

REPORT OF THE DEPOSITOR COMPENSATION SCHEME FOR 2008

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 2008.

The Scheme's audited financial statements for 2008 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. By means of a publication in Government Gazette No.18,017 of 9 January 2007, the 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 2007, as follows:

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 six meetings during 2008.

FINANCIAL STATEMENTS AS AT 31 DECEMBER 2008

The Scheme registered a surplus of €287,343 in 2008 compared to €146,173 in the previous year. Net Finance Income amounted to €305,379 (2007: €163,997). An amount of €18,036 has been spent in management and administration expenses (2007: €17,824). Accumulated capital and reserves amounted to €8,213,137 (2007: €6,823,847).

PARTICIPANTS OF THE SCHEME

The following is a list of participant banks in the Scheme:

<i>Akbank T.A.S.</i>	<i>Izola Bank Limited</i>
<i>APS Bank Limited</i>	<i>Lombard Bank Malta plc</i>
<i>Banif Bank (Malta) plc</i>	<i>Mediterranean Bank plc</i>
<i>Bank of Valletta plc</i>	<i>Nemea Bank Limited</i>
<i>BAWAG Malta Bank Ltd</i>	<i>Raiffeisen Malta Bank plc</i>
<i>CommBank Europe Ltd</i>	<i>Saadgroup Bank Europe Ltd</i>
<i>Erste Bank (Malta) Limited</i>	<i>Sparkasse Bank Malta plc</i>
<i>FIMBank plc</i>	<i>The International Banking Corporation</i>
<i>Finansbank (Malta) Limited</i>	<i>(Malta) plc</i>
<i>Fortis Bank Malta Ltd</i>	<i>Turkiye Garanti Bankasi A S</i>
<i>HSBC Bank Malta plc</i>	<i>Volksbank Malta Limited</i>
<i>Investkredit International Bank plc</i>	

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.

BUILDING THE FUND

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

The Regulations provide that participants need to ensure that their aggregate proportional contributions to the Scheme amount to 0.1% of their respective eligible deposits as at the previous financial year end. Accordingly, a minimum amount of €2,329,373 is to be contributed by credit institutions by 2007. Such contributions have to be made by participants proportionately to their share of eligible deposits. Contributions received from participants between 2003 and 2007 amounted to €6,016,289.

Furthermore, the Regulations require participants to adjust (that is to top-up as appropriate) their contributions from 2008 onwards to ensure that their aggregate proportional contribution amounts to 0.1% of their respective eligible deposits as at the previous financial year end. Discussions on the restructuring of the funding of the Scheme were ongoing during 2008 and were not yet finalised). Accordingly, this 'top-up' mechanism was 'postponed' in 2008. A further adjustment exercise will be conducted during 2009 to bring this 'top-up' exercise fully compliant.

The Scheme has also actively examined and duly reported to the competent authorities on its financial sustainability in view of the widening in its scope of responsibility.

The Depositor Compensation Scheme Regulations, as amended in 2006, had extended considerably the scope of protection to depositors of insolvent credit institutions and removed the pro rata reduction in compensation whenever funds are insufficient to meet claims, in order to satisfy the Scheme's obligations under EU Directive 1994/19/EC. However, these regulations were not appropriately reviewed in order to broaden the financial resources of the Scheme to enable it to better fulfil these wider protection requirements.

The existing Regulations put a limit (i) to the amount of liquid cash at the disposal of the Scheme to 0.1% of eligible deposits, (ii) to the amount which may be further collected in the event of an insolvency to an additional 0.2% of eligible deposits, and (iii) to the amount which may be borrowed by the Scheme to 30% of its net asset value.

In 2007, the Scheme's Management Committee had recommended to MFSA that (a) the financial resources at the disposal of the Scheme should be increased over the medium term to the European average coverage ratio of 0.55% of eligible deposits prevailing in 2004, based on the data available at that stage and (b) other cappings to the amounts which may be further collected would be removed.

Initial consultations between the MFSA and Government showed that this objective could be implemented in a gradual fashion through increased ex post contributions.

However, the European Commission's response to the international financial crisis by emphasising a more robust depositor guarantee scheme regime, has highlighted further the importance of strengthening the Maltese coverage ratio.

Accordingly, the Management Committee recommended to MFSA that the financial resources at the disposal of the Scheme should be increased over the medium term to the European average coverage ratio of 0.77% of eligible deposits prevailing in 2007.

In making this recommendation, the Management Committee acknowledges the fact that Government would have to top-up these finances to the extent that the Scheme is unable to provide reimbursement to eligible depositors in the event of a defaulting credit institution¹.

According to this proposal, participants would be required to make ex-ante payments up to a limit of 0.45% of eligible deposits by 2012. Moreover, they would be required to retain a Reserve in security for ex-post payments up to 0.32% of eligible deposits by 2012. In this way the funding of the Scheme will reach a combined ex-ante and ex-post coverage ratio of 0.77% of eligible deposits by the said year.

The proposed funding requirements are also in line with the de Larosière report² and with the Basel Committee on Banking Supervision "Core Principles for Effective Deposit Insurance Systems"³, which both stressed the utmost importance that DCS should be appropriately funded, while underlining the merits of ex-ante funding arrangements.

¹ Pursuant to the agreement of the Ecofin Council meeting of 7 October 2008, the Government on 8 October 2008 announced that the level of depositor protection was increased from €20,000 to €100,000.

² The de Larosière Group. "The High-Level Group on Financial Supervision in the EU", 25 February 2009: Paragraph 134: *the Group is of the view that preference should be given to schemes which are pre-funded by the financial sector. Such schemes are better to foster confidence and help avoiding pro-cyclical effects resulting from banks having to pay into the schemes at a time where they are already in difficulty.*; (http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf)

³ Basel Committee on Banking Supervision & International Association of Deposit Insurers. Consultative Document on *Core Principles for Effective Deposit Insurance Systems* (Issued for comment by 15 May 2009): Principle 11 – Funding: "A deposit insurance system should have available all funding mechanisms necessary to ensure the prompt reimbursement of depositors' claims including a means of obtaining supplementary back-up funding for liquidity purposes when required. Primary responsibility for paying the cost of deposit insurance should be borne by banks since they and their clients directly benefit from having an effective deposit insurance system. Ex-ante funding can help lessen the reliance of the deposit insurance scheme on public funds during periods of financial stress and crisis". (<http://www.iadi.org/NewsRelease/JWGD1%20CBRG%20core%20principles%20BS0911%20final.pdf>)

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 (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 2008 there have been no defaults of payments by participating credit institutions, which give rise to a claim against the Scheme.

ADVISORY FUNCTION

The fifth function of the Scheme is to advise the MFSA on matters relating to compensation of depositors.

As already reported, the Management Committee has examined closely the financial sustainability of the Scheme in regard to which it has made detailed recommendations to the MFSA.

At the end of 2008, the Scheme was also requested to examine other matters relating to compensation of depositors. This followed (a) the Maltese Government's statement on 8 October 2008 to "raise the deposit protection scheme to EUR100,000" and (b) the European Commission's proposal to strengthen the deposit guarantee scheme framework in the light of the international financial turmoil. The consultations between the Authority and the Scheme on these new proposals commenced in November 2008 and progressed in 2009 with draft regulations that would:

1. increase depositor compensation under the Scheme from the current amount of €20,000 to €100,000;
2. remove co-insurance – depositors will no longer have to bear the initial (10%) part of their losses in the event of a default by a credit institution;
3. hasten the payout period from the current three months;
4. perform regular stress testing to ensure that the Scheme is effectively able to compensate depositors; and
5. require participants to be more transparent with regard to the information that they are obliged to provide to current or prospective depositors in connection with the Scheme.

These legislative proposals are intended to align the Scheme regulations to the EU Directive 2009/14/EC of 11 March 2009 which amended EU Directive 94/19/EC on deposit guarantee schemes.

BANK REPORTING OBLIGATIONS

On an annual basis, all participant banks are required to compile 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 Euro, Sterling or other EEA currency.

In view of the Government's announcement of 8 October 2008 to raise the level of coverage for the scheme, the DCS drew up an extended version of the schedule with a view to capturing a more complete picture of deposit holdings for the purposes of its requirements.

EUROPEAN FORUM OF DEPOSIT INSURERS (EFDI)

The EFDI is recognised by the European Commission as an important and representative point of reference to the development of deposit guarantee schemes in Europe.

The Maltese Scheme is a full member of EFDI which has over 40 members representing 32 European countries. It is 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.).

In 2008, the Scheme participated in an EFDI conference in Dublin on "Financial Integration and the Safety Net".

The conference examined the main results of four studies prepared by EFDI on (1) the scope of cover under national DGSs; (2) Information exchange; (3) Consumer Information; and (4) Payment Delays. The outcome of these studies was submitted to the European Commission and has been influential in the Commission's drawing up of recommendations for the strengthening of deposit guarantee schemes in Europe.



Dr Anton Felice

Chairman – Depositor Compensation Scheme Management Committee

26 June 2009

Attachment: Audited Financial Statements of the Depositor Compensation Scheme for 2008