

# REPORT OF THE INVESTOR COMPENSATION SCHEME FOR 2005

## INTRODUCTION

In terms of regulation 8 of LN 368 of 2003 (the Investor Compensation Scheme Regulations, 2003), the Compensation Schemes Management Committee of the Investor Compensation Scheme (hereinafter referred to as “the Scheme”) is pleased to present its report on the discharge of its functions and its operations during 2005.

The Scheme’s audited financial statements for 2005 are also attached.

## MANAGEMENT COMMITTEE

In accordance with regulation 3 of the Regulations, the Scheme is managed and administered by a Management Committee (hereinafter referred to as “the Committee”) appointed by the Malta Financial Services Authority. In terms of article 12 of the Investment Services Act and regulations 3 and 5 of LN 368 of 2003, the Malta Financial Services Authority appointed the Compensation Schemes Management Committee for a period of three years commencing on 1 January 2004. The following persons have served on the Management Committee during 2005:

### *Chairman*

Dr Anton Felice

### *Members*

Mr Charles Borg (*resigned on 21 January 2005*)

Prof Andrew Muscat

Mr Benny Borg Bonello

Mr George F Farrugia

Mr Kenneth Farrugia (*appointed as of 6 September 2005*)

Mr Rene Saliba

Dr Massimo Vella

Mr Geoffrey Bezzina has served as Secretary of the Committee.

The Management Committee held 4 meetings during 2005.

## **FINANCIAL STATEMENTS AS AT 31 DECEMBER 2005**

The Scheme registered a surplus of Lm6,434 in 2005 compared to Lm 2,309 registered in the previous year. Investment income amounted to Lm12,101, from which Lm5,667 have been spent in management and administration expenses.

Accumulated capital and reserves amounted to Lm250,365. Of the capital and reserves the sum of Lm3,646 is held on deposit as part of the variable contribution of licence holders. A further Lm15,923 is held by participants in a reserve (the "Investor Compensation Scheme Reserve") which is pledged to the Scheme and is payable on call whenever the Scheme's funds are inadequate.

## **FUNCTIONS OF THE SCHEME**

In terms of regulation 4, the functions of the Scheme are:

- (a) To maintain a fund for the payment of claims for compensation by investors;
- (b) To place contributions to the fund on deposit or to invest such funds;
- (c) To establish procedures and arrangements for the payment of claims for compensation by investors;
- (d) To handle and pay claims for compensation by investors;
- (e) To advise the Malta Financial Services Authority on matters relating to compensation of investors.

## **BUILDING THE FUND**

The first function of the Scheme is to build and maintain a fund for the payment of claims to investors.

### *Fixed Contributions*

All Category 2 and Category 3 participants reported to the Scheme by the Malta Financial Services Authority as being licensed to provide investments services to private individuals have fulfilled their obligation to pay their Fixed Contribution to the Scheme.

The Fixed Contribution is established in the Second Schedule of Legal Notice 368 of 2003 at Lm1250 for Category 2 licence holders and at Lm7500 for Category 3 licence holders. The Fixed Contributions for 2005 amounted to Lm45,865.

The Third Schedule of Legal Notice 368 of 2003 provides inter alia that the Malta Stock Exchange Compensation Fund is to cease and become absorbed as an integral part of

the Scheme. Furthermore, according to this Schedule, a moratorium has been allowed to the members of the Malta Stock Exchange who had paid into the Malta Stock Exchange Compensation Fund so that their respective contributions are to be set-off against contributions now due by them to the Scheme.

The Management Committee has relied on a statement issued by the Malta Financial Services Authority showing those members of the Malta Stock Exchange who were entitled to set off their previous MSE contributions against their contributions to the Scheme. On the basis of this list, the amount of the set-off effected in 2005 has been of Lm10,000.

#### *Variable Contribution*

The Second Schedule of Legal Notice 368 of 2003 also provides for the maintenance by participating licence holders of an Investor Compensation Scheme Reserve to be accounted for in the financial year when the Fixed Contribution is paid.

Participating licence holders are required to transfer to this Reserve a “variable contribution”. This contribution, which cannot be less than Lm300, is calculated annually, though not incrementally at the rate of 0.1 %, of the licence holder's total revenue. Moreover the Regulations provide that the said Reserve is to be invested by the licence holder with a third party who is approved by the Scheme.

The majority of participants have pledged their investments to the Scheme in terms of guidelines which were issued in 2004. More than half of the participants hold the minimum of Lm300 by way of Reserve.

Only a few participants took the opportunity to pay the amount of the Variable Contribution directly to the Scheme. The Management Committee determined that the payment of the variable contribution to the Scheme shall be on account against a potential claim on the Scheme, which may call on these funds in terms of regulation 16. No interest shall be payable by the Scheme to the licence holder on funds deposited with the Scheme.

The *Statement of changes in net assets/equity* in the attached financial statements gives an explanation of the amounts held by licence holders and pledged in favour of the Scheme. This amounts to Lm19,569. The Statement also shows the variable contribution paid directly to the Scheme. This is indicated as part of the Scheme's net assets and amounts to Lm3,646.

## **PROTECTION OF FUNDS**

The second function of the Scheme is to protect and safeguard the fixed and variable contributions that are transferred or transferable by participating licence holders to the Scheme.

The Management Committee is required to deposit or invest the fixed contributions that are made to the fund, until such time as they are required for the payment of claims for compensation by investors.

In the performance of this task and in accordance with regulation 7, the Committee appointed the Central Bank of Malta to provide investment management services including financial, accounting and other related support services. This appointment has been effected in terms of an agreement (which was signed in 2003), which established the parameters for the investment of funds of the Scheme.

These parameters apply prudent investment criteria that take account of both the short and long term liquidity requirements of the Scheme.

## **PROCEDURES FOR THE PAYMENT OF CLAIMS**

The third function of the Scheme is to establish procedures for the payment of claims for compensation by investors.

In this connection, the Committee is required to inform the general public about the procedures and arrangements for claiming against the Scheme. For this purpose it has set up a website ([www.compensationschemes.org.mt](http://www.compensationschemes.org.mt)), from where users can obtain information about the scheme, as well as access to an information booklet that describes how investors may claim against the Scheme and in which circumstances.

Regulation 11 and 35 require the Committee to consult the relevant compensation schemes in other countries for the purpose of facilitating the procedures by which investors may claim against the respective Schemes. Claims against foreign schemes may follow defaults by branches of an investment services provider, which is situated overseas.

During the year, there were no participants with branches outside Malta.

## **INVESTORS' CLAIMS**

The fourth function of the Scheme is to handle and pay claims to investors.

The Committee is pleased to report that during 2005 there have been no defaults of payments by participating licence holders which give rise to a claim against the Scheme.

## **CONSULTATION**

The fifth function of the Scheme is to advise the Malta Financial Services Authority on matters relating to investors' compensation.

## *Proposed changes to Regulations*

At the time this report is being compiled, the Prime Minister and Minister of Finance, acting on the advice of the MFSA, published and put into force L.N. 36 of 2006 — *Investor Compensation Scheme (Amendment) Regulations, 2006* — which as the title suggests, amends L.N. 368 of 2003 — the Investor Compensation Scheme Regulations, 2003 (“principal regulations”).

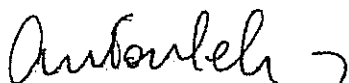
Essentially, L.N. 36 of 2006 is intended to bring the principal regulations in line with Directive 97/9/EC on investor-compensation schemes. Towards this objective, there are a number of modifications which include the re-definition of “investor” to include both individuals and small and medium-sized companies (with the exception of those entities defined in the First Schedule). The alignment with the Directive has also led to the redrafting of the exclusions list in the First Schedule of the regulations.

The amendments also contemplate the deletion of the compensation limit in the proviso to regulation 17 and incorporation of revised guidelines in the Second Schedule in respect of the investment of funds in the Investor Compensation Scheme Reserve. In addition there are a number of minor amendments that improve the legislation.

## **LIST OF PARTICIPANTS**

APS Bank Ltd.	Fexco Investment Services (Malta) Ltd.	Jesmond Mizzi Financial Services Ltd.
Atlas Investment Services Ltd.	First International Merchant Bank plc	Lombard Bank Malta plc
Azzopardi Investment Management Ltd.	Financial + Investment Services Ltd.	Mediterranean Bank plc
Bank of Valletta plc	Financial Planning Services Ltd.	Michael Grech Financial Investment Services Ltd.
BOV Stockbrokers Ltd.	Finco Treasury Management Ltd.	MZ Investments Ltd.
Barclays International Investments (Malta) Ltd.	Globe Financial Management plc	Rizzo, Faruglia & Co. (Stockbrokers) Ltd.
Calamatta Cuschieri & Co. Ltd.	Growth Investments Ltd.	Sparkasse Bank Malta PLC
Charts Investment Management Services Ltd.	Hogg Capital Investments Ltd.	Valletta Fund Management Ltd.
Crystal Finance Investments Ltd.	HSBC Bank (Malta) plc	Volksbank Malta Ltd.
Curmi & Partners Ltd.	HSBC Investment Services (Malta) Ltd.	W & J Coppini Investment Services Ltd.
D.B.R. Investments Ltd.	HSBC Stockbrokers (Malta) Ltd.	
Elmo Investments Ltd.	Island Financial Services Limited	
Epic Investment Services Ltd		

During the year, *Island Financial Services Limited* and *Mediterranean Bank plc* became participants of the Scheme.



**Dr Anton Felice**  
*Chairman – Compensation Schemes Management Committee*

13 June 2006

*Attachment: Audited Financial Statements of the Depositor Compensation Scheme for 2005*

Investor Compensation Scheme  
Report and financial statements  
For the year ended 31 December 2005

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## Statement of responsibilities of the Management Committee

The Management Committee consists of the Chairman and the Committee Members, who are to ensure that:

- a. proper accounting records are kept of all transactions entered into by the Scheme and of its assets and liabilities
- b. adequate controls and procedures are in place for safeguarding the assets of the Scheme and the prevention and detection of fraud and other irregularities.

The Investor Compensation Scheme Regulations require that financial statements are prepared for each financial year. In preparing those financial statements which give a true and fair view of its state of affairs as at the end of the financial year and of its surplus or deficit for that year, the Management Committee:

- adopts the going concern basis unless it is considered inappropriate;
- selects suitable accounting policies and then applies them consistently;
- makes judgements and estimates that are reasonable and prudent;
- accounts for income and charges relating to the accounting period on the accruals basis;
- values separately the components of asset and liability items; and
- reports comparative figures corresponding to those of the preceding accounting period.

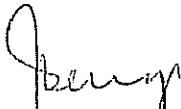


## Report of the auditors to the Committee

We have audited the financial statements on pages 3 to 11. These financial statements are the responsibility of the Management Committee. 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 plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Management Committee, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements give a true and fair view of the state of affairs of the Scheme as at 31 December 2005 of its surplus, changes in equity and cash flows for the year then ended in accordance with International Financial Reporting Standards and have been properly prepared in accordance with the Investor Compensation Scheme Regulations.



**Austin Demajo**  
f/Grant Thornton

Certified Public Accountants

Grant Thornton House  
Princess Elizabeth Street  
Ta' Xbiex MSD 11  
Malta

30 March 2006

## Income and expenditure account

	Note	2005 Lm	2004 Lm
<b>Income</b>	3	12,101	8,326
<b>Administrative expenses</b>		5,667	6,017
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<b>Surplus for the year</b>	4	6,434	2,309
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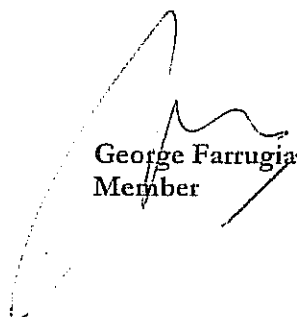
## Balance sheet at 31 December

	Note	2005 Lm	2004 Lm
<b>Non-current assets</b>			
Financial assets	6	234,185	190,987
<b>Current assets</b>			
Debtors	7	6,479	5,359
Cash at bank and in hand		12,869	1,653
<b>Creditors : amounts falling due within one year</b>	8	19,348 3,168	7,012 427
<b>Net current assets</b>		16,180	6,585
<b>Net assets</b>		250,365	197,572
<b>Capital and reserves</b>			
Contributions fund		164,746	108,881
Deferred contributions fund		73,860	83,860
Variable contributions		3,646	3,152
Income and expenditure account		8,113	1,679
		250,365	197,572

The financial statements on pages 3 to 11 were approved by the Management Committee on 30 March 2006 and were signed on their behalf by:



Dr. Anton Felice  
Chairman



George Farrugia  
Member

## Statement of changes in net assets/equity

	Contributions fund Lm	Variable contributions fund Lm	Deferred contributions fund Lm	Investment revaluation reserve Lm	Income and expenditure account Lm	Total Lm
At 31 December 2003	56,250	-	93,860	(7)	(630)	149,473
Contributions during the year	42,631	3,152	-	-	-	45,783
Transfer of deferred contributions to current year	10,000	-	(10,000)	-	-	-
Realised	-	-	-	7	-	7
Surplus for the year	-	-	-	-	2,309	2,309
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At 31 December 2004	108,881	3,152	83,860	-	1,679	197,572
Contributions during the year	45,865	494	-	-	-	46,359
Transfer of deferred contributions to current year	10,000	-	(10,000)	-	-	-
Surplus for the year	-	-	-	-	6,434	6,434
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At 31 December 2005	164,746	3,646	73,860	-	8,113	250,365

### Notes -

- a) The variable contributions fund represents variable contributions received from licence holders who have elected to follow the guidelines issued by MFSA in September 2004 and pay the variable contribution directly to the Scheme. In addition to these amounts received the Scheme holds pledges amounting to Lm 15,923 in terms of item 3, para (b)(ii) of the Second Schedule of the Regulations which may be called upon by the Management Committee in terms of Regulation 16.
- b) The deferred contributions fund represents the funds transferred from the Malta Stock Exchange Compensation Fund to the Scheme in terms of Regulation 36 of the Regulations. Whereas these funds have been absorbed as an integral part of the Scheme by virtue of the Third Schedule under Regulation 36, these funds shall be accounted for over the moratorium period which is established in paragraph 3 of the Third Schedule of the Regulations.

## Cash flow statement

	Note	2005 Lm	2004 Lm
<b>Operating activities</b>			
Cash generated from operations	10(a)	8,055	1,092
<b>Investing activities</b>			
Payments to acquire financial assets		(100,000)	(92,122)
Proceeds on maturity of financial assets		56,802	-
<b>Cash used in investing activities</b>			
		(43,198)	(92,122)
<b>Financing activities</b>			
Contributions received		46,359	45,783
<b>Increase/(decrease) in cash and cash equivalents</b>			
		11,216	(45,247)
Cash and cash equivalents at beginning of year	10(b)	1,653	46,900
Cash and cash equivalents at end of year	10(b)	12,869	1,653

## Notes to the financial statements

### **1 Presentation of financial statements**

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS).

These financial statements are presented in Maltese Liri (Lm).

### **2 Summary of significant accounting policies**

The financial statements have been prepared on the historical cost basis except for the revaluation of certain financial assets. The principal accounting policies are set out below.

#### **Income recognition**

The Scheme's income consists of earnings on investments. Income is recognised on the accruals basis.

#### **Impairment**

At each balance sheet date the Scheme reviews the carrying amounts of its assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any).

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Impairment losses are recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

#### **Financial instruments**

Financial assets and financial liabilities are recognised on the Scheme's balance sheet when the Scheme has become a party to the contractual provisions of the instruments.

## Notes to the financial statements (continued)

### 2 Summary of significant accounting policies (continued)

#### *Investments in securities*

Investments in securities are recognised on a settlement date basis and are initially measured at cost.

At subsequent reporting dates, loans and receivables and held-to-maturity investments are carried at amortised cost using the effective yield method, less any provision for impairment.

Investments in available-for-sale securities are measured at subsequent reporting dates at fair value. For available-for-sale securities, unrealised gains and losses are recognised directly in equity until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the net profit or loss for the period.

In respect of available-for-sale investments, any difference between the initial measurement amount and the maturity amount (premium or discount) arising on financial assets that have a fixed maturity is amortised to the profit and loss account using the effective interest rate method over the period to maturity in accordance with the requirements of IAS 39. Fair value changes on available-for-sale assets are calculated as the differences between fair value and amortised cost of such instruments.

#### *Debtors*

Debtors are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts.

#### *Creditors*

Creditors are stated at their nominal value.

### 3 Income

	2005 Lm	2004 Lm
Earnings on investments	11,911	6,976
Amortisation of discount	190	1,350
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	12,101	8,326
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## Notes to the financial statements (continued)

### 4 Surplus for the year

	2005	2004
	Lm	Lm
The surplus for the year is stated after charging:		
Committee Members' honoraria	5,490	5,580
Auditors' remuneration	177	177
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### 5 Taxation

The Investor Compensation Scheme is exempt from taxation under section 12(1)(c) of the Investment Services Act, Cap. 370.

### 6 Financial assets

	2005	2004
	Lm	Lm
7.25% Malta Government Stocks 2006	8,000	8,000
7.35% Malta Government Stocks 2007	10,300	10,300
7.2% Malta Government Stocks 2008	11,000	11,000
6.25% Malta Government Stocks 2011	11,800	11,800
6.35% Malta Government Stocks 2013	11,800	11,800
6.6% Malta Government Stocks 2014	13,300	13,300
6.6% Malta Government Stocks 2019	12,800	12,800
5.1% Malta Government Stocks 2022	32,700	32,700
3.8% EIB Bond 2009	18,500	18,500
5% Malta Government Stocks 2021	100,000	-
Treasury Bills	3,985	60,787
	<hr/>	<hr/>
	234,185	190,987
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Note -

The fair value of the above financial assets at 31 December 2005 amounted to Lm 255,060 (2004: Lm 200,795).

### 7 Debtors

	2005	2004
	Lm	Lm
Amounts falling due within one year:		
Unpaid contributions	1,250	2,885
Prepayments and accrued income	5,229	2,474
	<hr/>	<hr/>
	6,479	5,359
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## Notes to the financial statements (continued)

### 8 Creditors: amounts falling due within one year

	2005 Lm	2004 Lm
Accruals	3,168	427
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### 9 Financial instruments

Financial assets include securities, debtors and cash held at bank and in hand. Financial liabilities include creditors. At 31 December 2005 and 2004 the Scheme had no unrecognised financial instruments.

#### Risk management policies

- (a) Credit risk on amounts receivable is limited through the systematic monitoring of outstanding balances and the presentation of debtors net of allowances for doubtful debts, where applicable. Cash is placed with reputable banks.
- (b) Liquidity risk is limited as the Scheme has sufficient funding resources to meet its financial obligations as these arise.

#### Fair values

At 31 December 2005 and 2004 the fair values of financial assets, other than securities, and liabilities of the Scheme were not materially different from their carrying amounts except as disclosed in note 6.

### 10 Notes to the cash flow statement

#### (a) Cash generated from operations

	2005 Lm	2004 Lm
Surplus for the year	6,434	2,309
Adjustments for:		
Interest receivable	(5,229)	(2,474)
	<hr/>	<hr/>
Operating surplus/(deficit) before working capital changes	1,205	(165)
Decrease in debtors	4,109	1,570
Increase/(decrease) in creditors	2,741	(313)
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	8,055	1,092
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## Notes to the financial statements (continued)

### 10 Notes to the cash flow statement (continued)

#### (b) Cash and cash equivalents

Cash and cash equivalents consist of cash in hand and balances with banks. Cash and cash equivalents included in the cash flow statement comprise the following balance sheet amount:

	2005	2004
	Lm	Lm
Cash in hand and balances with banks	12,869	1,653
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## Income and expenditure account (detailed)

	2005 Lm	2004 Lm
<b>Income</b>		
Earnings on investments	11,911	6,976
Amortisation of discount	190	1,350
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	12,101	8,326
	<hr/>	<hr/>
<b>Administrative expenses</b>		
Committee Members' honoraria	5,240	5,562
Management fees	250	250
Sundry expenses	-	18
Auditors' remuneration	177	177
Postage	-	10
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	5,667	6,017
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<b>Surplus for the year</b>	6,434	2,309
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