

**Consumer Council
Submission to LegCo
Bills Committee on
Deposit Protection Scheme (DPS) Bill**

Introduction

1. The Council welcomes the opportunity to provide its comments on the proposed DPS Bill.
2. The Council supports the introduction of a deposit insurance scheme in Hong Kong for reason that:
 - a) it will contribute to a banking stability by providing an element of confidence in the industry;
 - b) in the event of a bank failure DPS would ensure that small depositors are guaranteed of receiving funds to meet their immediate expenses because they would not have to wait for the full process of administration of assets, and recognition of creditor priority, to run its course; and
 - c) having a DPS is consistent with the protection that is already in place for investors in the stock and futures markets.
3. The Council understands that LegCo Members have raised a number of questions regarding some provisions in the Bill. The Council would like to respond to some of those questions that relate to consumer protection, as follows.

Administration of the DPS by HKMA

4. It has been suggested that appointing the HKMA as the agent for day-to-day administration of the DPS might undermine the credibility and independence of the DPS, and there would be conflict for HKMA as the regulator of banks to take up the role.
5. The Council has previously indicated its view that the DPS Board's role should be
 - a) confined largely to that of a "paybox";
 - b) its size should be kept at a minimal level in order to save costs;
 - c) the functioning of the DPS, in terms of the day-to-day administration of the DPS, should rest with the public sector, e.g. carried out by existing HKMA staff; and
 - d) the board should comprise a majority of lay members to ensure sufficient independence and allow for direct consumer representation.
6. The Council's suggestion as to the composition of the Board was to remove any perception, and possibility of industry control over the administration of the DPS, that would run counter to consumers' interests. The Council's rationale was that if the Board had a majority of persons who represented consumer interests, and the

HKMA was subject to the Board's directions in the day to day administration of the DPS, then the possibility that administration of the scheme would run counter to consumer interests would be diminished.

7. The Council notes that while Clause 4 of the Bill, which deals with composition of the Board, requires that no fewer than four and not more than seven persons shall be appointed to the Board, there is no statutory requirement that persons so appointed, have appropriate qualifications to represent consumer, or at least, not the industry's interests.

8. Therefore, the Council suggests that in order to ensure that depositors' interests are adequately represented, and protected in the event of the HKMA having to administer payments to depositors, that sub clause 4(1)(c)(ii) be amended to read

"not fewer than 4 and not more than 7 other members, who have knowledge of, or experience in consumer protection or are competent to otherwise represent consumer, as distinct from industry, interests"

Exemption from the DPS

9. Some members were concerned that exempting an overseas bank that has a comparable scheme in the bank's home jurisdiction that protects deposits taken by its Hong Kong office would encourage depositors to move their deposits to overseas banks.

10. The ability for consumers to move their deposits to overseas institutions that have deposit insurance has existed in the past, without any apparent discernible detriment to the banking system. Therefore, there does not appear to be any great threat to the local banking system if the proposed exemption is provided. The Council considers that it is of the utmost importance to have measures in place to ensure that depositors can distinguish between member and non-member institutions. There should be provisions prohibiting false or deceptive representations concerning membership status.

Contributions based on CAMEL rating system

11. A concern has been expressed that there would be the problem of moral hazard associated with the DPS and that lower rated banks might be forced to undertake businesses with higher risks in order to recover the higher cost involved.

12. The Council is of the view that the introduction of a DPS would improve the competitive position of smaller banking institutions by increasing confidence on the part of consumers to utilise those smaller institutions' services. Accordingly, the ability to attract a wider consumer base than currently exists would be expected to improve the competitive position of those smaller institutions. A stronger market position by those smaller institutions could diminish any incentive by them to take higher risks in order to gain market share.

Banks might increase charges to customers to recover the cost of the DPS

13. The Council would expect that the increased competition in the market, which in theory should come about because of the enhanced consumer confidence in all participating authorised institutions, would ensure that the extent to which premium costs would be passed on to consumers would be minimal.

Interim payments to depositors

14. The Council notes that some Members have suggested that interim payments should be made to depositors pending the determination of compensation.

15. The Council understands that the method by which payments will be made in the event of the DPS coming into operation will, in effect, be the making of interim payments. This is because in the event of a bank failure the scheme would ensure that small depositors are guaranteed of receiving funds to meet their immediate expenses up to \$100,000 and they would not have to wait for the full process of administration of assets, and recognition of creditor priority, to run its course.

Consumer Council
18 August 2003