Monte Carlo simulation.

Idiosyncratic risk will be measured on all forms of single name risk. For debt instruments the measure includes rating migration risk and prepayment risk. For equity instruments, the measure is based on index models, or the special case of the Capital Asset Pricing Model ("CAPM"), supplemented by a "deal break" methodology for equity arbitrage positions, where Nemea Bank will be long in the stock of one company and short in that of another. The deal break measure assesses the probability of collapse of a merger or takeover, and its impact on the two stock prices – a one-off jump move generating the same potential loss for both 10-day and 1-day VaR.

The Chairman's Office regularly approves of a 10-day VaR limit for the Bank as a whole and allocations to the business areas, the largest being to the corporate & institutional business. In the business groups, VaR limits are set for lower organizational levels as necessary.

In the start-up phase of a business, some market risks may be controlled outside VaR but the level of such risk is deliberately kept small, typically by application of operational limits.

## Backtesting

The predictive power of the VaR model will be monitored by "backtesting". Backtesting compares the 1-day VaR calculated on trading portfolios at close of each business day with the actual revenues arising on those positions on the next business day. These revenues ("backtesting revenues") exclude non-trading components such as commissions and fees, and estimated revenues from intraday trading. If backtesting revenues are negative and exceed the 1-day VaR, a "backtesting exception" is considered to have occurred. If the number of backtesting exceptions in a rolling 12-month period exceeds levels specified by regulators, the "multiplier" by which the market risk regulatory capital requirement is derived from 10-day VaR is increased.

Although Nemea Bank will be using VaR to measure general market risks arising in non-trading books, the results are not formally backtested because these books are not generally marked to market.

VaR based on a 1-day horizon provides an estimate of the likely range of daily mark to market revenues on trading positions under normal market conditions. When 1-day VaR is measured at a 99% confidence level, such an exception can be expected, on average, one in a hundred business days. More frequent backtesting exceptions are likely to occur if market moves are greater than those seen in the look-back period, if the frequency of large moves increases, or if historical correlations and relationships between markets or variables break down (for example, in a period of market disruption or a stress event). Backtesting exceptions are also likely to arise if the way positions are represented in VaR does not adequately capture all their differentiating characteristics and the relationships between them. Such granularity can become particularly important as business grows and as markets evolve.

All backtesting exceptions and any exceptional revenues on the profit side of the returns distribution will be investigated, and all backtesting results are reported to senior business management and the CRO.

## Stress loss

The purpose of stress testing is to quantify exposure to extreme and unusual market movements. It is an essential complement to VaR.

The VaR measure is based on observed historical movements and correlations, whereas stress loss measures are informed but not constrained by past events. Nemea Bank's objectives in stress testing will be to explore a wide range of possible outcomes, to understand vulnerabilities, and to provide a control framework that is comprehensive, transparent and responsive to changing market conditions.

Nemea Bank's stress scenarios will include an industrial country market crash with a range of yield curve and credit spread behavior, and emerging market crises, with and without currency pegs breaking. A general recovery scenario will also be assessed. The standard scenarios will be run daily, and it is against these that the development of stress loss exposure is tracked and comparisons are made from one period to the next. Stress loss limits, approved by the Chairman's Office, will be applied to the outcome of these scenarios for all business groups. Emerging markets stress loss in aggregate and stress loss for individual emerging market countries, measured under the standard stress scenarios, will also be separately limited. The scenarios and their components will be reviewed at least annually.

Specific scenarios targeting current concerns and vulnerabilities will also be used. They must, by definition, be constantly adapted to changing circumstances and portfolios. The choice of scenarios is judgmental, depending on management's view of

potential economic and market developments and their relevance to the positions the Bank will carry. The market moves envisaged in a targeted stress test might prove to be less than the moves actually seen in a stress event, and actual events may differ significantly from those modeled in the stress scenarios.

The VaR results beyond the 99% confidence level will be analyzed to better understand the potential risks of the portfolio and to help identify risk concentrations. The results of this analysis are valuable in their own right and can also be used to formulate position-centric stress tests. Although the standard scenarios incorporate generic elements of past market crises, more granular detail of specific historical events is provided by the VaR tail.

Additionally, Nemea Bank will be measuring and limiting the impact of increased default rates on the value of its portfolio of single name exposures.

Nemea Bank will apply country ceilings to limit exposure to all but the best-rated countries and these measures will cover market as well as credit risks.

Most financial institutions employ stress tests, but their approaches differ widely and there is no benchmark or industry standard in terms of scenarios or the way they are applied to an institution's positions. Furthermore, the impact of a given stress scenario, even if measured in the same way across institutions, will depend entirely on the make-up of each institution's portfolio, and a scenario highly applicable to one institution may have no relevance to another. Comparisons of stress results between institutions can therefore be highly misleading, and for this reason Nemea Bank, like most of its peers, will not publish quantitative stress results.

### **Concentration limits and other controls**

The Bank will apply concentration limits to exposures to general market risk factors and to single name exposures. The limits will take account of variations in price volatility and market depth and liquidity.

In the corporate & institutional business, limits will be placed on exposure to individual risk factors. They will be applied to general market risk factors or groups of highly correlated factors based on market moves broadly consistent with the basis of VaR, i.e. 10-day, 99% confidence moves. Each limit will be applied to exposures arising from all instrument types in all corporate & institutional trading businesses. The market moves will be updated in line with the VaR historical time series and the limits are reviewed annually or as necessary to reflect market conditions. The effectiveness of risk factor limits in controlling concentrations of risk will depend critically upon the way risk positions are represented. If long and short positions are considered to be sensitive to the same risk factor, potential gains and losses from changes in that factor will be netted. The steps Nemea Bank is taking to enhance granularity of risk representation in its VaR measure will be equally relevant to its risk concentration controls.

The corporate & institutional business will carry exposure to single names, and therefore to event – including default – risk. This risk will be measured across all relevant instruments (debt and equity, in physical form and from forwards, options, default swaps and other derivatives including basket securities) as the aggregate change in value resulting from an event affecting a single name or group. The maximum amount that could be lost if all underlying debt and equity of each name became worthless will be also tracked. Positions will be controlled in the context of the liquidity of the market in which they are traded, and all material positions will be monitored in light of changing market conditions and specific, publicly available

information on individual names – market risk officers will not have access to non-public information and must therefore rely to a significant extent on external ratings.

This form of single name exposure measure will be most appropriate to corporate clients, financial institutions and other entities, the value of whose equity and debt instruments will be dependent on their own assets, liabilities and capital resources. Asset-backed securities are usually issued through special purpose, bankruptcy remote vehicles and it will be more important to aggregate risk in other dimensions than the issuer name, in particular the factors affecting the value of the underlying asset pools.

Exposures arising from security underwriting commitments will be subject to the same measures and controls as secondary market positions. There will be also governance processes for the commitments themselves, generally including review by a commitment committee with representation from both the business and the control functions. All firm underwriting commitments will be approved under specific delegated risk management and risk control authorities.

### **Other applications of market risk measures**

Market risk measurement tools may be selectively applied to portfolios for which the primary controls are in other forms. VaR can, for example, provide additional insight into the sensitivity of investment positions to market risk factors, even though some of the assumptions of VaR – in particular the relatively short time horizon – may not be representative of their full risk. The results can be used by business management and risk controllers for information or to trigger action or review.

### **Risk control**

As explained under “Risk measures”, where values of different instruments were assessed to be driven by the same risk factor, sensitivities in standard risk control measures will have typically been expressed net across instruments and positions. If the drivers are not, in fact, the same risk factor but, rather, risk factors, which have historically been very closely correlated, this netting will disguise “basis” risk – the risk of divergent movements between risk factors that are not perfectly correlated.

The specific characteristics of individual instruments, which are critical in a stress event cannot always be predicted and it is therefore important to have a multi-faceted framework with complementary controls. The Bank will be applying extensive limits, by asset class, based on gross values as well as risk sensitivities, in order to protect against extreme losses in the event of future dislocations and breakdowns – even if the probability of their occurring currently appears to be remote. Additionally, controls are in place to highlight positions, which are large relative to market depth. Such risks often only materialize when markets move beyond the range covered by statistical and stress loss parameters, and thus they do not show up in the regular risk measures. Controls over these deep tail risks already exist for some portfolios and are being widely applied. An important additional aspect of stress testing is to consider liquidity as well as price sensitivity.

### **Market risk in 2014**

The structure of the portfolio during the year exposed the Bank to two forms of market risks; interest rate risk and a form of systematic risk arising from exposure to particular sectors.

The Bank's exposure to investment in the fund is subject to the performance of the underlying investments of the fund. The fund has invested in corporate bonds of companies, which have been returning a steady double digit yield. The underlying companies are not rated and are being monitored by the Bank on a periodic basis.

As at 31 December 2014, the Bank did not hold any positions in the trading book.

## INVESTMENT POSITIONS

Nemea Bank makes investments for a variety of purposes. As at 31 December 2014, the investment positions consisted of holdings in a private investment fund, mainly for revenue generation. There were no equity investments or debt instruments held by the Bank.

The investment positions may be debt or equity holdings, some of which are made for revenue generation or as part of strategic initiatives, while others, such as exchange and clearing house memberships may be held in support of the Bank's business activities. Investments may also be made in funds managed by Nemea Bank to seed them at inception or other investment products to demonstrate alignment of the Bank's interests with those of investors.

### Equity investments

Many equity investments may be unlisted and therefore illiquid. Investments in listed stocks, if any, are normally limited in number both by individual market and in total. The fair values of equity investments are generally dominated by factors specific to the individual stocks and the correlation of individual holdings to equity indices varies. Furthermore, equity investments are generally intended to be held medium or long-term and may be subject to lock-up agreements. For these reasons, they may not be directly controlled using the market risk measures applied to trading activities. They are, however, subject to controls, including pre-approval of new investments by business management and risk control, and regular monitoring and reporting.

Where investments are made as part of an ongoing business they will be also subject to standard controls, including portfolio and concentration limits. All investments must be explained and justified, approved according to delegated authorities, and monitored and reported throughout their life.

While equity investments are not subject to the Bank's VaR limits, market risk measurement tools may be selectively applied to them, where appropriate, for internal management information. VaR can, for example, provide additional insight into the sensitivity of the assets and other exposures in the form of tradable financial instruments. Although some of the assumptions of VaR – in particular the relatively short time horizon – may not be representative of the full risk on equity investments, the results can be used by business management and risk controllers for information or to trigger action or review.

Under International Financial Reporting Standards as adopted by the European Union (IFRS), equity investments may be classified as Financial investments available-for-sale, Financial assets designated at fair value through profit and loss, or Investments in associates, joint ventures or subsidiaries.

### Composition of equity and other non-fixed income instruments

As at 31 December 2014, equity and other non-fixed income instruments classified as financial assets at fair value through profit or loss amounted to EUR 886,200 (2013: 797,160).

### **Debt investments**

Debt investments classified for IFRS as Financial investments available-for-sale or held-to-maturity can be broadly categorized as money market papers and debt securities, which are mainly held for statutory, regulatory or liquidity reasons, and non-performing loans, which can be purchased in the secondary market.

The risk control framework applied to debt instruments classified as Financial investments available-for-sale varies will depend on the nature of the instruments and the purpose for which they are held.

Other debt investments are predominantly securities issued by sovereigns of the Organization for Economic Co-operation and Development (OECD) and highly rated financial institutions.

Where applicable, debt investments are reflected in internal reports to of consolidated credit exposures and in large exposure reports to the Central Bank of Malta.

As at 31 December 2014, the Bank did not hold any debt instruments (2013: none as at 31 December 2013).

## OPERATIONAL RISK

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external causes, whether deliberate, accidental or natural. It will be inherent in all Nemea Bank's activities, not only in the business the Bank conducts but due to the fact it is a business – because Nemea Bank is an employer, it may own and occupies property and holds assets, including information, belonging to both the Bank and its clients. The approach to operational risk is not designed to eliminate risk per se but, rather, to contain it within acceptable levels, as determined by senior management, and to ensure that the Bank has sufficient information to make informed decisions about additional controls, adjustments to controls, or other risk responses. The Risk Officer (RO) will be responsible for the independence, objectivity and effectiveness of the operational risk framework.

### **Operational risk framework**

Every function, whether a front-end business or a control or logistics unit, must manage the operational risks that arise from its own activities. Because these risks are all pervasive, with a failure in one area potentially impacting many others, the Bank's framework will be based on mutual oversight across all functions. Each area of operations will therefore have established cross-functional cooperation with the Risk Management unit as an integral part of its governance structure, to actively manage operational risk.

The foundation of the operational risk framework is the definition by all functions of their roles and responsibilities so that, collectively, they can ensure that there is adequate segregation of duties, complete coverage of risks and clear accountability. From this analysis, they will develop control objectives and standards to protect the Bank's tangible and intangible assets and interests, based on the types of operational risk events that might arise, ranging from daily reconciliation problems to potentially severe events such as fraud. The Bank recognises that it cannot eliminate all risks, because errors and accidents will always happen, and that even where it is possible it is not always cost effective to do so. Nemea Bank's internal control framework will differentiate potential events depending on their likely frequency and impact. Its mitigation and avoidance efforts will be focused on areas where the Bank believes it is most exposed to severe events – including both those that are reasonably foreseeable and those that, while not predictable, are thought to be reasonably possible. For lower impact risks Nemea Bank will concentrate on management and monitoring.

The functions will monitor compliance with their controls and assess their operating effectiveness in several ways, including self-certification by staff, and evaluation of responses by management. Additionally, they will track a wide range of metrics to provide potential early warning of increased risk associated with non-attainment of control objectives. These include numbers and characteristics (severity, size, age, etc.) of, for example, client complaints and claims, deal cancellations and corrections, non-reconciled items on cash and client accounts, and systems failures. The implications of

internal and external audit findings and other relevant sources of information will also be assessed.

As major operational risk events occur, Nemea Bank will assess their causes and the implications for its control framework, whether or not they lead to direct financial loss. This will include events affecting third parties that are relevant to the Bank's business if sufficient information is made public. It is important to use all available information to test the control framework because, even if an internal event does not lead to a direct or indirect financial loss, it may indicate that Nemea Bank's standards are not being complied with.

The totality of this information will be reviewed by functional managers to assess their operational risk exposure and the actions needed to address specific issues. These issues will be formally captured on a risk inventory, which will form the basis of reporting to senior management. Regular reports will be made both within the business areas and to the CRO to allow senior management to assess the overall operational risk profile.

### **Operational risk measurement**

Nemea Bank will be developing a model for quantification of operational risk, which meets the regulatory capital standard under the Basel II Advanced Measurement Approach (AMA), while taking into account the prospective requirements for the subsequent Basel III regime. It will have two main components. The historical component will be based on Nemea Bank's own internal losses and is used primarily to determine the expected loss portion of the capital requirement.

The scenario component of the AMA model will be used primarily to determine the unexpected loss portion of the capital requirement. It will be based on a set of generic scenarios that represent categories of operational risks to which the Bank will be exposed. The scenarios themselves will be generated from an analysis of internal and external event information, the current business environment, and Nemea Bank's own internal control environment through comparison to the risk inventory. For each scenario, Nemea Bank will estimate a base case mainly derived from its own experience, a stressed case mainly derived from integrating experiences of select peers and a worst case based on events experienced by an expanded set of peers in the financial industry. The scenarios will be reviewed at least annually by experts in the relevant subject matter and their risk control counterparts to ensure their validity and may be updated based on material new information or events that occur.

The Bank does not set limits on operational risk but will report the measured risk through the standard reporting processes.

The operational risk framework is primarily qualitative rather than quantitative – financial losses and capital considerations are only one, and not the most important, element. The Bank uses the operational risk framework as the basis for specialist internal control assessments in areas such as legal, compliance, tax and human resources and to meet internal control-related regulatory requirements, such as Basel II, and Basel III, when implemented.

## INTEREST RATE AND CURRENCY MANAGEMENT

### Management of non-trading interest rate risk

The Bank's largest non-trading interest rate exposures will arise in its banking and asset management business. Risks from fixed-maturity, short-term euro and all non-euro transactions are generally transferred to the Treasury. These fixed-rate lending products do not contain embedded options such as early prepayment that would allow clients to prepay at par – all prepayments are subject to market-based unwinding costs.

Risks from euro transactions with fixed maturities greater than one year will be transferred to Treasury by individual back-to-back transactions. Current and saving accounts and many other retail banking products have no contractual maturity date or direct market-linked rate, and therefore their interest rate risk cannot be transferred by simple back-to-back transactions. Instead, they are transferred on a pooled basis via "replicating" portfolios. A replicating portfolio is a series of loans or deposits at market rates and fixed terms between the originating business unit and Treasury, structured to approximate – on average – the interest-rate cash flow and re-pricing behavior of the pooled client transactions. The portfolios will be rebalanced monthly. Their structure and parameters will be based on long-term market observations and client behavior, and are regularly reviewed and adjusted as necessary. The originating business units will be thus immunized as far as possible against market interest rate movements, but retain and manage their product margin.

A significant amount of interest rate risk will also arise from the financing of non-monetary related balance sheet items, such as the financing of bank property and equity investments in associated and subsidiary companies. These risks are generally transferred to Treasury through replicating portfolios, which, in this case, are designed to approximate the funding profile mandated by senior management.

Treasury will manage its residual open interest rate exposures – taking advantage of any offsets that arise between positions from different sources – within its approved market risk limits (Value at Risk (VaR) and stress loss). The preferred risk management instrument will be interest rate swaps, for which there is a liquid and flexible market.

### Market risk arising from management of capital

Nemea Bank is required, by international banking regulation (BIS regulations), to hold a minimum level of capital against assets and other exposures (risk-weighted assets). The relationship between Nemea Bank's capital and its risk-weighted assets – the BIS Tier 1 ratio – is monitored by regulators and is a key indicator of its financial strength.

As at 31 December 2014, Nemea Bank's capital and assets were almost entirely denominated in euros, with a relatively small client deposit liability and the matching deposit asset held in British pounds, US dollar, Swedish Krona and Polish Zloty. If the Bank held risk-weighted assets and eligible capital in other currencies, such as US dollar and UK sterling, any significant appreciation of the euro against these currencies would adversely impact the Bank's BIS Tier 1 ratio. Treasury's mandate will be therefore to protect this ratio against adverse currency movements and to generate an income flow from the capital. This mandate determines a currency, tenor and product mix – a target profile – against which Treasury will manage the Bank's capital.

On an overall basis, Treasury's target profile will be based on a currency mix, which broadly reflects the currency distribution of the consolidated risk-weighted assets, using products and tenors, which generate the desired income stream. When the euro depreciates (or appreciates) against these currencies, the consolidated risk-weighted assets increase (or decrease) relative to Nemea Bank's capital. These currency fluctuations also lead to translation gains (or losses) on consolidation, which are recorded through equity. Thus, Nemea Bank's consolidated equity will rise or fall in line with the fluctuations in the risk-weighted assets, protecting the Tier 1 ratio.

The capital of the Bank itself is intended to be held predominantly in euros in order to avoid any significant effects of currency fluctuations on its standalone financial results.

For the purposes of measuring and managing Treasury's market risk position, the Bank's equity is planned to be represented in the Treasury book by replicating portfolios (liabilities) with the target currency and interest rate profile. The interest rate positions created by Treasury's deposits, and the associated derivatives, will generally offset the interest rate risk of the replicating portfolios. Any mismatches between the two will be managed, together with other non-trading interest rate risk positions within Treasury's market risk limits (VaR and stress).

The structural foreign currency exposures will be controlled by senior management but are not subject to internal market risk limits and are not included in Treasury's reported VaR.

#### **Treasury interest rate risk development**

In measuring Treasury's interest rate risk – expressed as VaR – both the representation of the Bank's equity (replicating portfolios) and the deployment of the equity described above are included in the calculations.

As at 31 December 2014, the Bank's equity was deployed in euros.

#### **Corporate currency management**

Nemea Bank's corporate currency management activities will be designed to reduce the impact of adverse currency fluctuations on its reported financial results, given regulatory constraints. Nemea Bank will specifically focus on three principal areas of currency risk management: match funding / investment of non-euro assets / liabilities; sell-down of non-euro profit and loss; and selective hedging of anticipated non-euro profit and loss.

#### **Match funding and investment of non-euro assets and liabilities**

As far as it is practical and efficient to do so, the Bank will follow the principle of matching the currency of its assets with the currency of the liabilities, which fund them – thus a US dollar asset is typically funded in US dollars, etc. This avoids profits and losses arising from retranslation at the prevailing exchange rates to the euro at each reporting period end.

#### **Sell-down of reported profits and losses**

For accounting purposes, reported profits and losses will be translated each month from the original transaction currencies into euros at the exchange rate prevailing at the end of the month. Treasury will be centralizing profits or losses in foreign currencies that arise in the Bank, and selling or buying them for euros in order to eliminate earnings volatility which would arise from retranslation at different exchange rates of previously reported non-euro profits and losses. Other Nemea Bank operating

entities, if any, would follow a similar monthly sell-down process into their own reporting currencies. Profits retained in operating entities with a reporting currency other than euro will be managed as part of the Bank's consolidated equity, as described earlier.

**Hedging of anticipated future reported profits**

The monthly sell-down process would not be able to protect the Bank's earnings from swings caused by a sustained depreciation against the euro of one of the main currencies in which Nemea Bank earns net revenues or by an appreciation of one in which it incurs significant net costs.

The Bank's corporate currency management will seek to mitigate the potential adverse impact of any such development by executing a dynamic and cost-efficient rollover hedge strategy on a portion of the profits that Nemea Bank anticipates for the next three months, on a rolling one-month basis.

Although intended to hedge future earnings, these transactions will be considered open currency positions. They will be therefore subject to internal market risk VaR and stress loss limits.

## LIQUIDITY AND FUNDING MANAGEMENT

Liquidity risk is the risk of being unable to raise funds to meet payment obligations when they fall due. Funding risk is the risk of being unable, on an ongoing basis, to borrow funds in the market at an acceptable price to fund actual or proposed commitments and thereby support Nemea Bank's current business and desired strategy. Liquidity and funding are not the same, but they are closely related and both are critical to a financial institution.

Liquidity must be continuously managed to ensure that the Bank can survive a crisis, whether it is a general market event, a localized difficulty affecting a smaller number of institutions, or a problem unique to an individual firm. An institution that is unable to meet its liabilities when they fall due may collapse, even though it is not insolvent, because it is unable to borrow on an unsecured basis, or does not have sufficient good quality assets to borrow against or liquid assets to sell to raise immediate cash.

### **Liquidity approach**

Nemea Bank's approach to liquidity management is to ensure that it will always have sufficient liquidity to meet liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking sustained damage to its various business franchises.

Central to the integrated framework is an assessment of all material, known and expected cash flows and the level of high-grade collateral that could be used to raise additional funding. It entails both careful monitoring and control of the daily liquidity position, and regular liquidity stress testing. Risk limits are set by the Chairman's Office and monitored by Treasury, and a contingency plan for a liquidity crisis will be incorporated into Nemea Bank's wider crisis management process.

The liquidity position will be assessed and managed under a variety of potential scenarios encompassing both normal and stressed market conditions. The Bank will consider the possibility that its access to markets could be impacted by a stress event affecting some part of its business or, in the extreme case, if it was to suffer a period of general market uncertainty.

### **Liquidity management**

The Bank will manage its liquidity position in order to be able to ride out a crisis without damaging the ongoing viability of its business. This is complemented by the Bank's funding risk management which aims to achieve the optimal liability structure to finance its businesses cost-efficiently and reliably. The long term stability and security of Nemea Bank's funding in turn will help protect its liquidity position in the event of a Nemea Bank-specific crisis.

Nemea Bank's business activities will generate liability portfolios, which are intrinsically diversified with respect to market, product and currency. This provides a

broad range of investment opportunities for Nemea Bank's clients and thus reduces the Bank's exposure to individual funding sources, which in turn reduces liquidity risk.

Nemea Bank adopts a centralized approach to liquidity and funding management to exploit these advantages to the full. The liquidity and funding process is undertaken by the Treasury unit. Treasury runs comprehensive operational cash and collateral management within the established parameters.

This centralization permits close control of both Nemea Bank's global cash position and its stock of highly liquid securities. The central treasury process also ensures that the Bank's general access to cash markets is concentrated. Funds raised externally are largely channeled into Treasury, also meeting all internal demands for funding by channeling funds from units generating surplus cash to those requiring finance. In this way, the Bank minimizes its external borrowing and use of available credit lines, and presents a consistent and coordinated face to the third parties.

### **Liquidity modeling and contingency planning**

The daily liquidity position – the net cumulative funding requirement for a specific day – will be projected under cautious assumptions for each business day from the current day out to one month to produce a cumulative "cash ladder". The short-term cash ladder is the tool used by Treasury to manage net daily funding requirements efficiently, and monitor liquidity exposure against limits set by the Chairman's Office.

Nemea Bank will also be regularly assessing the impact of a liquidity crisis scenario, combining a firm-specific crisis with market disruption and focusing on a time horizon starting with overnight and extending up to one year. This Nemea Bank-specific scenario envisages large draw-downs on otherwise stable client deposits, an inability to renew or replace maturing unsecured funding and limited capacity to generate liquidity from trading assets. Liquidity crisis scenario analysis will support the liquidity management process so that immediate corrective measures, such as the build-up of a liquidity buffer to absorb potential sudden liquidity gaps, can be put into effect.

The starting point for stress testing analyzes will be a breakdown of the contractual maturity of Nemea Bank's assets and liabilities. Since a liquidity crisis could have a myriad of causes, the Bank will focus on a scenario that encompasses all potential stress effects across all markets, currencies and products.

The assessment will include the likelihood of maturing assets and liabilities being rolled over in a Nemea Bank-specific crisis, and gauge the extent to which the potential crisis-induced shortfall could be covered by available funding. This would be raised on a secured basis against available collateral, which includes securities eligible for pledging at the major central banks, or by selling liquid inventory. In both cases Nemea Bank will apply crisis-level discounts to the value of the assets. It assumes that it would be generally unable to renew any of the Bank's unsecured debt and that no contingency funding could be raised on an unsecured basis. It will also factor in potential liquidity outflows from contingent liabilities, in particular those resulting from the drawdown of committed credit lines.

Liquidity needs may also result from commitments and contingencies, including credit lines extended to secure the liquidity needs of clients. Nemea Bank will be regularly monitoring undrawn committed credit facilities and other latent liquidity risks.

Nemea Bank will also analyze the potential impact on its net liquidity position of adverse movements in the replacement values of its over-the-counter (OTC) derivative transactions, which are subject to collateral arrangements and includes the potential outflows in its crisis scenarios. Given the potential diversity of Nemea Bank's

derivatives business and that of its counterparties, there is not necessarily a direct correlation between the factors influencing net replacement values with each counterparty and a firm-specific crisis scenario.

### **Liquidity limits and controls**

While its estimated capacity to generate liquidity when required will naturally vary, Nemea Bank will generally apply a constant limit structure, which imposes a ceiling on the projected net funding requirement along the cash ladder. Limits are based on the amount of cash Nemea Bank believes it could raise in a firm-specific crisis.

The Bank will also be developing detailed contingency plans for liquidity crisis management, the cornerstone of which is the Bank's access to secured funding either from the market or from the relevant central banks, coupled with the ability to turn sufficient liquid assets into cash within a short time frame.

The liquidity contingency plan will be an integral part of the global crisis management concept, which covers all types of crisis events. It would be implemented under a core crisis team with representatives from Treasury, and from other related areas including the functions responsible for payments and settlements, market and credit risk control, collateral and margin management, and information technology and infrastructure.

The Bank will be strengthening its relationships with relevant central banks, consistent with its general policy, which is to base contingency plans on secured funding against pledges of high-quality collateral, rather than relying on third-party credit lines.

### **Liquidity ratios**

In addition to the limits and controls described above, the Bank will also measure three ratios to monitor liquidity risk – the ratio of trading assets (trading portfolio assets and positive replacement values on derivatives) to total assets, the ratio of "level 1" trading assets to total assets, and the ratio of client savings and deposits to mortgages. Level 1 trading assets are those for which fair values can be obtained from observable market prices and which are therefore considered to be the most liquid. The first two ratios will show the proportion of Nemea Bank's total assets that are of a trading nature and are dominated by the corporate and institutional business activities. The third ratio will be mainly driven by the retail banking activity and shows the extent to which Nemea Bank aims at effectively funding its largest asset portfolio with client deposits (savings and deposit accounts only), which are a stable funding source – the higher this percentage, the less the Bank will be reliant on wholesale funding for these potentially longer-term assets.

### **Funding**

Through broad diversification of its funding sources (by market, product and currency), Nemea Bank plans to create and maintain a well-balanced portfolio of liabilities, which will generate a stable flow of financing and provides protection in the event of market disruptions. This, together with its centralized funding management, will enable the Bank to pursue a strategy of efficient funding of business activities.

### **Funding approach**

Medium- and long-term funding activities will be planned by assessing the overall funding profile of the balance sheet, taking due account of the effective maturity of the asset base and the amount of maturing debt that will have to be replaced. The ability to

continue to fund ongoing business activities through periods of difficult market conditions is also factored in.

To ensure that a well-balanced and diversified liability structure is preserved, Treasury will routinely monitor the Bank's funding status and reports its findings on a monthly basis to the Chairman's Office. Two main analysis tools will be employed – "cash capital" and "secured funding capacity". Nemea Bank complements these analyzes with regular assessments of any concentration risks in its main funding portfolios.

Cash capital is the excess of Nemea Bank's long-term funding over the total of illiquid assets. "Long-term" and "illiquid" both refer to a time horizon of one year. The secured funding capacity concept ensures that short-term, unsecured funding is effectively only invested in freely marketable assets. Nemea Bank will seek to maintain a minimum stock of unencumbered assets and cash that exceeds its outstanding short-term unsecured wholesale borrowings.

#### **Funding position**

Nemea Bank's secured funding base will reduce its exposure to periods of stressed market conditions when the ability to raise unsecured funding could be temporarily restricted.

#### **Maturity analysis of assets and liabilities**

As at 31 December 2014, all client deposits placed with the Bank were either placed on term deposits or available on call. Treasury deposits were placed for terms equal to 1 month or less of original maturity.

#### **Contingent claims and commitments**

The Bank enters into commitments to extend credit lines to secure the liquidity needs of clients. At the end of the reporting period, there were no credit lines opened.

## CAPITAL MANAGEMENT

In managing its capital, Nemea Bank will consider a variety of requirements and expectations. Sufficient capital must be in place to support current and projected business activities, according to both Nemea Bank's own internal assessment and the requirements of its regulators, in particular its lead regulator, the Maltese Financial Services Authority (MFSA).

Capital is also managed in order to achieve sound capital ratios that ensure that Nemea Bank remains a well-capitalized firm in the banking sector. This will be crucial in retaining clients' confidence in the Bank's financial strength and also supports the Bank's funding position and favorable borrowing costs in the international financial markets.

The Bank aims to maintain sound capital ratios at all times, and it therefore considers not only the current situation but also projected developments in both its capital base and capital requirements. The main tools by which Nemea Bank manages the supply side of its capital ratios will be active management of capital instruments and dividend payments.

### **Capital adequacy management**

Ensuring compliance with minimum regulatory capital requirements and targeted capital ratios is central to capital adequacy management. In this ongoing process, Nemea Bank manages towards Tier 1 and Total capital target ratios. In the target setting process Nemea Bank takes into account the regulatory minimum capital requirements and regulators' expectations that Nemea Bank holds additional capital above the minimum, Nemea Bank's internal assessment of aggregate risk exposure in terms of Capital-at-risk, and comparison to peer institutions, considering Nemea Bank's business mix and market presence.

### **Capital requirements**

At year-end 2014, Nemea Bank was subject to regulatory guidelines based on the Basel III framework established by the Basel Committee on Banking Supervision ("BIS guidelines / ratios"). The capital it is required to hold is determined by its risk-weighted assets – its balance sheet, off-balance sheet and market risk positions, measured and risk-weighted according to criteria defined by its lead regulator, the MFSA. Under BIS guidelines, a financial institution's eligible capital must be at least 8% of its total risk-weighted assets.

Nemea Bank measures on- and off-balance sheet claims according to regulatory formulas. Claims are weighted according to type of counterparty and collateral. The least risky claims, such as claims on OECD governments and claims collateralized by cash, are weighted at 0%, meaning that no regulatory capital support is required, while the claims deemed most risky, including unsecured claims on both corporate and private clients, are weighted at 150%, meaning that 8% capital support is required.

Securities not held for trading are treated as claims, based on the net position in the securities of each issuer, including both actual holdings and exposures from derivative instruments. The Bank's investments in entities which are consolidated under

International Financial Reporting Standards (IFRS) and which are not active in the field of banking and finance (including consolidated industrial holdings) are treated for regulatory capital purposes as positions in securities not held for trading.

Claims arising from derivatives transactions have two components – the current replacement values, and "add-ons" to reflect the potential future exposure. Where Nemea Bank has entered into a master netting agreement that is considered legally enforceable in insolvency, positive and negative re-placement values with individual counterparties can be netted. Off-balance sheet claims arising from contingent commitments and irrevocable facilities are converted into credit equivalent amounts based on percentages of nominal value specified by the regulators.

Regulatory capital is required to support market risk arising on all foreign exchange, energy, metal and other commodity positions, and on all positions held for trading purposes, including equities and traded debt obligations held in the trading book.

The Bank will initially be controlling and reporting as per Basel III Standardized approach of allocating capital with the intention to develop its processes and information systems to arrive at the Internal Rating / Advanced approach in the minimum time span necessary.

Other assets, most notably property and equipment, and intangibles are not subject to credit or market risk, but they represent a risk to the Bank in respect of their potential for write-down and impairment and therefore require capital underpinning in accordance with regulatory formulas.

### **Risk-weighted assets (BIS)**

As at 31 December 2014 total risk-weighted assets were EUR 17,521,943 (2013: EUR 8,558,500).

### **Eligible capital**

The capital available to support risk-weighted assets – eligible capital – consists of Tier 1 and Tier 2 capital. To determine eligible Tier 1 and total capital, adjustments have to be made to shareholders' equity as defined under IFRS, most notably by deducting intangible assets and investments in unconsolidated entities engaged in banking and finance activities.

Eligible capital is the same under BIS guidelines and MFSA regulations.

### **Tier 1 capital / Nemea Bank shares**

The majority of Tier 1 capital comprises share capital injected at inception of the Bank as increased by the retained earnings for the year attributable to the Bank's shareholders. As at 31 December 2014, total IFRS equity attributable to Nemea Bank shareholders amounted to EUR 5,546,206 (2013: EUR 5,345,248), which serves as the basis for determining the regulatory eligible Tier 1 capital.

### **Hybrid Tier 1 capital**

Hybrid Tier 1 instruments are perpetual instruments that can only be redeemed if they are called by the issuer. The payment of interest is subject to compliance with minimum capital ratios and any payment missed is non-cumulative. As at 31 December 2014 and 2013, there were no hybrid Tier 1 instruments issued by the Bank.

As at 31 December 2014, BIS Tier 1 capital was EUR 5,454,190 (2013: EUR 5,325,299) reflecting primarily the capital of the Bank.

### **Tier 2 capital**

Tier 2 capital consists mainly of subordinated long-term debt that ranks senior to both Nemea Bank shares and hybrid Tier 1 instruments but is subordinated with respect to all senior obligations of Nemea Bank. As at 31 December 2014 and 2013, there were no Tier 2 instruments issued by the Bank.

### **Capital ratios**

The BIS ratios compare the amount of eligible capital (in total and Tier 1) with the total of risk-weighted assets.

Future capital ratios will depend on, among other factors, developments in financial markets and their impact on profit and loss, valuations and capital requirements for market risk; the development of the credit quality of the Bank's obligors and counterparties; future issuances of capital instruments; capital requirements for operational risk; and future changes in the regulatory frameworks.

## SHARES AND CAPITAL INSTRUMENTS

### Shares

#### Nemea Bank shares and Tier 1 capital

The majority of Tier 1 capital comprises retained earnings attributed to Nemea Bank shareholders. As at 31 December 2014, total International Financial Reporting Standard (IFRS) equity attributable to Nemea Bank amounted to EUR 5,785,922 and was represented by a total of 5,500,000 issued Nemea Bank shares. Each outstanding share has a par value of EUR 1 and entitles the holder to one vote at the shareholders' meeting and to receive a proportionate share of the dividend that is distributed. There are no preferential rights for individual shareholders and no other classes of shares have been issued by the Bank (Nemea Bank plc) directly.

During 2014, the outstanding shares remained unchanged, compared to previous year.

### Capital Instruments

#### Hybrid Tier 1 capital

Hybrid Tier 1 instruments are perpetual instruments which can only be redeemed if they are called by the issuer. If such a call is not exercised at the respective call date, the terms might include a change from fixed to floating coupon payments and, in the case of innovative instruments only, a limited step-up of the interest rate. Non-innovative instruments do not have a step-up of the interest rate and are therefore viewed as having a higher equity characteristic for regulatory capital purposes. The instruments are issued either through trusts or subsidiaries of Nemea Bank and rank senior to Nemea Bank shares in dissolution. Payments under the instruments are subject to the adherence to minimal capital ratios by Nemea Bank. Any payment missed is non-cumulative.

As at 31 December 2014 Nemea Bank had not issued any hybrid instruments.

#### Tier 2 capital

The major element in Tier 2 capital consists of subordinated long-term debt.

As at 31 December 2014 Nemea Bank had not issued any Tier 2 instruments.

### Distributions to shareholders

Nemea Bank may pay an annual dividend to shareholders registered as of the date of the AGM (the record date). Payment is usually scheduled three business days thereafter.

The level of the dividend is dependent on Nemea Bank's targeted capital ratios and the cash flow generation of the Bank.

The decision on dividend payments falls under the AGM's authority and is subject to shareholder approval.

#### Total distributions in 2014

For the financial year 2014, the Board of Directors proposes that dividend of EUR 216,436 shall be paid to the shareholders i.e. the parent company of the Bank.

Cash dividend payments are deducted from the Bank's net profits and retained earnings, which are some of the major components of the Bank's core (Tier 1) capital. In contrast, by issuing new shares in lieu of a cash dividend payment, the level of Nemea Bank's (Tier 1) capital base is maintained.





GRAND HOTEL

### 3 CORPORATE GOVERNANCE AND COMPENSATION

Corporate governance - the way that the leadership and management of a firm are organised and how they operate in practice - ultimately aims to lead the Bank towards sustainable growth, protect the interests of its shareholders and create value for both them and all stakeholders. Good corporate governance seeks to balance entrepreneurship, control and transparency, while supporting the Bank's success by ensuring efficient decision-making processes. As part of good corporate governance is compensation structure that aligns shareholder and management interests in long-term value creation for the company. Nemea Bank is a strict meritocracy, where superior performance leads to superior compensation and rewards. In addition, this section summarises the regulatory and supervisory environment of Nemea Bank in its principal location.



## GROUP STRUCTURE AND SHAREHOLDERS

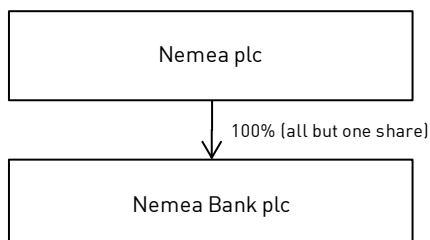
Under Maltese company law, Nemea Bank is organized as a public limited company, a corporation that has issued shares of common stock to investors. Nemea plc is the parent company of Nemea Bank plc. Nemea plc is the parent company of the Nemea Group.

### Nemea Group legal entity structure

The legal entity structure of Nemea Bank is designed to support its businesses within an efficient legal, tax, regulatory and funding framework. Neither the planned business groups nor the corporate center will be separate legal entities: they will be operating out of the parent bank, Nemea Bank plc, directly. This structure is designed to capitalize on the increased business opportunities and cost efficiencies offered by the use of a single legal platform and to enable the flexible and efficient use of capital.

Where it will be neither possible nor efficient to operate out of the parent bank - usually due to local legal, tax or regulatory rules or as a result of additional legal entities joining the Nemea Bank Group through acquisition - businesses will operate through local subsidiaries or other separate legal entities.

The following diagram describes the Group's legal structure of financial businesses with the parent company Nemea plc and the operating entity Nemea Bank plc.



### Operational group structure

The operational structure of the Bank is described in the section "Strategy and Structure" of this report.

### Subsidiaries

As at 31 December 2014, Nemea Bank plc did not have any subsidiaries.

### Significant shareholders

The shareholder of Nemea Bank plc is Nemea plc, holding all but one share, and Nevestor SA, holding one share.

### Cross shareholdings

Nemea Bank has no cross shareholdings with any other company.

## CAPITAL STRUCTURE

Nemea Bank is committed to capital management that is driven by shareholder value considerations. At the same time, Nemea Bank is dedicated to maintaining its strong capital position.

### Capital

Under Maltese company law, shareholders have to approve in a shareholders' meeting any increase in the total number of issued shares, which may be an ordinary share capital increase or the creation of conditional or authorised capital. At year-end 2014, the ordinary issued share capital was EUR 5,500,000.

### Conditional share capital

At year end 2014, there was no conditional share capital.

### Authorised share capital

At year-end 2014, the authorised share capital of the Bank was EUR 20,000,000. Up till 31 December 2014 the Board of Directors was not authorised to issue any more shares.

### Changes of shareholders' equity

According to International Financial Reporting Standards as adopted by the European Union (EU IFRS), equity attributable to Nemea Bank shareholders amounted to EUR 5,785,922 as at 31 December 2014.

### Shares, participation and bonus certificates, capital securities

Nemea Bank shares are issued in registered form. Each registered share has a par value of EUR 1 and carries one vote.

As at 31 December 2014, all 5,500,000 issued shares carried voting rights. All shares were fully paid up. There are no preferential rights for individual shareholders.

Nemea Bank has not issued any participation certificates or bonus certificates.

At year-end 2014, Nemea Bank had no hybrid capital securities outstanding, which count as Tier 1 capital under regulatory rules, nor did it have any outstanding Tier 2 capital securities.

### Limitation on transferability

Nemea Bank does apply restrictions and limitations on the transferability of its shares commensurate with a public limited company in accordance to the Maltese Companies Act of 1995.

Shares registered in the share register with voting rights according to the provisions of the "Memorandum of Association" of Nemea Bank plc may be voted without any limit in scope.

**Convertible bonds and options**

As at 31 December 2014, there were no convertible bonds or options authorised or issued.

## BOARD OF DIRECTORS

The Board of Directors is the most senior body with ultimate responsibility for the strategy and management of the Bank and for the supervision of its executive management. The shareholders elect each member of the Board of Directors, which appoints its Chairman or Co-Chairmen, Vice Chairmen, if any and the members of its committees, if any.

### Members of the Board of Directors

As at 31 December 2014, the membership consisted of 3 directors, of which 3 members were non-executive and 1 independent.

Information on the composition of the Board of Directors (BoD) as at 31 December 2014:

<b>Heikki Niemelä</b>	Co-Chairman
<b>Mika Lehto</b>	Co-Chairman
<b>Joseph F.X. Zahra</b>	Director

All directors were initially appointed upon incorporation on 2 September 2008 and re-appointed at the AGM 2014 up to the next AGM in 2015.

### Elections and terms of office

All the members of the BoD are elected individually by the AGM for a term of office until the next annual general meeting.

### Changes in 2014

There were no changes to the BoD composition during 2014.

### Company secretary

Dr. Michael Ellul Sullivan was appointed company secretary upon incorporation, also acting as secretary to the BoD.

### Organizational principles

The BoD has ultimate responsibility for the mid and long-term strategic direction of the Bank, for appointments and dismissals at top management levels and the definition of the Bank's risk principles and risk capacity. While a part of the members are always independent, the Chairman or Co-Chairmen of the BoD assume supervisory and leadership responsibilities.



Members of the Board of Directors Mika Lehto, Heikki Niemelä and Joseph F.X. Zahra, together with Company Secretary Dr Michael Ellul Sullivan

### **Internal organization, Board of Directors' meetings in 2014**

After each AGM, the shareholders elect the Chairman or Co-Chairmen of the BoD and appoint its Secretary. It meets as often as business requires, but at least four times per year. In 2014, six meetings were held. All the BoD members were present at the meetings physically or remotely over teleconferencing facilities.

The BoD is organized as follows:

#### **Chairman's Office**

The Board of Directors has formalized the Chairman's Office composed of the two Co-Chairmen, which meets to address issues that are fundamental for the Bank, such as overall strategy, mid-term succession plans at senior management level, compensation systems and principles and the risk profile of the Bank. The Chairman's

Office acts as the Risk Committee of the BoD. In this capacity it has the highest approval authority for the following (within the risk capacity and principles approved by the BoD): allocation of responsibility for credit, market and other risk-related matters; setting of standards, concepts and methodologies for risk control; and allocation of the major risk limits to the business groups. It will also be acting as the supervisory body for Internal Audit. The Chairman's Office is responsible for shaping the corporate governance of the Bank and formulates appropriate principles, which it submits to the full BoD for approval. It also assumes responsibility for long-term succession planning at BoD level and reviews, upon proposal by the Chairman/Co-Chairmen of the BoD, senior management candidates for appointment or dismissal by the full BoD. In exceptional cases, and in consideration of the non-transferable and inalienable duties of the BoD under mandatory corporate law, urgent decisions falling within the authority of the BoD may be taken by the Chairman's Office. Such decisions have to be reported to the full BoD as soon as possible.

The members of the Chairman's Office, as at 31 December 2014, were Heikki Niemelä, Co-Chairman of the BoD, and Mika Lehto, Co-Chairman of the BoD.

Co-Chairmen of the BoD Heikki Niemelä and Mika Lehto take a leading role in mid- and long-term strategic planning, the selection and supervision of the senior management, mid-term succession planning and developing and shaping compensation principles. They also actively support major client and transaction initiatives.

## **Independent members of the Board of Directors**

### **Important business connections of independent members of the Board of Directors with Nemea Bank**

Nemea Bank, as an international financial services provider, has business relationships with many companies including those in which Nemea Bank BoD members assume management or non-executive responsibilities. None of the relationships that members of the BoD have with other such companies is of a magnitude that jeopardizes the BoD members' independent judgment; furthermore, no independent director has personal business relationships with Nemea Bank that could infringe on his or her independence.

All relationships and transactions with Nemea Bank directors and their affiliated companies are in the ordinary course of business and are on the same terms as those prevailing at the time for comparable transactions with non-affiliated persons.

## **Checks and balances**

The supervision and control of the senior management remains with the BoD.

### **Information and control instruments vis-à-vis the senior management**

The BoD is kept informed of the activities of the senior management in various ways. The Co-Chairmen from time to time participate in senior management meetings, thus keeping the Chairman's Office apprised of all current developments. The minutes of the senior management meetings are filed with the Chairman's Office members. At BoD meetings, the senior management regularly brief the BoD on important issues.

At BoD meetings, members may request from members of the BoD or the senior management any information about any matters concerning the Bank that are necessary to fulfill their duties. Outside of meetings, any member may request

information from the Co-Chairmen concerning the Bank's business development. Requests for information about individual businesses or transactions must be approved by the Co-Chairmen of the BoD.

Internal Audit will be monitoring compliance of business activities with legal and regulatory requirements and all internal regulations, policies and guidelines. This internal audit organization, which will be independent from management, reports significant findings to the Co-Chairmen of the BoD and the Chairman's Office.

The senior management will submit a quarterly risk report to the Chairman's Office for approval. This report will provide an update on all categories of risk and contain a comprehensive assessment of the risk situation of the Bank. The full BoD will be briefed quarterly on the major developments through an executive summary of the report and an oral update. The compliance function will provide an annual compliance report to the BoD.

### **CVs of the Members of the Board of Directors**

#### **Mika Lehto, Co-Chairman**

Mika Lehto was elected to the Board of Directors of Nemea Bank plc in 2008 and is Co-Chairman and Co-Founder of the Bank and serves as member of the Chairman's Office of the Bank that also acts as the Risk Committee of the Board of Directors. Previously, Mika was chairman at Kaupthing Sofi in Helsinki, Finland, and Managing Director and Co-Founder at Sofi Securities in Finland. Mika was also elected Director and Co-Chairman of Nemea plc, the parent company of the Bank. Mika has also served as Director and Co-Chairman of Nevestor SA, a Belgium-based financial investment company, and has held and holds directorships in a number of other private companies - he has also served as Deputy Chairman and board member in Finnish publicly listed investment companies Norvestia plc and Neomarkka plc as well as the privately held industrial refrigeration business Huurre Group Ltd. Originally, he co-founded Sofi Securities plc in Helsinki as was Managing Director and later Chairman of Sofi Securities. After Kaupthing's acquisition of Sofi, he continued to serve as Chairman and subsequently as Senior Advisor until his departure to found Nemea together with his long-time business partner Heikki Niemelä. Mika graduated with an MBA from the Helsinki University of Technology with part of the courses taken at Stanford University, the U.S.A., and IMD, Switzerland. He is a Finnish citizen.

#### **Heikki Niemelä, Co-Chairman**

Heikki Niemelä was elected to the Board of Directors of Nemea Bank plc in 2008 and is Co-Chairman and Co-Founder of the Bank and serves as member of the Chairman's Office of the Bank that also acts as the Risk Committee of the Board of Directors. Previously, Heikki was Chief Executive Officer and Director at Kaupthing Bank in Helsinki, Finland. Heikki was also elected Director and Co-Chairman of Nemea plc, the parent company of the Bank. Heikki has also served as Director and Co-Chairman of Nevestor SA, a Belgium-based financial investment company, and has held and holds directorships in a number of other private companies. Originally, he joined Sofi Securities plc in Helsinki as Director of Corporate Finance and Business Development. He was appointed at Kaupthing Sofi plc as Senior Vice President, just after Kaupthing's acquisition of Sofi, and subsequently, Managing Director and President of Kaupthing Sofi plc, and nominated deputy Board member of the Kaupthing Bank Group, and also board member of Kaupthing Sofi plc. Heikki continued to serve as the CEO of Kaupthing Bank plc until his departure to found Nemea together with his long-time business partner Mika Lehto. Heikki graduated with a BBA (Honours) in international

business from the Helsinki School of Economics and Business Administration, and a year later with an MBA (Honours) in finance from the same school in conjunction with part of the courses taken at Indiana University in the U.S.A. He is a Finnish citizen.

**Joseph F.X. Zahra**

Joseph F.X. Zahra was elected to the Board of Directors in 2008 and appointed Director of the Bank. Joseph is Managing Director and Co-Founder of Misco, the leading recruitment and marketing consulting firm in Malta, and Director of Middlesea Insurance plc and its subsidiary companies. Previously, Joseph was the chairman of the Bank of Valletta Group in Malta. Joseph Zahra is also Managing Director of Misco International Ltd., and Director of Impetus Europe Consulting Group Ltd. Joseph Zahra, after having spent short spells with Lufthansa AG in Germany, and Hawker Siddeley subsidiary in Malta, joined the Malta Development Corporation as Head of Research. He has been a regular visiting lecturer at the University of Malta and the Università degli studi di Messina teaching micro economics, management and managerial economics. He has held various public positions such as Board Member of the Central Bank of Malta, Board Member of the Malta Development Corporation, Chairman, Bank of Valletta plc and its subsidiary companies, Chairman of Maltacom plc, Director, Corinthia Hotels International Ltd. Joseph graduated from University of Malta with a First Class Honours Degree in Economics and a Masters Degree in Economics, specialising in Managerial Economics. He is also a Chartered Marketer, Fellow of the Chartered Institute of Marketing, besides being a member of the Market Research Society (U.K.). He is a Maltese citizen.

## COMPENSATION

Nemea Bank's competitive strength is affected by its ability to attract, retain and motivate the most talented people in financial services. The policies established by the Board of Directors create incentives to promote a performance-driven culture, adhere to ethical values and support the Bank's integrated business strategy. Compensation of senior executives is linked to the creation of long-term value and sustainable shareholder returns.

### **Governance, authorities and responsibilities**

Nemea Bank is committed to the highest standards of corporate governance. The approval of senior executive compensation follows a rigorous process.

The BoD is responsible for reviewing the Nemea Bank total compensation and benefits principles. Additionally the BoD will have responsibilities in five key areas:

- reviewing and approving the design of the total compensation framework, including compensation programs and plans;
- determining the relationship between pay and performance;
- approving base salaries and annual incentive awards for senior executives;
- reviewing and approving individual employment agreements of senior management; and
- reviewing and approving the terms and conditions for senior management members relinquishing their positions.

Authority for compensation-related decisions governed by the BoD has been delegated to the Chairman's Office.

### **Senior executive compensation policy**

#### **Principles**

Two related principles govern the Bank's senior executive compensation framework (and, indeed, the compensation of all Nemea Bank employees): creation of shareholder value and pay-for-performance. Specifically:

- all elements of compensation are managed in a consistent and integrated fashion, with clear recognition of pay-for-performance, reflecting both company and individual performance; and
- compensation levels and practices are benchmarked against competitors, relevant operating environments and best practice

Annual total compensation is competitively positioned and Nemea Bank will place a strong emphasis on the variable components of compensation, with the understanding that only superior performance will be rewarded with superior compensation. Such incentives provide the motivation to excel in the entrepreneurial, performance-oriented culture that is required to execute Nemea Bank's integrated business strategy. In addition, the BoD will verify whether the senior executive fulfilled their

objectives and key performance indicators (KPIs), including the importance of maintaining and spreading Nemea Bank's ethical values throughout the Bank.

### **Shareholder alignment**

The BoD structures senior executive compensation to ensure alignment with shareholder interests and long-term value creation. Specifically:

- it rewards the achievement of personal and corporate objectives that balance individual performance and long-term business growth; and
- no additional severance payments are offered in instances of termination, although obligations earned up to and including the notice period are honored in line with the contractual arrangements.

All these mechanisms help focus senior leadership on the long-term interests of the Bank's shareholders and minimize the cost of any future terminations.

### **Employment agreements and contractual payments**

The BoD will regularly review the individual employment agreements of senior executives.

The senior executive employment agreement do not provide for any additional severance payment in case of termination, apart from contractual salary, pension and bonus entitlements.

### **Pay-for-performance**

Performance is the primary driver of compensation decisions. Nemea Bank is committed to providing superior compensation in return for superior performance and continually develops the benchmarks and processes that support informed compensation decision-making.

At the beginning of the year, each Nemea Bank senior executive will agree individual objectives and KPIs. Individual objectives focus on clients, economics, technical expertise, leadership, cross-business cooperation, strategic impact, risk management and personal contribution. KPIs vary by business and by individual and typically include such measures as revenue growth, net profit, return on equity, return on assets, cost / income ratio, net new money, progress on strategic initiatives and adherence to the Bank's values.

As the year draws to a close, a senior executive's performance against each objective and KPI will be rigorously evaluated, not only by his or her immediate superior but also by peers and subordinates. This 360-degree assessment is qualitative and quantitative - comprising financial and operational results for the year, as well as indicators of future performance. Performance against key competitors and performance trends over time is likewise reviewed to the extent that data is available.

To the extent that a senior executive's business and individual performance exceeds - or falls short - of his or her agreed expectations, total compensation will mirror the outcome. In consequence, compensation levels may be highly variable from year-to-year.

### **Elements of compensation**

The total compensation framework for senior executives will comprise three elements: base salary, annual incentive, and benefits.

### **Base salaries**

Base salaries are established in a manner consistent with the role of each senior executive. Base salary adjustments are limited to significant changes in job responsibility.

Due to the variability of annual incentive awards, the ratio of base salary (a fixed amount) to total compensation can vary significantly year-to-year.

### **Annual incentive awards**

Each annual incentive award is assessed according to the individual's achievement of his or her personal objectives and key performance indicators. All senior executives are considered for an annual incentive award provided performance targets are achieved, but with a few rare exceptions (for example, competitive practice or business strategy) annual incentives are completely discretionary and can vary considerably, both from individual-to-individual and from year-to-year. Exceptional individual performance is reflected in the annual incentive award rather than in an adjustment to base salary. The maximum annual incentive award is limited to double the senior executive's target.

### **Benefits**

The Bank provides benefits to help attract and retain the best employees. Changes, terminations and the introduction of new benefits are governed by the Bank's organisation regulations. Benefits are a supplemental element of total compensation and vary substantially from location to location.

## **Key elements for decision-making process within the BoD**

### **Actual process and decisions taken**

The BoD makes decisions on individual senior executive compensation based on:

- Bank-wide and relevant business area performance;
- the individual performance and personal contributions of each member;
- actual Nemea Bank compensation in prior periods;
- an assessment submitted by the Co-Chairmen of the BoD; and
- available market data on competitors.

However, market data is only one of several factors in the compensation decision-making process. Market data informs but does not directly drive any individual decisions on executive compensation.

### **Key competitors**

Compensation and benefit levels are primarily result-driven and will be further benchmarked against appropriate key competitors. These companies will be selected for the similarity or relevance of their core business to that of Nemea Bank, as well as for comparable size, geographic distribution, business strategy and performance. Typically, these will be also the companies from which Nemea Bank is most likely to hire and to which it is most likely to lose senior employees. Competitive compensation at a senior level is therefore a vital element in preventing the loss of leadership talent and experience from Nemea Bank to its competitors. In the view of the BoD, the Bank's compensation systems will be positioned appropriately relative to the key competitors. For certain positions and for purposes of other analysis (including the best practice

review), additional industry players (like global leaders that do not necessarily directly compete with the Bank for the time being) may be taken into account, which are increasingly becoming attractive alternatives for Nemea Bank employees).

#### **Determination of 2014 incentive targets**

In view of 2014 being a continued set-up period due to system delays, with few operations, incentive targets setting has been postponed to a point where the operating platforms of the Bank are fully functional.

#### **Determination principles for actual incentives**

The actual operating results for the relevant financial period will be assessed against the given forecast (the Bank's and business area financial targets) as well as against similar metrics of key competitors. Incentive awards of senior executives in business groups will be based equally on the financial performance of the Bank overall and the results of the respective business area (on a 50:50 ratio). Incentive awards for executives at Bank level and in Corporate Center will be based fully on bank-wide performance. These measurements and assessments will result in a fixed theoretical incentive award for each senior executive.

Finally, this theoretical incentive award will be measured against various additional factors: personal performance against objectives, future potential, leadership qualities and contributions to the overall success of Nemea Bank. This qualitative assessment will lead to discretionary increases or decreases from the theoretical incentive by up to + / -25%.

Senior management members appointed during the last quarter of a financial year will be generally assessed on their targets and performance objectives, while nevertheless taking account of the overall Bank results.

### **Actual 2014 compensation for members of the Board of Directors**

#### **Compensation of the Co-Chairmen of the Board of Directors**

For its decision on the Co-Chairmen of the BoD's compensation, the BoD will be relying on an annual assessment performed by the full BoD and its own judgment with regards to the Co-Chairmen's performance and contributions, taking into account pay levels for comparable functions outside of Nemea Bank.

The Co-Chairmen of the BoD's incentive award will be fully dependent on the Bank's financial performance.

For the financial year ended 31 December 2014, the Co-Chairmen opted not to take any compensation.

#### **Compensation details of the Board of Directors**

Payments to independent members of the Board of Directors amounted to EUR 15,000 during the year from 1 January to 31 December 2014, specifically as follows:

<b>Joseph F.X. Zahra</b>	EUR 15,000
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Remuneration of independent directors is not dependent on the Bank's financial performance, but is determined annually by the Co-Chairmen of the BoD, taking into account market practice in comparable global financial services and other relevant companies.

### **Loans**

Nemea Bank typically has business relationships with a number of companies. In many of these companies, members of the Nemea Bank BoD may assume management or non-executive board responsibilities. Moreover granting loans - both to individuals and to companies - is part of the ordinary business of the Bank.

## SHAREHOLDERS' PARTICIPATION RIGHTS

Nemea Bank is committed to making it as easy as possible for shareholders to take part in its decision-making processes.

### **Relationship with shareholders**

Nemea Bank fully subscribes to the principle of equal treatment of all shareholders, and regularly informs them about the development of the Bank. The annual general meeting (AGM) offers shareholders the opportunity to raise any questions regarding the development of the Bank and the events of the year under review. The members of the Board of Directors (BoD) and senior management, as well as the internal and external auditors, are present to answer these questions.

### **Voting rights, restrictions and representation**

In order to be recorded in the share register with voting rights, shareholders must confirm they acquired Nemea Bank shares in their own name and for their own account.

All shareholders registered with voting rights are entitled to participate in shareholder meetings. If they do not wish to attend in person, they can issue instructions to accept, reject or abstain on each individual item on the meeting agenda by either giving instructions to an independent proxy designated by Nemea Bank or by appointing Nemea Bank, another bank or another registered shareholder of their choice, to vote on their behalf.

### **Statutory quorums**

Shareholder resolutions, the election and re-election of members of the BoD, and the appointment of the statutory auditors are decided at the AGM by an absolute majority of the votes cast, excluding blank and invalid ballots. Maltese company law as well as the Memorandum and Articles of Association of the Bank require that for certain specific issues a majority of two-thirds of the votes represented at the meeting vote in favor of the resolution.

### **Convocation of general meetings of shareholders**

The annual general meeting of shareholders normally takes place in March, but in any case within 4 months of the close of the financial year. A personal invitation including a detailed agenda and explanation of each motion is sent to every registered shareholder at least 14 days ahead of the scheduled meeting. Extraordinary general meetings (EGMs) may be convened whenever the BoD deems it necessary.

### **Registrations in share register**

The general rules for being entered with voting rights in the share register of the Bank also apply before general meetings of shareholders. There is no "closing of the share register" in the days ahead of the meeting. Registrations including the transfer of voting rights are processed for as long as technically possible, normally until two days before the meeting.

## SHARE REGISTER INFORMATION

**Directors' direct or indirect interest in the share capital of the company as at 31 December 2014**

Director	Number of shares held	% of shares
Heikki Niemelä	2,750,000	50.0
Mika Lehto	2,750,000	50.0
<b>Total</b>	<b>5,500,000</b>	<b>100.0</b>

There were no changes to the Directors' interests as at 28 April 2015.

As at 31 December 2014 the Bank's issued share capital was effectively held by 2 shareholders. The share capital of the Bank consists of one class of ordinary shares with equal voting rights.

**Shareholders holding 5% or more of the equity capital as at 31 December 2014**

Shareholder	Number of shares held	% of shares
Nemea plc	5,499,999	99.99

There were no further changes in shareholders' holding 5% or more of the equity share capital as at 28 April 2015.

**Company Secretary**

Dr. Michael Ellul Sullivan

**Registered Address**

Level 17, Portomaso Tower  
St. Julian's STJ 4011  
Malta

Tel +356 2570 8000

## AUDITORS

Audit plays an important role in corporate governance. The Chairman's Office and ultimately the Board of Directors supervise the audit function.

### **External, independent auditors**

Deloitte Audit Limited, a company registered in Malta, has been assigned the mandate to serve as auditors for Nemea Bank. They assume the statutory auditing functions according to laws, regulatory requests and the Articles of Association. The Board of Directors (BoD) annually assesses the independence of Deloitte (Malta). Authority for pre-approval of all additional audit, audit-related and non-audit mandates to the principal auditors lies with the BoD, ensuring that independence of the auditors is not jeopardized by conflicts of interest through additional mandates. Deloitte (Malta) inform the BoD annually of the measures they are taking to ensure their own and their employees' independence from Nemea Bank. The BoD assesses this information.

### **Duration of the mandate and term of office of the lead partners**

Deloitte (Malta) were first appointed as Nemea Bank's principal external auditor for the audit of the 2009 financial statements. Following a comprehensive evaluation process during 2014, they will be proposed for re-election at the 2015 AGM.

The lead director in charge of the Nemea Bank audit is Stephen Paris.

### **Fees paid to external auditors**

The auditor's remuneration for the audited financial statements for the year ended 31 December 2014 amounted to EUR 16,520.

Audit work includes all services necessary to perform the audit in accordance with applicable generally accepted auditing principles as well as other assurance services that generally only the principal auditor can provide, including comfort letters, statutory and regulatory audits, attest services, consents and reviews of documents filed with regulatory bodies under applicable law.

### **Pre-approval procedures and policies**

All services other than the statutory annual audit provided by Deloitte (Malta) as appointed have to be pre-approved by the BoD. A pre-approval may be granted either for a specific mandate or in the form of a general pre-approval authorizing a limited and well-defined type and amount of services. The BoD has delegated pre-approval authority to its Co-Chairmen. After endorsement by the Chief Financial Officer or the person responsible for the Finance department, requests for mandates are routed to the Company Secretary, who submits them to the Chairman's Office for approval. At each quarterly meeting, the BoD will be informed on the approvals granted by its Co-Chairmen, if any.

### **Internal Audit**

The Internal Audit will be supporting the BoD by independently assessing the effectiveness of the Bank's system of internal controls and compliance of the Bank with statutory, legal and regulatory requirements. All key issues raised by Internal Audit will be communicated to the management responsible, and members of the

Chairman's Office via formal audit reports. The Chairman's Office and the BoD are regularly informed of important findings.

To maximize its independence from management, the Head of Internal Audit will be reporting directly to the Co-Chairmen of the BoD. Internal Audit will have unrestricted access to all accounts, books and records and must be provided with all information and data needed to fulfill its auditing duties. The Chairman's Office may order special audits to be conducted, and the senior management, with the agreement of the Co-Chairmen of the BoD, may also instruct Internal Audit to conduct such audits.

Coordination and close cooperation with the external auditors will be important to enhance the efficiency of Internal Audit's work.

### **Supervisory and control instruments vis-à-vis the external auditors**

The BoD monitors the qualification, independence and performance of the Auditors and their lead partners. It prepares proposals for appointment or removal of the external auditors for review and then submits the proposal to the AGM.

The BoD reviews the annual written statement submitted by the external auditors as to their independence. It also reviews the engagement letter between Nemea Bank and the external auditors and the fees and terms of the planned audit work. Mandates to the auditors for additional audit, audit-related and permitted non-audit work are subject to pre-approval by the BoD.

At least once per year, the Chairman's Office discusses with the lead partner of Deloitte (Malta) the audit work performed, the main findings and critical issues that arose during the audit. The Chairman's Office reports back to the BoD about its contacts and discussions with the external auditors.

## INFORMATION POLICY

Nemea Bank's financial disclosure policies aim at open, transparent and consistent communication with stakeholders.

Nemea Bank is committed to provision of regular information to its stakeholders.

When in full operation, Nemea Bank plans to regularly hold presentations, specialist seminars, road shows, individual and group meetings. Where possible, meetings will involve senior management.

The "About us" section of the website [www.nemeabank.com](http://www.nemeabank.com) has comprehensive information on Nemea Bank.

Once a year, unless they explicitly choose not to, registered stakeholders will be receiving an electronic summary/copy of Nemea Bank's annual report. It provides an overview of the Bank and its activities during the year as well as key financial information. Stakeholders can also request Nemea Bank's complete financial reports, produced on an annual basis, free of charge.

### Financial disclosure principles

Nemea Bank aims to communicate its strategy and results in a manner that allows stakeholders to gain a full and accurate understanding of how the Bank works, what its growth prospects are and what risks the strategy and results might entail.

To continue to achieve these goals, Nemea Bank will apply the following principles in its financial reporting and disclosure:

- transparency in disclosure is designed to enhance understanding of the economic drivers and detailed results of the business, building trust and credibility;
- consistency in disclosure within each reporting period and between reporting periods;
- simplicity in disclosure allows readers to gain the appropriate level of understanding of the Bank's businesses' performance;
- relevance in disclosure avoids information overload by focusing on what is relevant to Nemea Bank's stakeholders, or required by regulation or statute; and
- best practice in line with industry norms, leading the way to improved standards where possible.

### Financial reporting policies

Nemea Bank reports its results after the end of every year, in the future including a breakdown of results by business areas and extensive disclosures relating to credit and market risk.

Nemea Bank's financial statements are prepared according to International Financial Reporting Standards as adopted by the European Union (EU IFRS). A detailed explanation of the basis of Nemea Bank's accounting is given in Note 1 in Financial

Statements 2014. An explanation of the critical accounting policies applied in the preparation of Nemea Bank's financial statements is also provided in a specific section in Financial Statements 2014.

Nemea Bank is committed to maintaining the transparency of its reported results and to ensuring that stakeholders can make meaningful comparisons. If in the future there is a major reorganization of its business units, or if changes to accounting standards or interpretations lead to a material change in the Bank's reported results, the results are restated for previous periods to show how they would have been reported according to the new basis and provide clear explanations of all changes.

## REGULATION AND SUPERVISION

Nemea Bank complies with applicable regulatory provisions and works closely and maintains good relations with regulators.

Nemea Bank's operations internationally are regulated and supervised by the relevant authorities in each of the jurisdictions in or from which it conducts business. As a Maltese-registered company, Nemea Bank's home country regulator is the Malta Financial Services Authority (MFSA).

The following sections of this report describe the regulation and supervision of Nemea Bank's business in and from Malta.

### Regulation and supervision in Malta

#### General

Nemea Bank is regulated in Malta under a system established by the Banking Act of 1994, and the Investment Services Act, 1994, as amended. Depending on the license obtained under this law, banks in Malta may engage in a full range of financial services activities, including commercial banking and investment banking. Investment services require a separate license. The Banking Act establishes a framework for supervision of credit institutions such as Nemea Bank by the MFSA.

Anti-money laundering and terrorist financing legislation and regulation lays down a common standard for due diligence, ongoing monitoring, training and reporting obligations for the whole financial sector, which must be met in order to prevent the use of the financial system for money laundering and terrorist financing.

#### Supervisory responsibilities

The MFSA has direct responsibility for supervision of the Maltese banking groups, including Nemea Bank. The supervisory strategy entails direct supervision in the form of regular meetings with bank management, supervisory visits to the Bank's operations, on-site reviews, direct reporting (both routine and ad hoc).

#### Reporting requirements and capital requirements

Nemea Bank reports financial, capital, and risk information to the MFSA. The MFSA also reviews the Bank's risk management and control principles and procedures in all areas of risk, except for anti-money laundering practices which is undertaken by the Malta Financial Intelligent Analysis Unit (FIAU).

Malta applies the internationally agreed capital adequacy rules of the Basel Capital Accord.

#### Disclosures to the Maltese Central Bank

Malta's banks, according to Maltese banking law, are primarily supervised by the MFSA while compliance with liquidity rules is monitored by the Central Bank of Malta (CBM). Nemea Bank sends the CBM detailed monthly interim balance sheets, capital adequacy and liquidity statements. Nemea Bank also submits an annual statement of condition and quarterly stress testing results and cooperates with the CBM whenever required. The CBM can also require Nemea Bank to make additional disclosures of financial condition and other information relevant to its regulatory oversight.

### **Depositor Compensation & Investor Compensation Scheme**

Nemea Bank is a member of both the Maltese Depositor Compensation Scheme and the Investor Compensation Scheme, as obligated by the legislation. Retail depositors are protected by the Depositor Compensation Scheme in Malta up to EUR 100,000 per eligible depositor. Eligible investors are protected by the Investor Compensation Scheme up to a maximum of EUR 20,000.





## 4 FINANCIAL STATEMENTS 2014

This section comprises the audited financial statements of Nemea Bank plc for the financial year from 1 January to 31 December 2014, prepared in accordance with International Financial Reporting Standards as adopted by the European Union (EU IFRS). Additional disclosures required by Maltese regulations are included where appropriate.



## DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2014

The directors have the pleasure of submitting the annual report, together with the audited financial statements of Nemea Bank plc for the year ended 31 December 2014.

### Principal Activities

#### Operational Review

During the year under review the Bank continued to collect deposits from both local and foreign clients while it continued to increase its activities in Corporate and Investment Banking, which have continued to be the Bank's main source of income. In 2014 the Bank achieved certain milestones in the in-house development of its core and online banking system.

#### Performance Review

Strong performance continued to be experienced resulting in an increase in operating income for the year by 70%, from EUR 1,125,583 to EUR 1,907,947. This resulted mainly from an increase of 130% in net fee and commission income generated. During the year under review the Bank registered a profit after tax of EUR 222,678 (2013: EUR 37,773) which together with shareholders' funds brought forward from the prior year resulted in retained earnings of EUR 259,892 (2013: EUR 43,456) as at 31 December 2014.

#### Dividends

The Bank generated a net profit of EUR 222,678 (2013: EUR 37,773), The directors are proposing a final dividend of EUR 216,436 (2013: EUR nil) for the financial year ended 31 December 2014. The dividend will be re-invested back into the Bank in the form a share capital increase.

#### Board of Directors

The following directors served on the Board during the period:

Heikki Niemelä (Co-Chairman)  
Mika Lehto (Co-Chairman)  
Joseph F.X. Zahra

#### Directors' Responsibilities

Maltese company law requires that the directors prepare financial statements for each financial period which give a true and fair view of the state of affairs of the Bank as at the end of the financial period and of the results of their operations and cash flows for that period. In preparing the financial statements, the directors are required to:

- Select suitable accounting policies and then apply them consistently;
- Make judgments and estimates that are reasonable; and
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Bank will continue in business.

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 Bank and to enable them to ensure that the financial statements comply with the Banking Act (Cap. 371) and the Companies Act (Cap. 386). This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements whether due to fraud or error. They are also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

**Auditor**

A resolution to reappoint Deloitte Audit Limited as auditor of the company will be proposed at the forthcoming annual general meeting.

Approved by the board of directors, authorised for issue on 28 April 2015 and signed on its behalf by:



Heikki Niemelä  
Co-Chairman



Mika Lehto  
Co-Chairman

## INDEPENDENT AUDITOR'S REPORT

### To the members of Nemea Bank plc

#### Report on the financial statements

We have audited the accompanying financial statements of Nemea Bank plc ('the Bank') set out on pages 118 to 149, which comprise the statement of financial position as at 31 December 2014, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

#### Directors' responsibility for the financial statements

As explained more fully in the statement of directors' responsibilities in the Directors' Report on page 114 to 115, the directors of the Bank are responsible for the preparation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the EU and the requirements of the Companies Act (Cap. 386) and the Banking Act (Cap. 371), and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

#### Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about 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 the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the preparation of financial statements that give a true and fair view 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 internal control of the Bank. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, 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

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as of 31 December 2014, and of their financial performance and 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 requirements of the Companies Act (Cap. 386).

## Report on Other Legal and Regulatory Requirements

### Auditor's Responsibility

The Banking Act (Cap. 371) requires us to report whether 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, whether in our opinion, proper books of account have been kept by the Bank so far as appears from our examination thereof, whether the financial statements are in agreement with the books, and whether in our opinion, and to the best of our knowledge and according to the explanations given to us, the financial statements give the information required by any law in force in the manner so required and give a true and fair view.

We are also required to state whether the financial statements have been properly prepared in accordance with the provisions of the Companies Act (Cap. 386).

### Opinion

We have obtained all the information and explanations which to the best of our knowledge and belief are necessary for the purposes of our audit. In our opinion, proper books of account have been kept so far as appears from our examination thereof and the financial statements are in agreement with the books.

In our opinion, the financial statements have been properly prepared in accordance with the provisions of the Banking Act (Cap. 371) enacted in Malta.



Stephen Paris as Director  
in the name and on behalf of  
**Deloitte Audit Limited**  
Registered auditor

28 April 2015

## STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2014

EUR	Notes	2014	2013
Interest receivable and similar income:			
- on loans and advances	2	394,576	296,824
- on debt and other fixed income instruments	2	-	605
Interest expense	3	(292,500)	(83,434)
<b>Net interest income</b>		<b>102,076</b>	<b>213,995</b>
Fee and commission income		1,587,197	689,129
Fee and commission expense		(2,150)	(2,533)
<b>Net fee and commission income</b>	4	<b>1,585,047</b>	<b>686,596</b>
Trading income	5	89,040	96,317
Other income		131,784	128,675
		<b>220,824</b>	<b>224,992</b>
<b>Operating income</b>		<b>1,907,947</b>	<b>1,125,583</b>
Staff costs	6	(678,617)	(468,560)
General administrative expenses	6	(684,091)	(458,192)
Amortisation of intangible assets	14	(110,543)	(71,865)
Depreciation	15	(53,735)	(62,291)
Impairment loss	7	(31,817)	-
		<b>(1,558,803)</b>	<b>(1,060,908)</b>
<b>Profit before tax</b>	8	<b>349,144</b>	<b>64,675</b>
Income tax expense	9	(126,466)	(26,902)
<b>Profit for the year/total comprehensive income for the year</b>		<b>222,678</b>	<b>37,773</b>

The notes on pages 122 to 149 are an integral part of these financial statements.

## STATEMENT OF FINANCIAL POSITION AS OF 31 DECEMBER 2014

EUR	Notes	2014	2013
<b>Assets</b>			
Balances with Central Bank of Malta and cash	10	1,108,476	297,309
Financial assets at fair value through profit or loss	11	886,200	797,160
Loans and advances to banks	12	4,670,392	1,335,983
Loans and advances to customers	13	15,579,246	4,933,375
Intangible assets	14	150,676	136,026
Property, plant and equipment	15	154,310	123,754
Other assets	17	1,268,349	768,000
Prepayments and accrued income	18	327,308	144,020
<b>Total Assets</b>		<b>24,144,957</b>	<b>8,535,627</b>
<b>Liabilities</b>			
Amounts owed to customers	21	17,951,516	2,857,507
Deferred tax	16	35,717	419
Current tax		91,167	48,940
Other liabilities	22	1,210	449
Accruals and deferred income	23	279,425	65,068
<b>Total Liabilities</b>		<b>18,359,035</b>	<b>2,972,383</b>
<b>Equity</b>			
Equity attributable to shareholders of the Bank			
Called up share capital	19	5,500,000	5,500,000
Retained earnings		259,892	43,456
Other reserve	20	26,030	19,788
<b>Total Shareholders' Equity</b>		<b>5,785,922</b>	<b>5,563,244</b>
<b>Total Liabilities and Shareholders' Equity</b>		<b>24,144,957</b>	<b>8,535,627</b>
<b>Memorandum items</b>			
Commitments	26	12,006,995	1,000,000

The financial statements on pages 118 to 149 were approved by the Board of Directors on 28 April 2015 and signed on its behalf by:



Heikki Niemelä  
Co-Chairman



Mika Lehto  
Co-Chairman

## STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2014

EUR	Note	Share Capital	Retained Earnings	Other Reserve	Total
<b>2013</b>					
Balance at 1 January	19	5,500,000	25,471	-	5,525,471
Profit for the year/total comprehensive income for the year		-	37,773		37,773
Transfer to other reserve – note 20		-	(19,788)	19,788	-
<b>Balance at 31 December</b>		<u>5,500,000</u>	<u>43,456</u>	<u>19,788</u>	<u>5,563,244</u>

EUR	Note	Share Capital	Retained Earnings	Other Reserve	Total
<b>2014</b>					
Balance at 1 January	19	5,500,000	43,456	19,788	5,563,244
Profit for the year/total comprehensive income for the year		-	222,678	-	222,678
Transfer to other reserve – note 20		-	(6,242)	6,242	-
<b>Balance at 31 December</b>		<u>5,500,000</u>	<u>259,892</u>	<u>26,030</u>	<u>5,785,922</u>

The notes on pages 122 to 149 are an integral part of these financial statements.

## STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2014

EUR	Note	2014	2013
<b>Cash flows from operating activities</b>			
Interest and commission receipts		1,904,584	412,322
Interest and commission payments		(122,569)	(41,916)
Payment to employees and suppliers		(1,326,564)	(1,026,749)
Tax payment		(48,940)	-
Operating profit/(loss) before changes in operating assets and liabilities		406,511	(656,343)
(Increase)/decrease in operating assets:			
Loans and advances to customers		(10,540,845)	(14,143)
Loans and advances to related parties		(105,026)	(502,810)
Other assets		(500,349)	32,000
Increase/(decrease) in operating liabilities:			
Amounts owed to customers		15,094,009	149,461
Other liabilities		761	(34,562)
<b>Net cash generated / (used in) from operating activities</b>		<b>4,355,061</b>	<b>(1,026,397)</b>
<b>Cash flows from investing activities</b>			
Acquisition of property, plant and equipment		(84,292)	(10,019)
Acquisition of intangible assets		(125,193)	(7,785)
Proceeds from sale of other investments		-	254,375
<b>Net cash (used in) / from investing activities</b>		<b>(209,485)</b>	<b>236,571</b>
<b>Net increase/ (decrease) in cash and cash equivalents</b>		<b>4,145,576</b>	<b>(789,826)</b>
<b>Cash and cash equivalents at the beginning of the year</b>		<b>1,633,292</b>	<b>2,423,118</b>
<b>Cash and cash equivalents at the end of the year</b>	24	<b>5,778,868</b>	<b>1,633,292</b>

The notes on pages 122 to 149 are an integral part of these financial statements.

## NOTES TO THE FINANCIAL STATEMENTS

### 1. Significant accounting policies

#### a. Basis of preparation

The Bank's financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union (EU IFRS). These financial statements have also been prepared in accordance with the provisions of the Banking Act, 1994 (Cap. 371) and the Companies Act, 1995 (Cap. 386).

The financial statements have been prepared on the historical cost basis, except for certain financial instruments which are stated at their fair values.

#### International Financial Reporting Standards in issue but not yet effective

The final version of IFRS 9 brings together the classification and measurement, impairment and hedge accounting phases of the IASB's project to replace IAS 39 'Financial Instruments: Recognition and Measurement'.

The Standard supersedes all previous versions of IFRS 9.

IFRS 9 introduces a logical approach for the classification of financial assets, which is driven by cash flow characteristics and the business model in which an asset is held. This single, principle-based approach replaces existing rule based requirements that are generally considered to be overly complex and difficult to apply.

The new model also results in a single, forward-looking 'expected loss' impairment model that will require more timely recognition of expected credit losses. This standard is applicable for financial periods beginning on or after 1 January 2018 and has not yet been endorsed by the EU.

On 20 May 2013, IFRIC 21 Levies was issued. For financial statements prepared in accordance with International Financial Reporting Standards as adopted by the EU, IFRIC 21 is applicable for annual periods beginning on or after 7 June 2014. IFRIC 21 is an interpretation of IAS 37 Provisions, Contingent Liabilities and Contingent Assets. IAS 37 sets out criteria for the recognition of a liability, one of which is the requirement for the entity to have a present obligation as a result of a past event (known as an obligating event). The Interpretation clarifies that the obligating event that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy.

On 28 May 2014, the IASB issued IFRS 15 entitled Revenue from Contracts with Customers. The Standard is effective for annual periods beginning on or after 1 January 2017, with earlier application being permitted. IFRS 15 is the result of a convergence project between the IASB and the FASB. IFRS 15 specifies how and when an IFRS reporter will recognise revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures. The standard supersedes IAS 18 Revenue, IAS 11 Construction Contracts and a number of revenue-related interpretations. This Standard applies to nearly all contracts with customers with the main exceptions being leases, financial instruments and insurance contracts. This Standard has not been endorsed by the EU at the date of authorisation of these financial statements.

On 12 December 2013, the IASB issued amendments to IAS 24 Related party Disclosures (as part of the 'Annual Improvements to IFRSs 2010-2012 cycle') clarifying that an entity providing key management personnel services to the reporting entity or to the parent of the reporting entity is a related party of the reporting entity. This amendment has been endorsed by the EU for annual periods starting on or after 1 January 2015.

On 12 December 2013, the IASB issued amendments to IAS 38 Intangible Assets (as part of the 'Annual Improvements to IFRSs 2010-2012 cycle') clarifying that when an intangible asset is revalued the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount. This amendment has been endorsed by the EU for annual periods starting on or after 1 January 2015.

On 12 December 2013, the IASB issued amendments to IFRS 13 Fair Value Measurement (as part of the 'Annual Improvements to IFRSs 2011-2013 cycle') clarifying that that the scope of the portfolio exception defined in paragraph 52 of IFRS 13 includes all contracts accounted for within the scope of IAS 39 Financial Instruments: Recognition and

Measurement or IFRS 9 Financial Instruments, regardless of whether they meet the definition of financial assets or financial liabilities as defined in IAS 32 Financial Instruments: Presentation. This amendment has been endorsed by the EU for annual periods starting on or after 1 January 2015.

The directors are currently assessing the impact that the adoption of these International Financial Reporting Standards will have on the financial statements of the company in the period of initial application

#### **b. Functional and presentation currency**

The financial statements are presented in Euro, which currency represents the functional currency of the Bank.

#### **c. Financial assets at fair value through profit or loss and loans and receivables**

The Bank classifies its financial assets in the following categories: (i) financial assets at fair value through profit or loss; and (ii) loans and receivables. The classification depends on the purpose for which the investments were acquired.

##### **c.1 Financial assets at fair value through profit or loss**

This classification includes financial assets classified as held for trading, and those designated at fair value through profit or loss upon initial recognition. Derivatives are categorized as held for trading unless they are designated and effective hedging instruments.

Financial assets at fair value through profit or loss are initially recognised and are subsequently measured at fair value based on quoted market prices or dealer price quotations for financial instruments traded in active markets. If the market for a financial asset is not active, the Bank establishes fair value by using valuation techniques.

##### **c.2 Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those that are held for trading or are designated upon initial recognition as at fair value through profit or loss or as available-for-sale financial assets or those for which the Bank may not recover substantially all of its initial investment other than because of credit deterioration. These comprise loans and advances to banks and clients.

Loans and receivables are initially measured at fair value plus transaction costs, if any, that are directly attributable to their acquisition, and are subsequently measured at amortised cost using the effective interest method, less any impairment losses. Gains and losses are recognised in profit or loss when the financial asset is derecognised or impaired and through the amortisation process using the effective interest rate.

##### **c.2.1 Impairment of financial assets**

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

##### **c.2.2 Financial assets carried at amortised cost**

There are two components to the Bank's impairment allowances on financial assets carried at amortised cost: specific and collective allowances. The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. Specific impairment allowances are determined on a case-by-case basis after taking into account the cash-generating potential and the financial state of the borrower and the realisable value of collateral held against borrowings. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

For loans and receivables carried at amortised cost, if there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present

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

If, in a subsequent period, the amount of the impairment loss decreases, and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through an allowance account, but so that the reversal does not result in a carrying amount that exceeds what the amortised cost would have been had the impairment not been recognised at the date the impairment is reversed. The amount of the reversal is recognised in profit or loss.

#### **d. Financial liabilities and equity instruments**

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into, and the definitions of a financial liability and an equity instrument.

Financial liabilities are initially measured at fair value plus, in the case of financial liabilities not at fair value through profit or loss, transaction costs that are directly attributable to their issue. Financial liabilities are subsequently measured at amortised cost using the effective interest method, except for financial liabilities at fair value through profit or loss, which are measured at fair value.

Financial liabilities at fair value through profit or loss include financial liabilities classified as held for trading and those designated at fair value through profit or loss upon initial recognition. Derivatives are categorised as held for trading, unless they are designated and effective hedging instruments.

Financial liabilities that are measured at amortised cost using the effective interest method include amounts owed to banks and amounts owed to clients.

The gain or loss on financial liabilities classified as at fair value through profit or loss is recognised in profit or loss. For financial liabilities carried at amortised cost, the gain or loss is recognised in profit or loss when the financial liability is derecognised and through the amortisation process whereby any difference between the proceeds, net of transaction costs, and the settlement or redemption is recognised over the term of the financial liability.

Equity instruments are recorded at the proceeds received, net of direct issue costs.

#### **e. Recognition, de-recognition and offsetting of financial assets and financial liabilities**

Financial assets and financial liabilities are recognised when the Bank becomes a party to the contractual provisions of the instrument.

All loans and receivables are recognised when cash is advanced to borrowers.

All purchases and sales of securities are recognised and derecognised on settlement date, which is the date that an asset is delivered to or by the Bank.

A financial asset is derecognised when the contractual rights to the cash flows from the financial asset expire, or when the Bank transfers the financial asset and the transfer qualifies for derecognition. A financial liability is derecognised when it is extinguished. This occurs when the obligation specified in the contract is discharged, cancelled or expires.

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when the Bank has a legally enforceable right to set off the recognised amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

#### **f. Classification of financial assets and financial liabilities as at fair value through profit or loss upon initial recognition**

Financial assets and liabilities are designated as at fair value through profit or loss on initial recognition where such designation results in more relevant information because either:

- it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an "accounting mismatch") that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different basis; or

- a group of financial assets, financial liabilities or both, is managed and its performance is evaluated on a fair value basis, in accordance with the Bank's documented risk management and investment strategy, and information about the Bank is provided internally on that basis to senior management, including the Board of Directors.

Financial assets and liabilities are also designated as at fair value through profit or loss if these contain embedded derivatives and the Bank is permitted to apply this designation in terms of IFRSs.

#### **g. Property, plant and equipment**

Property, plant and equipment are classified into the following classes – premises finishings, IT infrastructure and equipment, motor vehicles and office furniture and fittings.

Property, plant and equipment are initially measured at cost. Subsequent costs are included in the asset's carrying amount when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. Expenditure on repairs and maintenance of property, plant and equipment is recognized as an expense when incurred.

Property, plant and equipment are derecognised on disposal or when no future economic benefits are expected from their use or disposal. Gains or losses arising from derecognition represent the difference between the net disposal proceeds, if any, and the carrying amount, and are included in profit or loss in the period of derecognition.

Property, plant and equipment are stated at cost less any accumulated depreciation and any accumulated impairment losses.

#### **h. Intangible assets**

Intangible assets comprise computer software. In determining the classification of an asset that incorporates both intangible and tangible elements, judgment is used in assessing which element is more significant. Computer software which is an integral part of the related hardware is classified as property, plant and equipment and accounted for in accordance with the Bank's accounting policy on property, plant and equipment. Where the software is not an integral part of the related hardware, this is classified as an intangible asset.

Computer software is recognised if it is probable that the expected future economic benefits that are attributable to the asset will flow to the Bank and the cost of the asset can be measured reliably.

Computer software is derecognised on disposal or when no future economic benefits are expected from its use or disposal. Gains or losses arising from derecognition represent the difference between the net disposal proceeds, if any, and the carrying amount, and are included in profit or loss in the period of derecognition.

An internally-generated intangible asset arising from the company's development of software is recognised only if all of the following can be demonstrated by the company:

- the technical feasibility, the availability of resources and the intention and ability of completing the asset so that it will be available for use or sale,
- available for use or sale,
- how the asset will generate probable future economic benefits, and
- the ability to measure reliably the expenditure attributable to the asset during its development.

Where no internally-generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred. After initial recognition, internally-generated intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

#### **i. Depreciation and amortisation**

Depreciation on property, plant and equipment and amortisation on intangible assets commence when these assets are available for use and are charged to profit or loss so as to write off the cost or revalued amount of assets, other than

land, less any estimated residual value, over their estimated useful life, using the straight line method, on the following bases:

**Property, plant and equipment**

Premises finishings	10% per annum
IT infrastructure and equipment	33% per annum
Motor vehicles	20% per annum
Office furniture and fittings	20% per annum

**Intangible assets**

Computer software	33% per annum
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The depreciation or amortisation method applied, the residual value and the useful life are reviewed at the end of each reporting period.

**j. Impairment of property, plant and equipment and intangible assets**

At the end of every reporting period the Bank reviews the carrying amount of its property, plant and equipment and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If such indication exists the recoverable amount is estimated in order to determine the extent of the impairment loss and the carrying amount of the asset is reduced to its recoverable amount, as calculated. The recoverable amount is the higher of fair value less costs to sell and value in use.

An impairment loss is recognised immediately in profit or loss, unless the asset is carried at a revalued amount, in which case the loss shall be treated as a revaluation decrease to the extent that it does not exceed the amount in the revaluation surplus for that asset.

An impairment loss recognised in a prior year is reversed if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. When an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, to the extent that it does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. Impairment reversals are recognised immediately in profit or loss, unless the asset is carried at a revalued amount, in which case the impairment reversal is recognised directly in other comprehensive income, unless an impairment loss on the same asset was previously recognised in profit or loss.

**k. Provisions**

Provisions are recognised when the Bank has a present, legal or constructive obligation as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Provisions are measured at the directors' best estimate of the expenditure required to settle the present obligation at the end of the reporting period. If the effect of the time value of money 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. Provisions are not recognised for future operating losses.

**l. Taxation**

Current and deferred tax is charged or credited to profit or loss, except when it relates to items charged or credited directly to other comprehensive income or to equity, in which case it is also dealt accordingly. Current tax is based on the taxable result for the period. The taxable result for the period differs from the result as reported in the statement of profit or loss and other comprehensive income because it excludes items which are non-assessable or disallowed and it further excludes items that are taxable or deductible in other periods. It is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax is determined under the balance sheet liability method in respect of all temporary differences between the carrying amount of an asset or liability in the statement of financial position and its tax base. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled based on tax rates that have been enacted or substantively enacted by the end of the reporting period.

#### **m. Revenue recognition**

Revenue is recognised to the extent that it is probable that future economic benefits will flow to the Bank and these can be measured reliably. The following specific recognition criteria must also be met before revenue is recognised. Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the instrument or, when appropriate, a shorter period to that instrument's net carrying amount. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the instrument but not future credit losses. The calculation includes payments and receipts that are an integral part of the effective interest rate, transaction costs and all other discounts or premiums.

Fees and commissions that are earned on the execution of a significant transaction are recognised as revenue when the significant transaction has been completed. Fees and commissions that are earned as services are provided to the client are recognised as revenue as the services are provided. Where fees are charged to cover the cost of a continuing service, these are recognised on an appropriate basis over the relevant period.

Dividend income from investments is recognised when the right to receive payment has been established.

#### **n. Foreign currency translation**

In preparing the financial statements, transactions denominated in currencies other than the functional currency are translated at the exchange rates ruling on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated to the euro at the rates of exchange ruling at the end of the reporting period. Gains and losses arising from such translation are dealt with in profit or loss. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to euro at the exchange rate prevailing on the date the fair value was determined. Non-monetary assets and liabilities denominated in foreign currencies that are measured in terms of historical cost are not retranslated.

#### **o. Employee benefits**

The Bank contributes towards the state pension in accordance with local legislation. The only obligation of the Bank is to make the required contributions. Costs are expensed in the period in which they are incurred.

#### **p. Cash and cash equivalents**

Cash and cash equivalents comprise cash in hand and deposits repayable on demand or with a contractual period to maturity of less than 90 days; advances to banks repayable within 90 days from the date of the advance and balances with the Central Bank of Malta. Amounts owed to banks that are repayable on demand or with a contractual period to maturity of less than 90 days and which form an integral part of the Bank's cash management are included as a component of cash and cash equivalents for the purpose of the cash flow statement.

#### **q. Dividends payable**

Dividends payable on ordinary shares are recognised as liabilities on the date on which they are declared.

**r. Judgments in applying accounting policies and key sources of estimation uncertainty**

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates.

In the process of applying the Bank's accounting policies, management has made no judgements which can significantly affect the amounts recognised in the financial statements and, at the end of the reporting period, there were no key assumptions concerning the future, or any other key sources of estimation uncertainty, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

**2. Interest receivable and similar income**

EUR	2014	2013
On loans and advances to banks	36,428	43,886
On loans and advances to customers	358,148	252,938
	<u>394,576</u>	<u>296,824</u>
On debt and other fixed income instruments -fair value through profit or loss	-	605
<b>Interest income</b>	<u>394,576</u>	<u>297,429</u>

**3. Interest expense**

EUR	2014	2013
On amounts owed to customers	271,803	83,434
Other interest	20,697	-
<b>Interest payable</b>	<u>292,500</u>	<u>83,434</u>

**4. Net fee and commission income**

EUR	2014	2013
On loans and advances, sale of financial products and similar activities	1,585,047	686,596
<b>Net fee and commission income</b>	<u>1,585,047</u>	<u>686,596</u>

**5. Trading income**

EUR	2014	2013
Fair value movements of financial instruments at fair value through profit or loss	89,040	81,970
Gain on disposal of debt instruments	-	14,347
<b>Trading income</b>	<u>89,040</u>	<u>96,317</u>

**6. Administrative and other expenses**

EUR	2014	2013
Staff costs:		
-wages and salaries	619,830	428,090
-social security costs	31,782	20,157
-other staff costs	27,005	20,313
Staff costs	<u>678,617</u>	<u>468,560</u>
General administrative expenses	684,091	458,192
<b>Total administrative expenses</b>	<b><u>1,362,708</u></b>	<b><u>926,752</u></b>

	2014	2013
The average number of employees are analysed as follows:	Number	Number
Managerial	5	3
Clerical	11	8
Total	<u>16</u>	<u>11</u>

**Key management personnel compensation**

EUR	2014	2013
Directors' emoluments:		
-fees	<u>15,000</u>	<u>15,000</u>

**7. Impairment loss**

EUR	2014	2013
Accrued income written off	<u>31,817</u>	<u>-</u>
<b>Net impairment loss</b>	<b><u>31,817</u></b>	<b><u>-</u></b>

**8. Profit before tax**

EUR	2014	2013
Profit before tax is stated after charging:		
Total remuneration payable to the company's auditors for the audit of the company's financial statements	16,520	14,000
Directors' emoluments:		
-fees	15,000	15,000
Staff costs:		
-wages and salaries	651,612	448,247
	<u>666,612</u>	<u>463,247</u>

**9. Income tax expense**

EUR	2014	2013
Current tax	91,168	48,940
Deferred tax	35,298	[22,038]
<b>Income tax expense</b>	<u>126,466</u>	<u>26,902</u>

The income tax expense and the product of accounting profit multiplied by the statutory domestic income tax rate are reconciled as follows:

EUR	2014	2013
Profit before tax	349,144	64,675
Tax at the applicable rate of 35%	122,200	22,636
Tax effect of permanent differences:		
Tangible fixed assets	4,266	4,266
<b>Income tax expense</b>	<u>126,466</u>	<u>26,902</u>

**10. Balances with Central Bank of Malta and cash**

EUR	2014	2013
Balances with Central Bank of Malta	11,936	3,771
Cash	1,096,540	293,538
	<u>1,108,476</u>	<u>297,309</u>

Balances with the Central Bank of Malta include a reserve deposit amounting to EUR30 (2013: EUR 30) in terms of Article 37 of the Central Bank of Malta Act (Cap. 204).

**11. Financial assets at fair value through profit or loss**

EUR	2014	2013
<b>Financial assets designated at fair value through profit or loss:</b>		
Equity and other non-fixed income instruments		
- collective investment scheme	886,200	797,160
	<u>886,200</u>	<u>797,160</u>
Listing status		
-local unlisted	886,200	797,160
At the end of the year	<u>886,200</u>	<u>797,160</u>
<b>Summary of movements during the year:</b>		
At the beginning of the year	797,160	955,218
Disposals	-	(254,375)
Net movement in fair value during the year	89,040	96,317
At the end of the year	<u>886,200</u>	<u>797,160</u>

**12. Loans and advances to banks**

EUR	2014	2013
Repayable on call and at short notice	1,068,195	101,573
Term loans and advances	3,602,197	1,234,410
<b>Loans and advances to banks</b>	<u>4,670,392</u>	<u>1,335,983</u>
Weighted average effective interest rate	0.8%	1.5%

**13. Loans and advances to customers**

EUR	2014	2013
Term loans and advances to customers	14,137,131	3,596,286
Term loans and advances to related parties	1,461,897	1,356,871
	15,599,028	4,953,157
Less: impairment losses – specific allowances	(19,782)	(19,782)
<b>Loans and advances to customers</b>	<u>15,579,246</u>	<u>4,933,375</u>
Weighted average effective interest rate	10.2%	8.1%

The advances to related parties consist of mortgage and other loans to bank officers amounting to EUR 334,621 (2013: EUR 398,762) bearing interest between 1% and 2% over the monthly EURIBOR and payable in full within 30 years and an advance of EUR 1,127,276 (2013: EUR 958,109) to the parent and ultimate parent companies. The advances to the parent and ultimate parent companies carries no interest, no security and has no fixed date of repayment.

Loans and advances includes a loan item amounting to EUR 100,000 that has a convertible option for the Bank to convert the advance into a discounted bond upon its issuance in a private placement by the client.

The aggregate amount of advances on which interest has been suspended as at 31 December 2014 is EUR 1,323,445 (2013: EUR 803,000).

#### 14. Intangible assets

EUR	2014	2013
<b>Cost</b>		
At 1 January	224,134	136,349
Acquisitions	125,193	87,785
At 31 December	349,327	224,134
<b>Amortisation</b>		
At 1 January	88,108	16,243
Charge for the year	110,543	71,865
At 31 December	198,651	88,108
<b>Carrying amounts</b>		
At 31 December	150,676	136,026

Internal development cost of banking software amounting to EUR 120,000 (2013: EUR 80,000) has been capitalised during the year.

#### 15. Property, plant and equipment

EUR	Premises finishings	IT infra- structure & equipment	Motor Vehicles	Office furniture & fittings	Total
<b>Cost</b>					
At 1 January 2013	35,109	94,795	57,390	183,589	370,883
Acquisitions	-	10,019	-	-	10,019
At 1 January 2014	35,109	104,814	57,390	183,589	380,902
Acquisitions	-	66,617	-	17,675	84,292
At 31 December 2014	35,109	171,431	57,390	201,264	465,194
<b>Depreciation</b>					
At 1 January 2013	13,933	66,544	22,956	91,425	194,858
Charge for the year	3,511	23,785	11,478	23,517	62,291
At 1 January 2014	17,444	90,329	34,434	114,942	257,149
Charge for the year	3,511	32,915	11,478	5,831	53,735
At 31 December 2014	20,955	123,244	45,912	120,773	310,884
<b>Carrying amounts</b>					
At 31 December 2013	17,665	14,486	22,956	68,647	123,754
At 31 December 2014	14,154	48,187	11,478	80,491	154,310

**16. Deferred tax liability**

Deferred tax liabilities are attributable to the following temporary differences:

EUR	2014	2013
At 1 January	(419)	(22,457)
Property, plant and equipment	(3,068)	15,992
Provision for exchange differences	(1,067)	(94)
Provision for impairment	-	-
Tax value of losses and capital allowances carry-forwards	-	(9,840)
Fair value remeasurement of financial instruments	(31,163)	15,980
<b>Net deferred tax liabilities at 31 December</b>	<b>(35,717)</b>	<b>(419)</b>

**17. Other assets**

EUR	2014	2013
Other receivables	1,168,349	560,000
Amounts due from related party	100,000	208,000
<b>Other assets</b>	<b>1,268,349</b>	<b>768,000</b>

Other assets are made up of advisory and support fees receivable as at the year-end.

**18. Prepayments and accrued income**

EUR	2014	2013
Prepayments	46,145	40,013
Accrued income	281,163	104,007
<b>Prepayments and accrued income</b>	<b>327,308</b>	<b>144,020</b>

**19. Share capital**

	2014 Number	2014 EUR	2013 Number	2013 EUR
<b>Share capital</b>				
<b>Authorised</b>				
20,000,000 ordinary shares of EUR 1 each	<u>20,000,000</u>	<u>20,000,000</u>	<u>20,000,000</u>	<u>20,000,000</u>
<b>Issued</b>				
5,500,000 ordinary shares of EUR 1 each fully paid up	<u>5,500,000</u>	<u>5,500,000</u>	<u>5,500,000</u>	<u>5,500,000</u>

**20. Other reserve**

This relates to the reserve for General Banking Risks pursuant to the revised Banking Rule 09. The revised Banking Rule 09 requires banks in Malta to hold additional reserves for general banking risks against non-performing loans. This reserve is required to be funded from planned dividend (retained earnings). As at the reporting date, under the 3 year transitional rules, this reserve amounted to EUR 26,030 (2013: EUR 19,788).

**21. Amounts owed to customers**

EUR	2014	2013
<b>Retail and corporate customers</b>		
Term deposits	15,950,767	1,985,417
Repayable on demand	2,000,749	872,090
<b>Amounts owed to customers</b>	<u>17,951,516</u>	<u>2,857,507</u>
Weighted average effective interest rate	<u>3.3%</u>	<u>3.5%</u>

Amounts owed to customers included amounts owed to related parties amounting to EUR 220,691 (2013: EUR 232,517), which earn interest between 0% and 5.05%. EUR 104,791 (2013: EUR 67,517) are repayable on demand.

**22. Other liabilities**

EUR	2014	2013
Other creditors	<u>1,210</u>	<u>449</u>

**23. Accruals and deferred income**

EUR	2014	2013
Accrued expenses	279,425	65,068
<b>Accruals and deferred income</b>	<u>279,425</u>	<u>65,068</u>

## 24. Note to the statement of cash flows

Balances of cash and cash equivalents as shown in the cash flow statement are analysed below:

EUR	2014	2013
<b>Analysis of cash and cash equivalents</b>		
Balances with Central Bank of Malta and cash	1,108,476	297,309
Term deposits	3,602,197	1,234,410
Repayable on call and at short notice	1,068,195	101,573
<b>Cash and cash equivalents</b>	<b>5,778,868</b>	<b>1,633,292</b>

## 25. Related party transactions

During the course of banking operations, the Bank conducted business transactions with the parent company and other related parties. The related party transactions are as follows:

EUR	2014			2013		
	Related party activity	Total activity	%	Related party activity	Total activity	%
<b>Interest receivable and similar income</b>						
-Key management and personnel	3,907			4,426		
	<u>3,907</u>	<u>394,576</u>	<u>1.0</u>	<u>4,426</u>	<u>296,824</u>	<u>1.5</u>
<b>Fee and commission income</b>						
-Group related entities	100,000			208,000		
	<u>100,000</u>	<u>1,587,197</u>	<u>6.3</u>	<u>208,000</u>	<u>689,129</u>	<u>30</u>
<b>Interest expense</b>						
-Key management and personnel	547			568		
-Other related parties	6,372			1,614		
	<u>6,919</u>	<u>292,500</u>	<u>2.4</u>	<u>2,182</u>	<u>83,434</u>	<u>2.6</u>
<b>Trading income</b>						
-Group related entities	89,040			81,970		
	<u>89,040</u>	<u>89,040</u>	<u>100</u>	<u>81,970</u>	<u>96,317</u>	<u>85.1</u>
<b>Other Income</b>						
-Group related entities	128,730			128,675		
	<u>128,730</u>	<u>131,784</u>	<u>97.7</u>	<u>128,675</u>	<u>128,675</u>	<u>100</u>
<b>Administrative expenses</b>						
-Parent	7,907			7,904		
-Directors' fees	15,000			15,000		
	<u>22,907</u>	<u>684,091</u>	<u>3.3</u>	<u>22,904</u>	<u>458,192</u>	<u>5.0</u>

The amounts due from and to related parties and the terms and conditions are disclosed in notes 13 and 21, respectively.

## 26. Commitments

Commitments represent commitments to provide financing of up to EUR 12,000,000 (2013: EUR 1,000,000) and guarantees amounting to EUR 6,995 (2013: EUR nil). These commitments are authorised and contracted.

## 27. Fair values of financial assets and financial liabilities

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

Pricing is based on quoted prices where available. Where quoted prices are not readily available, the fair value is determined using pricing models that incorporate observable market prices and the contractual prices of the underlying instruments, the time value of money, yield curves and volatility factors. If necessary, fair value is adjusted to take into account market, model and credit risks as well as related costs.

The fair values of financial assets are determined as follows.

- The fair values of financial assets with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market prices.
- The fair values of other financial assets are determined in accordance with generally accepted pricing models using prices from observable current market transactions and dealer quotes for similar instruments.

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3.

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3 fair value measurements are those derived from inputs that are not based on observable market data (unobservable inputs).

EUR	2014			Total
	Level 1	Level 2	Level 3	
Financial assets designated as at fair value through profit or loss upon initial recognition	-	-	886,200	886,200
<b>Total</b>	<b>-</b>	<b>-</b>	<b>886,200</b>	<b>886,200</b>

The level 3 financial assets designated as at fair value through profit or loss upon initial recognition that amounts to EUR886,200 consists of an investment in a collective investment scheme which has invested in private placement debt instruments. The valuation is based on the audited NAV as at the end of the same reporting period. The collective investment scheme utilises discounted cash flow valuation methodologies in arriving at the valuation of the positions held. The key inputs used in arriving at the discount factor comprise an observable risk free rate and unobservable credit spreads of the issuers and liquidity risk premiums. A 5% change in the unobservable inputs would not give rise to a material difference in the fair value of the unobservable inputs. This investment in the collective investment scheme was transferred from Level 2 to Level 3 during 2013.

**27. Fair values of financial assets and financial liabilities (continued)**

EUR	2013			Total
	Level 1	Level 2	Level 3	
Financial assets designated as at fair value through profit or loss upon initial recognition	-	-	797,160	797,160
<b>Total</b>	<b>-</b>	<b>-</b>	<b>797,160</b>	<b>797,160</b>

The following is a description of the fair value measurement of financial assets and financial liabilities measured on a basis other than fair value.

**Loans and advances to banks and customers**

This category is reported net of allowances to reflect the estimated recoverable amount. For loans and advances to banks and customers within “less than one year” contractual repricing or maturity bands, fair value is taken to be the amount carried at the end of the reporting period. Interest rates on these loans reflect current market rates, and therefore the carrying amount approximates to fair value.

As at 31 December 2014, the Bank’s carrying amount of loans and advances to customers was EUR 15,579,246 (2013: EUR 4,933,375) of which EUR 8,740,042 (2013: EUR 1,754,096) are repriceable at current market rates within 6 months. EUR 5,711,927 (2013: EUR 2,221,169) of the loans are with a fixed interest rate, most of which were granted towards the end of the reporting period and therefore their carrying amount approximates fair value. EUR 1,127,276 (2013: EUR 958,109) of the loans is interest-free, has no fixed repayment date, and is repriceable at the Bank’s discretion, hence the carrying value of the loan approximates its fair value. As at 31 December 2014, the carrying amount of loans and advances to banks was EUR 5,778,868 (2013: EUR 1,633,292) including balances with Central Bank of Malta and cash. EUR 2,176,671 (2013: EUR 398,943) is repayable on demand and at short notice, EUR 3,409,608 matures within 1 month (2013: EUR 1,054,428) and EUR 192,579 matures in 5 years (2013: EUR 179,921). The fair value of loans and advances to banks and customers is a Level 2 measurement and approximates the carrying value.

**Amounts owed to customers**

Amounts owed to customers is carried at amortised cost and totals EUR 17,951,516 (2013: EUR 2,857,507). These amounts bear fixed rates of interest. Of these liabilities, EUR 2,000,749 (2013: EUR 872,090) are repayable on demand and EUR 6,098,735 (2013: EUR 465,000) mature within one year. EUR 9,852,032 of the amounts mature within 1-5 years period (2013: EUR 1,520,417 of the amounts mature within 2-5 years). Most of the latter were granted during the current financial year and therefore interest rates reflect the current market rates, and hence the carrying amount approximates to fair value. For demand deposits and deposits maturing within one year, fair value is taken to be the amount payable on demand at the end of the reporting period. The fair value of amounts owed to customers is a Level 2 measurement and approximates the carrying value.

**Other financial assets and liabilities**

Other financial assets and financial liabilities comprise accrued income, prepayments, other receivables, accrued expenses and other liabilities. As at 31 December 2014 and 2013, the carrying amounts of these financial instruments approximated their fair values due to their short term maturities.

## 28. Risk management

The Bank has exposure to the following risk from financial instruments:

- credit risk
- liquidity risk
- market risk

The Bank is also exposed to non-financial risks, namely operational risk.

This note presents information about the Bank's exposure to each of the above risks, and the Bank's objectives, policies and processes for measuring and managing risk.

### Risk Management Framework

The Risk Committee of the BoD has overall responsibility for the establishment and oversight of the risk management framework. It is made up of the 2 Chairmen of the Bank. It assists the BoD in identifying, measuring monitoring and controlling the Bank's key risks. It also reviews the current practices employed by Risk Management and the overall risk management structure within the business areas. The Risk Committee's responsibilities extend to supervising regulatory capital management and risk-based performance measurement. This committee is also responsible for ensuring the Bank's exposures are in line with the risk appetite approved by the BoD on an annual basis.

The Chief Risk Officer of the Bank is the one responsible for the development of risk models to be applied to the various types of risk together with day-to-day control involving risk assessment against established policies and limits.

### Credit Risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's loans and advances to customers and banks and investment debt securities.

Credit risk constitutes the Bank's most significant risk and arises mainly from lending, treasury and investment activities. To identify, measure and manage its credit risk arising from all these activities, the Bank has adequate methodologies, policies, procedures and expertise in place. The Bank has adopted a policy of only dealing with creditworthy counterparties and obtaining sufficient collateral where appropriate, as a means of mitigating the risk of financial loss from defaults. In line with the limited exposure the Bank has at the end of reporting period, the Credit Committee, made up of the Co-Chairmen of the BoD of the Bank, monitors large client exposure and any conditions for the impairment of assets and allowances.

### Exposure to credit risk

The carrying amount of financial assets represents the maximum credit exposure and is shown gross, without taking into account any collateral or other credit enhancements, unless these credit enhancements qualify for offset in accordance with *IAS 32 Financial Instruments: Presentation*. The maximum exposure at the reporting date was:

EUR	2014	2013
<b>Assets at amortised cost</b>		
Loans and advances to related parties	1,461,897	1,356,871
Loans and advances to banks*	5,778,868	1,633,292
Loans and advances to customers	14,117,349	3,576,504
Other assets	1,268,349	768,000
	<u>22,626,463</u>	<u>7,334,667</u>

[\*] includes balances with Central Bank of Malta and cash

## 28. Risk management (continued)

The amount of exposure to credit risk of financial assets presented in the table is equal to their carrying amount recognised in the statement of financial position. A financial asset is past due when a counterparty has failed to make a payment when contractually due. Impaired facilities are those credit facilities with payments on interest and/or capital overdue by 90 days or where the Bank has reasons to doubt the eventual recoverability of funds.

### Loan commitments

The maximum exposure to credit risk arising on loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities is the full amount of the committed facilities.

### Allowances for impairment

The Bank establishes an allowance for impairment losses carried at amortised cost that represents its estimate of incurred losses on its loan portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loan loss allowance established for groups of homogeneous assets in respect of losses, if any, that have been incurred but have not been identified on loans that are considered individually insignificant, as well as individually significant exposures that were subject to individual assessment for impairment but not found to be individually impaired. As at 31 December 2014, specific provision amounted to EUR 19,782 (2013: EUR 19,782).

### Write-off policy

The Bank writes off a loan/security balance and related allowances for impairment losses when it determines that the loan or security is uncollectible.

This determination is reached after considering information such as the occurrence of significant changes in the borrower's/issuer's financial position such that the borrower/issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

For smaller standardised loans, write-off decisions generally are based on a product specific past due status.

During 2014, accrued income amounting to EUR 31,817 was written off by the Bank (2013: EUR nil).

### Collateral and other credit enhancements obtained

The Bank actively uses collaterals in its credit risk mitigation. The Bank policy is to obtain collateral if and when required prior to the disbursement of approved loans.

Depending on the type of the collateral received, customer limits are extended. In the extension of secured facilities to corporate clients, the following categories are considered as acceptable types of security:

- cash collateral in a blocked account;
- pledged time deposit with the Bank;
- pledged fiduciary deposits with acceptable prime banks;
- pledged government bonds or other marketable securities at the discretion of the Credit Committee, whose covering value is to be determined against a percentage of the actual market value at the time of the pledge.

The applicable percentages will be directly related to the issuing country and company and will be subject to regular review.

Also, other types of listed securities and real estate assets are considered for collateral with appropriate haircuts applied.

Estimates of fair value are based on the value of the collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired. Collateral is not held over loans and advances to the parent company.

**28. Risk management (continued)**

The estimate of collateral and other security enhancements held against loans and advances to customers amounted to EUR 8,320,242 (2013: EUR 2,550,000) consisting of property held as collateral and EUR 1,769,445 consisting of other security enhancements.

**Concentration of risks**

The Bank monitors concentrations of credit risk by sector, geographic location and industry.

	Other assets 2014	Loans and advances to related parties 2014	Loans (*) and advances to banks 2014	Loans and advances to customers 2014
EUR				
Carrying amount	<u>1,268,349</u>	<u>1,461,897</u>	<u>5,778,868</u>	<u>14,117,349</u>
<b>Concentration by sector</b>				
-Individuals	2,022	334,621	-	1,749,764
-Corporates	1,266,327	1,127,276	-	12,367,585
-Banks	-	-	5,778,868	-
	<u>1,268,349</u>	<u>1,461,897</u>	<u>5,778,868</u>	<u>14,117,349</u>
<b>Concentration by industry</b>				
-Holding companies	-	1,127,276	-	800,000
-Information technology	456,698	-	-	164,000
-Real estate	300,000	-	-	5,970,000
-Households	-	334,621	-	1,749,764
-Energy and technology	-	-	-	100,000
-Manufacturing	27,271	-	-	1,159,445
-Financial institutions	482,358	-	5,778,868	4,174,140
-Others	2,022	-	-	-
	<u>1,268,349</u>	<u>1,461,897</u>	<u>5,778,868</u>	<u>14,117,349</u>
<b>Concentration by geography</b>				
-Malta	22	1,445,490	4,972,648	1,358,597
-Belgium	458,698	-	806,220	423,800
-Finland	809,629	-	-	12,334,952
-Cyprus	-	16,407	-	-
	<u>1,268,349</u>	<u>1,461,897</u>	<u>5,778,868</u>	<u>14,117,349</u>

(\*) includes balances with Central Bank of Malta and cash

During the year the Bank acquired term loans from a third party (the 'seller'), which at year end amounted to EUR 3,424,140. The Bank contracted to acquire a further EUR10,000,000 from this company at year end and intends to further expand its loan portfolio by acquiring additional loans. The loans are guaranteed by the seller, yet the Bank's exposure to credit risk is the underlying borrowers, since it has acquired direct ownership of these facilities from the seller.

**28. Risk management (continued)****Concentration of risks (continued)**

	Other assets	Loans and advances to related parties	Loans and (*) advances to banks	Loans and advances to customers
EUR	2013	2013	2013	2013
Carrying amount	<u>768,000</u>	<u>1,356,871</u>	<u>1,633,292</u>	<u>3,576,504</u>
<b>Concentration by sector</b>				
-Individuals	-	398,762	-	1,129,887
-Corporates	768,000	958,109	-	2,446,617
-Banks	-	-	1,633,292	-
	<u>768,000</u>	<u>1,356,871</u>	<u>1,633,292</u>	<u>3,576,504</u>
<b>Concentration by industry</b>				
-Holding companies	-	958,109	-	-
-Information technology	-	-	-	828,120
-Real estate	588,000	-	-	150,000
-Households	-	398,762	-	1,129,887
-General cleaning	180,000	-	-	-
-Energy and technology	-	-	-	100,000
-Manufacturing	-	-	-	1,168,497
-Financial institutions	-	-	1,633,292	200,000
	<u>768,000</u>	<u>1,356,871</u>	<u>1,633,292</u>	<u>3,576,504</u>
<b>Concentration by geography</b>				
-Malta	-	1,290,723	1,531,768	112,490
-Belgium	-	52,800	101,524	844,487
-Finland	768,000	-	-	2,619,527
-Cyprus	-	13,348	-	-
	<u>768,000</u>	<u>1,356,871</u>	<u>1,633,292</u>	<u>3,576,504</u>

(\*) includes balances with Central Bank of Malta and cash

The Bank assigns limits on the level of credit risk undertaken in relation to any single counterparty or sovereign exposure in accordance with external ratings based on the three main external credit rating institutions, 'ECAIs' namely, Fitch, Moody's and Standard & Poor's.

Changes in credit ratings are monitored on a daily basis and are subject to frequent review, when considered necessary. The limits on the level of credit risk are reviewed consistently and approved by the BoD at regular intervals. Actual exposures are monitored against limits on an ongoing basis. The Bank enters into security transactions only with such authorised counterparties and it invests only in securities or paper with credit quality that falls within specific parameters stated in the Investment Management Policy.

The level of concentration in respect of other significant financial assets is disclosed in the remaining notes to the financial statements.

**28. Risk management (continued)****Maximum exposure**

The carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, represents the maximum exposure to credit risk without taking account of the value of any collateral obtained.

**Credit quality**

Credit ratings of debt securities and loans and advances to banks by the three rating agencies are as follows:

EUR	Loans (*) and advances to banks 2014
<b>Fitch ratings</b>	
- AA-	-
- A+	-
- BBB+	1,080,815
- BB-	2,006,759
- Not rated	2,691,294
	5,778,868
<b>Moody's ratings</b>	
- Aa1	-
- A2	830,839
- Baa2	-
- Not rated	4,948,029
	5,778,868
<b>Standard &amp; Poor's ratings</b>	
- A	830,839
- AA-	-
- Not rated	4,948,029
	5,778,868

(\*) includes balances with Central Bank of Malta and cash

**28. Risk management (continued)**

EUR	Loans (*) and advances to banks 2013
<b>Fitch ratings</b>	
- AA-	101,524
- A+	-
- A	-
- BBB+	67,711
- Not rated	1,464,057
	1,633,292
<b>Moody's ratings</b>	
- Aa1	-
- Aa2	101,524
- Baa2	-
- Not rated	1,531,768
	1,633,292
<b>Standard &amp; Poor's ratings</b>	
- A+	101,524
- AA-	-
- Not rated	1,531,768
	1,633,292

(\*) includes balances with Central Bank of Malta and cash

Management of the Bank has assessed the credit quality of the unrated debt securities and loans and advances to banks and considers the quality of these assets to be acceptable.

**28. Risk management (continued)**

The following table provides additional information of the credit quality of the Bank's lending portfolio.

EUR	Loans and advances to customers	Loans and advances to customers
	2014	2013
Neither past due nor impaired	14,255,801	2,970,930
Past due but not impaired	1,323,445	1,962,445
Impaired	19,782	19,782
	<u>15,599,028</u>	<u>4,953,157</u>
Neither past due nor impaired: Regular	14,255,801	2,970,930
	<u>14,255,801</u>	<u>2,970,930</u>
Past due but not impaired: Past due over 90 days	1,323,445	1,962,445
	<u>1,323,445</u>	<u>1,962,445</u>

EUR226,367 of the amounts which are neither past due nor impaired relate to three loans that were restructured.

**Settlement risk**

The Bank'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 the failure of an entity to honor its obligations to deliver cash, securities or other assets as contractually agreed.

For certain types of transactions, the Bank mitigates the risk by conducting settlements through a settlement/clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual obligations. Settlement limits form part of the credit approval/limit monitoring process described above.

**Liquidity risk**

Liquidity risk is the risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may result from an inability to sell a financial asset quickly at close to its fair value.

**Management of liquidity risk**

The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

The Bank monitors its liquidity position on a daily basis. The Bank maintains a portfolio of short-term liquid assets, largely made up of short-term loans and advances to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained with the Bank as a whole.

All liquidity policies and procedures are subject to review and approval by the Chairman's Office, which is subject to a liquidity limit imposed by the regulator. The Treasurer is responsible for the daily monitoring of liquidity procedures and ratios.

Liquidity gaps showing size and maturity mismatches of assets and liabilities together with liquidity stress testing are also being planned as the bank deposits increase, expand and diversify the balance sheet.

**28. Risk management (continued)****Residual contractual maturities of financial assets**

The table below analyses the assets with contractual maturities that are recognised in the statement of financial position into relevant maturity groupings, based on the remaining period at end of the reporting period to their contractual maturity table.

	Less than 3	Between 3	Over 2	Other	Total
	months	months and	years		
EUR	2014	2 years	2014	2014	2014
Loans and advances to related parties	1,130,150	19,457	312,290	-	1,461,897
Loans and advances to banks (*)	5,586,289	-	192,579	-	5,778,868
Loans and advances to customers	1,507,250	5,058,032	7,552,067	-	14,117,349
Investments	-	-	-	886,200	886,200
Other assets	1,168,349	-	-	100,000	1,268,349
	<u>9,392,038</u>	<u>5,077,489</u>	<u>8,056,936</u>	<u>986,200</u>	<u>23,512,663</u>
EUR	2013	2013	2013	2013	2013
Loans and advances to related parties	3,441	27,804	1,325,626	-	1,356,871
Loans and advances to banks (*)	1,453,371	-	179,921	-	1,633,292
Loans and advances to customers	2,691	2,537,225	1,036,588	-	3,576,504
Investments	-	-	-	797,160	797,160
Other assets	-	768,000	-	-	768,000
	<u>1,459,503</u>	<u>3,333,029</u>	<u>2,542,135</u>	<u>797,160</u>	<u>8,131,827</u>

(\*) includes balances with Central Bank of Malta and cash

## 28. Risk management (continued)

### Residual contractual maturities of financial liabilities

The table below analyses the liabilities with contractual maturities that are recognised in the statement of financial position into relevant maturity groupings, based on the remaining period at end of the reporting period to their contractual maturity table.

	Less than 3 months 2014	Between 3 months and 2 years 2014	Over 2 years 2014	Total 2014
EUR				
Amounts owed to customers	<u>2,523,923</u>	<u>6,569,349</u>	<u>8,858,244</u>	<u>17,951,516</u>
	<u>2,523,923</u>	<u>6,569,349</u>	<u>8,858,244</u>	<u>17,951,516</u>
	Less than 3 months 2013	Between 3 months and 2 years 2013	Over 2 years 2013	Total 2013
EUR				
Amounts owed to customers	<u>1,007,090</u>	<u>350,000</u>	<u>1,500,417</u>	<u>2,857,507</u>
	<u>1,007,090</u>	<u>350,000</u>	<u>1,500,417</u>	<u>2,857,507</u>

### Market risk

Market risk is the risk that changes in market prices, such as interest rates, equity prices and foreign exchange rates will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Market risk comprises three types of risk: currency risk, interest rate risk and other price risk. It arises in all areas of the Bank's activities and is managed by a variety of different techniques as detailed below. The market risk appetite is articulated in the investment management policy. It is defined as the quantum and composition of market risk that the Bank is currently exposed to and the direction in which the Bank desires to manage this risk. Market risk is managed with the limits set in the investment management policy.

### Exposure to other price risk and currency risk

At the end of the reporting period the Bank, was not exposed to other price risk or currency risk on balances that were denominated in a currency other than its functional currency.

### Exposure to interest risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Bank is exposed to fair value interest rate risk arising from financial assets with fixed interest rates and to cash flow interest rate risk arising from financial assets with floating interest rates. The Bank follows the standardised approach to calculate the capital against the position risk on a traded debt instrument which is subdivided into two components, specific and general. Its specific risk component is the risk of a price change in the instrument concerned due to factors related to its issuer whereas its general risk component is the risk of a price change in the instrument due to a change in the level of interest rates. Since the bank had no such instruments in its trading book at the reporting date no capital was allocated by the Bank for these risk components for both 2014 and 2013 respectively.

## 28. Risk management (continued)

### Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risk such as those arising from legal and regulatory requirements and generally accepted standards of corporate behavior. Operational risks arise from all the Bank's operations.

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management. This responsibility is supported by the development of overall standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorisation of transactions;
- requirements for the reconciliation and monitoring of transactions;
- compliance with regulatory and other legal requirements;
- documentation of controls and procedures;
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risk identified;
- development of contingency plans;
- training and professional development;
- ethical and business standards; and
- risk mitigation, including insurance where this is effective.

Capital allocation for operational risk is based upon the basic indicator approach which takes 15% of the average net interest and non-interest income of the Bank for the last three years. For the Bank, the figure taken as income for the operational risk capital allocation amounted to EUR 200,282 (2013: EUR 127,198).

### Capital risk management

The Bank's capital management approach ensures sufficient level of capitalisation to manage the risk exposures at hand while enabling business growth and providing adequate returns to the shareholders. Risk capital management does not in any way substitute risk mitigation measures. It is vital that the structure of limits and thresholds should be able to prevent concentrations of risk from building up in such a way as to compromise a significant portion of the Bank's capital resources.

The Basel II implementation program together with the ICAAP implementation have been assigned to the Bank's senior management and will be executed in parallel to the growing operations of the Bank.

Capital management is under the direct control of the Chairman's Office. At reporting date, the Bank's funding was completely based on own funds (Tier 1) and so was the Eligible Capital.

**28. Risk management (continued)**

The following table shows the components and basis of calculation of the Bank's Capital Adequacy ratios.

EUR	2014	2013
Own funds		
Tier 1		
-Ordinary shares	5,500,000	5,500,000
-Retained earnings	259,892	43,456
-Other reserves	26,030	19,788
-Less: Intangible assets	(150,676)	(136,026)
Unrealised trading gains	(89,040)	(81,970)
Total Tier 1 Capital and Total Own Funds	5,546,206	5,345,248
-Unrealised trading gains	89,040	81,970
	<u>5,635,246</u>	<u>5,427,218</u>

EUR	Face value	Risk Weighted Assets	Face value	Risk Weighted Assets
	2014	2014	2013	2013
-Financial assets at fair value through profit or loss	886,200	886,200	797,160	797,160
-Balances with Central Bank of Malta and Cash	11,956	-	3,944	-
-Loans and advances to banks	5,776,912	1,119,871	1,629,348	325,870
-Loans and advances to customers	15,579,246	11,332,042	4,933,375	4,674,694
-Other assets	1,900,643	1,900,643	1,171,800	1,171,800
	<u>24,144,957</u>	<u>15,238,756</u>	<u>8,535,627</u>	<u>6,969,524</u>
Operational risk		1,227,578		1,588,976
Foreign exchange risk		1,055,609		-
<b>Total Risk Weighted Assets</b>		<u>17,521,943</u>		<u>8,558,500</u>
<b>Capital Adequacy Ratio</b>				
Tier 1 and Total Capital Ratio		32%		63%

Risk weighted assets are regulatory capital requirements multiplied by 12.5, or, in other words, capital requirements equal to 8% of risk weighted assets.

## 29. Encumbered and unencumbered assets

This note is presented in terms of Appendix 2 of Banking Rule 07.

EUR	Carrying amount of encumbered assets 2014	Fair value of encumbered assets 2014	Carrying amount of unencumbered assets 2014	Fair value of encumbered assets 2014
Equity instruments	-	-	886,200	886,200
Debt securities	-	-	-	-
Other assets	11,936	11,936	23,246,821	23,246,821
	<u>11,936</u>	<u>11,936</u>	<u>24,133,021</u>	<u>24,133,021</u>

## 30. Registered office

The registered and principal office of Nemea Bank plc is Level 17, Portomaso Tower, St. Julians STJ 4011, Malta.

## 31. Parent and ultimate controlling party

The parent company of Nemea Bank plc is Nemea plc, a company incorporated in Malta. The ultimate parent companies of Nemea plc are Ninovan Limited and Shilmore Limited, which are both incorporated in Cyprus and are controlled by Heikki Niemelä and Mika Lehto respectively.

THE BANK'S FIVE YEAR SUMMARY  
AS EXTRACTED FROM THE RESPECTIVE AUDITED FINANCIAL STATEMENTS

**1. STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME**

For the year/period ended 31 December	2014	2013	2012	2011	2010
EUR					
<b>Revenue</b>					
Interest receivable and similar income:					
on loans and advances, balances with CBM	394,576	296,824	325,689	172,801	98,009
on debt and other fixed income instruments	-	605	33,156	132,409	133,240
Interest payable	(292,500)	(83,434)	(96,599)	(4,031)	-
Net interest income	<u>102,076</u>	<u>213,995</u>	<u>262,246</u>	<u>301,179</u>	<u>231,249</u>
Fee and commission income	1,587,197	689,129	620,752	766,605	337,608
Fee and commission expense	(2,150)	(2,533)	(3,991)	(8,192)	(891)
Net commission income	<u>1,585,047</u>	<u>686,596</u>	<u>616,761</u>	<u>758,413</u>	<u>336,717</u>
Trading income/(expense)	89,040	96,317	47,038	(63,681)	98,525
Other income	<u>131,784</u>	<u>128,675</u>	<u>46,070</u>	<u>73,220</u>	<u>36,563</u>
	<u>220,824</u>	<u>224,991</u>	<u>93,108</u>	<u>9,539</u>	<u>135,088</u>
<b>Operating income</b>	<u>1,907,947</u>	<u>1,125,583</u>	<u>972,115</u>	<u>1,069,131</u>	<u>703,054</u>
Staff costs	(678,617)	(468,560)	(419,663)	(488,605)	(342,919)
General administrative expenses	(684,091)	(458,192)	(426,399)	(318,572)	(268,438)
Amortisation of intangible assets	(110,543)	(71,865)	(7,146)	(4,298)	(2,846)
Depreciation	(53,735)	(62,291)	(56,727)	(62,204)	(43,507)
Provision and impairment costs	(31,817)	-	(19,782)	-	-
	<u>(1,558,803)</u>	<u>(1,060,908)</u>	<u>(929,717)</u>	<u>(873,679)</u>	<u>(657,710)</u>
<b>Profit before tax</b>	<u>349,144</u>	<u>64,675</u>	<u>42,398</u>	<u>195,452</u>	<u>45,344</u>
Income tax (expense)/credit	(126,466)	(26,902)	(19,105)	(70,837)	(19,272)
<b>Profit/(loss) for the year/period / total comprehensive income for the year/period</b>	<u><u>222,678</u></u>	<u><u>37,773</u></u>	<u><u>23,293</u></u>	<u><u>124,615</u></u>	<u><u>26,072</u></u>

**2. STATEMENTS OF FINANCIAL POSITION**

As at 31 December EUR	2014	2013	2012	2011	2010
<b>Assets</b>					
Balances with Central Bank of Malta and Cash	1,108,476	297,309	1,986,711	163,160	92,652
Financial assets at fair value through profit or loss	886,200	797,160	955,218	208,180	271,861
Investments	-	-	-	1,000,000	1,000,000
Loans and advances to banks	4,670,392	1,335,983	436,466	1,100,381	206,826
Loans and advances to customers	15,579,246	4,933,375	4,416,422	2,849,249	2,784,929
Intangible assets	150,676	136,026	120,106	4,912	4,025
Property, plant and equipment	154,310	123,754	176,025	144,169	166,363
Deferred tax	-	-	-	-	50,925
Other assets	1,268,349	768,000	112,021	380,000	605,000
Prepayments and accrued income	327,308	144,020	143,645	213,624	219,159
<b>Total Assets</b>	<b>24,144,957</b>	<b>8,535,627</b>	<b>8,846,614</b>	<b>5,850,051</b>	<b>5,401,740</b>
<b>Liabilities</b>					
Amounts owed to customers	17,951,516	2,857,507	2,708,046	524,776	727
Current tax	91,167	48,940	12,080	4,659	-
Deferred tax	35,717	419	22,457	15,253	-
Other liabilities	1,210	449	33,831	4,260	1,252
Accruals and deferred income	279,425	65,068	44,669	12,549	22,198
<b>Total Liabilities</b>	<b>18,359,035</b>	<b>2,972,383</b>	<b>2,821,083</b>	<b>561,497</b>	<b>24,177</b>
<b>Shareholders' equity</b>					
Equity attributable to shareholders of the Bank					
Called up share capital	5,500,000	5,500,000	5,500,000	5,500,000	5,500,000
Retained earnings/(accumulated losses)	259,892	43,456	25,471	2,178	(122,437)
Other reserves	26,030	19,788	-	-	-
<b>Total Shareholders' Equity</b>	<b>5,785,922</b>	<b>5,563,244</b>	<b>5,525,470</b>	<b>5,502,178</b>	<b>5,377,563</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>24,144,957</b>	<b>8,535,627</b>	<b>8,346,554</b>	<b>6,063,675</b>	<b>5,401,740</b>
<b>Memorandum items</b>					
Commitments	12,006,995	1,000,000	100,000	1,025,000	78,000

**3. STATEMENTS OF CASH FLOW**

For the year/period ended 31 December EUR	2014	2013	2012	2011	2010
<b>Cash flows from operating activities</b>					
Interest and commission receipts	1,904,584	412,322	1,233,542	563,872	375,920
Interest and commission payments	(122,569)	(41,916)	(98,272)	(7,223)	(494)
Payments to employees and suppliers	(1,326,564)	(1,026,749)	(837,863)	(359,459)	(1,200,638)
Tax payment	(48,940)	-	-	-	-
Operating (loss)/profit before changes in operating assets and liabilities	406,511	(656,343)	297,407	197,190	(825,212)
(Increase)/decrease in operating assets:					
Loans and advances to customers	(10,540,845)	(14,143)	(1,333,227)	(166,985)	(1,590,797)
Loans and advances to related parties	(105,026)	(502,810)	(233,948)	(138,012)	(291,525)
Other assets	(500,349)	32,000	-	225,000	605,000
Increase/(decrease) in operating liabilities:					
Amounts owed to customers	15,094,009	149,461	2,181,885	524,049	726
Other liabilities	761	(34,562)	38,378	7,340	(591,829)
<b>Net cash (used in)/generated from operating activities</b>	<b>4,355,061</b>	<b>(1,026,397)</b>	<b>950,495</b>	<b>648,582</b>	<b>(2,693,637)</b>
<b>Cash flows from investing activities</b>					
Acquisition of tangible fixed assets	(84,292)	(10,019)	(88,583)	(40,010)	(78,792)
Acquisition of intangible fixed assets	(125,193)	(7,785)	(122,339)	(5,186)	(285)
Acquisition of intangible investments	-	-	(700,000)	-	-
Maturity of held-to-maturity investments	-	-	1,000,000	-	-
Interest received from held-to-maturity debt and other fixed income instruments	-	-	120,000	120,000	120,000
Proceeds from sale of other investments	-	254,375	-	-	-
<b>Net cash from/(used in) investing activities</b>	<b>(209,485)</b>	<b>236,571</b>	<b>209,078</b>	<b>74,804</b>	<b>40,923</b>
<b>Cash flows from financing activities</b>					
Proceeds from the issue of share capital	-	-	-	-	-
Amount advanced from parent company	-	-	-	240,677	-
Repayment of bank borrowings	-	-	-	-	(63,800)
<b>Net cash from/(used in) financing activities</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>240,677</b>	<b>(63,800)</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>	<b>4,125,576</b>	<b>(789,826)</b>	<b>1,159,573</b>	<b>723,386</b>	<b>(2,716,514)</b>
<b>Cash and cash equivalents at the beginning of the year</b>	<b>1,633,292</b>	<b>2,423,118</b>	<b>1,263,542</b>	<b>299,478</b>	<b>3,015,992</b>
<b>Cash and cash equivalents at the end of the year</b>	<b>5,778,868</b>	<b>1,633,292</b>	<b>2,423,115</b>	<b>1,022,864</b>	<b>299,478</b>

## CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This report contains statements that constitute “forward-looking statements”, including but not limited to statements relating to the anticipated effect of transactions described herein, risks arising from the current market crisis and other risks specific to Nemea Bank’s business, strategic initiatives, future business development and economic performance. While these forward-looking statements represent the Bank’s judgments and expectations concerning the development of its business, a number of risks, uncertainties and other important factors could cause actual developments and results to differ materially from the Bank’s expectations.

These factors include, but are not limited to:

- (1) the extent and nature of future developments in the market segments that have been or may be affected by the current market crisis and their effect on Nemea Bank’s assets and exposures;
- (2) developments affecting the availability of capital and funding to Nemea Bank and other financial institutions, including any changes in Nemea Bank’s credit spreads and ratings;
- (3) other market and macroeconomic developments, including movements in local and international securities markets, credit spreads, currency exchange rates and interest rates;
- (4) changes in internal risk control and limitations in the effectiveness of Nemea Bank’s internal processes for risk management, risk control, measurement and modeling, and of financial models generally;
- (5) the degree to which Nemea Bank is successful in implementing its business and development plans, and whether those plans will have the effects anticipated;
- (6) changes in the financial position or creditworthiness of the Bank’s clients, obligors and counterparties, and developments in the markets in which they operate, including possible failures resulting from the current market crisis and adverse economic environment;
- (7) management changes and changes to the internal or overall structure of the Bank;
- (8) the occurrence of operational failures, such as fraud, unauthorized trading and systems failures;
- (9) legislative, governmental and regulatory developments, including the effect of more stringent capital requirements and of regulatory constraints on the Bank’s activities;
- (10) changes in accounting standards or policies, and accounting determinations affecting the recognition of gain or loss, the valuation of goodwill and other assets or other matters;
- (11) changes in and the effect of competitive pressures, including the possible loss of key employees as a result of compensation issues or for other reasons;
- (12) technological developments; and
- (13) the impact of all such future developments on positions held by the Bank, on its short-term and longer-term earnings, on the cost and availability of funding and on Nemea Bank’s capital ratios. In addition, these results could depend on other factors that we have previously indicated could adversely affect our business and financial performance which are contained in our past and future filings and reports. Nemea Bank is not under any obligation to (and expressly disclaims any obligation to) update or alter its forward-looking statements, whether as a result of new information, future events, or otherwise.

Rounding EUR amounts presented throughout this report may not add up precisely to the totals provided in the tables. Percentages and percent changes are calculated based on rounded figures displayed in the tables and text and may not precisely reflect the percentages and percent changes that would be derived based on figures that are not rounded.







**Nemea Bank**

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