# REPORT OF THE DEPOSITOR COMPENSATION SCHEME FOR 2010

## INTRODUCTION

In terms of regulation 8 of LN 369 of 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 2010.

The Scheme's audited financial statements for 2010 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. 18,532 of 12 January 2010, 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 2010, as follows:

*Chairman*
Dr Anton Felice

*Members*
Mr Benny Borg Bonello
Mr James Bonello
Mr George F Farrugia
Mr Kenneth Farrugia
Mr Rene Saliba
Dr Massimo Vella

Mr Geoffrey Bezzina was appointed Secretary of the Committee.

## MEETINGS OF THE COMMITTEE

The Management Committee held four meetings during 2010.

**FINANCIAL STATEMENTS AS AT 31 DECEMBER 2010**

The Scheme registered a surplus of €351,331 in 2010 compared to €325,855 in the previous year. Net Finance Income amounted to €371,693 (2009: €345,071). An amount of €20,362 has been spent in management and administration expenses (2009: €19,216). Accumulated capital and reserves amounted to €10,775,702 (2009: €8,444,662).

**PARTICIPANTS OF THE SCHEME**

The following is a list of participant banks in the Scheme as at 31 December 2010:

Akbank T.A.S.
APS Bank Limited
Banif Bank (Malta) plc
Bank of Valletta plc
BAWAG Malta Bank Ltd
CommBank Europe Limited
Deutsche Bank (Malta) Limited
Erste Bank (Malta) Limited
FCM Bank Limited
FIMBank plc
Fortis Bank Malta Ltd
HSBC Bank Malta plc
IIG Bank (Malta) Ltd
Investkredit International Bank plc
Izola Bank plc
Lombard Bank Malta plc
Mediterranean Bank plc
NBG Bank Malta Limited
Nemea Bank Ltd
Raiffeisen Malta Bank plc
Sparkasse Bank Malta plc
Turkiye Garanti Bankasi A S
VoiceCash Bank Limited
Volksbank Malta Limited

**Amendments to the Depositor Compensation Scheme Regulations**

On 5 March 2010, the Depositor Compensation Scheme (Amendment) Regulations, 2010 [Legal Notice 109 of 2010] were published amending LN 368 of 2003 (the primary Regulations).

By virtue of these amendments, banks are required to maintain 0.1% of their eligible deposits with the Scheme by way of a cash contribution at all times.

Furthermore, banks are required to create and maintain a Depositor Compensation Scheme Reserve equivalent to 0.67% of their eligible deposits. The funds constituting this Reserve shall become payable to the Scheme if a call on such funds is made by the Management Committee to enable it to exercise its functions under the Regulations. Such funds are not repayable upon cessation of a bank's licensable activities for whatsoever reason.

## 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.

*Initial and Supplementary Contributions*

Any bank joining the Scheme is required to pay an Initial Contribution.

Banks are also required to pay a Supplementary Contribution. Following the publication of LN 109 of 2010, banks were required to maintain a level of 0.1% of eligible deposits as at 31 December 2009 with the Scheme.

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 amount to €8,068,085.

*Special Contribution*

In terms of paragraph 5(a) of the Second Schedule of the Regulations, every bank is required to establish a Depositor Compensation Scheme Reserve for the payment of its Special Contribution in accordance with regulation 16 of the Regulations. The Reserve shall consist of funds amounting to 0.67% of the bank's respective eligible deposits.

Pursuant to paragraph 5(c) of the same Schedule, funds in the Reserve are required to be held in admissible assets and shall be 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 is subject to the following requirements:

(a) Investment or placement requirements

(b) Pledge requirements
(c) Valuation requirements

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

The amount of the Special Contribution is required to be held in a "Depositor Compensation Scheme Reserve". Funds making up this reserve are to be invested/deposited in accordance with the Second Schedule of the Regulation and "Additional conditions for the admissibility of assets" issued in terms of subparagraph (e)(iii) of paragraph 5 of the same Schedule (available on-line from www.compensationschemes.org.mt). As at 31 December 2010, banks' obligations in terms of paragraph 5 of the Second Schedule amounted to €48,440,574.

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

i. deposit the entire amount of the "Depositor Compensation Scheme Reserve" with the Scheme (in which case no interest is 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 €1,002,353 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 is only eligible for this purpose if the bank with whom it is placed has 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, the market value of €45,241,902 in Malta Government Stocks were pledged in favour of the Scheme to secure banks' obligations of €39,797,712; 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, €7,640,509 were deposited with the Central Bank of Malta and pledged in favour of the Scheme.

*(b) Pledge requirements*

If the participant has not placed the entire amount of the "Depositor Compensation Scheme Reserve" with the Scheme, the investment making up the Special Contribution is 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).

None of the banks pledged deposits with banks outside Malta and none have offered, as security, pledges of securities listed on any foreign investment exchange.

*(c) Valuation requirements*

The value of assets in the Reserve shall be the market value of such assets less "Valuation Haircuts" determined by the Malta Financial Services Authority, in consultation with the Management Committee, in terms of sub-paragraph (f) of paragraph 5 of the Second Schedule of such Regulations (also available on-line).

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 the its appointed auditors. In respect of the Reserve, the statement shall include 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.

**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.

*Information to depositors*

All banks are obliged to inform current or prospective depositors of the provisions of the deposit compensation scheme, including the amount, scope and conditions of the cover offered by the scheme. On request, banks shall make available to current depositors information about the conditions for compensation and the formalities which must be completed to obtain compensation from the Scheme. All banks have published detailed information on their respective websites regarding the level and extent of the Scheme's coverage.

The Committee is also required to inform the general public about the Scheme's workings, including 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. During the year, the website was revamped and updated to reflect the new provisions of the amended regulations. Information on the website is available in English and Maltese.

*Modalities of payout*

The Scheme is required to make its own administrative arrangements for verifying claims and to process payments to depositors in the event of a payout within 20 working days that are reckoned from the date when the competent authorities determine that a credit institution is unable to repay its deposit liabilities.

Banks are also required to ensure that they have electronic information systems in place to enable the Scheme to process claims for compensation by depositors.

For this purpose, the Scheme prepared a detailed document to initiate a consultation process with credit institutions to discuss and consequently agree on the best possible approach that will ensure payout of compensation within the stipulated period.

The Scheme convened all banks to a half day seminar during which it discussed different options which could be availed of such that the Scheme could process depositor data within the timeframes envisaged by law. Technical aspects of the electronic systems to be used to securely communicate the required information to the Scheme were also identified. However, the Scheme acknowledges that further work is required in this area.

In addition, 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 2010 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.

During 2010, the Scheme was requested by the Authority to prepare opinions and reports about issues which concern depositor compensation and implications for the stability of the financial systems in view of the European Commission's proposal to amend the directive on depositor guarantee schemes.

## EU developments

On 12 July 2010, the Commission adopted a legislative proposal for a thorough revision of the Directive on Deposit Guarantee Schemes.

This initiative is part of a broader package on compensation and guarantee schemes that comprises the proposal for amendment of the Directive on Investor Compensation Schemes and a White Paper on the insurance schemes.

In the main, the proposal deals with the harmonisation and simplification of protected deposits, a faster payout, and an improved financing of schemes. These proposed amendments follow urgent legislative changes that the Commission proposed in 2008 and which entered into force early 2009.

The proposal, which is currently being discussed at Council and European Parliament level, envisages that all banks throughout the EU would provide a uniform level of protection to depositors of €100,000 per depositor – whether citizens or corporate entities. All schemes would have to build up a fund over time to repay depositors when needed. If necessary, banks would also have to make ad hoc contributions. Banks with a higher risk profile would be required to pay higher contributions to schemes.

The proposal envisages that depositors would be given information on how their deposits are protected when they sign a contract with a bank. Up-to-date information would be provided on account statements.

The proposal also envisages broader and transparent mandates for schemes across the EU.

**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.

**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 2010, the Scheme participated in an EFDI conference in Rome on "Strengthening Financial Stability".

**Dr Anton Felice**
***Chairman – Depositor Compensation Scheme Management Committee***

13 May 2011

*Attachment: Audited Financial Statements of the Depositor Compensation Scheme for 2010*

# DEPOSITOR COMPENSATION SCHEME

**Annual Report**
**and**
**Financial Statements**

**31 December 2010**

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# GENERAL INFORMATION

The Depositor Compensation Scheme was established by virtue of the Depositor Compensation Scheme Regulations, Legal Notice 369 of 2003 (amended) of the Laws of Malta.

## MEMBERS OF THE MANAGEMENT COMMITTEE

Dr A Felice (Chairman)
Mr B Borg Bonello
Mr G Farrugia
Mr K Farrugia
Mr R Saliba
Dr M Vella
Mr J Bonello

## COMMITTEE'S SECRETARY

Mr G. Bezzina

## ADDRESS

c/o Malta Financial Services Authority
Notabile Road
Attard BKR 3000
Malta

## INVESTMENT MANAGERS

Central Bank of Malta
Pjazza Kastilja
Valletta VLT 1060
Malta

## BANKERS

Central Bank of Malta
Pjazza Kastilja
Valletta VLT 1060
Malta

## AUDITORS

Ernst & Young Malta Limited
Certified Public Accountants
Regional Business Centre
Achille Ferris Street
Msida MSD 1751
MALTA

# REPORT OF THE MANAGEMENT COMMITTEE OF THE SCHEME

The Management Committee of the Scheme submit their annual report together with the audited financial statements for the year ended 31 December 2010.

## Principal activity

The Depositor Compensation Scheme was established by virtue of the Depositor Compensation Scheme Regulations (the "Regulations"), Legal Notice 369 of 2003 (amended) of the Laws of Malta for the purposes of carrying out the functions defined in the said Regulations.

The main objective of the Scheme is to provide a means of protection for depositors within the framework of the Regulations. The Scheme maintains a fund out of which payments will be made to depositors where it appears that a participant to such Scheme is unable to repay money owed to or belonging to depositors and held on their behalf in connection with the banking business.

## Results

The results are shown in the Statement of Comprehensive Income, set out on page 6.

## Members of the Management Committee

The Members who served during the year under review and any changes thereof, were as noted on page 2.

In accordance with Regulation 3 of the Regulations, the Scheme is managed and administered by the Management Committee. Such committee is appointed by the Malta Financial Services Authority for a maximum period of not less than three years but not more than five years. Every member of the Committee shall be eligible for re-appointment.

## Statement of committee members' responsibilities

The committee members are required by the Depositor Compensation Scheme Regulations, Legal Notice 369 of 2003 (amended) of the Laws of Malta to prepare financial statements which give a true and fair view of the state of affairs of the Scheme as at the end of each financial year and of the income and expenditure for that year.

The Committee members are responsible for ensuring that:-

- appropriate accounting policies have been consistently applied and supported by reasonable and prudent judgements and estimates
- the financial statements have been drawn up in accordance with International Financial Reporting Standards as adopted by the EU, subject to any material departures disclosed and explained therein;
- the financial statements are prepared on the basis that the Scheme must be presumed to be carrying on its business as a going concern; and
- account has been taken of income and charges relating to the accounting period, irrespective of the date of receipt or payment.

The committee members are also responsible for designing, implementing and maintaining internal control relevant to the preparation and the fair presentation of the financial statements that are free from material misstatement, whether due to fraud and error, and that comply with the Depositor Compensation Scheme Regulations, Legal Notice 369 of 2003 (amended) of the Laws of Malta. They are also responsible for safeguarding the assets of the Scheme and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

## REPORT OF THE MEMBERS OF THE AUTHORITY - continued

### Auditors

Ernst & Young Malta Limited have expressed their willingness to continue in office and a resolution for their re-appointment will be proposed at the board members' meeting.

The report of the Members was approved and signed on their behalf by:

**DR. ANTON FELICE**
Chairman

**GEORGE FARRUGIA**
Member

c/o Malta Financial Services Authority
Notabile Road
Attard

13 May 2011

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# INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF DEPOSITOR COMPENSATION SCHEME

We have audited the financial statements of Depositor Compensation Scheme, set on pages 6 to 18, which comprise the statement of financial position as at 31 December 2010 and the statement of comprehensive income, statement of changes in funds and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

## Management Committee's Responsibility for the Financial Statements

As described in the Management Committee's Report set out on page 3, the Management Committee is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the European Union and the requirements of the Depositor Compensation Scheme Regulations, Legal Notice 369 of 2003 (amended), and for such internal control as management committee determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud and error.

## Auditors' Responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate for the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the committee, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

In our opinion, the financial statements:

- give a true and fair view of the financial position of the Scheme as at 31 December 2010, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union; and
- have been properly prepared in accordance with the requirements of the Depositor Compensation Scheme Regulations, Legal Notice 369 of 2003 (amended).

*This copy of this audit report has been signed by Mario P. Galea for and on behalf of*

Ernst & Young Malta Limited
Certified Public Accountants

13 May 2011



A member firm of Ernst & Young Global Limited
Registered in Malta No: C30252
Registered Address: 4th Floor, Regional Business Centre, Achille Ferris Street, Msida MSD 1751, Malta

## STATEMENT OF COMPREHENSIVE INCOME

| | Notes | 2010 EUR | 2009 EUR |
|---|---|---|---|
| Income | 6 | **371,693** | 345,071 |
| Administrative expenses | 7 | **(20,362)** | (19,216) |
| **Surplus for the year** | | **351,331** | 325,855 |
| **Other comprehensive income** | | | |
| Net gain/(loss) on available-for-sale financial assets | | **101,637** | (117,629) |
| **Total comprehensive income for the year** | | **452,968** | 208,226 |

*The accounting policies and explanatory notes on pages 10 to 18 form an integral part of the financial statements.*

## STATEMENT OF FINANCIAL POSITION
## as at 31 December 2010

| | Notes | 2010 EUR | 2009 EUR |
|---|---|---|---|
| **ASSETS** | | | |
| **Non-current assets** | | | |
| Financial assets | 9 | **9,305,286** | 7,968,040 |
| **Current assets** | | | |
| Financial assets | 9 | **158,921** | 276,249 |
| Receivables | 10 | **170,994** | 173,507 |
| Cash at bank | | **1,143,364** | 29,729 |
| | | **1,473,279** | 479,485 |
| **TOTAL ASSETS** | | **10,778,565** | 8,447,525 |
| **FUNDS AND LIABILITIES** | | | |
| **Funds and reserves** | | | |
| Contributions fund | 11 | **8,068,085** | 7,192,366 |
| Special contribution fund | 12 | **1,002,353** | - |
| Revaluation reserve | 13 | **365,892** | 264,255 |
| Accumulated fund | 13 | **1,339,372** | 988,041 |
| | | **10,775,702** | 8,444,662 |
| **Current liabilities** | | | |
| Other payables | 14 | **2,863** | 2,863 |
| **TOTAL FUNDS AND LIABILITIES** | | **10,778,565** | 8,447,525 |

*The accounting policies and explanatory notes on pages 10 to 18 form an integral part of the financial statements.*

*The financial statements on pages 6 to 18 have been approved by the Management Committee on 13 May 2011 and were signed on its behalf by:*

**DR. ANTON FELICE**
Chairman

**GEORGE FARRUGIA**
Member

## STATEMENT OF CHANGES IN FUNDS

| | Contributions fund EUR | Special contribution fund EUR | Revaluation reserve EUR | Accumulated fund EUR | Total EUR |
|---|---|---|---|---|---|
| At 1 January 2009 | 7,169,067 | - | 381,884 | 662,186 | 8,213,137 |
| Surplus for the year | - | - | - | 325,855 | 325,855 |
| Other comprehensive income | - | - | (117,629) | - | (117,629) |
| | - | - | (117,629) | 325,855 | 208,226 |
| Contributions for the year | 23,299 | - | - | - | 23,299 |
| **At 31 December 2009** | **7,192,366** | **-** | **264,255** | **988,041** | **8,444,662** |
| At 1 January 2010 | 7,192,366 | - | 264,255 | 988,041 | 8,444,662 |
| Surplus for the year | - | - | - | 351,331 | 351,331 |
| Other comprehensive income | - | - | 101,637 | - | 101,637 |
| | - | - | 101,637 | 351,331 | 452,968 |
| Contributions for the year | 875,719 | 1,002,353 | - | - | 1,878,072 |
| **At 31 December 2010** | **8,068,085** | **1,002,353** | **365,892** | **1,339,372** | **10,775,702** |

*The accounting policies and explanatory notes on pages 10 to 18 form an integral part of the financial statements.*

## STATEMENT OF CASH FLOWS

| | **2010 EUR** | 2009 EUR |
|---|---|---|
| **Operating activities** | | |
| Surplus for the year | **351,331** | 325,855 |
| Adjustment to reconcile surplus to net cash flow | | |
| Non cash: | | |
| Interest receivable | **(425,077)** | (396,239) |
| Amortisation | **53,384** | 51,377 |
| Gain on disposal of financial assets | **-** | (209) |
| Working capital adjustment | | |
| Increase/(Decrease) in other payables | **-** | 118 |
| Interest received | **404,290** | 389,665 |
| **Net cash flow from operating activities** | **383,928** | 370,567 |
| **Investing activities** | | |
| Payments to acquire financial assets | **(4,325,643)** | (2,269,144) |
| Proceeds on maturity of financial assets | **3,153,978** | 1,249,678 |
| **Net cash flows used in investing activities** | **(1,171,665)** | (1,019,466) |
| **Financing activities** | | |
| Contributions received | **1,901,372** | 659,622 |
| **Net movement in cash and cash equivalents** | **1,113,635** | 10,723 |
| Cash and cash equivalents at 1 January | **29,729** | 19,006 |
| **Cash and cash equivalents at 31 December** | **1,143,364** | 29,729 |

*The accounting policies and explanatory notes on pages 10 to 18 form an integral part of the financial statements.*

# NOTES TO THE FINANCIAL STATEMENTS

## 1. SCOPE AND FUNCTIONS OF THE SCHEME

The Depositor Compensation Scheme ("the Scheme") was established on 23 November 2003 by virtue of the Depositor Compensation Regulations, ("the Regulations") Legal Notice 369 of 2003 (amended) of the Laws of Malta.

The Scheme is intended to promote confidence in licensed banks by providing a means of protection for depositors within the framework of the Regulations. The Scheme shall also carry out various other related functions and duties as set out in Regulation 4(1) of the Regulations.

## 2. BASIS OF PREPARATION AND STATEMENT OF COMPLIANCE

These financial statements have been prepared under the historical cost convention except for available-for-sale financial assets that have been measured at fair value. These financial statements are in accordance with International Financial Reporting Standards as adopted by the EU and comply with Legal Notice 369 of 2003 (amended) of the Laws of Malta.

## 3. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES

**Standards, interpretations and amendments to published standards as adopted by the European Union effective in 2010**

The Scheme has adopted the following new and amended IFRS and IFRIC interpretations during the year. Adoption of these revised standards and interpretations did not have any effect on the financial performance or position of the Scheme.

| | |
|---|---|
| IFRS 1 Revised | First Time Adoption of IFRS *effective for annual periods beginning on or after 1 July 2009* |
| IFRS 1 | Amendments Additional Exemptions for First-time Adopters *effective for annual periods beginning on or after 1 January 2010* |
| IFRS 2 | Amendment - Group Cash-settled Share-based Payment Transactions *effective for annual periods beginning on or after 1 January 2010* |
| IFRS 3 | Revised Business Combinations *effective for annual periods beginning on or after 1 July 2009* |
| IAS 27 | Amendment - Consolidated and Separate Financial Statements *effective for annual periods beginning on or after 1 July 2009* |
| IAS 39 | Amendment - Financial Instruments: Recognition and Measurement - Eligible Hedged Items *effective for annual periods beginning on or after 1 July 2009* |
| IFRIC 9 | Reassessment of Embedded Derivatives and IAS 39 Financial Instruments: Recognition and Measurement' – Embedded derivatives *effective for annual periods beginning on or after 30 June 2009* |
| IFRIC 17 | Distributions of Non-Cash Assets to Owners *effective for annual periods beginning on or after 1 July 2009* |

Improvements to IFRSs (April 2009)

## NOTES TO THE FINANCIAL STATEMENTS - continued

### 3. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES - continued

**Standards, interpretations and amendments to published standards that are not yet effective**

Up to date of approval of these financial statements, certain new standards, amendments and interpretations to existing standards have been published but are not yet effective for the current reporting period and which the Scheme has not early adopted. None of the below mentioned standards will have an effect on the Scheme's financial position and performance. These are as follows:

| | |
|---|---|
| IFRS 1 | First Time Adoption of International Financial Reporting Standards – Limited Exemption from Comparative IFRS 7 Disclosures for First Time Adopters *effective for annual periods beginning on or after 1 July 2010* |
| IAS 24 | Related Party Disclosures (Revised) *effective for annual periods beginning on or after 1 January 2011* |
| IAS 32 | Financial Instruments: Presentation – Amendments relating to classification of rights issues *effective for annual period beginning on or after 1 February 2010* |
| IFRIC 14 | IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (Amendments) *effective for annual periods beginning on or after 1 January 2011* |
| IFRIC 19 | Extinguishing Financial Liabilities with Equity Instruments *effective for annual periods beginning on or after 1 July 2010* |

Improvements to IFRSs (Issued by the IASB in May 2010) - *The amendments in the 2010 Improvements to IFRSs are effective for annual periods beginning on or after 1 July 2010, except for the amendments to IFRS 1, IFRS 7, IAS 1, IAS 34 and IFRIC 13 which are effective for annual periods beginning on or after 1 January 2011.*

**Standards, interpretations and amendments issued by the International Accounting Standards Board (IASB) but not yet endorsed by the EU:**

The following standards, interpretations and amendments have been issued by the IASB but not yet endorsed by the EU:

| | |
|---|---|
| IFRS 1 | Amendments - Severe Hyperinflation and Removal of Fixed Dates for First-Time Adopters |
| IFRS 7 | Amendments – Financial Instruments: Disclosures |
| IFRS 9 | Financial Instruments |
| IAS 12 | Amendments – Deferred tax: Recovery of Underlying Assets |

### 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Income recognition**

Income is recognised to the extent that it is probable that the economic benefits will flow to the Scheme and the income can be reliably measured.

## NOTES TO THE FINANCIAL STATEMENTS - continued

### 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

**Income recognition - continued**

*Interest income*

For all financial instruments measured at amortised cost and interest bearing financial assets classified as available-for-sale, interest income is recorded using the effective interest rate (EIR), which is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or liability. Interest income is included in income in the statement of comprehensive income.

**Financial assets**

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity financial assets and available-for-sale financial assets, as appropriate. All financial assets are initially recognised at cost, being the fair value of the consideration given, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Scheme determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year-end.

The Scheme has classified its financial assets as 'available-for-sale' financial assets. The latter are debt securities which are intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity and in response to changes in market conditions.

After initial recognition, financial assets which are classified as 'available-for-sale' are measured at fair value, without any deduction for transaction costs that may be incurred on sale or other disposal. Unrealised gains or losses on available-for-sale securities are reported as a separate component of reserves until the financial asset is sold, collected or otherwise disposed of, or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in reserves is included in income.

For financial assets actively traded in organised financial markets, fair value is generally determined by reference to quoted market bid prices at the close of business on the reporting date. For investments where there is no quoted market price, a reasonable estimate of the fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions, reference to the current market value of another instrument which is substantially the same, discounted cash flow analysis based on the expected cash flows of the underlying net asset base of the investment and option pricing models.

**Derecognition of financial assets**

A financial asset is derecognised (or, where applicable a part of a financial asset or part of a group of similar financial assets) when:

- the right to receive cash flows from the asset has expired;
- the right to receive cash flows from the asset is retained, but the Scheme has assumed an obligation to pay them in full without material delay to a third party under a 'pass through' arrangement; or
- the rights to receive cash flows from the asset have been transferred and either the Scheme (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

## NOTES TO THE FINANCIAL STATEMENTS - continued

### 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

**Other Receivables**

Other Receivables are recognised and carried at original invoice amount less an allowance or any uncollectible amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written-off as incurred.

**Cash and cash equivalents**

Cash in hand and at banks are carried at cost.

Cash and cash equivalents are defined as cash in hand, demand deposits and short-term, highly liquid investments readily convertible to known amounts of cash and subject to insignificant risk of changes in value. For purposes of the Statement of cash flows, cash and cash equivalents consist of cash in hand and deposits at banks.

**Other payables**

Liabilities for other amounts payable are carried at cost which is the fair value of the consideration to be paid in the future for goods and services received, whether or not billed to the Scheme.

### 5. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

In preparing the financial statements, the management committee is required to make judgements, estimates and assumptions that affect reported income, expenses, assets, liabilities and disclosure of contingent assets and liabilities. Use of available information and application of judgment are inherent in the formation of estimates. Actual results in the future could differ from such estimates and the differences may be material to the financial statements. These estimates are reviewed on a regular basis and if a change is needed, it is accounted for in the period the changes become known.

In the opinion of the management committee, the accounting estimates, assumptions and judgements made in the course of preparing these financial statements are not difficult, subjective or complex to a degree which would warrant their description as critical in terms of the requirements of IAS 1 (revised)- 'Presentation of financial statements'.

### 6. INCOME

| | **2010** | 2009 |
|---|---|---|
| | **EUR** | EUR |
| Interest on available-for-sale financial assets | **421,916** | 395,837 |
| Amortisation of net premiums | **(53,384)** | (51,377) |
| Effective interest | **368,532** | 344,460 |
| Bank interest | **3,161** | 402 |
| Gains on disposal of financial assets | **-** | 209 |
| | **371,693** | 345,071 |

## NOTES TO THE FINANCIAL STATEMENTS - continued

### 7. EXPENSES BY NATURE

| | **2010** | 2009 |
|---|---|---|
| | **EUR** | EUR |
| Committee members' honoraria | **13,394** | 13,394 |
| Auditors' remuneration | **2,006** | 2,006 |
| Membership fees | **860** | 850 |
| Travelling expenses | **1,862** | 2,384 |
| Central Bank of Malta management fee | **582** | 582 |
| Professional fees | **1,656** | - |
| | **20,360** | 19,216 |

### 8. TAXATION

The Depositor Compensation Scheme is exempt from taxation under section 28A of the Banking Act, Cap 371 of the Laws of Malta.

### 9. FINANCIAL ASSETS

**Available-for-sale financial assets (at fair value)**

a. The fair value of the financial assets is as follows:

| | **2010** | 2009 |
|---|---|---|
| | **EUR** | EUR |
| *Non-current* | | |
| Malta Government Stocks | **9,305,286** | 7,968,040 |
| *Current* | | |
| Malta Government Stocks | **-** | - |
| Treasury Bills | **158,921** | 276,249 |
| | **158,921** | 276,249 |
| Total financial assets | **9,464,207** | 8,244,289 |

## NOTES TO THE FINANCIAL STATEMENTS - continued

### 9. FINANCIAL ASSETS - continued

b. The amortised cost of the financial assets is as follows:

| | **2010 EUR** | 2009 EUR |
|---|---|---|
| *Non-current* | | |
| Malta Government Stocks | **8,939,396** | 7,703,563 |
| *Current* | | |
| Malta Government Stocks | **-** | - |
| Treasury Bills | **158,919** | 276,471 |
| | **158,919** | 276,471 |
| Total financial assets | **9,098,315** | 7,980,034 |

c. The fair value of the financial assets (recognised in reserves) is as follows:

| | **2010 EUR** | 2009 EUR |
|---|---|---|
| *Non-current* | | |
| Malta Government Stocks | **365,890** | 264,477 |
| *Current* | | |
| Malta Government Stocks | **-** | - |
| Treasury Bills | **2** | (222) |
| | **2** | (222) |
| Total financial assets | **365,892** | 264,255 |

**Fair value hierarchy**

As at 31 December 2010, the Scheme held the following financial instruments measured at fair value. The Scheme uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly

Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

## NOTES TO THE FINANCIAL STATEMENTS - continued

### 9. FINANCIAL ASSETS - continued

| | Total EUR | Level 1 EUR | Level 2 EUR | Level 3 EUR |
|---|---|---|---|---|
| **Available-for-sale financial assets** | | | | |
| 31 December 2010 | **9,464,207** | **9,464,207** | - | - |
| 31 December 2009 | 8,244,289 | 8,224,289 | - | - |

During the reporting years ended 31 December 2010 and 2009, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

### 10. RECEIVABLES

| | **2010 EUR** | 2009 EUR |
|---|---|---|
| Contributions receivable (note i) | **-** | 23,300 |
| Accrued income | **170,994** | 150,207 |
| | **170,994** | 173,507 |

i. Contributions receivable are non-interest bearing and are neither past due nor impaired.

### 11. CONTRIBUTIONS FUND

The contributions fund represents initial and supplementary contributions, that are either paid directly to the Scheme or a valid expectation exist that they are receivable by the Scheme. These are paid annually by the credit institutions participants by virtue of the Second Schedule in terms of regulation 12 of Legal Notice 369 of 2003 (amended).

No supplementary contributions by banks were effected in 2009, due to ongoing discussions regarding changes in the Scheme Regulations, which were concluded in 2010. The supplementary contributions' position of the banks was regularised during 2010.

### 12. SPECIAL CONTRIBUTION FUND

As at 31 December 2010, the participants' obligations in terms of article 5 of Schedule 2 of the Regulations amounted to EUR48,440,574. These obligations were based on eligible deposits as at year end 2009. The participant obligations have been met as follows:

- Deposits directly with the Scheme of EUR1,002,353 (note i)
- Deposits with the Central Bank of Malta of EUR7,640,509 pledged in favour of the Scheme
- Malta Government Stocks of EUR39,797,712 pledged in favour of the Scheme (note ii)

In terms of Regulation 16, the Management Committee may call upon such pledged assets.

i. The Special Contribution Fund represents special contributions from participants who have elected to deposit their contribution directly with the Scheme.
ii. The market value of Malta Government Stocks pledged in favour of the Scheme as at year end amounted to EUR45,241,902.

Special contributions may need to be increased or refunded in terms of the Regulations.

## NOTES TO THE FINANCIAL STATEMENTS - continued

### 13. OTHER RESERVES

**Revaluation reserve**

This reserve represents the unrealised gains or losses on the available-for-sale financial assets recognised directly in reserves.

**Accumulated fund**

The accumulated fund represents accumulated surpluses over the years.

### 14. OTHER PAYABLES

| | **2010** | 2009 |
|---|---|---|
| | **EUR** | EUR |
| Accruals | **2,863** | 2,863 |

### 15. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

As at year end, the Scheme's main financial assets include available-for-sale financial assets, receivables and cash held at bank. Financial liabilities consist of other payables. As at year end, there were no off-balance sheet financial assets and financial liabilities.

The main risks arising from the Scheme's financial assets and liabilities are credit risk, liquidity risk, interest rate risk and fair value risk. The Management Committee reviews and agrees policies for managing each of these risks which are summarised below.

**Risk management policies**

*Credit risk*

Financial assets which potentially subject the Scheme to concentrations of credit risk consist primarily of available-for-sale financial assets and cash at bank. Available-for-sale financial assets include Malta Government Stock and Treasury Bills. The Scheme's exposure to credit risk is limited to the carrying amounts of financial assets recognised.

The credit risk relating to available-for-sale financial assets is considered to be low in view of management's policy of investing only in high quality sovereign securities which are listed on a recognised stock exchange. The Scheme's cash is placed with quality credit institutions.

*Liquidity risk*

Liquidity risk is limited as the Scheme has sufficient funding resources to meet its financial obligations as these arise. However, the Scheme may be required to seek substantial borrowings and extraordinary funding assistance from third party entities in the event of a claim by depositors following a bank default.

## NOTES TO THE FINANCIAL STATEMENTS - continued

### 15. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES - continued

**Risk management policies - continued**

*Interest rate risk*

All interest-bearing financial assets have fixed interest rates. The Scheme's incoming and operating cash flows are substantially independent of changes to market interest rates. Up to the reporting date, the Scheme did not have a hedging policy with respect to interest rate risk as exposure was not deemed to be significant by the Management Committee.

*Fair value risk*

The Scheme is exposed to fair value risk in respect of its available-for-sale financial assets. However, such instruments are held for strategic rather that trading purposes and the Scheme's Management Committee does not consider that its exposure to fair value risk is significant.

### 16. CAPITAL MANAGEMENT POLICIES AND PROCEDURES

The objective of the Scheme is to provide a means of protection for depositors within the framework of the regulation. The Managements Committee, which manages and administers the Scheme, is required to work in the best interest of the Scheme and shall pursue and promote its objective.

The Scheme's capital management objectives are:

- to ensure the Scheme's ability to continue as a going-concern. For this purpose, it is required to maintain a fund or funds out of which payments shall be made to depositors and to meet such other payments or expenses as may be paid out of the fund or funds in accordance with the Regulations.

- to process claims for compensation by depositors as expeditiously as possible and to ensure that compensation is paid out without undue delay. To this end, the Scheme is required to consult with the competent authority (i.e. Malta Financial Services Authority) as to arrangements for the making of payments to depositors in terms of the Regulations.

The capital structure of the Scheme consists of a contributions fund made up of accumulated contributions paid by participants since its inception in 2003. In terms of the Regulations, participants are required to maintain a fund "on call" either as a capital reserve or a contingent liability. The Management Committee may require participants to pay such amounts within 30 days of such funds being called for the proper discharge of its duties.

The Committee is committed to strengthen the Scheme's capital base in line with European and international best practices. To this end, it will continue to advise the competent authority on methods related to the strengthening of the financing of the Scheme.