

REPORT OF THE DEPOSITOR COMPENSATION SCHEME FOR 2017

Contents

Introduction	1
Management Committee.....	1
Meetings of the Committee.....	1
Financial Statements as at 31 December 2017	2
Participants of the Scheme	2
Bank Reporting Obligations	2
Functions of the Scheme.....	2
Recovery and Resolution Regime	3
Building the Fund.....	3
Contributions to the Scheme	3
The Banking Rules.....	3
Contingency Contribution Agreement.....	5
Protection of Funds.....	5
Procedures for the Payment of Claims	5
Depositors' Claims	7
Advisory Function	8
EU Developments.....	8

Introduction

In terms of regulation of 5 (9) LN 383 of 2015, the Compensation Schemes Management Committee of the Depositor Compensation Scheme (hereinafter referred to as "the Scheme") is pleased to present its report on the discharge of its functions and its operations during 2017.

The Scheme's audited financial statements as at 31st December 2017 are also attached.

Management Committee

In accordance with regulation 5 of the Regulations, the Scheme is managed and

administered by a Management Committee (hereinafter referred to as "the Committee") appointed by the Malta Financial Services Authority. The members of the Management Committee during 2017 were:

Chairman

Mr Robert Caruana (appointed member on the 29 August 2017 and Chairman on 23 April 2018)

Dr Anton Felice (resigned from member and Chairman on 29 March 2018)

Members

Mr Benny Borg Bonello

Mr James Bonello

Mr George F Farrugia

Mr Kenneth Farrugia

Dr Massimo Vella

Mr Oliver Bonello (resigned on 29 August 2017)

Mr Silvio Galea (appointed on 23 April 2018)

Secretary

Mr Aldo Giordano

Meetings of the Committee

The Management Committee held 10 meetings during 2017.

Financial Statements as at 31 December 2017

The Scheme registered a surplus of €2,754,292 in 2017 compared to €2,239,967 in the previous year. Net Finance Income amounted to €2,912,266 (2016: €2,372,451). An amount of €157,974 has been spent in management and administration expenses (2016: €132,485). Accumulated funds and reserves amounted to €30,465,898 (2016: €48,572,465).

Participants of the Scheme

The following is a list of participant banks in the Scheme as at 31 December 2017:

Agri Bank plc
APS Bank Limited
BNF Bank plc
Bank of Valletta plc
Commbank Europe Limited
Credorax Bank Limited
ECCM Bank plc
FCM Bank Limited
FERRATUM Bank plc
FIMBank plc
HSBC Bank Malta plc
IIG Bank (Malta) Limited
Izola Bank plc
Lombard Bank Malta plc
*MeDirect Bank (Malta) plc **
MFC Merchant Bank plc
NBG Bank Malta Limited
Novum Bank Limited
Pilatus Bank Ltd
Satabank plc
Sparkasse Bank Malta plc
Yapi Kredi Bank Malta Ltd

*Mediterranean Bank plc and Mediterranean Corporate Bank Limited

entered into a voluntary merger in June 2017, and the name of the merged bank was changed to MeDirect Bank (Malta) plc in November 2017.

Branches outside Malta of a Bank licensed in Malta

If a credit institution licensed in Malta opens a branch in another Member State, depositors of that branch are covered by the Scheme in Malta. There were no such branches as at 31 December 2017.

Bank Reporting Obligations

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

Functions of the Scheme

In terms of regulation 3 of the Depositor Compensation Scheme Regulations 2015, the functions of the Scheme are:

- (a) 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;
- (b) To establish and maintain, after consultations 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;

- (e) To use its available financial means for alternative measures to prevent the failure of a member;
- (f) To use its 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;
- (g) To advise the competent authority on matters relating to the functions of the Scheme.

Recovery and Resolution Regime

During 2017 the Scheme was not required to exercise any of its functions referred to in paragraphs (d), (e) and (f) above, under the recovery and resolution regime established by the Bank Recovery and Resolution Directive.

Building the Fund

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

Contributions to the Scheme

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

Regulation 23 requires that the available financial means should amount to 1.3% of the covered deposits of its members, or such higher percentage as may be established by banking rules issued by the Malta Financial Services Authority (MFSA) as the Competent Authority.

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

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

The Rules governing the contributions to the Scheme under the 2015 Regulations were implemented by the Scheme as from January 2016.

As at the end of 2017, the Scheme's available financial means amounted to €111,185,422.48.

The Banking Rules

The Scheme in consultation with the MFSA engaged with the industry, for the purpose of devising new banking rules for the implementation of the new contribution regime. These banking rules establish:

- (a) A risk- based method determining the degree of risk incurred by members;
- (b) A payment commitment banking rule; and
- (c) A management expenses banking rule.

The risk -based method and the payment commitment banking rules adhere to the guidelines issued by the European Banking Authority (EBA).

With regard to the management expenses banking rule, this emanates from national agenda and not from any European Banking Authority guidelines.

Compensation Contribution - Cash Contributions

Any bank joining the Scheme is required to pay an Initial Management Expenses Contribution amounting to €35,000. Banks are also required annually to pay a compensation contribution, partly in cash and partly by way of a payment commitment.

As at end of the reporting year of the Scheme, the aggregate amount of contributions paid in cash to the Scheme amounted to €97,546,736 (2016: €95,486,618).

Compensation Contribution - Payment Commitments

In terms of regulation 25 (8) of the Regulations, the Scheme may provide that a portion of a compensation contribution be provided to the Scheme by means of a payment commitment. The payment commitment which banks were required to maintain with the Scheme as at 31 December 2017 amounted to 69.00% of each Bank's respective covered deposits outstanding at the end of 2016.

As at 31st December 2017, the banks' obligations in terms of regulation 25 (8) of the Regulations amounted to €92,550,006 (2016: €92,446,851).

A bank may:

- i. With the prior approval of the Scheme, deposit the entire amount of the payment commitment with the Scheme (in which case no interest is payable by the Scheme to the member for such funds). As at

the end of the reporting year of the Scheme, an amount of €9,060,306 had been deposited by participant banks directly with the Scheme;

- ii. Pledge cash balances in euro which it holds with another bank as security in favour of the Scheme. Such a deposit is only eligible for this purpose if the bank with which it is placed has a long term credit rating of not less than BBB. As at 31 December the amount pledged stood at €6,307,390.
- iii. Pledge securities listed on the Malta Stock Exchange or any foreign recognised investment exchange in favour of the Scheme. As at the end of the reporting year of the Scheme, Securities with a market value of €86,242,676, were pledged in favour of the Scheme to secure banks' obligations of €82,179,040 (2016: €85,150,378)

Pledge requirements

If the member has not placed the entire amount of the payment commitment with the Scheme, the assets making up the payment commitment are required to be pledged in favour of the Scheme.

As at reporting year end, all banks were in compliance with the requirements of the Regulations regarding pledging of eligible assets.

Valuation requirements

The value of assets supporting the payment commitment shall be the market value of such assets, discounted in

accordance with such 'Valuation Haircuts', established by the European Central Bank for the implementation of the Euro System Monetary Policy as may be amended from time to time, to the extent that is compatible with the Regulations and this rule. Provided that such haircuts shall not be applied when the collateral is provided by way of cash balances denominated in Euro.

The valuation haircuts are aimed to protect against the risk of financial loss if assets pledged in favour of the Scheme had to be realized owing to circumstances mention in regulation 25 (12) of the Regulations.

The Scheme has to ensure that the value of assets provided as collateral for payment commitments is reviewed regularly in accordance with paragraph 9 of Banking Rule 19. The Scheme requires members to ensure that the value of the assets provided as collateral is at least equal to the value of the maximum amount of payment commitment which may be provided in accordance with regulation 25 (8) of the Regulations.

The general documentation providing for such Valuation Haircuts is available on the website of the Scheme (www.compensationschemes.org.mt).

Contingency Contribution Agreement

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

Protection of Funds

The Committee is required to deposit or invest the cash 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, the Committee appointed the Central Bank of Malta to provide investment management services including financial, accounting and other related support services. The agreement with the Central Bank includes parameters for the investment of funds by the Central Bank of Malta on behalf of the Scheme. These parameters apply prudent investment criteria that take account of both the short and long term liquidity requirements of the Scheme.

Procedures for the Payment of Claims

The third function of the Scheme is to establish procedures for the payment of claims for compensation to depositors.

Information to depositors

The Regulations, oblige all banks to make available to actual and intending depositors the information necessary for the identification of the Scheme or other deposit guarantee schemes of which the institution and its branches are members within the European Union. Members shall inform actual and intending depositors of the applicable exclusions from protection under these regulations or the Directive.

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

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

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

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

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

If the member withdraws or is excluded from the DGS of which it is a member, the member shall inform its depositors within one month of such withdrawal or exclusion. If a depositor uses internet banking, the information may be communicated by electronic means.

Where the depositor so requests, it shall be communicated on paper.

Modalities of pay-out

The Department of Contracts on behalf of the Scheme published a tender offer on 2 February 2016 for the provision of a Fully Integrated Data Exchange and Payment Solution for the Depositor Compensation Scheme.

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

The tender submission deadline was 3 May 2016 and Fintech Consortium was chosen by the Tender Evaluation Committee.

All members have been required to develop or modify their respective internal electronic systems to be able to generate the data files as and when required. In order to facilitate the automation of the system, members will be responsible to provide their electronic files in a standard format according to pre-defined rules and codes contained in data templates provided by the Scheme. Specific account codes have to be applied to indicate whether an account is fit for straight-through pay-out (whereby payment will be made within the statutory payment period of 20 days) or requires more processing

before the relevant compensation is paid (in regard to accounts held under nominee, for example). In addition, the system will have automated verification processes to ensure that the data is reliable enough to enable the correct processing of compensation payments.

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

Fintech Consortium has been conducting meetings with the Scheme, during the year, for the writing of the system. The testing of the system is envisaged for 2018.

Depositors' Claims

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

In March 2017 the MFSA made a determination in terms of regulation 8 of the Regulations to the effect that Nemea Bank plc was unable for the time being to repay deposits placed by its depositors.

The Scheme published notices in three local newspapers informing eligible depositors how the Scheme will commence payment of compensation to all eligible depositors. Detailed Q&As were made available on the scheme's website, which was updated from time to time.

The Scheme staff answered queries from clients of the failed firm about the claims process. The same members of staff assessed claims made by the firm's clients in accordance with the Scheme's rules and procedures.

All depositors were paid compensation within the time frames stipulated in the Regulations, that is 20 working days for SCV depositors and 3 months for deferred depositors.

On paying any compensation, the Scheme became subrogated in the depositor's rights and claims against Nemea Bank plc and against any other party solely with respect to the recovery of the compensation paid by the Scheme. The aforesaid subrogation shall not prejudice any claims that the depositor may have for amounts in excess of the amount paid by the Scheme.

It is estimated that the Scheme paid around €35.2M in compensation to eligible depositors.

The Scheme entered into a Repo agreement with Mediterranean Corporate Bank Limited whereby the Bank loaned the Scheme the amount of €17 Million, which the Scheme agreed to pay over a maximum period of 2 years.

The payout to depositors was covered partly by the Repo arrangement and partly through the Scheme's available funds. Therefore the Central Bank was authorised to sell an amount of the Scheme's securities to fund the balance of the payout which was not covered by the Repo arrangement.

Advisory Function

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

During 2017 the Scheme assisted the Malta Financial Services Authority in issuing amendments to the Regulations.

EU Developments

The Malta Depositor Compensation Scheme participated in discussions with the Ministry for Finance and provided its feedback on the proposed European Deposit Insurance Scheme Regulation. (EDIS).

The Scheme has also participated in meetings, provided information and completed surveys with respect to the proposed text of the EDIS Regulation.



Robert Caruana
Chairman – Compensation Schemes Management Committee

28 May 2018

Attachment: Audited Financial Statements of the Depositor Compensation Scheme for 2017