

## LEGISLATIVE COUNCIL PANEL ON FINANCIAL AFFAIRS

### REVIEW OF THE DEPOSIT PROTECTION SCHEME

#### PURPOSE

This paper provides Members with an update on the progress of the review of the Deposit Protection Scheme (“DPS”) and the legislative proposal for taking forward the enhancements to the DPS concluded in the review.

#### BACKGROUND

2. In the light of relevant developments in international and local financial markets since the outbreak of the global financial crisis in 2007, and experience gained from operating the DPS, the Hong Kong Deposit Protection Board (the “Board”) commenced a two-phase review of the DPS in the fourth quarter of 2008. The first and second phases of the review were completed by March 2009 and July 2009 respectively as scheduled, each followed by a two-month public consultation. The two phases of the review were concluded by the publication of the respective consultation reports in August 2009 and November 2009.

3. During the public consultations, the Board launched extensive publicity campaigns to draw public attention to the review and invite public comments. The Board also actively approached and engaged relevant stakeholders, including the banking industry, Consumer Council, Standing Committee on Company Law Reform, academics and professional bodies. The Board briefed this Panel on the first phase of the review in June 2009 and had arranged a briefing to the assistants of Legislative Council (“LegCo”) Members to facilitate Members in considering the recommendations set out in the consultation document. The Board also gathered public responses to the key recommendations under consultation during its regular opinion surveys on public opinions about the DPS.

4. According to the responses to the consultations and findings of the opinion surveys, the recommendations of the Board received broad support from the public and different stakeholders, including the banking industry and Consumer Council. To put the recommendations into effect, the Financial Services and the Treasury Bureau, together with the Board, are now following

up the preparation of the legislative proposal for amending the Deposit Protection Scheme Ordinance (“DPSO”) (Cap. 581) as well as some of its subsidiary legislation, and making consequential amendments to the Companies Ordinance (“CO”) (Cap. 32).

## **HIGHLIGHTS OF THE LEGISLATIVE PROPOSAL**

### ***(A) Enhancing the level and scope of protection***

5. After considering the costs and benefits of various options and the results of the consultations, the Board decided to raise the DPS protection limit from HK\$100,000 to HK\$500,000. This will bring the level of deposit protection in Hong Kong in line with the levels in major markets in absolute terms and to the higher end of international standards (90%) in terms of percentage of depositors fully covered. Raising the limit to above HK\$500,000 would add little to effectiveness, at a disproportionately higher cost and a higher level of moral hazard. To effect this enhancement, all references to HK\$100,000 in the DPSO will need to be changed to HK\$500,000.

6. In addition to raising the protection limit, the results of the consultations also supported the Board’s recommendation of expanding DPS coverage to include secured deposits. This will have the effect of removing any uncertainties surrounding the protection status of a deposit taken as security by banks, or subject to any forms of encumbrance, for supporting other banking and financial services provided to depositors, most commonly under an integrated account. The improved clarity of the coverage of the DPS brought about by this enhancement is expected to help foster stronger confidence in the DPS. To effect this enhancement, the definition of deposit in the DPSO will be revised by adding deposits upon terms referable to the provision of other banking and financial services.

### ***(B) Mitigating the likelihood of cost transfer to depositors***

7. Raising the DPS protection limit and protecting secured deposits will cause an increase in the amount of deposits in the industry protected by the DPS, which will be translated into a higher level of contribution payable by banks. As a result, the target size of the DPS Fund will increase in absolute terms, but will decrease slightly as a percentage of the total amount of deposits protected. In order to eliminate any incentive for banks to pass the added cost to depositors, the Board decided to cut the rates for charging annual premium on banks by 65% to keep the annual contribution payable by the industry at the current level. In addition, the Board also decided to allow banks to report their

amounts of relevant deposits for contribution assessment purposes on a basis (net deposit basis) more reflective of the basis on which compensation under the DPS is determined. The aforesaid changes can be effected by adjusting the figures for the target size of the DPS Fund and the rates for charging annual premium on banks, and by setting out the rules for banks to report relevant deposits on a net deposit basis for contribution assessment purposes in the DPSO.

8. As the DPS relies heavily on subrogating into the priority claims of depositors to recover the compensation it pays, consequential amendments to the provisions on priority claims of depositors in the CO will have to be made to contain the cost of enhancing deposit protection under the DPS at a manageable level. Specifically, the definition of deposit and the level of preferential claims in the CO are proposed to be linked to their counterparts in the DPSO.

***(C) Improving the efficiency of making compensation payments***

9. Based on the experience gained by the Board from payout rehearsals and simulation tests conducted since the inception of the DPS, the Board has identified a number of enhancements to the DPSO that can help expedite the process of making compensation to depositors in a payout. The enhancements include legitimising the Board members' participation in Board meetings while they are overseas so as to ensure that swift resolutions can be passed on payout-related matters; and empowering the Board to decide the amount of accrued interests on complex interest-bearing products and the values of annuities and future and contingent liabilities to avoid delays due to the need to perform precise calculations. The Board also suggested articulating more clearly its power to determine the amount of interim payments applicable to individual groups of depositors. The legislative provisions relating to the proceedings of the Board as well as the calculation and limit of compensation will need to be amended to effect these enhancements.

***(D) Enhancing the representation regime of the DPS***

10. In the light of the heightened public attention to the coverage of the DPS after the outbreak of the global financial crisis as well as a clear public demand for strengthening the representation regime of the DPS, the Board decided to enhance the regime by tightening some of the existing disclosure requirements and adding new ones. The recommendations received broad support from the public, and the banking industry also indicated willingness to co-operate.

11. The recommendations of the Board include abolishing the flexibility of making negative disclosures on non-protected deposit on an account basis, except in the case of automatic rollovers or disclosures made to institutional clients. Positive disclosures are recommended to be introduced to require banks to confirm the protection status of a deposit to depositors. Specifically, such disclosures will be required to be made at least on an account basis, and within specified timeframe and in specified manners upon request. There will also be requirements on the size and location of disclosure statements to ensure disclosures made by banks are prominent, legible and easily identifiable by depositors. Restrictions are also recommended to be imposed on the use of the term “structured deposit” to remove any uncertainties caused by protected deposits being named as structured deposits, which are a type of deposit excluded from protection in the DPSO. The details of the revised and added requirements will be reflected in the subsidiary legislation of the DPSO.

### **TIMETABLE FOR THE LEGISLATIVE PROPOSAL**

12. Preparation for the proposed legislative amendments for effecting the recommendations concluded in the review is now underway. We aim to introduce the amendment bill into LegCo in the second quarter of 2010. The bill will include amendments to the DPSO as well as consequential and related amendments to the CO and subsidiary legislation under the DPSO. Further amendments to the subsidiary legislation under the DPSO will be submitted to LegCo for negative vetting after the passage of the amendment bill.

### **IMPLEMENTATION SCHEDULE**

13. Subject to LegCo’s consideration and approval, we plan to bring the proposed legislative amendments into effect before the start of 2011. We will render full support to LegCo upon the introduction of the amendment bill, with a view to facilitating the early passage of the bill.

14. To ensure a smooth transition to the enhanced DPS, the Board will engage the industry at the earliest possible time to ensure their readiness, and will launch a publicity campaign to highlight the new features of the enhanced DPS on enactment of the proposed legislative amendments.