

REPORT OF THE DEPOSITOR COMPENSATION SCHEME FOR 2006

INTRODUCTION

In terms of regulation 8 of LN 369 of 2003, as amended by LN 35 of 2006 (the Investor Compensation Scheme Regulations, 2003), the Compensation Schemes Management Committee of the Depositor Compensation Scheme (hereinafter referred to as “the Scheme”) is pleased to present its report on the discharge of its functions and its operations during 2006.

The Scheme’s audited financial statements for 2006 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 2006:

Chairman

Dr Anton Felice

Members

Prof Andrew Muscat

Mr Benny Borg Bonello

Mr George F Farrugia

Mr Kenneth Farrugia

Mr Rene Saliba

Dr Massimo Vella

Mr Geoffrey Bezzina has served as Secretary of the Committee.

The Management Committee held 5 meetings during 2006.

FINANCIAL STATEMENTS AS AT 31 DECEMBER 2006

The Scheme registered a surplus of Lm56,027 in 2006 compared to Lm31,469 in the previous year. Investment income amounted to Lm62,636, from which Lm6,609 have been spent in management and administration expenses. Accumulated capital and reserves amounted to Lm1,777,092.

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 depositors;
- (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 depositors;
- (d) To handle and pay claims for compensation by depositors;
- (e) To advise the Malta Financial Services Authority on matters relating to compensation of depositors.

AMENDED REGULATIONS COME INTO FORCE

During the first quarter of the year, the Prime Minister and Minister of Finance, acting on the advice of the MFSA, published and put into force L.N. 35 of 2006 — Depositor Compensation Scheme (Amendment) Regulations, 2006 — which as the title suggests, amends L.N. 369 of 2003 - the Depositor Compensation Scheme Regulations, 2003 (“principal regulations”).

Essentially, L.N. 35 of 2006 is intended to harmonise the primary regulations with Directive 94/19/EC on deposit guarantee schemes.

Towards this objective, there are a number of modifications which include the re-definition of “depositor” 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.

As a result of these amendments, the compensation limit in the proviso to regulation 17 has been deleted and the Scheme now protects all deposits in every currency of the European Union (regulation 18).

The extension of protection to deposits in every currency of the EEA and the re-definition of “depositors” will have these effects:

- (a) current participants will be required to contribute more to the Scheme as their deposit base will be greater; and
- (b) a number of other banks (which prior to the amendments were not members of the Scheme) have become participants and will be required to make similar annual contributions (based on their respective deposit base).

In addition there are a number of minor amendments that improve the legislation.

PARTICIPANTS OF THE SCHEME

By virtue of the amendments to the Regulations, the following is a list of participant banks in the Scheme:

<p><i>Akbank T.A.S.</i> <i>APS Bank Limited</i> <i>Bank of Valletta plc</i> <i>BAWAG Malta Bank Ltd</i> <i>CommBank Europe Limited</i> <i>Erste Bank (Malta) Limited</i> <i>FIMBank plc</i> <i>Finansbank (Malta) Limited</i> <i>Fortis Bank Malta Ltd</i></p>	<p><i>HSBC Bank Malta plc</i> <i>Investkredit International Bank plc</i> <i>Izola Bank Limited</i> <i>Lombard Bank Malta plc</i> <i>Mediterranean Bank plc</i> <i>Raiffeisen Malta Bank plc</i> <i>Sparkasse Bank Malta plc</i> <i>Turkiye Garanti Bankasi A S</i> <i>Volksbank Malta Limited</i></p>
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Exercise of the right of establishment

Credit Europe Bank N.V. Malta Branch

BUILDING THE FUND

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

The Regulations provide that a minimum amount of Lm1 million is to be contributed proportionately over a period not exceeding five years in accordance with each participants' share of the total eligible deposits.

As at 31 December 2006 all participating licence holders had duly fulfilled their obligation in respect of 2006 to transfer their supplementary contribution to the Fund which, as at 31 December 2006, stood at Lm1,678,924. Moreover there was no special commitment of the Scheme for which it was necessary to raise a Special Contribution.

The Committee, the Malta Bankers' Association (MBA), the Central Bank of Malta (CBM) and the MFSA have intensified discussions on a number of proposals for the restructuring of contributions from participants.

The Malta DGS is under-funded compared to other schemes across the EU. According to EU studies, Malta's coverage ratio of around 0.04% (the size of the fund as a proportion of total eligible deposits) was well below the EU average of 0.55%. In this respect, ways are being discussed with banks to increase the level of funding. Although the DGS Regulations are harmonised with the EU Directive 94/19/EC, the EU Directive does not at this stage impose any funding arrangements. This aspect is currently under thorough assessment by the Scheme's Committee to find a plausible solution which, in ensuring the appropriate funding of the scheme, would not have undue negative impact on the industry.

As at year end, the matter was still being considered by the parties concerned..

PROTECTION OF FUNDS

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

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 depositors.

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), from where users can obtain information about the scheme.

Regulation 11 and 34 require the Committee to consult the relevant compensation schemes in other countries for the purpose of facilitating the procedures by which depositors may claim against the respective Schemes. Claims against foreign schemes may follow defaults by branches of a credit institution, which are situated overseas. The EU Directive 94/19/EC sets out different procedures according to whether the defaulting institution is incorporated in a EU country or a third party state.

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

DEPOSITORS' CLAIMS

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

The Committee is pleased to report that during 2006 there have been no defaults of payments by participating credit institutions, which give rise to a claim against the Scheme.

BANK REPORTING SCHEDULES

The Scheme, in conjunction with the MFSA and the CBM, has drawn up a schedule which banks would be required to compile annually for the purposes of collecting data in respect of all eligible deposits, the number of deposit accounts and their aggregate liability to depositors who hold such deposits, whether held in Maltese Lira, Euro or other EEA currency.

All banks will be required to compile this schedule as from 2007.

EU DEVELOPMENTS

The European Commission has set out, in the form of a Communication¹ (COM (2006) 729), its approach to modernising current EU legislation on deposit guarantee schemes, which provide consumers with a safety net so that, if a bank fails, they will be able to recover at least €20,000 of their deposits. The Commission has concluded that while the current rules are sufficient for the time being, a number of self-regulatory steps could be taken to improve how schemes work cross-border within the EU. A more fundamental overhaul is considered premature at this stage, while any decision about further convergence of national rules and practices is tied to broader discussions on crisis management.

The Deposit Guarantee Schemes (DGS) Directive (94/19/EC) obliges all Member States to set up compensation schemes for depositors. However, some Member States have introduced guarantee thresholds higher than the minimum €20,000, and how the schemes function in practice is also not uniform across the EU. The Communication examines how this situation, combined with increased competition and integration in the EU banking market, affects the functioning of the current rules.

Based on the results of a consultation launched in 2005, the Communication proposes a number of improvements that the EU banking industry could introduce by 'self-regulatory' means, including:

- fine tuning "topping up" arrangements (where a bank branch in another Member State voluntarily joins the host country's deposit guarantee system);
- shortening the time it takes for schemes to pay out to depositors after a bank failure;

¹ http://ec.europa.eu/internal_market/bank/guarantee/index_en.htm

- improving exchange of information between schemes.

The Communication also concludes that there is currently no case for changing the current minimum guarantee level of €20,000. Research carried out by the Commission's Joint Research Centre (JRC) has provided evidence that the differences in deposit levels held by depositors across EU Member States remain too large, especially since the 2004 EU enlargement.

In addition, discussions are currently underway in a number of different forums about the efficiency of current supervisory arrangements. As DGS constitute an important component of the supervisory safety net intended to mitigate the effect of cross-border banking crises, further clarity is needed in particular on the question of the overall division of supervisory responsibilities and financial liabilities in crisis situations, before it can be decided whether more fundamental changes to the existing DGS arrangements might prove necessary.

EUROPEAN FORUM OF DEPOSIT INSURERS (EFDI)

The Scheme is a full member of the European Forum of Deposit Insurers. EFDI (www.efdi.net) was launched in Vienna in October 2002 and has over 40 members representing 32 European countries. It was established with the aim of contributing to the stability of financial systems by promoting European co-operation in the field of deposit insurance. In furtherance of this aim, EFDI members facilitate discussion and exchange of expertise and information on issues that are of mutual interest and concern (e.g. protection of cross-border services, financial customers' protection in the single market etc.).

During 2006, the Secretary attended an EFDI meeting in Palermo on behalf of the Management Committee.

During the year, EFDI published its first report on the main features of deposit guarantee schemes in the EU and non-EU countries, focusing on schemes that adhere to the forum and which participated in two broad surveys carried out in 2004 and 2005. The report is available online: <http://www.efdi.net/scarica.asp?id=102&Types=DOCUMENTS>.



Dr Anton Felice

Chairman – Depositor Compensation Scheme Management Committee

3 May 2007

Attachment: Audited Financial Statements of the Depositor Compensation Scheme for 2006