

## **Results of the Second Public Consultation on Deposit Protection**

In March 2002, the Hong Kong Monetary Authority (HKMA) conducted a second public consultation on the subject of enhancing deposit protection in Hong Kong. The second consultation focused on the HKMA's recommendations on how the proposed deposit protection scheme in Hong Kong should be structured.

2. A total of 20 written submissions were received from the banking industry, insolvency practitioners, the Consumer Council and other interested parties. A full list of the respondents is set out below. A summary of the major comments received and the HKMA's responses is at the Annex.

### **List of Respondents to the Second Public Consultation on Deposit Protection**

#### **Banking sector**

1. Hong Kong Association of Banks
2. Agricultural Bank of China
3. Asia Commercial Bank
4. Bank of America (Asia) Ltd
5. BNP Paribas
6. Chekiang First Bank
7. Dah Sing Bank
8. The Hongkong and Shanghai Banking Corporation Ltd.
9. Liu Chong Hing Bank
10. Royal Bank of Scotland
11. Shanghai Commercial Bank
12. Standard Chartered Bank
13. UBS Warburg
14. Wing Hang Bank
15. Wing Lung Bank

#### **Other organisations**

16. Consumer Council
17. Canada Deposit Insurance Corporation
18. Hong Kong Democratic Foundation
19. KPMG
20. Official Receiver

**Summary of Comments  
Received in the Second Public Consultation<sup>1</sup>**

<b>Comments</b>	<b>HKMA's Responses</b>
<b><i>Establishment of Deposit Protection Board</i></b>	
<ul style="list-style-type: none"><li>• The Consumer Council supported the proposed establishment of a statutory independent Deposit Protection Board (DPB). It considered that separation of governance between the DPB and the supervisory authority could avoid conflict of interest and provide greater accountability and transparency to the public. However, to reduce the running cost of the scheme, the Council supported the DPB to outsource the day to day administration of the scheme to the HKMA. But the DPB should retain responsibility for oversight of the operations of the scheme.</li><li>• The Hong Kong Association of Banks (HKAB) suggested that consideration might be given to putting the administrative function within the existing set-up of the HKMA and funded by the overall budget of the HKMA. They considered that this could facilitate better co-ordination of the various functions of the HKMA such as bank supervision, lender of last resort and “pay-box” function of the DPS. This would also have the advantage of keeping the administrative structure lean and efficient. In its letter of 30 October 2002, the Consumer Council expressed support to the proposal for the HKMA performing the administrative functions of the Scheme.</li></ul>	<p>The consultation exercise conducted in 2000 showed that the majority of the respondents were in favour of establishing a separate legal entity to run the DPS. This can help to promote accountability and transparency to the public. It is relevant to note that a separate independent deposit insurer is commonly adopted by other financial centres such as the US, UK and Canada.</p> <p>Nevertheless, in view of the industry's concern about cost, the HKMA has taken on board the Consumer Council and HKAB's suggestion that the DPS Board should outsource the day-to-day administration of the scheme to the HKMA as a means of cost saving. In keeping with the “user-pays principle”, the costs incurred by the HKMA in the administration of the DPS would be recovered from the DPS Fund.</p> <p><b>(See clause 6 of the DPS Bill)</b></p>

<sup>1</sup> This table should be read together with the second consultation paper published by the HKMA in March 2002. The consultation paper can be downloaded from the HKMA's website at <http://www.hkma.gov.hk>.

<ul style="list-style-type: none"> <li>• A political group expressed opposition against setting up a new statutory body to administer the proposed DPS. It was concerned that there had been a proliferation of such bodies in recent years. It preferred the scheme to be administered by the HKMA.</li> </ul>	
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Comments	HKMA's Responses
<b><i>Membership – exemption of foreign bank branches</i></b>	
<ul style="list-style-type: none"> <li>• The Office of the Official Receiver (ORO) commented that to ensure that the protection offered by an exempted overseas scheme was no less favourable than the Hong Kong DPS might be a very complicated issue, particularly when different taxation systems (e.g. on interest earned on deposits) of different jurisdictions were involved.</li> <li>• A number of banks were against the proposed exemption arrangement for foreign bank branches in Hong Kong for fears that the exempted banks would have competitive advantages over their local peers. Moreover, allowing option of exemption would entail additional costs in assessing and monitoring overseas schemes, and cause further complications in determining whether a home country scheme was comparable or not.</li> </ul>	<p>The HKMA believes that it is desirable as a matter of general principle to introduce such an arrangement so that foreign bank branches would not be required to pay double premium for the same deposits. This arrangement is also conducive to maintaining Hong Kong's attractiveness as an international financial centre. The costs concern can be somewhat mitigated by imposing a suitable exemption fee on the banks concerned to help defray the costs of granting and monitoring the exemption status.</p> <p><b>(See clause 12 of the DPS Bill)</b></p>
<b><i>Membership – disclosure of protected membership status</i></b>	
<ul style="list-style-type: none"> <li>• The Consumer Council considered that in addition to requiring authorized institutions (AIs) which are not members of the DPS to disclose their unprotected status, it would seem preferable that member banks should be required to display some form of official DPS sign or logo at their premises, thereby allowing consumers to distinguish between member and non-member institutions.</li> </ul>	<p>The HKMA agrees that measures should be in place to ensure that depositors can readily ascertain the membership status of an AI. The DPS legislation would contain provisions governing how Scheme members should disclose their DPS membership as well as provisions prohibiting false or deceptive representations concerning membership status. These would include provisions empowering the DPB to set rules on representations concerning DPS membership.</p> <p><b>(See clause 47 and clause 49(1)(e) of the DPS Bill)</b></p>

Comments	HKMA's Responses
<p><b>Trigger</b></p> <ul style="list-style-type: none"> <li>HKAB considered that to reduce the element of subjectivity, the trigger of the DPS should be directly related to the inability of a participating bank to repay deposits and not to a judgment by the HKMA on the stability of the banking system. They commented that the proposed loose definition on the trigger would be against the user-pays principle and add potential financial burden to all participating banks. They emphasized that clear, objective criteria were needed.</li> </ul>	
	<p>Relating the DPS trigger to the stability of the banking system would provide the MA with greater flexibility in dealing with a crisis situation. However, such a provision could potentially be prejudicial to the interests of the creditors and shareholders of the affected bank. It is further noted that the trigger conditions for the schemes in Canada and the UK are related solely to a participating bank's ability to repay deposits. In line with the practices of other deposit insurers, we have accepted HKAB's view that the trigger conditions for the DPS should not be related to the regulator's judgement of the stability of the banking system.</p> <p>However, the trigger criteria cannot be made entirely objective. For example, one of the trigger criteria is that the MA believes that the institution is <u>likely</u> to become unable to meet its obligations. This is necessary because sometimes a problem bank may have no immediate problem in meeting its obligations. However, it may be the MA's judgement that it would not be able to meet its obligations in the longer term. This happened in the case of BCCHK in 1991. A certain element of judgement is therefore necessary. This formulation is consistent with the grounds under which the MA may use his powers under section 52 of the Banking Ordinance to appoint a Manager.</p> <p><b>(See clause 21 of the DPS Bill)</b></p>

Comments	HKMA's Responses
<p><b><i>Coverage – special types of accounts</i></b></p> <ul style="list-style-type: none"> <li>• HKAB raised concerns that significant systems enhancements and considerable manual intervention would be involved in calculating the protected deposits with respect to client accounts and trust accounts. The Association cautioned that the proposed treatment on client accounts had serious operational and cost implications, and the administrative work on annual disclosure on the number of beneficiaries and their respective entitlements would spill over to solicitors and other professional firms. The Association also pointed out that there might also be privacy and confidentiality issues since clients of an accountholder who happened to be a trustee or a professional practice were not bank customers by definition. It suggested excluding these special types of accounts or introducing a simpler treatment. It also sought clarification on whether the bank or agent would be held liable for not including the potential claims of the principals for the purpose of contribution assessment.</li> <li>• The ORO and an insolvency practitioner considered that the proposed treatment in respect of each type of these special accounts was in line with the general provision in law. The ORO also agreed that s.265 of the Companies Ordinance (CO) should be amended to spell out the proposed treatment. The insolvency practitioner noted that the proposal with respect to client accounts would be an additional administrative burden for both the banks and accountholders, but it would be necessary in order to protect clients' interests.</li> </ul>	
	<p>This issue could be best addressed by looking at compensation entitlement and contribution assessment separately. It would still be right in principle to protect the underlying beneficiaries of client accounts. To exclude them would undermine the effectiveness of the scheme. It is also relevant to note that the leading DPSs do extend protection to these types of accounts, e.g. the UK, US and Canada.</p> <p>However the HKMA notes the banks' concern about the disclosure requirement and its implications for system enhancements and the administrative burden on other professional firms. The proposed disclosure requirement on client accounts is for the purpose of facilitating contribution calculation only. In view of the difficulties expressed, we consider that contribution calculation should be simplified by treating the accountholder of a client account as a separate depositor without the need to identify the respective beneficiaries. This would likely result in a smaller protected deposit figure and less contribution income for the DPS. But the reduction would not be significant as the balance of these accounts is not expected to contribute to a large percentage of the total deposit base.</p> <p>This proposed simplified treatment in relation to contribution calculation should not affect the actual entitlements in compensation payment. In a payout situation, the underlying beneficiaries should still be entitled to compensations, but their entitlement in a client account would need to be aggregated with their other deposits for determining the amount of compensation payment.</p> <p>This treatment for contribution calculation should also be applied to bare trust accounts and agent accounts, as they are akin to client accounts.</p>

Comments	HKMA's Responses
	(See section 1(2) of Schedule 4 for contribution calculation and clause 27 for entitlement to compensation in respect of bare trusts, agencies and client accounts)
<b><i>Coverage – Treatment of accrued interest</i></b>	
<ul style="list-style-type: none"> <li>• HKAB supported the treatment of accrued interest as proposed in paragraph 3.10 of the consultation paper by amending s.227E of the Companies Ordinance (CO) to make the DPS trigger date as the relevant date for the purpose of this section. This would mean applying the same treatment of accrued interest by the liquidator and that of the DPS which should help in lowering the cost of liquidation.</li> <li>• However, the ORO did not favour the idea of amending s.227E of the CO to make the DPS trigger date the “relevant date” for the purpose of that section in cases where the payment was made by the DPS before the appointment of a provisional liquidator. Other insolvency practitioners also had reservation about the proposed amendment as this might be prejudicial to the interests of other creditors.</li> </ul>	<p>Comments received regarding the proposal to make the DPS trigger date as the relevant date for the purpose of section 227E of the Companies Ordinance are mixed. While the banking industry favours this proposal as this would avoid the need for apportioning DPS payment to the various accounts of the depositor, some insolvency practitioners have expressed strong reservation on this proposal. They argued that this proposal would affect the interests of other creditors of the failed bank.</p> <p>In view of the above comments, we have reconsidered our approach regarding accrual of interest under the DPS. The DPS should have the ability to make quick payment to depositors even if the liquidation proceedings have not yet commenced. In the case where the DPS makes payment before the liquidation valuation date (which would usually be the date of appointment of the provisional liquidator), the funding costs of the DPS will be higher since it will be paying out earlier in the liquidation process. It also opens up the possibility of depositors receiving a double benefit because they will have received payment from the DPS but interest will continue to accrue on their underlying deposits.</p> <p>To deal with this situation, it is proposed that the DPS should <u>not</u> take assignment of the depositor's rights in respect of the underlying deposits. Rather, the DPS would simply make a compensation payment (up to the coverage limit) and would be entitled to recover the amount paid out of the depositor's ultimate net claim on the assets of the failed bank. This would be achieved by means of subrogation rather than</p>

Comments	HKMA's Responses
	<p>assignment as originally proposed. This approach would avoid the need for the compensation payment to be apportioned to different accounts of the depositor.</p> <p>In order to compensate the DPS for the time value of its money and to reduce the extent of double benefit received by depositors, the payment made by the DPS would accrue interest. This would be calculated at a standard rate for the period from the date on which the DPS payment is made to the liquidation valuation date. Under the subrogation approach, such interest would be recoverable by the DPS (along with the principal of the compensation payment) from the amount due to the depositor in the liquidation. In the interests of simplicity, it is further proposed that the standard rate of interest payable on the DPS payment should be the average Hong Kong dollar savings account rate during the relevant period.</p> <p><b>(See clause 36 of the DPS Bill)</b></p>



Comments	HKMA's Responses
<b><i>Coverage- exclusion</i></b>	
<ul style="list-style-type: none"> <li>• A number of banks sought clarification on whether a deposit pledged for loan facility would be excluded outright or excluded only if and when the facility was utilized.</li> <li>• An insolvency practitioner suggested that deposits which were charged, mortgaged or pledged as collateral be excluded only to the extent that they had been used to cover indebtedness for which they were provided as security.</li> </ul>	<p>The HKMA considers it appropriate to take out this exclusion for the sake of simplicity. It is relevant to note that such exclusion does not feature in the existing priority claim system or other overseas schemes (e.g. Canada, the US and UK). Including pledged deposits in DPS coverage would not significantly increase compensation payout since payout would be made on a fully netted basis in any case.</p> <p><b>(See Schedule 1 of the DPS Bill)</b></p> <p>In developing the proposed design of the DPS, the HKMA has considered a number of ways to distinguish “wholesale” deposits from “small” deposits. There appear to be two possible ways to exclude wholesale deposits from the protection of the DPS. The first option is to specify an amount of deposits (e.g. \$500,000) over which a depositor would be regarded as “wholesale” and thus would not be covered. Despite its simplicity, this option could give rise to unfair situations (e.g. a depositor who has an aggregate amount of deposits slightly <u>below</u> the specified limit would be protected while another depositor who has an aggregate amount of deposits slightly <u>above</u> would not). For this reason, we do not favour this option.</p> <p>Another option is the approach currently adopted by the UK scheme, which does not protect large companies, firms (other than sole trader firms or small businesses), overseas financial services institutions and collective investment schemes etc. For this approach to be practicable, terms such as “large company”, “small business” and “financial service institution” must be clearly defined. This is not an easy task and could give rise to a lot of controversies. In addition, incorporating such exclusions might unnecessarily complicate our scheme. This could ultimately affect the DPS’ ability</p>

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	<p>to make quick payment to eligible depositors.</p> <p>For these practical reasons, our preference remains to be that no distinction need be made between “small” and “wholesale” depositors. Given that contribution is only calculated up to the first \$100,000 of such large deposits, it is not expected that inclusion of such deposits would result in significant financial burden on the banks.</p> <p>Nonetheless, it is reasonable to exclude interbank deposits from DPS protection. The HKMA therefore proposes that overseas banks which are not AIs in Hong Kong should also be excluded. This is in line with the treatment for deposits by AIs, which would also be excluded from DPS protection.</p> <p><b>(See definition of “excluded person” in Schedule 1)</b></p>

Comments	HKMA's Responses
<b><i>Target fund size</i></b>	
<ul style="list-style-type: none"> <li>• HKAB considered that 99.8% confidence interval and \$1.5 billion seemed to be on the high side. The sum in the region of \$1 billion which would be capable of meeting the losses arising from failure of 1 mid-sized bank and 1 smaller mid-sized bank could be an equitable target.</li> <li>• HKAB queried the justifications for the \$1.5 billion target. It considered that benchmarks using capital ratio and investment grade rating might not be relevant since the credibility would stem from Government liquidity backup. It argued further that according to the discussion paper of September 2001, payment required to cope with failure of 2 mid-sized banks would in any event be larger than \$1.5 billion. In the absence of solid objective criteria, it appeared that there was room for bringing this figure down further.</li> <li>• The Consumer Council did not support a further reduction of the target fund size, as it might further reduce the protection to depositors.</li> </ul>	<p>The HKMA proposes that the target fund size be set at 0.3% of the total protected deposits of the banking sector. At current deposit levels, this would amount to approximately \$1.6 billion. This target fund size was based on a statistical model developed by the Consultant who advised the HKMA on the establishment of the DPS. The main considerations for the proposed fund size are:</p> <ul style="list-style-type: none"> <li>• The proposed fund size corresponds to a solvency standard that matches an investment grade rating of BBB-: and</li> <li>• The proposed fund size would be able to cope with the simultaneous failure of two medium-sized banks. This is specified as a benchmark for assessing the adequacy of deposit protection funds by the IMF.</li> </ul> <p>Reducing the fund size further would have a negative impact on the credibility of the DPS. It also compares unfavourably with other schemes that have adopted a similar approach in setting the fund size.</p>
<ul style="list-style-type: none"> <li>• The Consumer Council queried whether the reduction in the upper limit from +30% to +15% would still provide an adequate buffer to the DPS as was originally considered necessary.</li> </ul>	<p>The proposed fund size would already provide adequate buffer. The upper and lower limits are set primarily to reduce the possibility of volatile contributions, i.e. reduce the frequency of surcharge and rebate. Accordingly, lowering the upper limit to +15% is not expected to have any significant impact on the DPS' ability to absorb losses.</p>

Comments	HKMA's Responses
<p><b><i>Funding</i></b></p> <ul style="list-style-type: none"> <li>• HKAB commented that the Government should assist by making initial contribution and by absorbing administrative costs to avoid the cost being a drain on the fund. It argued that as the Government ultimately would approve the setup of the DPB, it would have a much greater incentive to control costs if it was funding them directly.</li> <li>• The ORO however was of the view that the Government should not be liable for contribution to the capital of the DPS.</li> </ul>	
<p><b><i>Contribution</i></b></p> <p><b><i>Definition</i></b></p> <ul style="list-style-type: none"> <li>• HKAB pointed out that the term “protected deposits” is not defined in the paper.</li> </ul>	
<p><b><i>Netting</i></b></p> <ul style="list-style-type: none"> <li>• HKAB suggested that the netting principle should be extended to contribution calculation to align contribution paid with payout and avoid inflating the target fund unnecessarily.</li> </ul>	<p>In keeping with the user-pays principle, the HKMA still considers it inappropriate for the Government to provide any form of direct subsidies, other than provision of back-up liquidity, to the scheme. Nevertheless, the HKMA has adopted HKAB's proposal that the Board should outsource the day-to-day administration of the scheme to the HKMA as a means of cost saving.</p> <p><b>(See clause 6 of the DPS Bill)</b></p> <p>Relevant terms will be defined clearly in the legislation.</p> <p><b>(See Schedule 1 of the DPS Bill)</b></p> <p>Our proposition that contribution is to be levied on a gross basis was based on the following considerations:</p> <ul style="list-style-type: none"> <li>▪ Set-off is only crystallised at the point of liquidation;</li> <li>▪ The net balance reported for contribution calculation may be quite different from the position when DPS payout is triggered;</li> <li>▪ Substantial system changes or administrative burden will be required for reporting the net figures; and</li> <li>▪ Leading deposit insurers, such as the Federal Deposit Insurance Corporation (FDIC), the Financial Services Authority (FSA) and the Canada Deposit Insurance Corporation (CDIC), levy contribution on the basis of gross deposits even though they do compensate depositors on a netted or partially netted basis.</li> </ul> <p>The HKMA considers that these reasons remain sound.</p>

Comments	HKMA's Responses
<p><u>Accrued interest</u></p> <ul style="list-style-type: none"> <li>HKAB raised the point that substantial costs in systems upgrade would be incurred for capturing accrued interest in the calculation of the balance of protected deposits. It pointed out that as accrued interest typically represented an insignificant percentage of the deposit principal, its exclusion should not significantly affect the calculation of target fund size.</li> </ul>	<p>The HKMA agrees with the Association that in view of the relatively small amount involved and the technical difficulties, accrued interest need not be included in the calculation of protected deposits for the purpose of determining the target fund size and contribution.</p> <p><b>(See section 1(2) of Schedule 4 of the DPS Bill)</b></p>
<p><u>Minimum contribution</u></p> <ul style="list-style-type: none"> <li>HKAB considered that the proposed minimum contribution of \$10,000 was far too low for a participating bank or new banks. It suggested raising it to \$100,000 to reflect a greater commitment on the part of such banks.</li> </ul>	<p>A minimum contribution could be seen as a management expense levy as the DPB will have to incur administrative expenses irrespective of the amount of protected deposits. Management expense levy and minimum contribution do feature in leading DPSs such as the schemes in the UK and Canada.</p> <p>The HKMA agrees that the current proposed minimum contribution of \$10,000 may be on the low side. Raising the minimum contribution could generate larger income for the DPB to help offset the administrative expenses. However, we would prefer the minimum level not to be excessively high as it would affect a larger number of banks that have a small protected deposit base. It would seem appropriate to increase the minimum contribution to \$50,000.</p> <p><b>(See section 7 of Schedule 4 of the DPS Bill)</b></p>

Comments	HKMA's Responses
<p><u>Contribution range</u></p> <ul style="list-style-type: none"> <li>• A number of banks which favoured flat rate contribution requested the HKMA to reconsider how wide the contribution range should be and to clearly set out the rationale for the proposed ranges (5bp, 8bp, 11bp and 14bp).</li> <li>• A leading deposit insurer commented that the proposed contribution range did not appear wide enough to provide incentive for banks to move into a better category.</li> </ul>	<p>While it is understandable that those who favour flat rate contribution prefer a narrower contribution range, the width of the proposed contribution range is modest compared with other leading schemes such as those in Canada and the US.</p> <p>We need to strike a balance in view of the banks' concern. Under the proposed contribution range, moving into a better category would still enable a bank to achieve reasonable cost savings.</p>
<p><u>Scale-up rate</u></p> <ul style="list-style-type: none"> <li>• HKAB commented that the scale-up rates (i.e. the percentage change in contribution rate when the CAMEL rating deteriorates into the next category) for the build-up contributions and expected-loss contributions should be aligned.</li> </ul>	<p>The difference in the scale-up rates between build-up contributions and expected-loss contributions is due to slight adjustments to eliminate odd numbers so that the contribution range can be kept simple. The proposed expected-loss contributions will yield a weighted-average contribution of around one basis point, which approximates the annual expected loss of the DPS fund. The HKMA would therefore prefer to leave the proposed contribution scale intact.</p>
<p><u>CAMEL rating</u></p> <ul style="list-style-type: none"> <li>• A few foreign banks opined that a bank's overall credit rating was a better yardstick of the risk of default. They considered that in the case of overseas incorporated banks, the institution's overall credit ratings (reflecting its general ability to pay) was relevant, not just a locally derived assessment. They further argued that credit ratings could provide more effective differentiation than CAMEL ratings since the vast majority of banks received a CAMEL 2 rating. They suggested that CAMEL ratings should be used only to differentiate between those institutions which did not benefit from a rating by a recognized agency.</li> </ul>	<p>The use of CAMEL ratings for contribution assessment is consistent with the current approach adopted by the FDIC, except that it also takes into account capital adequacy as a separate element. CDIC differentiates banks by a number of objective factors (e.g. earnings and asset quality) in combination with supervisory ratings. The HKMA believes that CAMEL rating is a good starting point as the CAMEL system has been well established and understood. Further, as a bank supervisor, the HKMA may have access to information that rating agencies do not have. Moreover, credit rating is affected by sovereign rating and not all banks have such a rating. Nonetheless, in the light of experience, the DPB could review the basis of contribution assessment, including bringing in credit ratings and various objective factors.</p>

Comments	HKMA's Responses
<p><u>Foreign currency deposits</u></p> <ul style="list-style-type: none"> <li>• HKAB and a bank suggested that banks should be allowed to use their own foreign currency take-over rate for calculating foreign currency deposit value for the purpose of contribution calculation. The daily take-over exchange rates are for conversion of all foreign currency assets and liabilities into the home currency for accounting statements. In the case of foreign banks, the take-over rates are usually uniform rates advised by the Head Office. The bank argued that manual operation would be needed if they were required to use other rates.</li> </ul>	<p>The exchange rate to be used for calculating the balance of protected deposits for contribution assessment purposes was not addressed in the consultation paper. The HKMA has no strong view on which rate should be used, but a standard approach should be followed by all banks. In principle, the approach adopted should be convenient to the banks and have low risk of manipulation. Whether banks should use their own foreign currency take-over rate or the middle market TT rates at close of business as used in completing the banking returns will be considered when the relevant operational rules are developed.</p>
<p><u>Reporting date</u></p> <ul style="list-style-type: none"> <li>• HKAB opined that 15th day of a calendar month should also be avoided because many employers made payment on a bi-weekly basis.</li> <li>• A bank had reservations on using the balance of protected deposits on one particular day of a year to determine contribution payable for the following year. It expressed concern that this approach would encourage banks to actively manage their deposits so as to minimise contribution payable, which would in turn result in unnecessary fund movements and instability in the banking system.</li> </ul>	<p>Using some form of “average” balance of protected deposits has been considered. Looking at CDIC and FSA, all of them assess contribution for a year based on deposit figures as at a particular day, rather than the “average” balance. It is generally considered that the extra costs involved in reporting average balance would outweigh the benefits of increased accuracy.</p> <p>The HKMA's preference therefore remains that contribution payable for a year is to be assessed on the basis of the balance of protected deposits as at a particular day in the previous year. In view of the industry's concern, it is suggested that the deposit figures as of “20<sup>th</sup> October” be used instead of those as of “15<sup>th</sup> October”.</p> <p><b>(See Schedule 4 of the DPS Bill)</b></p>



Comments	HKMA's Responses
<b><i>Interim payment</i></b>	
<ul style="list-style-type: none"> <li>HKAB remarked that the accounting records and financial statements of a failed bank are usually not in very good order. It therefore recommended to be more conservative on the percentage of interim payment made and to put in place remedies to cater for situations where it was subsequently found that the claimant's deposit was well below that of its liabilities to the bank.</li> </ul>	<p>The HKMA agrees that the data and records of a failed bank in some instances may not provide the DPB with all the necessary information for effecting an interim payment. It is therefore proposed that the DPB should have the discretion, not the obligation, to make interim payment of not more than 25% of the principal balance or \$25,000 (whichever is smaller). Further, the interim payment should be made after setting off the depositor's liabilities as far as possible. The details of the interim payment will be set out in the rules to be made by the DPB under the DPS legislation. As regards remedies, the DPS legislation will provide the DPB a discretionary power to claw back any money to which the depositor is not entitled.</p> <p><b>(See clauses 34, 35 and 49(1)(b) of the DPS Bill)</b></p>
<b><i>Timing of implementation</i></b>	
<ul style="list-style-type: none"> <li>HKAB commented that it was not a good time for the implementation of the DPS and that the timing alluded to might give insufficient time to make systems preparations. It remarked that it would be beneficial to all parties by allowing some flexibility on the timing of implementation. It suggested that consideration might be given to setting objective criteria or circumstances under which the DPS would be implemented or postponed.</li> </ul>	<p>The HKMA has made it clear that the scheme cannot be implemented overnight. It has to go through legislation procedure; the DPB has to be established first to ensure that its systems, operation and procedures and the banks are ready for the implementation. Sufficient time will need to be allowed to ensure that the required infrastructure is ready before banks are required to pay contribution. It would be desirable to put the legal framework in place so that the Scheme can commence at an appropriate time.</p>
<b><i>Customer Notification</i></b>	
<ul style="list-style-type: none"> <li>HKAB suggested that the HKMA should take responsibility for notifying the general public of the implication of any changes in related Ordinances and exempt banks from individual customer notification.</li> </ul>	<p>These are operational issues that would need to be considered when the DPB is established.</p>