

Comments on the Deposit Protection Scheme Bill

The following are comments on the Committee Stage Amendments to the Bill by the Law Society's Company and Financial Law Committee:

Subrogation

The Committee considers Clause 36 on subrogation must be clarified to state exactly what rights are being subrogated. Are they rights held by the depositor in respect of his own deposits (i.e. the depositor's own rights), or are they rights of the relevant beneficiaries (under bare trusts), or clients (in respect of funds in the client's account)?

Corresponding amendments will also be necessary, in respect of payments made to a depositor, in order to clarify the capacity in which the payment is received by the depositor - i.e. is it payment to the depositor in his own right or is the depositor holding the compensation simply for those who are entitled to claim (i.e. beneficiaries under bare trusts and clients of a client's account)?

The drafting should clarify that the subrogation is specific to:

- (a) the depositor in his own right, and
- (b) individual clients of the depositor or beneficiaries under a bare trust to which the depositor acts as the trustee.

It is appreciated that these changes may have a consequential affect in relation to other parts of the Bill. However, without such clarification, the provisions in Clause 36 are unclear.

Deposits held on trust by law firms

It is noted that in most cases involving a law firm, deposits held by the firm in its own right will be quite clear and this will therefore be dealt with by the first round distribution. Clients' deposits, or other deposits held on trust (whether it be active trust or bare trust) will be dealt with by a subsequent round of distribution as the Board will need some time to investigate the background in order to determine entitlement.

From that perspective, the HKMC has indicated its view that in most cases, there should not be any practical problems because the law firm will first be compensated for its own deposits. The law firm's own entitlements will not be subrogated on account of payments made to it in respect of its clients' accounts because compensation to clients will only be paid later on.

Client's Account

The definition of client's account should refer to "one or more clients". Discussion has taken place with the HKMA on whether or not the definition of client's account should be more restricted as these accounts cover professional services. In this connection, it is noted that the accounts must be maintained for the purpose of holding money on behalf of clients and therefore, unless such an account is maintained, it will not constitute a client's account.

Funds received from clients/customers and used by the depositor as its working capital will not therefore be regarded as clients'/customers' accounts because an account has not been maintained separately for that purpose. This, however, also means that if an account is separately maintained, the Board has to decide what "client" means and whether it is a client's account.

Depositor

In relation to the definition of "depositor", while it probably covers the situation of a garnishee (because payment to the garnishee discharges the repayment obligations in respect of the underlying deposit and should therefore count as a "repayment" of a deposit), the drafting should be clarified to cover the situation where the garnishee order relates only to part of the deposit. Note that only a "protected deposit" is defined to mean part thereof.

Stakeholders' funds

With respect to section 2(1)(a), it is not clear what is meant by "under a trust for the client" when perhaps the whole point is that a stakeholder does not hold the funds on trust for any specific client. The sub-section has to be redrafted to clarify that stakeholders' funds, as well as "uncleared trusts" (money paid into a client's account which in fact belongs to the solicitor, but the solicitor has not yet transferred the funds over to the office account) should be excluded as a deposit in a client's account for the purpose of the Ordinance.

In connection with Note 11, it should be noted that the law firm is not entitled to compensation in respect of monies held as a stakeholder. Any compensation to be paid to the law firm will be held by it as stakeholders. In addition to the example of stakeholder, there is also the situation of unsplit trusts referred to above (i.e. money paid into a client's account but actually belonging to the solicitor). The new definition of a stakeholder's account should perhaps refer to funds in a clients' account which are subject to a stakeholders' agreement or arrangement.