Responses to the follow-up questions of the Legislative Council Panel on Financial Affairs

Enhancing deposit protection under the Deposit Protection Scheme

(1) In relation to Hon Paul CHAN's concern about the investment strategy and return of the Deposit Protection Scheme (DPS) Fund, the Administration/Hong Kong Deposit Protection Board (HKDPB) were requested to consider and advise whether the sums in the DPS Fund should be placed with the Exchange Fund for investment, and receive a "fixed rate" fee payment like that for the fiscal reserves.

The main investment objectives of the DPS Fund are to preserve capital and maintain a high level of liquidity for meeting the cost of payouts. Consistent with these objectives, the DPS Ordinance specifies that the DPS Fund can be invested only in:

(a) deposits with the Exchange Fund;
(b) Exchange Fund Bills;
(c) US Treasury Bills;
(d) exchange rate or interest rate contracts for hedging purpose; and
(e) any other investments approved by the Financial Secretary (FS). Up-to-date, the FS has approved, subject to specified limits, investments in Exchange Fund Notes and US Treasury Notes of a tenor up to 2 years, and the maintenance of bank balances to facilitate the investment in the government papers.

The DPS Ordinance also specifies that the HKDPB has a function to manage and administer the DPS Fund. For the performance of this function, the HKDPB has established an investment committee. The committee comprises members with expertise in investment, banking and accounting. Given the relatively limited investment mandate and scope of the DPS Fund, the investment operation of the DPS Fund has been conducted very smoothly under the guidance of the committee.

The Exchange Fund does not have a mandate to provide fund management or investment service to other entities. Currently, it pays a market-based interest rate on deposits it takes from the DPS Fund. Unlike fiscal transfers from the Hong Kong SAR Government, which are public monies, the DPS Fund mainly comprises contributions paid by banks. Requiring the Exchange Fund to offer a fixed rate of interest to the placements by the DPS Fund similar to that applicable to fiscal transfers may result in the Exchange Fund's subsidisation of the privately-funded DPS.

(2) ***In relation to Hon James TO's concern about the implementation of the full deposit guarantee arrangement, the HKDPB was requested to provide the latest information on the number of account holders with non-protected deposits, following the deadline for notifications by Authroized Institutions (AIs) to account holders with non-protected deposits by the end of May 2009.***

According to the statutory guideline issued by the Hong Kong Monetary Authority (HKMA) in December 2008, all AIs are required to notify their customers of the non-protected deposits held by them before the end of May 2009. Based on the statistics reported by major retail banks after the completion of the notification exercise, it is estimated that less than 5% of their depositors are holding a non-protected deposit.

(3) ***To address Hon James TO's concern about the scope of protection under the DPS, the HKDPB was requested to provide the following information:***

(a) ***if the protection limit under the DPS was increased to HK$200,000, the percentage of depositors and the percentage of value of deposits covered (taking into account the effect of account splitting behaviour of depositors in response to the increase); and***

(b) ***if the protection limit under the DPS was increased to HK$500,000, the percentage of depositors and the percentage of value of deposits covered and not covered (taking into account the effect of account splitting behaviour of depositors in response to the increase)***

Based on the statistics reported by major retail banks to a survey of the HKDPB (with reference to their end-October 2008 positions), it is projected that about 84% and 91% of their depositors would be fully protected by the DPS if the protection limit is raised to HK$200,000 and HK$500,000 respectively. In terms of value of deposits covered, the corresponding percentages are estimated to be 17% and 27%. The estimations, however, were made without considering possible deposit splitting behaviour of depositors.

The findings of the past opinions surveys conducted by the HKDPB suggest that splitting of deposits into different banks has not been common among depositors under the current protection limit of HK$100,000. Whether depositors will opt to split their deposits at higher protection limits will depend on a host of factors, for example, the stability and the competitive environment of the banking sector, the benefits and costs relevant to individual depositors. It is therefore potentially difficult, if not impossible, to model the deposit splitting behaviour of depositors. The HKDPB, however, will continue to monitor the relevant trends and patterns through regular opinion surveys.

The current design of the DPS can to some extent accommodate an increase in deposit splitting behaviour. As the contributions payable by banks are calculated as a percentage of the amount of relevant deposits held with them, the amount of contributions collected will increase with the growth in the amount of relevant deposits due to deposit splitting behaviour. Hence, the effectiveness of the DPS will not be unduly affected unless deposit splitting becomes very common place. As mentioned above, the Board will keep this under close monitor.

(4) To address the Chairman's concern about the types of institution covered by the DPS, the HKDPB was requested to provide Information regarding the number of deposit accounts in the restricted licence banks (RLBs) and deposit-taking companies (DTCs), with breakdown by the number of accounts with a deposit of HK$500,000 or below and those with a deposit of over HK$500,000

Compensations under the DPS are calculated on a per depositor basis, that is, the deposits of a depositor in different accounts will be aggregated for compensation assessment purpose. It is therefore more relevant to assess the effectiveness of the DPS in terms of the number of depositors, instead of the number of accounts, of an institution covered by it. For the DPS to be effective in preventing rumour-driven run on an institution, it must be able to provide full protection to a majority of its depositors. Under a protection limit of HK$500,000, over 90% of depositors at banks would become fully protected by the DPS.

As RLBs are permitted by law to take only deposits of HK$500,000 or above, they have no depositors with a deposit balance of less than HK$500,000. In other words, none of their depositors would become fully protected under a protection limit of HK$500,000.

DTCs are permitted by law to take only deposits of HK$100,000 or above. Based on the statistics available to the HKDPB, only 8 out of the all 27 DTCs have more than 10 depositors. On average, about 60% of the depositors of DTCs have a deposit balance of over HK$500,000. Only around 40% of their depositors have a balance of HK$500,000 or below. This confirms that the DPS will not be able to fully protect a majority of their depositors even if its protection limit is raised to HK$500,000.

Hong Kong Deposit Protection Board
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