

# Depositor Compensation Scheme

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*Issued by the Depositor Compensation Scheme on 21 November 2016*

## Valuation Haircuts

### 1 General Principle

- 1.1 Banking Rule 19/2016 on 'Payment Commitments' under the Depositor Compensation Scheme Regulations, 2015 (hereinafter referred to as the Regulations) applies valuation haircuts to the valuation of assets, provided as collateral for payment commitments, in order to protect against the risk of financial loss if the said assets have to be realised owing to a determination or ruling that deposits are unavailable as described in regulation 2 of the Regulations.
- 1.2 This implies that the value of the underlying asset is calculated as the market value of the asset less a certain percentage (haircut).

### 2 Application of ECB Valuation Haircuts

- 2.1 The Valuation Haircuts established by the European Central Bank for the implementation of monetary policy in the Euro Area and in particular those established in Chapter 6.4.2 of the General Documentation on Euro system Monetary Policy Instruments and Procedures as may be amended from time to time (hereinafter referred to as the General Documentation) shall apply *mutatis mutandi* to the valuation of assets provided as collateral for payment commitments (hereinafter referred to as 'eligible assets') to the extent that is compatible with the Regulations and Banking Rule 19/2016. On 18 November 2015, the ECB issued Guideline (EU)2015/35 regarding further reviews of its risk control framework including updating of haircuts for marketable and non-marketable assets with effect from 25 January 2015 (refer to the link below).  
[https://www.ecb.europa.eu/ecb/legal/pdf/en\\_dec\\_2015\\_35f.pdf](https://www.ecb.europa.eu/ecb/legal/pdf/en_dec_2015_35f.pdf)
- 2.2 In the interpretation of these valuation haircuts and to the extent that is compatible with the Regulations and Banking Rule 19/2016, account shall be had of all relevant decisions and statements of the European Central Bank or the Central Bank of Malta including any other relevant provisions of the General Documentation.
- 2.3 The link to the current General Documentation is:  
<http://www.ecb.europa.eu/pub/pdf/other/gendoc201109en.pdf>

### 3 Main elements of Valuation Haircuts

- 3 The Valuation Haircut framework for eligible assets includes the following main elements:
  - 3.1 Eligible assets are allocated to one of four valuation haircut categories, based on issuer classification and asset type. The allocation is described in Table 1.

**Table 1****Haircut categories for eligible assets**

<i>Category I</i>	<i>Category II</i>	<i>Category III</i>	<i>Category IV</i>
Central government debt instruments	Local and regional government debt instruments	Traditional covered bank bonds	Credit institution debt instruments (senior unsecured)
Debt instruments issued by central banks prior to the date of adoption of the euro in their respective Member State	Debt instruments issued by multilateral development banks and international organisations	Debt instruments issued by non-financial corporations	Debt instruments issued by financial corporations other than credit institutions (senior unsecured)
	Debt instruments issued by entities classified as agencies		
	Jumbo covered bonds		

3.2 Individual debt instruments are subject to specific valuation haircuts. The haircuts are applied by deducting a certain percentage from the market value of the underlying asset. The haircuts applied to debt instruments included in categories I to IV differ according to the residual maturity and coupon structure of the debt instruments as described in Table 2.

**Table 2: Valuation haircut levels applied to eligible marketable assets**

		Haircut categories							
Credit quality	Residual maturity (years)*	Category I		Category II		Category III		Category IV	
		fixed coupon	zero coupon	fixed coupon	zero coupon	fixed coupon	zero coupon	fixed coupon	zero coupon
Steps 1 and 2	[0-1)	0.5	0.5	1.0	1.0	1.0	1.0	6.5	6.5
	[1-3)	1.0	2.0	1.5	2.5	2.0	3.0	8.5	9.0
	[3-5)	1.5	2.5	2.5	3.5	3.0	4.5	11.0	11.5
	[5-7)	2.0	3.0	3.5	4.5	4.5	6.0	12.5	13.5
	[7-10)	3.0	4.0	4.5	6.5	6.0	8.0	14.0	15.5
	[10, ∞)	5.0	7.0	8.0	10.5	9.0	13.0	17.0	22.5
Credit quality	Residual maturity (years)*	Category I		Category II		Category III		Category IV	
		fixed coupon	zero coupon	fixed coupon	zero coupon	fixed coupon	zero coupon	fixed coupon	zero coupon
Step 3	[0-1)	6.0	6.0	7.0	7.0	8.0	8.0	13.0	13.0
	[1-3)	7.0	8.0	10.0	14.5	15.0	16.5	24.5	26.5
	[3-5)	9.0	10.0	15.5	20.5	22.5	25.0	32.5	36.5
	[5-7)	10.0	11.5	16.0	22.0	26.0	30.0	36.0	40.0
	[7-10)	11.5	13.0	18.5	27.5	27.0	32.5	37.0	42.5
	[10, ∞)	13.0	16.0	22.5	33.0	27.5	35.0	37.5	44.0

\* i.e. [0-1) residual maturity less than one year, [1-3) residual maturity equal to or greater than one year and less than three years, etc.

- 3.3 Assets allocated to credit quality steps 1 and 2 must have a credit rating ranging between AAA and A-, whereas assets allocated to credit quality step 3 must have a credit rating ranging between BBB+ and BBB-.
- 3.4 For assets with zero or fixed coupons, the relevant maturity for the valuation haircut to be applied shall be the residual maturity of the asset.
- 3.5 For assets with floating coupons, the valuation haircut shall equal the valuation haircut applied to fixed coupon marketable assets with zero-to-one-year residual maturity, except in the following cases and without prejudice to paragraph 2.
- (a) Floating coupons with a resetting period of longer than one year shall be treated as fixed rate coupons and the relevant maturity for the valuation haircut to be applied shall be the residual maturity of the asset.
  - (b) The relevant maturity for the valuation haircut to be applied to floating coupons that have a euro area inflation index as a reference rate shall be the residual maturity of the asset.
  - (c) The valuation haircut applied to assets that have more than one type of coupon structure shall solely depend on the coupon structure in place during the remaining life of the asset and shall equal the highest haircut applicable to a marketable asset with the same residual maturity and credit quality step. Any type of coupon structure in place during the remaining life of the asset may be considered for this purpose.
- 3.6 Covered bonds and unsecured debt instruments issued by credit institutions that are theoretically valued in accordance with the rules contained in Article 134 of Guideline (EU) 2015/510 (ECB/2014/60) shall be subject to an additional valuation haircut in the form of a valuation markdown of 5%.

### **Additional Conditions for the eligibility of assets**

Subject to the provisions of regulation 25 (sub-regulations 8 to 15) of the Depositor Compensation Scheme Regulations, 2015 and to articles 6 to 8 of the Banking Rule on Payment Commitments (BR/19/2016), an asset shall be eligible if it satisfies the following conditions:

- 1 It must be a debt instrument having:
  - (a) A fixed, unconditional principal amount. Therefore a bond with warrants or other similar rights attached are not eligible; and
  - (b) A coupon that cannot result in a negative cash flow. In addition the coupon should be one of the following: (i) a zero coupon; (ii) a fixed rate coupon; or (iii) a floating rate coupon linked to an interest rate reference. The coupon may be

linked to a change in the rating of the issuer itself. Furthermore inflation-indexed bonds are also eligible.

Chapter 6.2.1 of the General Documentation on Eurosystem Monetary Policy Instruments and Procedures (hereinafter referred to as the General Documentation) shall apply to the interpretation of this condition, and account shall be had of all relevant decisions and statements of the European Central Bank or the Central Bank of Malta including any other relevant provisions of the General Documentation, as amended from time to time.

- 2 It must be a debt instrument having a reference price that is quoted on a recognized investment exchange established in the EEA that is not older than five days and which has moved during the said five days. If the reference price obtained is older than five days, or has not moved for at least five days, then such debt instrument shall be eligible on condition that its valuation is based on the market value after haircut as provided by the Central Bank of Malta.