ANNUAL REPORT 2022

DEPOSITOR COMPENSATION SCHEME

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Introduction

Pursuant to regulation 5(9) of the Depositor Compensation Scheme Regulations ("the Regulations"), S.L. 371.09, the Management Committee of the Depositor Compensation Scheme ("the Scheme") hereby presents the report on the discharge of functions and operation of the Scheme for the year 2022.

The Scheme's audited financial statements as at 31 December 2022 are attached.

Management Committee

In accordance with regulation 5(1) of the Regulations, the Scheme is managed and administered by a Management Committee ("the Committee"), appointed by the Malta Financial Services Authority ("MFSA"). The members of the Committee during 2022 were:

Chairman

Mr Robert Caruana

Members

Mr Ian Meli (appointed on 4th March 2022)

Mr Kenneth Farrugia (resigned on 4th November 2022)

Mr Silvio Galea

Mr Karol Gabarretta

Dr Mauro Magro

Dr Edmond Zammit Laferla

Mr Joseph Camilleri (appointed 23rd January 2023)

Secretary

Mr Aldo Giordano (resigned 04th October2022)

Dr Charlotte Gauci (appointed on 4th October 2022)

Meetings of the Committee

The Committee held fifteen meetings during 2022.

Membership in the Scheme

In line with regulation 7 of the Regulations, a credit institution which is licensed in Malta under the Banking Act shall participate in the Scheme, excluding branches established in Malta by a credit institution which has its head office outside the European Union.

List of participants in 2022:

Agri Bank plc

APS Bank Limited

BNF Bank plc

Bank of Valletta plc

Credorax Bank Limited

ECCM Bank plc

FCM Bank Limited

Multitude Bank plc

FIMBank plc

HSBC Bank Malta plc

IIG Bank (Malta) Limited

Izola Bank plc

Lombard Bank Malta plc

Me Direct Bank

MFC Merchant Bank Limited

NBG Bank Malta Limited

Novum Bank Limited

Sparkasse Bank Malta plc

Financial Statements as at 31 December 2022

The Scheme registered a deficit of €140,813 in 2022, compared to a surplus of €129,697 registered in 2021. Income from available financial means amounted to €412,399 compared to €630,198 in 2021 caused by the non-repeat of the one-off sale of a security in 2021 which generated a profit on sale of €224,954. On the other hand, Management Expenses incurred during the year were €553,212, an increase of €52,711, mainly due to IT related expenses, from €500,501 in 2021. As at the end of 2022, the Accumulated Contribution Funds and Reserves amounted to €89,846,478 (2021: €83,339,065), the increase was mainly due contributions made during the year.

Objective and functions of the Scheme

As outlined in EU Directive 2014/49/EU on deposit guarantee schemes ("DGS"), the key task of a DGS is to protect depositors against the consequences of the insolvency of credit institutions. The primary aim is thus to repay depositors up to a harmonised coverage level of €100,000 per depositor.

Once the Competent Authority makes a determination that a financial institution has unavailable deposits, that is, the institution failed to repay deposits which are due and payable, and appears for the time being to be unable to repay deposits for reasons which are directly related to its financial circumstances, or otherwise, a judicial authority has made a ruling for reasons which are directly related to the member's financial circumstances and which has the effect of suspending the rights of depositors to make claims against it, the Scheme shall be informed of such determination by the Competent Authority, as soon as possible.

Upon being informed, the Committee shall publish a notice on its website and in at least two local newspapers, informing depositors of the financial institution concerned of such determination or ruling and of the manner in which the compensation to the depositors shall be processed.

The Scheme shall then proceed to pay compensation as specified in the Regulations, for eligible deposits, taking into consideration the provisos and exclusions set out in regulation 9. Regulation 13 sets the time limit for payment of compensation at ten working days if the pay-out is affected from 1 January 2021 until 31 December 2023, and seven working days as from 31 December 2024.

On a more specific level, the functions of the Scheme, as outlined in regulation 3 of the Regulations are:

a) to maintain 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 funds in accordance with the Regulations;

b) to establish and maintain, after consultation with the Competent Authority, arrangements for the making of payments to depositors;

c) to process claims for compensation by depositors as expeditiously as possible and to ensure that compensation is paid out without undue delay;

d) to finance the resolution of members, pursuant to regulation 33(2);

e) to use available financial means for alternative measures to prevent the failure of a member, pursuant to regulation 33(3);

f) to use available financial means for alternative measures to preserve the access of depositors to covered deposits, including transfer of assets and liabilities and deposit book transfer, in the context of insolvency proceedings, pursuant to regulation 33(6); and

g) to advise the MFSA on matters relating to the functions of the Scheme.

Recovery and Resolution Regime

During 2022, the Scheme was not required to exercise any of its functions referred to in functions (d), (e) and (f) above, under the recovery and resolution regime established by the Bank Recovery and *Resolution Directive.*

Compensation Contribution

The compensation contribution is calculated by the Scheme on the amount of covered deposits, excluding temporary high balances, of each member and the degree of risk incurred by the respective member.

The annual compensation contributions are determined by the Scheme for each member in accordance with the compensation contribution method as stated above.

The annual compensation contributions for the year 2022 were determined having regard to:

a) 1.1% of the covered deposits of the members;

b) the covered deposits of each member at the end of the year immediately preceding the relevant financial year;

c) the degree of risk incurred by each member by reference to an aggregate risk weight for the year immediately preceding the relevant financial year, in accordance with the risk-based method;

d) an adjustment coefficient, determined by the Competent Authority at least once in every financial year for all members.

The risk-based method, for determining the degree of risk incurred by members and the compensation contribution method, for determining the amount of compensation contribution due by each member in

each financial year are established by banking rules set by the Competent Authority and which adhere with guidelines issued by the European Banking Association.

The compensation contribution may be paid partly in cash contribution and partly by means of a payment commitment, as outlined in regulation 25(8) of the Regulations. From the year 2022, the total portion of payment commitment could not exceed 30%. Payment commitments may be paid directly into the Scheme's account at the Central Bank of Malta, in the form of deposits pledged in favour of the Scheme, or as securities pledged in favour of the Scheme.

As at 31 December 2022, the total compensation contribution required in terms of regulation 23 of the Regulations amounted to €164,925,688. The compensation contribution representing 70% paid in cash from members collected by the Scheme as at 31st December 2022 amounted to €115,447,982.

The compensation contribution representing the 30% in payment commitments from members amounted as at 31 December 2022, to €49,477,706. Payment commitments in the form of deposits pledged directly with the Scheme amounted to €6,165,967 whereas the value of deposits pledged in favour of the Scheme was €11,905,168. On the other hand, the value of securities pledged in favour of the Scheme amounted to €53,863,654, with a the market value of €56,530,750.

As at reporting year end, all banks were in compliance with the requirements of the Regulations regarding Compensation Contribution.

Management Expenses Contribution

The Scheme may also require members to pay a management expenses contribution if it has reasonable grounds to believe that the funds available to it meet management expenses in that financial year are, or will be, insufficient. During 2022, the Committee once again decided not to make any collection from the member banks for management expenses.

Contingency Contribution

For a number of years, the Competent Authority had imposed a licence condition on a number of local banks, requesting an additional contingency contribution by means of a pledge in favour of the Scheme. Such contributions were set aside in a Contingency Contribution Reserve, which could only be used by the Scheme for the payment of claims of depositors in the event of the pledgor bank's default. In 2021, the Competent Authority issued new methodologies to replace the licence conditions that required the payment of contingency contributions. Therefore, during the 2022, the Contribution Contingency Agreements with the relevant banks were terminated. Hence, the Scheme, in agreement with the Competent Authority, released the pledges of the contingency contributions to the respective banks. However, for one particular bank, its contingency contribution license condition was not revoked by

the Competent Authority, thus the funds pledged in favour of the Scheme by this bank could not be released by the Scheme.

Maintenance of the Fund

In line with regulation 23 of the Regulations, the available financial means of the Scheme for 2022 shall amount to 1.1%, as per Legal Notice 262 of 2022, of the covered deposits of its members and the target level must be maintained. 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. As indicated above, at the end of 2022, the Scheme's available financial means amounted to €129,828,673 (2021: €150,137,365) whereas the target level required as at the end of 2022 was €164,925,688 (2021: €184,747,862). The difference in the target level may be accounted for in the compensation paid out to depositors of a determined credit institution in 2017. In this respect, the Committee is taking all the necessary action to reach the target level of the available financial means within the deadline set by the Regulations. In August 2021, a Controller was appointed by the MFSA, to wind-up the credit institution in question, with whom the Scheme held several meetings and correspondence to establish the way forward and resolve the shortfall.

As required by regulation 23(2)(c) of the Regulations, if funds are not recovered from the Controller of the particular credit institution by 8th March 2023, the Scheme would need to recover the funds from its members through extraordinary contributions.

Protection of Funds

The Scheme may place its available financial means in a low-risk and sufficiently diversified manner. Funds managed and administered by it may either be held on deposit or invested, having regard to the need for prudence.

In carrying out this function, in 2003, the Committee had appointed the Central Bank of Malta for Investment Management Services. As the Investment Portfolio Manager, the Central Bank of Malta is tasked with financial, accounting and reporting services. Given the nature of the Scheme, the parameters for the investment of funds are primarily safety and liquidity.

Data Exchange and Payment Solution

The Scheme has a duty to process a pay-out expeditiously and to ensure that compensation is paid without undue delay. To this end, the Data Exchange and Payment Solution (DEPS) system has been designed and commissioned. Its objective is to enable the Scheme to receive, load and verify the single customer view (SCV) data file, the deferred data file and associated metadata files for the purpose of implementing the requirements of the Regulations in relation to pay-outs. Both types of files are be

received directly from the banks electronically via a secure transmission solution within the timeframes set by the Scheme. The system went live in January 2019. All banks were connected to DEPS and successfully submitted their test file. Simulations are conducted regularly to ascertain that the system is working correctly and efficiently, at all times, in case of a pay-out.

In 2019, the Scheme also subscribed to EDDIES, a platform regarding the exchange of information between deposit guarantee schemes within the European Union and the European Economic Area. In line with the Deposit Guarantee Scheme Directive ("DGSD"), as Host DGS, the Scheme shall cover depositors on behalf of the Home DGS, should a determination be made. The EDDIES platform facilitates the exchange of information from the Home DGS to the Host DGS in order for the Host DGS to make the pay-out efficiently and expeditiously. In 2022, the Secretariat of the Scheme successfully performed a functional test with the Dutch DGS to familiarise itself with the platform.

Compensation

On 24 March 2017, the MFSA made a determination of unavailable deposits in respect of a credit institution. The Scheme subsequently compensated the covered depositors of the said credit institution and has been actively seeking to recover the paid funds to replace the reduction in the Scheme's available financial means as a result of the amount of compensation paid out. In November 2021, a Controller was appointed by the MFSA, and the Committee has held several meetings and correspondence to recover the compensation paid possibly before the time limit set by the Regulations. Regulation 23(2)(c) of the Regulations requires that if funds are not recovered from the Controller by 8th March 2023, the Scheme would need to recover the funds from its members through extraordinary contributions. The Controller has informed the Scheme that he will not be in a position to repay the amount due before 8th March 2023. Thus, the Scheme was constrained to request from the member banks a pro-rated extraordinary contribution to ensure that the Scheme reaches the target level within the terms of the regulation 25(2) of the Regulations.

Alternative Funding Arrangement

To come in line with regulation 23(5) of the Regulations, the Committee initiated the project to create alternative funding arrangements early in 2020. Given that Infringement Proceedings were initiated by the EU Commission in 2021, further emphasis was given on this initiative which led in 2022 to discussions between the Scheme and the Ministry for Finance and Employment for the creation of a guarantee by the Maltese government in favour of the Scheme as a backstop measure. The conclusion of this guarantee is currently ongoing to finalise an agreement between the Scheme and the Ministry of the terms and conditions of the guarantee. The guarantee would ultimately be used by the Scheme to back-up credit lines which could be arranged in the near future. The Scheme is also considering other

options with regards to Alternative Funding Arrangements such as borrowing from other DGSs and purchasing insurance cover from reputable insurance undertakings.

Service Agreement with the MFSA

A service agreement with the MFSA was also discussed and drafted in order to improve the Scheme's services provided to the Scheme by the Authority. The Scheme had also drafted a memorandum of understanding outlining the transactions between the Scheme and the Technology Function within the MFSA. The main focus was the increase in cyber security measures and the enhancement of the operational efficiency within the operation of the Scheme.

Consultation

The Scheme works closely with the Competent Authority on matters relating to the compensation of depositors, contributions due by members and other issues that may arise. In 2022, discussions continued from the previous year concerning amendments to the Regulations, as promulgated in LN 43 of 2019. Most noteworthy, the amendments specify that electronic money and funds received in exchange for electronic money do not qualify as an eligible deposit. Furthermore, provisions have been added clarifying the payment of contributions when available financial means are reduced beyond specific levels. The discussions were concluded and the amendments were ultimately implemented into the Regulations via Legal Notice 193 and 262 of 2022.

Consultation is also ongoing with other stakeholders, particularly the Central Bank of Malta, the Ministry for Finance and Employment and the Malta Bankers' Association on matters of mutual interest.

The Scheme was once again present for discussions held within the Expert Group on Banking, Payments and Insurance(EGBPI), the Task Force for Deposit Guarantee Schemes set up by the European Banking Association as well as the Joint Workstream on Anti-Money Laundering and Available Financial Means and other meetings held by the European Forum of Deposit Insurers (EFDI). Discussions on the European Deposit Insurance Scheme Regulation (EDIS) were still ongoing during 2022 and the Scheme, together with the Ministry for Finance and Employment and other stakeholders provide feedback and support where necessary for these discussions.

Infringement Proceedings

Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes was transposed in the Depositor Compensation Scheme Regulations (S.L 371.09) by means of LN 383 of 2015. Article 10(2) of the Directive provides that Member States shall ensure that, by 3 July 2024, the available financial means of a DGS shall at least reach a target level of 0.8 % of the amount of the covered deposits of its members.

Article 10(3) of the Directive provides that the available financial means to be taken into account in order to reach such target level may include payment commitments and that the total share of payment commitments shall not exceed 30% of total amount of available financial means.

Article 10(3) of the Directive was transposed in regulation 23(3) of the Depositor Compensation Scheme Regulations as follows:

"The available financial means to be taken into account in order to reach the target level may include payment commitments. The total share of payment commitments shall not exceed 30% of the total amount of available financial means raised in accordance with this regulation."

This gradual approach was further qualified in regulation 25(8) which specified permissible share of payment commitments by year to reach a 30-70 ratio by 2024.

By means of a Letter of Formal Notice (INFR(2021)2133 C(2021)6347 final) dated 23 September 2021, the EU Commission (the Commission) found that, as has already been stated elsewhere in this Report, this was an incorrect transposition of the Directive owing to the fact that since the national transposition of the share of payment commitments under Article 10(3) should not have exceeded 30% and there were no transitional provisions that would allow a higher level of payment commitments until 2024. In this respect, Article 10 read in conjunction with Article 20(1) of the Directive 2014/49/EU, is among the provisions which should be transposed into national law and entered into force by 3 July 2015. The Commission therefore concluded that the national transposition, by not respecting the 30% threshold, constitutes a non-conformity issue and undermines the objective of ensuring a level of playing field and non-discriminatory treatment between credit institutions as set out by the European Banking Authority. This infrindgement was addressed by the Scheme via the aforementioned amendments which were implemented into the Regulations via Legal Notices 193 and 262 of 2022 after several discussions between the Scheme, the Competent Authority, the Central Bank of Malta and the Malta Bankers' Association.

Ian Meli

Member

For and on behalf of

the Compensation Schemes Management Committee

as approved by the Committee on 27th July 2023

Attachment: Audited Financial Statements of the Depositor Compensation Scheme for 2022