

REPORT OF THE INVESTOR COMPENSATION SCHEME FOR 2004

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 2004.

The Scheme’s audited financial statements for 2004 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 2004:

Chairman

Dr Anton Felice

Members

Mr Charles Borg

Prof Andrew Muscat

Mr Benny Borg Bonello

Mr George F Farrugia

Mr Rene Saliba

Dr Massimo Vella [appointed on 5 April 2004)

Mr Geoffrey Bezzina has served as Secretary of the Committee.

The Management Committee held 6 meetings during 2004.

Financial Statements as at 31 December 2004

The Scheme registered a surplus of Lm2,309 in 2004 compared to a deficit in 2003 of Lm630. Investment income amounted to Lm8,326, from which Lm6,017 have been spent in management and administration expenses.

Accumulated capital and reserves amounted to Lm197,572. Of the capital and reserves the sum of Lm3152 is held on deposit as part of the variable contribution of licence holders. A further Lm12,634 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 2003 amounted to Lm42,631.

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 2004 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.

During the year, the Management Committee has consulted closely with the MFSA and licence holders over revised guidelines that determine the classes of approved investments. The Authority issued these Guidelines in September 2004 pursuant to Article 3, para (b)(ii) of the Second Schedule to the Regulations. The Management Committee also issued specimen Pledge Agreement forms to facilitate the pledging of these investments to the Scheme.

In terms of the revised guidelines, participants were also given the opportunity to pay the amount of the Variable Contribution directly to the Scheme. A number of licence holders have elected to pursue this option and have paid their Variable Contribution to 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 Lm12,634. 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 Lm3,152.

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), 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. The EU Directive 97. 9/EC sets out different procedures according to whether the investment services provider is incorporated in a EU country or a third party state. The Committee has considered the procedures which will have to be put in place, and has proposed to MFSA appropriate amendments to the Regulations.

Investors' Claims

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

The Committee is pleased to report that during 2004 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

Following Malta's membership in the EU, it was considered necessary to amend the Regulations setting up the Scheme to ensure that they were fully in line with the

principles of the EU Directive 97/9/EC on investor compensation schemes. The Committee has submitted its proposals for the draft amendment of Legal Notice 368 of 2003 to MFSA for consideration.

Towards this goal, the Management Committee has recommended a number of changes to the Regulations. These include (i) a re-definition of “investor” to include both individuals and legal persons, (ii) a redefinition of the entities which may be excluded from the scope of protection that is in conformity with the requirements of the EU Directive, and a deletion of the pro rata reduction in compensation whenever funds are insufficient to meet claims.

List of Participants

APS Bank Ltd.
Atlas Investment Services Ltd.
Azzopardi Investment Management Ltd.
Bank of Valletta plc
BOV Stockbrokers Ltd.
Barclays International Investments (Malta) Ltd.
Calamatta Cuschieri & Co. Ltd.
Charts Investment Management Services Ltd.
Crystal Finance Investments Ltd.
Curmi & Partners Ltd.
D.B.R. Investments Ltd.
Elmo Investments Ltd.
Epic Investment Services Ltd
Fexco Investment Services (Malta) Ltd.
First International Merchant Bank plc
Financial + Investment Services Ltd.
Financial Planning Services Ltd.

Finco Treasury Management Ltd.
Globe Financial Management plc
Growth Investments Ltd.
Hogg Capital Investments Ltd.
HSBC Bank (Malta) plc
HSBC Investment Services (Malta) Ltd.
HSBC Stockbrokers (Malta) Ltd.
Jesmond Mizzi Financial Services Ltd.
Lombard Bank Malta plc
Michael Grech Financial Investment Services Ltd.
MZ Investments Ltd.
Rizzo, Farrugia & Co. (Stockbrokers) Ltd.
Sparkasse Bank Malta PLC
Valletta Fund Management Ltd.
Volksbank Malta Ltd.
W & J Coppini Investment Services Ltd.

During the year, two entities — Ivan Burridge Stockbroking Limited and Safin & Co. Ltd — surrendered their investment services licence and ceased being participants in the Scheme.



Dr Anton Felice
Chairman – Compensation Schemes Management Committee

31 May 2005

Attachment: Audited Financial Statements of the Depositor Compensation Scheme for 2004

Investor Compensation Scheme
Report and financial statements
For the year ended 31 December 2004

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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, LN368 of 2003 requires 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:

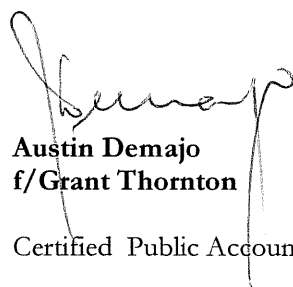
- adopts the going concern basis unless it is considered inappropriate;
- selects suitable accounting policies and then applies them consistently;
- makes judgements and estimates that are reasonable and prudent;
- accounts for income and charges relating to the accounting period on the accruals basis;
- 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 2004 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, LN368 of 2003.



Austin Demajo
f/Grant Thornton

Certified Public Accountants

Grant Thornton House
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Ta' Xbiex MSD 11
Malta

24 March 2005

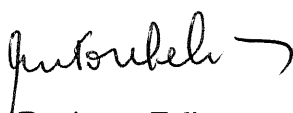
Income and expenditure account

	Note	2004 Lm	2003 Lm
Income	4	8,326	1,635
Administrative expenses		6,017	2,265
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Surplus/(deficit) for the year/period	5	2,309	(630)
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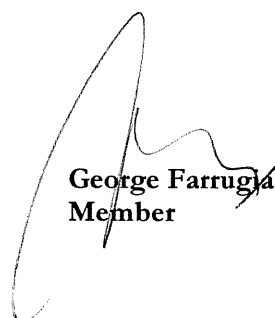
Balance sheet at 31 December

	Note	2004 Lm	2003 Lm
Non-current assets			
Financial assets	7	190,987	98,858
Current assets			
Debtors	8	5,359	4,455
Cash at bank and in hand		1,653	46,900
Creditors : amounts falling due within one year			
	9	7,012	51,355
		427	740
Net current assets			
		6,585	50,615
Net assets			
		197,572	149,473
Capital and reserves			
Contributions fund		108,881	56,250
Deferred contributions fund		83,860	93,860
Investment revaluation reserve		-	(7)
Variable contributions		3,152	-
Income and expenditure account		1,679	(630)
		197,572	149,473

The financial statements on pages 3 to 11 were approved by the Management Committee on 24 March 2005 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
Contributions during the period	150,110	-	-	-	-	150,110
Deferred contributions	(93,860)	-	93,860	-	-	-
Fair value adjustment	-	-	-	(7)	-	(7)
Deficit for the period	-	-	-	-	(630)	(630)
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 period	-	-	-	-	2,309	2,309
At 31 December 2004	108,881	3,152	83,860	-	1,679	197,572

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 12,634 in terms of Article 3, para (b)(ii) 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 Legal Notice. 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	2004 Lm	2003 Lm
Operating activities			
Cash generated from/(used in) operations	11(a)	<u>1,092</u>	<u>(1,491)</u>
Investing activities			
Payments to acquire financial assets		<u>(92,122)</u>	<u>(98,834)</u>
Financing activities			
Contributions received		<u>45,783</u>	<u>147,225</u>
(Decrease)/increase in cash and cash equivalents			
Cash and cash equivalents at beginning of year	11(b)	<u>46,900</u>	<u>-</u>
Cash and cash equivalents at end of year/period	11(b)	<u>1,653</u>	<u>46,900</u>

Notes to the financial statements

1 General

The Scheme was established by LN6 of 2003 as superseded by LN368 of the same year.

2 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).

3 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)

3 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, originated 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.

4 Income

	2004	2003
	Lm	Lm
Earnings on investments	6,976	1,604
Amortisation of discount	1,350	31
	<hr/>	<hr/>
	8,326	1,635
	<hr/>	<hr/>

Notes to the financial statements (continued)

5 Surplus/(deficit) for the year/period

	2004 Lm	2003 Lm
The surplus/(deficit) for the year/period is stated after charging:		
Committee Members' honoraria	5,580	1,833
Auditors' remuneration	177	177
	<hr/>	<hr/>

6 Taxation

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

7 Financial assets

	2004 Lm	2003 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	-
3.8% EIB Bond 2009	18,500	-
Treasury Bills	60,787	19,858
	<hr/>	<hr/>
	190,987	98,858
	<hr/>	<hr/>

Note -

The fair value of the above financial assets at 31 December 2004 amounted to Lm 200,795.

8 Debtors

	2004 Lm	2003 Lm
Amounts falling due within one year:		
Unpaid contributions	2,885	2,885
Prepayments and accrued income	2,474	1,570
	<hr/>	<hr/>
	5,359	4,455
	<hr/>	<hr/>

Notes to the financial statements (continued)

9 Creditors: amounts falling due within one year

	2004 Lm	2003 Lm
Accruals	427	740
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10 Financial instruments

Financial assets include securities, debtors and cash held at bank and in hand. Financial liabilities include creditors. At 31 December 2004 and 2003 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 and the ability to raise finance to meet its financial obligations as these arise.

Fair values

At 31 December 2004 and 2003 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 7.

11 Notes to the cash flow statement

(a) Cash used in operations

	2004 Lm	2003 Lm
Surplus/(deficit) for the year/period	2,309	(630)
Adjustments for:		
Interest receivable	(2,474)	(1,570)
Amortisation of discount on Treasury Bills	-	(31)
	<hr/>	<hr/>
Operating deficit before working capital changes	(165)	(2,231)
Decrease in debtors	1,570	-
(Decrease)/increase in creditors	(313)	740
	<hr/>	<hr/>
	1,092	(1,491)
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Notes to the financial statements (continued)

11 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:

	2004	2003
	Lm	Lm
Cash in hand and balances with banks	1,653	46,900

Income and expenditure account (detailed)

	2004 Lm	2003 Lm
Income		
Earnings on investments	6,976	1,604
Amortisation of discount	1,350	31
	<hr/>	<hr/>
	8,326	1,635
	<hr/>	<hr/>
Administrative expenses		
Committee Members' honoraria	5,562	1,833
Management fees	250	250
Sundry expenses	18	-
Auditors' remuneration	177	177
Postage	10	5
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	6,017	2,265
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Surplus/(deficit) for the year/period	2,309	(630)
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