

# REPORT OF THE DEPOSITOR COMPENSATION SCHEME FOR 2015

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## Introduction

In terms of regulation of 5 (9) LN 383 of 2015, 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 2015.

The Scheme’s audited financial statements as at 31<sup>st</sup> December 2015 are also attached.

## Management Committee

In accordance with regulation 5 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. The Management Committee, which was appointed on 1 January 2016 for a period of three years, is made up of:

### *Chairman*

Dr Anton Felice

### *Members*

Mr Benny Borg Bonello

Mr James Bonello

Mr Oliver Bonello

Mr George F Farrugia

Mr Kenneth Farrugia

Dr Massimo Vella

Mr Geoffrey Bezzina ended his term of office as Secretary of the Committee on 29 April 2016.

## Employees of the Scheme

In last quarter of 2015, the Scheme has employed a statistician and a legal officer on a full time basis to support its administrative needs.

## Meetings of the Committee

The Management Committee held 11 meetings during 2015.

## **Financial Statements as at 31 December 2015**

The Scheme registered a surplus of €1,001,378 in 2015 compared to €805,190 in the previous year. Net Finance Income amounted to €1,078,138 (2014: €870,269). An amount of €76,760 has been spent in management and administration expenses (2014: €65,079). Accumulated capital and reserves amounted to €35,819,392 (2014: €26,601,760).

## **Participants of the Scheme**

The following is a list of participant banks in the Scheme as at 31 December 2015:

*Agri Bank plc*  
*APS BANK LIMITED*  
*Banif Bank (Malta) plc*  
*Bank of Valletta plc*  
*Commbank Europe Limited*  
*Credorax Bank Limited*  
*Deutsche Bank (Malta) Limited*  
*ECCM Bank plc*  
*FCM Bank Limited*  
*FERRATUM Bank Limited*  
*FIMBank plc*  
*HSBC Bank Malta plc*  
*IIG Bank (Malta) Limited*  
*Izola Bank plc*  
*Lombard Bank Malta plc*  
*Mediterranean Bank plc*  
*Mediterranean Corporate Bank Limited*  
*MFC Merchant Bank plc*  
*NBG Bank Malta Limited*  
*Nemea Bank plc*  
*Novum Bank Limited*  
*Pilatus Bank Ltd*  
*Satabank plc*  
*Sparkasse Bank Malta plc*  
*Yapi Kredi Bank Malta Ltd*

Branches of banks whose Head Office is established outside the EU are no longer members of the DCS. Therefore as at 31 December 2015 two Turkish bank branches in Malta were no longer members of the Scheme:

*AKBANK T.A.S.*

*Turkiye Garanti Bankasi Anonim Sirketi*

*Branches outside Malta of a Bank licensed in Malta*

If a credit institution licensed in Malta opens a branch in another Member State, depositors of that branch are covered by the DCS in Malta.

## **Amendments to the Depositor Compensation Scheme Regulations**

In December 2015, Legal Notice 383 of 2015 - Depositor Compensation Scheme Regulations, was published in the Government Gazette of Malta No. 19.507 - 14.12.2015.

The new Regulations repealed the old Regulations on the Depositor Compensation Scheme entirely.

The Regulations will continue to cover deposits up to €100,000 and extended cover for deposits in all currencies. In addition, coverage is not only limited to individuals and small companies, but also extended to all non-financial corporates.

The Regulations also provide for additional compulsory protection above €100,000 for deposits resulting from private residential real estate transaction as well as deposits serving a social purpose or linked to private life events. These are known as Temporary High Balances.

Banks are now required to provide actual and intending depositors standardised information about the extent of cover and eligibility of the deposits. The Scheme will pay compensation to eligible depositors of a failed bank without the need for such depositors to submit an official claim.

### **Bank Reporting Obligations**

On an annual basis, all participant banks compile and report data in respect of all eligible deposits, the number of deposit accounts and their aggregate liability to depositors who hold such deposits, in all currencies.

### **Functions of the Scheme**

In terms of regulation 4 of the Depositor Compensation Scheme Regulations 2003 the functions of the Scheme were:

- (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; and
- (e) To advise the Malta Financial Services Authority on matters relating to compensation of depositors.

As previously stated the Depositor Compensation Scheme Regulations 2003 were replaced in 2015. Under the new Regulations three additional functions related to the recovery and resolution of credit institution were added namely:

- (f) To finance the resolution of credit institution pursuant to regulation 33 (2)
- (g) To use available financial means for alternative measures to prevent the failure of a member
- (h) To use available financial means for alternative measures to preserve access of depositors to covered deposits including transfer of assets and liabilities and deposit book transfer in the context of insolvency proceedings.

### **Recovery and Resolution Functions**

During 2015 the Scheme was not required to exercise any of its functions under recovery and resolution.

### **Building the Fund**

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

#### *Contributions to the Scheme*

#### *Initial and Supplementary Contributions*

Under the Depositor Compensation Scheme Regulations 2003, banks joining the Scheme were required to pay an Initial Contribution. Banks were also required to pay a Supplementary Contribution. Following the publication of LN 340 of 2012, banks were required to maintain with the Scheme, as at 31 December 2015, a level of 0.2% of eligible deposits outstanding at the end of 2014.

As at the end of the reporting year of the Scheme, the aggregate amount of initial and supplementary contributions which

have been paid to the Scheme amounted to €17,892,825 (2014: €13,343,725).

Special Contribution

In terms of paragraph 5(a) of the Second Schedule of the Depositor Compensation Scheme Regulations 2003, Banks were required to establish a Depositor Compensation Scheme Reserve for the payment of their Special Contribution in accordance with regulation 16 of the above mentioned Regulations. The Reserve, which banks were required to maintain with the Scheme as at 31 December 2015, amounted to 0.8% of each Bank's respective eligible deposits outstanding at the end of 2014.

Pursuant to paragraph 5 (c) of the same Schedule, funds in the Reserve were required to be held in admissible assets pledged in favour of the Scheme in guarantee of the participant's liabilities under regulation 16 at no cost to, and to the full satisfaction of the Scheme.

The Special Contribution was subject to the following requirements:

- (a) Investment or placement requirements;
- (b) Pledge requirements; and
- (c) Valuation requirements.

*(a) Investment or placement of the Special Contribution*

The amount of the Special Contribution was required to be held in a "Depositor Compensation Scheme Reserve". Funds making up this reserve were to be invested/deposited in accordance with the Second Schedule of the Regulations and "Additional conditions for the admissibility of assets" issued in terms of subparagraph (e) (iii) of paragraph 5 of the same Schedule.

As at 31<sup>st</sup> December 2015, the Banks' obligations in terms of paragraph 5 of the said Second Schedule amounted to €91,430,846 (2014: €82,559,051).

Depending on the respective amount of the Special Contribution, a bank could:

- i. deposit the entire amount of the "Depositor Compensation Scheme Reserve" with the Scheme (in which case no interest was payable by the Scheme to the licence holder for such funds). As at the end of the reporting year of the Scheme, an amount of €1,114,960 had been deposited by participant banks directly with the Scheme;
- ii. pledge a deposit which it holds with another bank established in the EEA as security in favour of the Scheme. Such a deposit was only eligible for this purpose if the bank with whom it was placed had a long term credit rating of not less than A;
- iii. pledge securities listed on the Malta Stock Exchange or any foreign recognised investment exchange with a minimum rating of A as security in favour of the Scheme. As at the end of the reporting year of the Scheme, Malta Government Stocks amounting to a market value of €77,195,101 were pledged in favour of the Scheme to secure banks' obligations of €73,876,323 ; and/or
- iv. deposit part or all of its admissible assets with the Central Bank of Malta. The eligibility of deposits held with the Central Bank of Malta has been determined by the

Malta Financial Services Authority in terms of paragraph 5(d)(v)(I)(c) and paragraph 5(d)(v)(II)(d) of the Second Schedule of the Regulations. As at the end of the reporting year of the Scheme, €15,430,846 were deposited with the Central Bank of Malta and pledged in favour of the Scheme.

*(b) Pledge requirements*

If the participant had not placed the entire amount of the “Depositor Compensation Scheme Reserve” with the Scheme, the investment making up the Special Contribution was required to be pledged in favour of the Scheme.

As at reporting year end, all banks were in compliance with the requirements of the Second Schedule regarding pledging of admissible assets. A number of banks placed deposits directly with the Scheme or opened an account with the Central Bank of Malta and pledged the entire amount in favour of the Scheme. A few banks pledged Malta Government Stock in favour of the Scheme, in addition to deposit accounts with the Central Bank of Malta (held directly in the name or pledged in favour of the Scheme).

The Malta Financial Services Authority has required a number of local banks to provide an additional contingency contribution by means of a pledge in favour the DCS. The funds making up the Contingency Contribution Reserve – which can be invested in prime securities and deposits – can only be used by the DCS for the payment of claims of depositors in the event of the pledgor bank’s default.

The Scheme in consultation with the Malta Stock Exchange (MSE) and the

Malta Bankers Association has developed arrangements to allow banks to offer foreign securities as collateral to the DCS.

These arrangements are now overshadowed by new guidelines developed by the European Banking Authority in 2015 under the Recast DGS Directive, that specify the type of and exposures to securities that DCSs may accept by way of “irrevocable payment commitments”.

*(c) Valuation requirements*

Under the Regulations of 2003, the value of assets in the Reserve were required to be the market value of such assets less “Valuation Haircuts” determined by the Malta Financial Services Authority, in consultation with the Scheme.

The valuation haircuts are aimed to protect against the risk of financial loss if assets pledged in favour of the Scheme had to be realised owing to circumstances mentioned in regulation 16 of the principal regulations.

Annually, a Bank is required to provide a detailed statement regarding its contributions and Reserve and certified by its appointed auditors. In respect of the Reserve, the statement includes the nominal and market value of the Reserve assets, their composition, as well as a maturity and liquidity date schedule according to the type of each asset.

**Contributions to the Scheme under the 2015 Regulations**

The Depositor Compensation Scheme Regulations 2015 requires that the Scheme has available the necessary financial means to meet its potential liabilities. The Regulations require that

these available financial means should be proportionate to its liabilities.

Regulation 23 requires that the available financial means amounts to 1.3% of the covered deposits of its members, or such higher percentage as may be established by banking rules.

Where the financing capacity falls short of such target level, the payment of contributions shall resume at least until the target level is reached again.

In the case where the available financial means have been reduced to less than two-thirds of such target level, the regular contribution shall be set at a level allowing such target level to be reached within six years.

In terms of regulation 23 (3) of the 2015 Regulations, part of the compensation contribution may be provided to the Scheme by means of a payment commitment, which is to be supported by a pledge on admissible assets.

The Regulations provide that the total share of payment commitments shall not exceed 30% of the Scheme's available financial means by 3 July 2024. According to the new Regulations the amount of contribution payable by each bank will be proportionate to the amount of covered deposits and the risk weight of each particular bank.

The Rules governing the contributions to the Scheme under the 2015 Regulations will be implemented by the Scheme from 2016 onwards.

Meanwhile the Scheme is consulting with the MFSA for the purpose of devising new banking rules for the implementation of the new contribution regime, which will establish:

- (a) A risk based method determining the degree of risk incurred by members;
- (b) A compensation contribution method for determining the amount of Compensation Contribution due by each member in each financial year

These banking rules will adhere to the guidelines issued by the European Banking Authority.

### **Protection of Funds**

Under both the old and the new Regulations, the Committee is required to deposit or invest the contributions that are made to the Scheme, until such time as they are required for the payment of claims for compensation by depositors.

In the performance of this task, the Committee appointed the Central Bank of Malta to provide investment management services including financial, accounting and other related support services. The agreement with the Central Bank, in force since 2003 and revised in 2011, includes parameters for the investment of funds by the Central Bank of Malta on behalf 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 to depositors.

#### *Information to depositors*

Under the new Regulations, all banks are obliged to make available to actual and intending depositors the information

necessary for the identification of the Scheme or other deposit guarantee schemes of which the institution and its branches are members within the European Union. Members shall inform actual and intending depositors of the applicable exclusions from protection under these regulations or the Directive.

Before entering into a contract on deposit-taking, members shall provide depositors with the information referred to above. The depositors shall acknowledge the receipt of that information. The template set out in the Schedule shall be used for that purpose.

Confirmation that the deposits are eligible deposits shall be provided by members to depositors on their statement of account. Such statements of account shall include a reference to the information sheet set out in the Schedule. The website of the Scheme shall be indicated on the information sheet. The information sheet set out in the Schedule shall be provided to the depositor at least once annually.

The information shall be made available in the manner prescribed by the new Regulations in the language that was agreed by the depositor and the member when the account was opened or in an official language of Malta.

Members shall limit the use of advertising of the information referred above to a factual reference to the DGS guaranteeing the product to which the advertisement refers and to any additional information required at law. Such information may extend to the factual description of the functioning of the DGS but shall not contain a reference to unlimited coverage of deposits.

In the case of a merger, conversion of subsidiaries into branches or similar operations, the members undergoing such operation shall inform its depositors of such operation shall inform its depositors of such operation at least one month before the operation takes legal effect unless the competent authority allows a shorter deadline on the grounds of commercial secrecy or financial stability.

If the members withdraws or is excluded from the DGS of which it is a member, the members in terms of this regulation may be communicated by electronic means. Where the depositor so requests, it shall be also communicated on-paper.

#### *Modalities of pay-out*

The Department of Contracts on behalf of the Scheme published a tender offer 2 February 2016 CT2191/2015 – Provision of a Fully Integrated Data Exchange and Payment Solution for the Depositor Compensation Scheme (MFSA).

The objective of a Data Exchange Solution is to enable the DCS to receive, load and verify the SCV data file the DEF data file and associated metadata files for the purpose of implementing the Proposed DCS Regulations. Both types of files should be received directly from the banks either electronically via a secure transmission solution or via physical media within allowed time scales. As a result, the data import functionality within the system must be able to handle both options.

An SCV data file is a single, consistent view of depositors' aggregate deposits with each bank that is eligible for compensation under the terms of the Proposed DCS Regulations but excludes

from view those deposits included in the DEF data file.

A DEF data file is a single, consistent view of a depositor's aggregate deposits with each bank that is eligible for compensation under the terms of the Proposed DCS Regulations limited to accounts which:

- I. hold funds to which the depositor is not absolutely entitled; or
- II. are not active;

The metadata files will consist of additional information relating to the submitted SCV data file and DEF data file. Typical information could include but is not limited to the total number of accounts, the total number of depositors, the total number of eligible depositors, the number of eligible depositors included in the SCV data file and the number of depositors included in the DEF data file, a description of how the SCV requirements have been implemented, and any other information deemed necessary for the whole process.

The Solution should be able to process multiple SCV data files, DEF data files and associated metadata information within the minimal of timescales.

The Solution should allow for flexible configuration of the fields pertaining to the SCV data files and DEF data files, permitting the DEPS System Administrator to quickly add, configure or change fields with minimal intervention.

On an on-going basis, banks will be required to submit SCV data files and DEF data files to the DCS on both a regular and an ad-hoc basis. Based on a set of verification criteria the Data Exchange

Solution will need to verify and confirm both the validity of the file formats being transmitted from the banks as well as the correctness of the data contained within those files. The verification process should include amongst others:

File Verification – this will verify that a correct and complete file has been received from the bank. Verifications would include that file naming conventions are correct, the file structure is as expected, no issues with transfer process encountered, and that the full SCV data files and DEF data files have been produced within a predetermined time period.

Load Verification – this will verify correct data load to the database from the file; record counts against the associated information, all mandatory fields are present, all fields have been loaded correctly, no erroneous characters, no empty fields and the ratio of depositors to accounts, from the associated Report, is the same as that in the SCV data files and DEF data files.

Data verification – this will verify correct data values and relationships within established tolerance levels, as established by the DEPS System Administrator in the DEPS Administration Area.

After the verification phase of SCV data files and DEF data files, the Data Exchange Solution should generate assessment reports per bank detailing the outputs of that verification process in relation to their specific data. These assessment reports will detail those areas where the data files have failed to adhere to the data requirements and will raise issues and queries that resulted from data quality checking.

In the event of a simulated or a real compensation event, the Data Exchange Solution should have a facility, requiring minimal intervention, to integrate and / or export data into the Payment Solution.

The tender submission deadline was 3 May 2016.

All members have been required to develop or modify their respective internal electronic systems to be able to generate the SCV data files as and when required. In order to facilitate the automation of the SCV system, members will be responsible to provide their electronic files in a standard format according to pre-defined rules and codes contained in data templates provided by the Scheme. Specific account codes have to be applied to indicate whether an account is fit for straight-through pay-out (whereby payment will be made within the statutory payment period of 20 days) or requires more processing before the relevant compensation is paid (in regard to accounts held under nominee, for example). In addition, the SCV system will have automated verification processes to ensure that the SCV data is reliable enough to enable the correct processing of compensation payments.

According to the Recast DGS Directive, members will be obliged to participate in periodic testing of the system to verify their ability to comply on an on-going basis with the SCV information requirements. Rigorous testing of the SCV platform is also planned to ensure that the system is resilient and can manage the maximum volume of data required. Moreover, the SCV system has allowed modifications in accordance with the changing environment.

## **Depositors' Claims**

The fourth function of the Scheme is to handle and pay compensation to depositors in case of a bank's failure.

The Committee is pleased to report that during 2015 there have been no defaults of payments by members, which give rise to a claim against the Scheme.

The Scheme is monitoring measures being taken by the Malta Financial Services Authority in respect of members for which a public notice has been given in 2016.

## **Advisory Function**

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

During 2015 the Scheme assisted the Malta Financial Services Authority in the transposition of the recast directive, into Maltese Legislation. As previously stated the new Depositor Compensation Scheme Regulations were published in December 2015.

In addition the Scheme is consulting with the Malta Financial Services Authority for the purpose of establishing:

1. The Management Expenses Banking Rule;
2. The Payment Commitment Banking Rule and;
3. The Risked Based Method Banking Rule.

## EU Developments

In the Five Presidents' Report<sup>1</sup>, one of the key deliverables under the first stage of the Completion of EMU is to move towards a European Deposit Insurance Scheme (EDIS) as a further step to a fully-fledged Banking Union. EDIS would mark an important step towards reinforcing financial stability by further weakening the link between banks and their national sovereigns and by delivering even greater trust in the safety of retail bank deposits, regardless of a bank's location in the Union.

The Commission's legislative proposal on 24 November 2015 introducing EDIS will strengthen the protection of banks depositors across the Banking Union. EDIS would develop over time and in three stages: first a re-insurance stage, then a co-insurance stage and, finally, a full European system of deposit guarantees, which is envisaged for 2024. The Commission's proposal is accompanied by a Communication which sets out other concrete measure to further reduce remaining financial stability risks in the Banking Union.

In 2012, the European Council agreed on completing EMU, based on deeper integration and mutual support. Completing the Banking Union is an indispensable step to a full and deep EMU. The first pillar of the Banking Union consists of a common framework for bank supervision to be implemented by the Single Supervisory Mechanism (SSM); the second pillar consists of a common framework for bank resolution to be implemented by the Single Resolution Mechanism (SRM). Those two pillars have

been put in place. The third pillar, a deposit insurance scheme, still needs to be put forward now. In contrast to the situation in 2012, the European banking sector is on a much more solid footing, following the introduction of more stringent capital and liquidity rules and centralised supervision and resolution.

EU legislation already ensures that all deposits up to €100 000 are protected, through their national deposit guarantee scheme (DGS). EDIS provides a stronger and more uniform degree of insurance cover for all retail depositors in the Banking Union, ensuring that the level of depositor confidence in a bank would not depend on the bank's location.

The Commission's proposal for EDIS seeks to deepen EMU and to weaken the link between banks and their national sovereigns by means of risk-sharing among all the Member States in the Banking Union. However, this risk-sharing must be accompanied by risk-reducing measures that are also designed to break sovereign link.

EDIS would intervene in two scenarios (along with the national DGS in the first two stages of EDIS):

- A. When a failing bank is liquidated and deposits need to be paid out and;
- B. When a failing bank is resolved and the transfer of the deposits to another institution needs to be financed so that deposit access is not disrupted.

The Malta Depositor Compensation Scheme is having discussions with the Ministry for Finance and its providing its feedback on the scope of EDIS.

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<sup>1</sup> The five presidents' report sets out plan for strengthening Europe's Economic and Monetary Union (EMU) as of 1 July 2015

The Malta DCS has also been requested to participate in surveys regarding the introduction of EDIS in the Maltese system along with the

Depositor Compensation Scheme Regulations published in December 2015.

**Anton Felice**

**Chairman – Compensation Schemes Management Committee**

25 May 2016

*Attachment: Audited Financial Statements of the Depositor Compensation Scheme for 2015*