

For information on
21 October 2003

**Bills Committee on
Deposit Protection Scheme Bill**

Board Structure and Administration Costs

Background

At the meeting of the Committee held on 25 September 2003, Members requested the Administration to provide a paper on the organisation structure of the DPS Board and an estimate of its administration costs.

Board Structure

2. To minimise the cost of the scheme, the Administration proposes that the DPS Board should only have minimal functions confined mainly to making compensation payments in the event of a bank failure. It is therefore not expected that the Board would need to maintain a large number of permanent staff but would instead rely on the flexibility to call upon a network of service providers (e.g. accounting firms) to assist in making compensation payments to depositors in the event of a bank failure. Given this, the Board would only need to be supported by a small core of staff to carry out the following functions:

- Assess and collect contributions from Scheme members;
- Manage the DPS Fund;
- Monitor compliance of member banks in respect of disclosure of protection status and whether a financial product is protected by the DPS;
- Manage and co-ordinate with service providers as part of contingency planning;
- Maintain and operate the payout IT system; and

- Promote understanding of the DPS through publicity campaigns.

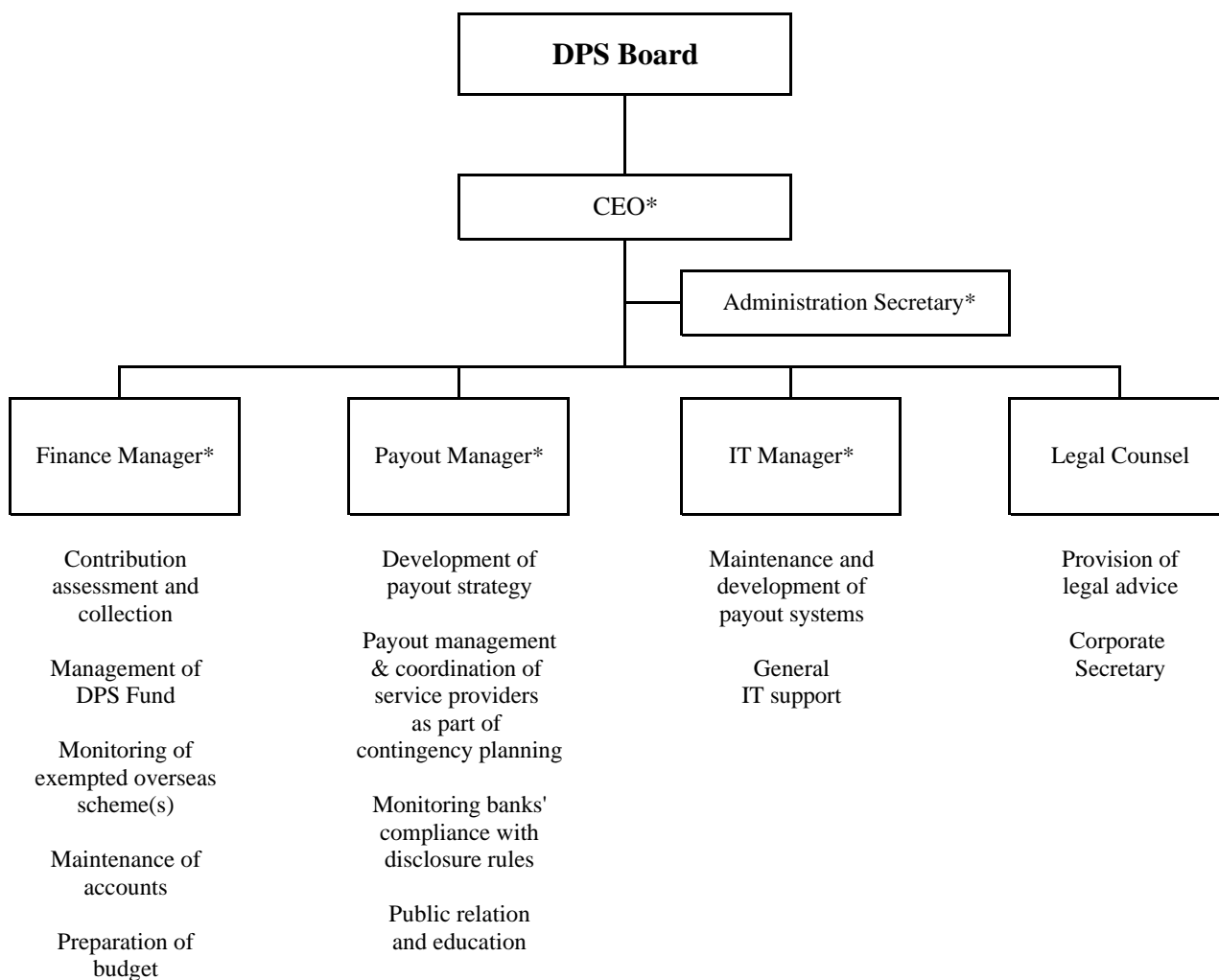
3. The proposed organisation chart, which is subject to the approval of the DPS Board, is attached at **Annex A**. The chart reflects the fact that the DPS would be administered by the Monetary Authority, but it would be advised by an independent legal counsel. Altogether it is estimated that there would be about 5 officers, with clerical and administrative support provided by the HKMA. The proposed structure is in line with the advice provided by Canada Deposit Insurance Corporation, which was commissioned in 2002 to help develop a payout mechanism for the DPS in Hong Kong (see **Annex B** for more details). Except where there is a bank failure, the officers from the HKMA are not expected to work full time on the DPS. A tentative allocation of responsibilities of the officers is also shown in the chart.

Administration costs

4. It is difficult to provide an accurate estimate of the administration costs of the Board at this stage. The actual figure depends on the amount of time that officers from the HKMA will need to spend on the affairs of the DPS, as well as the amount of professional fees payable for retaining the service providers. Nonetheless, based on the proposed structure mentioned above, it is expected that the annual administration costs of the Board would probably be in the range of \$7 - 8mn in normal times (i.e. when there are no bank failures). This compares with an estimated annual investment income of \$80 million from the DPS Fund assuming a fund size of \$1.6 billion and an investment return of 5% per annum. Apart from staff costs, this estimate includes rental, systems maintenance, professional fees payable to service providers and costs for public education. As noted above, the estimate does not cover costs that will be incurred by the Board in the event of a bank failure (e.g. fees payable to service providers to assist in making compensation payments to depositors).

Hong Kong Monetary Authority
Financial Services and the Treasury Bureau
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Organisation Structure of the DPS Board



(* HKMA staff who are not expected to work full time on the DPS)

Contingency Planning

The Administration recognises the importance of a robust contingency plan to a deposit protection scheme (DPS). In the event of a bank failure, the DPS Board should be capable of making payments to eligible depositors as quickly as possible. This is an essential design feature which can help to engender greater confidence of depositors in the scheme.

2. In view of this, the Administration has commissioned the Canada Deposit Insurance Corporation (CDIC) to help develop an effective payout mechanism for the DPS in Hong Kong. The main recommendations arising from the study by CDIC include:-

- (i) The DPS Board should formulate a payout strategy which can cope with different failure situations (e.g. failure of a retail bank or failure of a foreign bank with a branch in Hong Kong);
- (ii) To reduce the impact of a bank failure on the cash flow of affected depositors, the Board should consider making an interim payment to depositors within a short period;
- (iii) The Board should develop a “virtual organisation” comprising a small number of staff, supplemented by a network of service suppliers (e.g. audit firms) to ensure that appropriate resources are available to make timely, accurate compensation payments while avoiding the cost of retaining resources that are unnecessary between bank failures. To this end, the Board should prepare supplier selection criteria, performance measures and standby arrangements to accomplish payouts in an efficient, accountable and transparent manner;
- (iv) The Board should have access to and be entitled to rely upon the failed bank’s records and personnel as far as possible. It should develop effective IT systems which can process the data gathered from the failed bank’s systems in order to quickly determine the entitlement to compensation of individual depositors; and
- (v) During a payout, the Board should regularly communicate with affected depositors and explain to them the payment process, procedures and schedule.

3. The recommendations of the CDIC have already been taken into account in the preparation of the DPS Bill. For instances, clause 34 of the Bill

enables the Board to make interim payments to depositors under certain circumstances. Clause 7 empowers the Board to appoint agents to assist in the payout process. Clause 49 further provides that the Board may make rules specifying the information systems that should be maintained by Scheme members so as to facilitate payment to depositors.

4. After it is established, the DPS Board will need to further develop its payout strategy and systems. In particular, it will have to establish effective IT systems for the purpose of determining entitlement to compensation. The payout strategy and systems of the Board should be reviewed and tested from time to time. The Administration will, in due course, request the DPS Board to participate in the cross financial sector contingency rehearsal, which is conducted once every 12 to 18 months.

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