



**Directive issued by the Malta Financial Services Authority to
Bank of Valletta**

Independent Expert's Report

21 January 2013

Contents

	<i>Page</i>
1 Introduction	4
1.1 <i>Background</i>	4
1.2 <i>Our instructions</i>	4
1.3 <i>Scope of this report</i>	4
1.4 <i>Structure of this report</i>	5
2 The definition of an experienced investor	6
2.1 <i>Introduction</i>	6
2.2 <i>The supplementary prospectus</i>	6
2.3 <i>Qualifying investments</i>	7
3 Methodology and testing procedures	11
3.1 <i>Introduction</i>	11
3.2 <i>The total number of files to be reviewed</i>	11
3.3 <i>Execution only files</i>	12
3.4 <i>Advisory files</i>	13
4 Conclusions	18

Directive issued by the Malta Financial Services Authority to Bank of Valletta

Independent Expert’s Report

Schedules

A list of all Execution Only investments with an original carbon copy of the Statement of Compliance	Schedule 1(a)
A list of Execution Only investments with a photocopy of the Statement of Compliance	Schedule 1(b)
A list of all investments that are deemed by Mazars and BoV to qualify under the Experienced Investor criteria by virtue of evidence of previous investments or otherwise	Schedule 2
A list of all investments that are deemed by Mazars not to qualify under the Experienced Investor criteria by virtue of evidence of previous investments or otherwise and where BoV was given the opportunity to provide further evidence but did not do so	Schedule 3
A list of and explanatory narrative for all investments for which Mazars has not seen sufficient evidence that they qualify under the Experienced Investor criteria or otherwise but which BoV contend do	Schedule 4
A list of investments made via an intermediary	Schedule 5

1 Introduction

1.1 Background

1.1.1 This report is written by Mazars, the international accounting, legal, tax and business advisory firm. It relates to a directive dated 1 June 2012 (the “**Directive**”) issued by the Malta Financial Services Authority (the “**MFSA**” or the “**Authority**”) on the Bank of Valletta (the “**BoV**” or the “**Bank**”). The Directive required the Bank to cooperate with a professional services firm appointed by the Authority. The professional services firm was required to review BoV’s files relating to the investigation of the sales practices operated by BoV in connection with the La Valette Multi Manager Property Fund (“**LVMMMPF**” or “**the Fund**”).

1.2 Our instructions

1.2.1 In accordance with the Directive, BoV agreed to cooperate with Mazars (the professional services firm selected by the Authority). The Authority has instructed Mazars to:

- (a) obtain and consider relevant information on the sale of units in LVMMMPF by BoV to its clients;
- (b) review all the documentation held by BoV and any related companies (Valletta Fund Management Limited and Valletta Fund Services Limited) in their client files with respect to the sale of the LVMMMPF in order to substantiate which clients fell under the criteria of an “experienced investor”, as defined in the terms of the Fund’s supplementary prospectus; and
- (c) draw-up a list of investors who did not qualify as experienced investors.

1.3 Scope of this report

1.3.1 This report has been prepared for use in the proceedings between the Authority and BoV in respect of the sale of units in LVMMMPF. It is confidential in all respects other than to be made available to the parties and their advisors. The conclusions in this report are based on our

Independent Expert's Report

experience and on the evidence with which we have been provided. If further evidence becomes available to us, these conclusions may change.

1.3.2 This report should not be used, reproduced or circulated for any other purpose without Mazars' prior written consent. Mazars accepts no responsibility to third parties in relation to the matters in this report and / or for any breaches of this obligation.

1.3.3 This report reflects our understanding of matters of law but expresses no opinion on them, as they are not for us to determine.

1.4 Structure of this report

1.4.1 We have structured this report as follows:

- (a) in Section 2, we set out our understanding of the criteria of an experienced investor, as defined in the terms of the Fund's supplementary prospectus;
- (b) in Section 3, we set out in overview, our methodology and testing procedures; and
- (c) in Section 4, we set out our conclusions.

2 The definition of an experienced investor

2.1 Introduction

2.1.1 In this report, Mazars does not express any opinion as to what it considers to be an “experienced investor”. In accordance with our instructions (see paragraph 1.2.1(b) above), we have reviewed the relevant client files:

“in order to substantiate which clients fell under the criteria of an experienced investor, as defined in the terms of the Fund’s supplementary prospectus” (our emphasis)

2.1.2 We comment on the definitions of an experienced investor, as set out in the supplementary prospectus, in Section 2.2 below. Where there appears to be ambiguity we have sought legal advice from GVTH Advocates as discussed further below. Our conclusions are set out in Section 2.3.

2.2 The supplementary prospectus

2.2.1 We understand that the supplementary prospectus was issued and updated on a number of different occasions. We have been provided with copies of the Fund’s supplementary prospectus dated: (i) September 2005; (ii) January 2006; (iii) March 2006; (iv) December 2006; (v) July 2007 (vi) January 2008; and (vii) August 2010.

2.2.2 We have carried out a full comparison of the definition of an “experienced investor” as set out in each of the supplementary prospectuses. The following criteria are consistent across all of the supplementary prospectuses. An experienced investor is:

- (a) a person who has worked in the financial services sector for at least one year in a professional position. We note that the August 2010 supplementary prospectus adds “*or a person who has been active in these type of investments*”; or
- (b) a person who has been active, for at least one year in a professional position, in the acquisition and/or disposal of real estate property funds and/or in securities linked to real estate property. We note that the August 2010 supplementary prospectus replaces the

Independent Expert's Report

words “a person who has been active for at least one year in a professional position” with the words “a person who has reasonable experience”; or

- (c) a person who, within the past 5 years, carried out investment transactions amounting to at least a sum of or equivalent to USD50,000. In case of joint Applicants, the Applicants must have either: (i) carried out separately, within the past 5 years, investment transactions amounting to at least a sum of or equivalent to USD50,000 in which case each joint holder has to meet, individually, the Experienced Investor criteria, or, (ii) carried out jointly, within the past 5 years, investment transactions amounting to at least a sum of or equivalent to USD50,000 in which case, provided that they are the same joint holders, the Experienced Investor criteria may be met jointly. The August 2010 supplementary prospectus includes different wording. It states: “a person who has carried out investment transactions in significant size at a certain frequency (for example a person who within the past 2 years, carried out transactions amounting to at least EUR50,000 at an average frequency of 3 per quarter)”.

2.2.3 We have adopted the definitions set out in the early prospectuses, and not the definition set out in the August 2010 prospectus as all the investments under consideration were made prior to 2010.

2.3 Qualifying investments

2.3.1 With respect to “investment transactions” identified at paragraph 2.2.2(c) above, the Authority has instructed Mazars that:

“Qualifying investment holdings shall constitute instruments identified at Schedule II of the Investment Services Act at the relevant time.”

2.3.2 We have been provided with one copy of the Investment Services Act dated 2004, and two copies of the Investment Services Act dated 2007. We have compared Schedule II of the Investment Services Act in each copy, and determined that qualifying investment holdings are as follows:

- (a) Money Market Instruments, which are classes of instruments which are normally dealt in on the money market, such as treasury bills, certificates of deposit and commercial papers

Independent Expert's Report

excluding instruments of payment. The 2004 version of Schedule II did not include this definition;

- (b) Transferable Securities, which are classes of securities which are negotiable on the capital market and include:
- (i) Shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depository receipts in respect of shares; or
 - (ii) Bonds or other forms of securitised debt, including depository receipts in respect of such securities; or
 - (iii) Any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferrable securities, currencies, interest rates or yields, commodities or other indices or measures;

The 2004 version of securities refers to securities in general, including “*shares and stock in the capital of a company, debenture stock, loan stock, certificates of deposit, bonds, notes and any other instruments creating or acknowledging indebtedness.*”

- (c) Certificates or other instruments which confer property rights in respect to any instrument any instruments falling within Schedule II. The 2004 version of Schedule II also includes certificates or other instruments “*which create or acknowledge indebtedness and which upon issue confer the right to claim the debt created or acknowledged thereby at some time in the future, subject to the condition that the claim thereunder may be reduced to below the value or price of the certificates or instruments at the time of issue*”;
- (d) Options, futures, swaps, forward rate agreements and any other derivative contracts:
- (i) relating to securities, currencies, interest rates or yields, or other derivative instruments, financial indices or financial measures which may be settled physically or in case; or

Independent Expert's Report

- (ii) relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of default or other termination event); or
- (iii) relating to commodities that can be physically settled, are not for commercial purposes, are not included in article 6 of this Schedule, and, which have the characteristics of other derivative instruments, having regard to whether, *inter alia*, they are cleared and settled throughout recognized clearing houses or are subject to regular margin calls; or
- (iv) relating to climatic variables, freight rates, emission allowances or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event), as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Schedule, which have the characteristics of other derivative instruments, having regard to whether, *inter alia*, they are traded on a regulated market within the meaning of the Financial Markets Act or a Multilateral Trading Facility within the meaning of the First Schedule, are cleared and settled through recognized clearing houses or are subject to regular margin calls.

The 2004 version of Schedule II does not include the above in elaborate detail but provides one definition of investment holdings as: “*Warrants, options, certificates or other instruments, including any record whether or not in the form of a document, entitling the holder to subscribe for, acquire, sell or otherwise dispose of, underwrite or convert any instrument or an interest in any instrument falling within this Schedule or for any currency.*”

- (e) Foreign exchange acquired or held for investment purposes. We note that the 2004 Schedule also includes “*Futures and foreign exchange contracts entered into for investment purposes*”;
- (f) Units in a collective investment scheme;

Independent Expert's Report

- (g) Derivative instruments for the transfer of credit risk. This definition was not included in the 2004 version of Schedule II; and
- (h) Rights under a contract or under any other contract the purposes or intended purposes of which is to secure a profit or avoid a loss by reference to fluctuations in the value or price of property of any description or in an index or other factor designated for the purposes in the contract. The 2004 version of Schedule II also includes: *“(1) Subject to the following provisions of this article, rights under a contract the effecting and carrying out of which constitutes business of insurance within the meaning of class III, linked long term, under the description of classes of long term business contained in the Second Schedule to the Insurance Business Act. (2) Where the provisions of a contract of insurance are such that the effecting and carrying out of the contract: (a) constitutes both long term business within the meaning of that Schedule and general business within the meaning of the Third Schedule to that Act; or (b) by virtue of article 5(3) of that Act constitutes long term business notwithstanding the inclusion of subsidiary general business provisions. References in subarticle (1) to rights and benefits under the contract are reference only to such rights and benefits as are attributable to the provisions of the contract relating to long term business. (3) Subarticle (1) does not apply to rights under a contract of reinsurance. (4) Rights falling within subarticle (1) shall not be regarded as falling within article 6 of this Schedule.”*

2.3.3 GVTH have advised that prior to 1 January 2007 the BoV Lifelink product were qualifying investments, and after 1 January 2007 the BoV Lifelink product was not a qualifying product.

3 Methodology and testing procedures

3.1 Introduction

3.1.1 On 10th and 11th of September 2012 Mazars met with representatives of BoV and Deloitte & Touche LLP (“**Deloitte**”). Mazars, BoV, and Deloitte discussed the file review that Mazars had been instructed to complete by the MFSA.

3.1.2 As part of the discussions, Mazars was provided with approximately 20 files for review. Based on the explanations with which Mazars was provided, and the sample files reviewed, Mazars designed appropriate testing procedures to allow an assessment to be made as to whether investors in the fund were “experienced” or “not experienced”.

3.1.3 This section aims to summarise the testing procedures that were carried out by Mazars.

3.2 The total number of files to be reviewed

3.2.1 The BoV initially provided Mazars with 2,274 files to review. Mazars reviewed these files and prepared a preliminary report for MFSA dated 21 December 2012. The BoV has advised Mazars in January 2013 that of these files, 74 relate to investments that were redeemed before the Fund ceased trading. Of the remaining files provided by the BoV there were 19 duplicates. As such, 93 files do not form part of the Mazars review and have been excluded.

3.2.2 In January 2013 the BoV provided Mazars with a further 77 files to review, relating to investments sold by the BoV, and managed by the BoV from its wealth management division.

3.2.3 The total number of files reviewed by Mazars was therefore 2,258, calculated as follows:

Table 3.1: Files reviewed by Mazars

		Total
Files initially provided to Mazars	2,274	
Less redeemed files and duplicated files	(93)	
Files initially provided to Mazars, not redeemed		2,181
Wealth management files		77
Total files reviewed		2,258

3.3 Execution only files

3.3.1 All investors that acted on an execution only basis have been classified as “Execution Only”.

We have concluded that an investor acted on an Execution Only basis if:

- (a) we have been provided with a carbon copy, or the original, Statement of Compliance (“SoC”);
- (b) the SoC has been signed by the investor; and
- (c) on the SoC the investor has indicated that the he/she/they have not received any investment advice from the bank.

3.3.2 Unless all three of the above criteria are met, we have concluded that the investment was made on an “Advisory” basis, and we have therefore considered whether or not the investor was experienced or not (in accordance with the definitions described in Section 2).

3.3.3 For the avoidance of doubt where an investment has been deemed to be Execution Only, we have not considered whether the investor qualified as an experienced investor. Mazars has treated and categorised these as Execution Only as per the evidence provided. The fact that Mazars has seen a valid SoC confirming that the investment was made on an Execution Only basis does not preclude BOV to consider some of these investors as non experienced if advice was in fact given and those investors did not fulfil the conditions to be treated as an experienced investor.

Independent Expert's Report

- 3.3.4 Where the same investor has made a subsequent investment, Mazars has been advised by GVTH that any previous SoC has no status and that each investment must have its own signed SoC for it to be treated as Execution Only.
- 3.3.5 For clarity, it is noted that any investment that is not Execution Only is Advisory.
- 3.3.6 Where Mazars has not seen an original or a carbon copy, but a photocopy of the SoC this has been noted. GVTH has advised Mazars that only a certified photocopy is deemed evidence. Mazars has advised BoV of this. BoV has not at this juncture provided certified copies.

3.4 Advisory files

- 3.4.1 As set out in Section 2 above, the supplementary prospectus provides for a number of alternative ways for determining whether an investor was experienced or not (for example, by either relevant professional experience, or by the value of investments that the investor has made in the last five years). Our approach has been to firstly consider the value of transactions undertaken by the investor in the last five years (in accordance with paragraph 2.2.2(c)). In this respect, our testing process involves six separate steps as set out below:

Step 1: Establish review period for each investor

- 3.4.2 As set out in Section 2, in order for an investor to qualify as “experienced”, qualifying investments were required to be made over a five year period of over \$50,000. In respect of most files, the five year period was determined by reference to the five years preceding the date that the investor completed the application form. There are a number of issues to clarify in respect of this:
- (a) in some cases, we have not been provided with the application form. In the absence of an application form we have relied upon the date that the SoC was completed. In the absence of an SoC we have relied upon the date that the investment was recorded on BoV's accounting system;
 - (b) we have allowed transactions to be included on the day of the application if those transactions were not investments in the Fund. For example, if the application form was dated 9 January 2005, we have included transactions on that date in our review and

Independent Expert's Report

treated such investments as qualifying investments with respect to the five year period;
and

- (c) we have considered the application date as opposed to any other date such as the value date.

3.4.3 Where there is insufficient information to determine whether or not an investment was made within the review period (for example, there is no evidence as to the date on which the investment was made) GVTH Advocates have advised that such investments cannot be included.

Step 2: Obtain details of investments made by each investor from BoV, and ensure that it is accurate

3.4.4 In order to obtain details of investments made by each investor over the relevant five year period, we have been provided with information from BoV. BoV has relied on a number of separate sources of information, including:

- (a) Valletta Fund Management (“VFM”) – many of the investors in the Fund also invested in other funds managed by VFM. These funds qualify as Collective Investment Schemes under Schedule 2 of the Investment Services Act. BoV has obtained information from VFM in respect of investments made by investors in other VFM funds;
- (b) Prospero – if the investments made by each investor in VFM in the qualifying period are less than \$50,000, the bank has reviewed information that it holds on its “Prospero” system. Prospero is an asset management and banking software that is used by BoV (and, we understand, other banks) that records details of the investments made by BoV’s retail and wealth management divisions on behalf of its clients;
- (c) Lotus notes – we understand that the data from VFM and Prospero is only available for a certain time period. If BoV is required to go back further (but within the five year time period) then it may have to restore data held within its Lotus notes system that evidences investments being made by the investors; and

Independent Expert's Report

(d) Bank assurance and other: Where BoV required further evidence it has provided (in some instances) evidence from Bank Assurance or other information such as the client Fact Find.

3.4.5 Mazars carried out various audit tests in order to ensure that the data and source documentation provided to Mazars by the BoV could be relied upon. We performed the audit tests on a sample of approximately 20% of the files, which were selected by Mazars haphazardly. The testing was designed to provide comfort that the summaries on which Mazars relied were accurate reflections of the underlying records of BoV.

3.4.6 BoV has not attempted to provide all the information it has relating to investors. Rather, BoV has attempted to provide sufficient evidence to demonstrate whether or not investors are experienced. A lack of evidence provided to Mazars does not therefore necessarily indicate that such evidence is not available. BoV may be able to supplement any original evidence if it is found to be insufficient.

Step 3: Calculate the amount of qualifying investments

3.4.7 Based on the data with which we have been provided (and that we have tested, as set out in “Step 2” above), we have:

(a) reviewed the nature of each investment in order to check that each transaction (both acquisitions and redemption¹) qualifies as an investment under Schedule 2 of the Investment Services Act. We have not included an investment if the investment does not qualify;

(b) converted the transaction into USD using the rate of exchange at the date of investment², as obtained from www.oanda.com. OANDA provides Internet-based forex trading and currency information services to the market, and is a trusted source for currency data. It has access to one of the world's largest historical, high frequency, filtered currency

¹ Our understanding of the supplementary prospectus is that acquisitions and redemptions are to be treated as two separate transactions.

² GVTH have advised that the relevant foreign exchange date is the date that the qualifying investment was made and not the exchange rate as at the date of the investment in the fund.

Independent Expert's Report

databases. OANDA did not supply daily rates for USD/MTL in the period 3 January 2003 to 9 February 2004. In this period we relied on the USD/MTL exchange rate provided by the Central Bank of Malta. For all other periods we tested whether the OANDA rate for USD/MTL and the rate provided by the Central Bank of Malta were consistent and we found that they were, thereby legitimising our use of the Central Bank of Malta rates for the period 3 January 2003 to 9 February 2004; and

- (c) summed the total value of transactions in the qualifying period (both acquisition and redemptions) in order to assess whether or not they are less than, or more than, \$50,000.

3.4.8 GVTH Advocates have provided advice to Mazars as to:

- (a) whether individual investors can be categorised as experienced investors by virtue of previous jointly held investments. GVTH advised that an individual investor could not rely on previously jointly held investments to show that he / she was an experienced investor; and
- (b) whether joint investors can be categorised as experienced investors by virtue of previous individually held investments. GVTH advised that joint investors could be deemed experienced if:
 - (i) all of the joint investors had previously and individually qualified as an experienced investor; or
 - (ii) all of the joint investors had previously and together (i.e. in the same group) qualified as an experienced investor.

Step 4: Qualifying investors other than by way of qualifying investments

3.4.9 Investors are also deemed Experienced Investors if they have worked in the financial services sector for at least one year or they have been active, for at least one year, in a professional position, in the acquisition and/or disposal of real estate property funds and/or in securities linked to real estate property.

Independent Expert's Report

3.4.10 Where BoV has provided evidence of the above and Mazars has been unable to conclude (as the evidence is ambiguous) this has been categorised as inexperienced.

Step 5: Further evidence

3.4.11 In December, after completion of Mazars' review of each file, Mazars provided to BoV a list of all files that at that time it had considered had insufficient evidence to conclude they can be categorised as experienced investor. BoV was given an opportunity to provide further evidence in respect of these files and Mazars considered any such evidence provided and amended the categorisations where appropriate.

Step 6: Quality assurance of the file review

3.4.12 Mazars has ensured that the conclusions drawn in respect of each file have undergone two layers of independent review. This includes a quality assurance review carried out by both:

- (a) local Mazars Partners in Malta, who were not involved in the original file review; and
- (b) members of Mazars' Forensic and Investigation Services team in London, who were not involved in the original file review.

4 Conclusions

4.1.1 Following the review of the files, Mazars has categorised each investor into one of the following categories:

- (a) Execution Only – based on our review of the SoC;
- (b) Experienced investors – Experienced investors are investors who did receive investment advice, and the Bank has been able to demonstrate that they qualified as Experienced Investors by virtue of:
 - (i) having worked in the financial services sector for at least one year in a professional position; or
 - (ii) having been active for at least one year in a professional position in the acquisition or disposal of real estate property funds or of securities linked to real estate property; or
 - (iii) having completed qualifying transactions of over \$50,000 over the relevant five year period;
- (c) Inexperienced investors – Inexperienced investors are investors who did receive investment advice (including investments for which no properly completed SoC has been provided), and the Bank has not been able to demonstrate conclusively that they completed qualifying transactions of over \$50,000 over the relevant five year period or otherwise qualified as Experienced Investors. These are further sub categorised into those where BoV was given the opportunity to provide further evidence but did not do so and those that BoV contends are experienced investors; and
- (d) Investors who made their investment in the Fund via an intermediary.

4.1.2 A summary of our findings is set out below:

Independent Expert's Report

Table 4.1: Summary of our findings

	BoV files	Wealth management files	Total
Execution Only – based on original or carbon	442	-	442
Execution Only – based on photocopy	53	1	54
Experienced investors	1,131	59	1,190
Inexperienced investors – where BoV did not provide sufficient evidence	528	16	544
Inexperienced investors – where BoV contends they are experienced	22	1	23
Investments made via an intermediary ^(Note 1)	5	-	5
Total	2,181	77	2,258

Note 1: Mazars has classified 3 of these investors as experienced, and 2 as inexperienced

4.1.3 These findings are expanded in the five attached schedules:

- (a) Schedule 1(a) – A list of all Execution Only investments with an original or carbon copy of the Statement of Compliance;
- (b) Schedule 1(b) – A list of Execution Only investments with a photocopy of the Statement of Compliance;
- (c) Schedule 2 – A list of all investments that are deemed by Mazars and BoV to qualify under the Experienced Investor criteria by virtue of evidence of previous investments or otherwise;
- (d) Schedule 3 – A list of all investments that are deemed by Mazars not to qualify under the Experienced Investor criteria by virtue of evidence of previous investments or otherwise and where BoV was given the opportunity to provide further evidence but did not do so;

Independent Expert's Report

- (e) Schedule 4 – A list of, and explanatory narrative for, all investments for which Mazars has not seen sufficient evidence that they qualify under the Experienced Investor criteria or otherwise but which BoV contend do; and
- (f) Schedule 5 – A list of investments made via an intermediary.