

For discussion on
22 December 2003

**Bills Committee on
Deposit Protection Scheme Bill**

**Report to the Chief Executive in Council
On Occurrence of Specified Event**

Background

At the meeting held on 11 December 2003, the Administration was requested to provide a paper on clause 22 addressing the following issues:-

- (i) whether a Scheme member should be given an opportunity to present his case before the Monetary Authority (MA) triggers payment under the DPS;
- (ii) the need to specify in clause 22(4) the circumstances under which the Chief Executive in Council (CE in C) may exercise his power to revoke the MA's decision under clause 21(2); and
- (iii) the time frame within which the CE in C should decide whether to confirm or revoke the MA's decision.

Clause 22 and Part X of Banking Ordinance

2. Before discussing the above issues, it is useful for the Administration to explain the rationale behind clause 22 and how it will interact with the MA's powers provided in Part X of the Banking Ordinance (BO) to deal with a failed bank.

3. Clause 22 of the Bill aims to achieve three purposes. First, it provides a check and balance against the MA's power to trigger payment under the DPS. Under subclause (1), the MA shall, as soon as practicable after a specified event has occurred, report the incident to the CE in C. Subclause (4) further provides that the CE in C has the power to confirm or revoke the MA's decision made pursuant to clause 21(1)(a)(ii) ("MA's Decision").

4. Secondly, clause 22 effectively gives the affected bank an opportunity to appeal to the CE in C against the MA's Decision. As specified in subclause (2), the MA should allow the bank concerned to make representations to him within a period of not less than seven days¹. Any representations made by the bank should be included in the MA's report to the CE in C under subclause (1).

5. Thirdly, the "appeal" mechanism under clause 22 seeks to ensure that any "appeal" against the MA's Decision is "lodged" and disposed of within a reasonably short period without affecting the Board's ability to make prompt payments to the depositors.

6. To understand the last point, it is necessary to discuss briefly how the MA deals with a failed bank under the BO (the relevant provisions of the BO are enclosed at the **Annex**). A precondition for triggering payment under

¹ However, where the circumstances so warrant, the MA may, with the consent of the Financial Secretary (FS), shorten the period for making representations (see clause 22(3) of the Bill).

the DPS is the appointment of a Manager by the MA under section 52(1)(C) of the BO. After the appointment of the Manager, the next likely step would be for FS to present a petition to the court to wind up the failed bank. In order to do so, the MA should give the failed bank a period of at least seven days to make representations under section 52(2)². He should then report the circumstances, together with any representations made by the failed bank under section 52(2), to the CE in C in accordance with section 52(1)(D). Based on the MA's report, the CE in C may under section 53(1) confirm or reverse the appointment of the Manager. He may also direct the FS to present a petition to wind up the failed bank.

7. The intention is that a failed bank will be allowed to make representations to the MA under section 52(2) of the BO and clause 22(2) of the Bill on the relevant MA's decisions at the same time. It is also expected that the CE in C will consider the MA's reports under section 52(1)(D) of the BO and clause 22(1) of the Bill concurrently. In summary, a typical sequence of events in handling a bank failure would be as follows:-

- (i) the MA becomes aware that a bank has failed or is about to fail;
- (ii) a Manager is appointed under section 52(1)(C) of the BO and the MA issues a direction under section 52(1)(A) of the BO to close the failed bank;
- (iii) payment under the DPS is triggered by the MA upon, or shortly after, the appointment of the Manager under clause 21(2) of the Bill;

² Section 52(2A), on which clause 22(3) of the Bill is resembled, allows the MA to shorten the period for making representations if he has the FS's consent to do so and to do so is reasonable in the circumstances.

- (iv) the DPS Board obtains access to the records of the failed bank and makes preparations for paying compensation to the depositors;
- (v) the MA allows the failed bank to make representations to him within a period of seven days under clause 22(2) of the DPS Bill and section 52(2) of the BO;
- (vi) the MA submits reports to the CE in C under clause 22(1) of the DPS Bill and section 52(1)(D) of the BO; and
- (vii) the CE in C determines, as a matter of urgency, whether the MA's decisions to appoint a Manager in respect of the failed bank and to trigger payment under the DPS should be upheld. At the same time, the CE in C also decides whether to direct the FS to petition the winding up of the failed bank.

8. As shown in the preceding paragraph, the “appeal” mechanism under clause 22 ties in closely with the existing procedures for handling a bank failure. Even if the failed bank does submit representations to the MA, they can be handled quickly without affecting the Board's ability to make prompt payments to the depositors.

**Providing an opportunity of being heard before the
occurrence of a specified event**

9. It is not appropriate to introduce a statutory requirement on the the MA to afford a failed bank an opportunity of being heard before the occurrence of a specified event (i.e. the decision to trigger DPS payout). The following paragraphs will explain why this is the case.

10. In the interests of natural justice, the MA would usually give the affected bank an opportunity of being heard before he exercises any of his supervisory powers under section 52 of the BO. However, it may not be appropriate for the MA to do so in some circumstances. For instances:-

- (i) The management of the bank may not be trustworthy (e.g. they may be involved in fraudulent activities as in the case of a few problem banks in 1980s). In such circumstances, if the MA were to sound out the bank his decision to appoint a Manager in respect of the bank, “*smart*” funds might immediately leave the bank, and the interests of ordinary depositors would be prejudiced.
- (ii) Time may not permit the MA to do so. For example, an overseas bank in Hong Kong might be closed overnight and the MA has to decide in a few hours how to deal with the situation.

11. This explains why the BO does not impose a requirement on the MA to consult the affected bank before he exercises any of the supervisory powers under section 52 (including the power to appoint a Manager in respect of the institution). The same principle applies to the MA’s decision to trigger

DPS payouts which will follow immediately or shortly after the decision to appoint a Manager.

12. Once a Manager is appointed, the MA is required under section 53A(4) of the BO to notify the public of the appointment. At that moment, the public's confidence in the banking system is most fragile. The MA must quickly decide whether to trigger payment under the DPS in order to limit the risk of contagion to other banks. If the MA were required to provide the failed bank a period of seven days to make representations before payment under the DPS could be triggered, depositors would be left in a state of uncertainty and their confidence in the banking system would continue to diminish. Any market rumours, however unfounded, might lead to a run on other banks. Obviously, this would not be conducive to maintaining the stability of the banking system.

13. Our experience in dealing with the failure of the Bank of Credit and Commerce Hong Kong Ltd (BCCHK) will illustrate the importance of taking expeditious actions in a banking crisis. On 8 July 1991, the then Commissioner of Banking ordered the closure of BCCHK. As required by law, he allowed the bank to make representations to him within a period of seven days before submitting a report to the Executive Council. However, as soon as the decision to close the bank was announced, hundreds of depositors protested outside the offices of the Government. Rumours of insolvency began to affect other banks. When the Executive Council announced its decision to wind up BCCHK on 17 July 1991, thousands of people queued to withdraw money from two medium-sized local banks. Even though the Government later arranged with the liquidator to make an interim payment to the depositors of BCCHK, the public's confidence in the banking system had already been damaged. The run on the banks spread to a note-issuing bank and a major US bank until it gradually subsided in August.

14. The above has explained why it is essential for the MA to make an early decision and announcement on DPS payout in order to maintain depositors' confidence in the banking system. This is precisely the reason for introducing a deposit protection scheme. Thus it would not be appropriate to make it a requirement on the MA to afford the failed bank an opportunity of being heard before payment under the DPS is triggered. Nonetheless, given the importance of the MA's Decision and its potential impact on the affected bank, it is still reasonable to provide the failed bank an opportunity to appeal to a higher authority after the MA has made the decision to pay compensation to the depositors. As shown in the previous section, the proposed appeal mechanism under clause 22 ties in closely with the procedures for dealing with failed bank under the BO. As the CE in Council would deal with incidents of this kind as a matter of urgency, it is expected that the Board would still be able to make an interim payment to the depositors within a short period after payment under the DPS is triggered (e.g. 10 days).

Circumstances where CE in C may revoke MA's Decision

15. The CE in C may revoke the MA's decision to trigger payment under the DPS in the following situations:-

- (i) the MA's decision is clearly unreasonable in the circumstances; or
- (ii) although the MA's decision is appropriate at the time when the decision was made, developments thereafter have rendered the decision no longer appropriate. Such developments may include, for example, an offer by a "white knight" with strong financial background to rescue the failed bank and to assume all the deposit liabilities.

16. The Administration does not object in principle that the Bill provides some general guidance on the factors that the CE in C may take into consideration in determining whether to confirm or revoke the MA's decision. Such factors may include, for example, the interests of the depositors of the failed bank and the general stability and effective working of the banking system. However, any such guidance should be drafted in a way not to undermine the CE in C's ability to handle a banking crisis.

**Time frame within which CE in C should make
a determination under clause 22(4)**

17. It is only reasonable to expect that under the circumstances as urgent as the occurrence of a banking crisis, upon receipt of the MA's report, the CE in C will expeditiously determine whether to confirm or revoke the MA's decision to trigger payment under the DPS. In the case of BCCHK, the Executive Council convened a special meeting and directed the FS to present a petition to wind up the bank on the same day when it received the report from the then Commissioner of Banking.

18. The Administration does not consider it appropriate to specify in the Bill a specific time frame within which the CE in C has to make a decision under clause 22(4). Any fixed time limit would be inflexible and would potentially undermine the CE in C's ability to handle a banking crisis.

Hong Kong Monetary Authority
Financial Services and the Treasury Bureau
December 2003

PART X

POWERS OF CONTROL OVER AUTHORIZED INSTITUTIONS

52. Powers of Monetary Authority

- (1) Where—
- (a) an authorized institution informs the Monetary Authority—
 - (i) that it is likely to become unable to meet its obligations; or
 - (ii) that it is insolvent or about to suspend payment;
 - (b) an authorized institution becomes unable to meet its obligations or suspends payment;
 - (c) the Monetary Authority is of the opinion that—
 - (i) an authorized institution is carrying on its business in a manner detrimental to the interests of—
 - (A) its depositors or potential depositors;
 - (B) its creditors; or
 - (C) holders or potential holders of multi-purpose cards issued by it or the issue of which is facilitated by it;
 - (ii) an authorized institution is insolvent or is likely to become unable to meet its obligations or is about to suspend payment;
 - (iii) an authorized institution has contravened or failed to comply with any of the provisions of this Ordinance;
 - (iv) an authorized institution has contravened or failed to comply with any condition attached under section 16 to its authorization or approval, the condition specified in section 49(1), the condition specified in section 50(1), the condition specified in section 50(2) or the condition specified in section 51A(2); or
 - (v) his power under section 22(1) to propose to revoke the authorization of an authorized institution is exercisable (and whether or not section 23(1) has been complied with); or (*Replaced 4 of 1997 s. 10*)
 - (d) the Financial Secretary advises the Monetary Authority that he considers it in the public interest to do so,
- the Monetary Authority, after consultation with the Financial Secretary, may exercise such one or more of the following powers as may from time to time appear to him to be necessary—
- (A) to require the institution, by notice in writing served on it, forthwith to take any action or to do any act or thing whatsoever in relation to its affairs, business and property as he may consider necessary (including any requirement imposing

restrictions on the banking business, business of taking deposits as a deposit-taking company or business of taking deposits as a restricted licence bank, or business of issuing or facilitating the issue of multi-purpose cards as the case may be, which may be carried on by the institution); (*Replaced 49 of 1995 s. 13. Amended 4 of 1997 s. 10*)

- (B) subject to subsection (3E), to give a direction that, during the period for which the direction is in force, the institution shall seek advice on the management of its affairs, business and property from an Advisor, for which purpose the Monetary Authority shall appoint a person to be the Advisor of that institution; (*Replaced 49 of 1995 s. 13*)
 - (C) subject to subsections (3D) and (3E), to give a direction that, during the period for which the direction is in force, such of the affairs, business and property of the institution as are specified in the direction shall be managed by a Manager, for which purpose the Monetary Authority shall—
 - (I) appoint a person to be the Manager of that institution; and
 - (II) specify in the direction the primary objective or objectives (not inconsistent with the provisions of this Ordinance) with which the Manager shall comply; (*Replaced 49 of 1995 s. 13*)
 - (D) to report the circumstances to the Chief Executive in Council. (*Amended 68 of 1999 s. 3*)
- (2) Except in the circumstances specified in subsection (1)(a), the Monetary Authority shall not exercise the power conferred by subsection (1)(D) unless he has—
- (a) where the authorized institution is incorporated in Hong Kong and a direction given under subsection (1)(C) is in force in respect of the institution—
 - (i) given to the institution, and such relevant persons, if any, as he thinks fit, not less than 7 days' notice in writing (or such lesser period as is permitted under subsection (2A)) stating—
 - (A) his intention to exercise such power; and
 - (B) his reasons for the exercise thereof; and
 - (ii) afforded the institution, and such relevant persons, if any, as he thinks fit, an opportunity to submit to him representations in writing thereon (which representations, if any, shall form part of his report to the Chief Executive in Council); (*Replaced 49 of 1995 s. 13. Amended 68 of 1999 s. 3*)

- (b) where the authorized institution is incorporated outside Hong Kong and a direction given under subsection (1)(C) is in force in respect of the institution—
- (i) given to the institution, at its principal place of business outside Hong Kong, not less than 7 days' notice in writing (or such lesser period as is permitted under subsection (2A)) stating—
 - (A) his intention to exercise such power; and
 - (B) his reasons for the exercise thereof; and
 - (ii) afforded the institution an opportunity to submit to him representations in writing thereon (which representations, if any, shall form part of his report to the Chief Executive in Council); (*Replaced 49 of 1995 s. 13. Amended 68 of 1999 s. 3*)
- (c) in any other case—
- (i) given to the authorized institution not less than 7 days' notice in writing (or such lesser period as is permitted under subsection (2A)) stating—
 - (A) his intention to exercise such power; and
 - (B) his reasons for the exercise thereof; and
 - (ii) afforded the institution an opportunity to submit to him representations in writing thereon (which representations, if any, shall form part of his report to the Chief Executive in Council). (*Added 49 of 1995 s. 13. Amended 68 of 1999 s. 3*)

(2A) The Monetary Authority may give an authorized institution and any relevant person less than the 7 days' notice in writing referred to in subsection (2) where— (*Amended 49 of 1995 s. 13*)

- (a) he has the consent of the Financial Secretary to do so; and
- (b) to do so is reasonable in the circumstances. (*Added 67 of 1992 s. 3*)

(3) (*Repealed 49 of 1995 s. 13*)

(3A) Subject to subsection (3D), the Monetary Authority may from time to time vary a direction given under subsection (1)(C) in respect of—

- (a) the affairs, business and property specified in the direction of the authorized institution to which the direction relates;
- (b) the primary objective or objectives specified in the direction with which the Manager of the institution shall comply. (*Added 49 of 1995 s. 13*)

(3B) It is hereby declared that any thing done, in reliance on a direction given under subsection (1)(C), at any time before a variation under subsection (3A) of that direction shall not be invalid by reason only of that variation. (*Added 49 of 1995 s. 13*)

(3C) During the period for which a direction given under subsection (1)(C) is in force in respect of an authorized institution, any reference in this Part to—

- (a) the affairs, business or property, or any combination thereof, of the institution; or
- (b) the primary objective or objectives with which the Manager of the institution shall comply,

shall, unless the context otherwise requires, be construed to mean—

- (i) where paragraph (a) is applicable, such affairs, business or property, or combination thereof, as the case may be;
- (ii) where paragraph (b) is applicable, such primary objective or objectives,

specified in that direction as varied from time to time under subsection (3A).
(*Added 49 of 1995 s. 13*)

(3D) Notwithstanding any other provision of this Part, no direction given under subsection (1)(C) (including any variation thereof under subsection (3A)) in respect of an authorized institution incorporated outside Hong Kong shall apply to any of the affairs, business or property of the institution except—

- (a) so much of the affairs and business of the institution as are carried on, or managed, in or from Hong Kong; and
- (b) so much of the property of the institution as is either or both of the following—
 - (i) located in, or managed from, Hong Kong;
 - (ii) an asset of the institution's principal place of business in Hong Kong or of any local branch or local office. (*Added 49 of 1995 s. 13. Amended 32 of 2001 s. 10*)

(3E) The Monetary Authority shall not give a direction under subsection (1)(B) or (C) in respect of an authorized institution in relation to which the Court of First Instance has made an order for the winding-up of the institution. (*Added 49 of 1995 s. 13. Amended 25 of 1998 s. 2*)

(3F) It is hereby declared that the Monetary Authority may exercise his power under subsection (1)(B) or (C) in such a way as to appoint—

- (a) a company or partnership; or
- (b) without prejudice to the generality of paragraph (a), 2 or more persons,

to be the Advisor or Manager, as the case may be, of an authorized institution.
(*Added 49 of 1995 s. 13*)

(3G) Where the Monetary Authority exercises his power under subsection (1)(C) in such a way as to appoint 2 or more persons to be the Manager of an authorized institution, he shall—

- (a) by notice in writing, specify which of the duties and powers imposed or conferred on a Manager under this Ordinance shall

be discharged or exercised, as the case may be, in relation to the institution, by—

- (i) any such person alone;
- (ii) any such persons jointly;
- (iii) each such person; and

(b) attach that notice to the direction concerned given under that subsection served on the institution under section 53A(1), and the provisions of this Ordinance (including section 53G) shall be read and have effect with such modifications as are necessary to take into account that notice. (*Added 49 of 1995 s. 13*)

(3H) For the avoidance of doubt, it is hereby declared that a person appointed under subsection (1)(B) or (C) to be the Advisor or Manager of an authorized institution may be a person who holds an appointment under section 5A(3) of the Exchange Fund Ordinance (Cap. 66). (*Added 49 of 1995 s. 13*)

(3I) (*Repealed 4 of 1997 s. 27*)

(4) Every director, every chief executive and every manager of an authorized institution which fails to comply with any requirement of the Monetary Authority under subsection (1)(A) commits an offence and is liable— (*Amended 32 of 2001 s. 24*)

- (a) on conviction upon indictment to a fine at tier 9 and to imprisonment for 5 years and, in the case of a continuing offence, to a further fine at tier 5 for every day during which the offence continues; or
- (b) on summary conviction to a fine at tier 5 and to imprisonment for 2 years and, in the case of a continuing offence, to a further fine at tier 2 for every day during which the offence continues. (*Amended 4 of 1997 s. 27*)

(5) In this section, “relevant person” (有關人士), in relation to an authorized institution, means any person who—

- (a) is the Manager of the institution;
- (b) is a minority shareholder controller, majority shareholder controller or indirect controller of the institution;
- (c) has ceased to be a chief executive or director of the institution by virtue of section 53B(1)(a);
- (d) is a chief executive or director of the institution by virtue of the operation of section 53B(2). (*Added 49 of 1995 s. 13*)

(*Amended 82 of 1992 s. 25*)

53. Powers of Chief Executive in Council

(1) Where—

- (a) the Monetary Authority makes a report to the Chief Executive in Council under section 52(1)(D);

- (b) any person appeals to the Chief Executive in Council under section 132A(1) against a decision of the Monetary Authority under section 52(1)(A), (B) or (C) or (3A); or (*Amended 49 of 1995 s. 14; 4 of 1997 s. 27*)
- (c) the Financial Secretary refers a report and his recommendations thereon to the Chief Executive in Council under section 117(5)(c),

the Chief Executive in Council may, without prejudice to any of the powers conferred on the Monetary Authority by Part V or VI, exercise one or more of the following powers— (*Amended 94 of 1993 s. 17; 49 of 1995 s. 14*)

- (i) to confirm, vary or reverse any requirement, appointment or direction made by the Monetary Authority;
- (ii) (*Repealed 49 of 1995 s. 14*)
- (iii) to direct the Financial Secretary to present a petition to the Court of First Instance for the winding-up of the authorized institution or former authorized institution by the Court of First Instance. (*Amended 82 of 1992 s. 25; 25 of 1998 s. 2*)

(2) The Chief Executive in Council may, before considering any report or appeal under subsection (1), seek the advice of the Banking Advisory Committee or the Deposit-taking Companies Advisory Committee, or both, but shall not be bound to follow any such advice.

- (3) (*Repealed 49 of 1995 s. 14*)

(*Amended 68 of 1999 s. 3*)

53A. Notification of direction under section 52(1)(B) or (C), etc.

- (1) A direction given under section 52(1)(B) or (C) shall—
 - (a) be in writing;
 - (b) be served on the authorized institution specified in the direction at its principal place of business in Hong Kong;
 - (c) take effect immediately it is so served; and
 - (d) state the name and address of the Advisor or Manager, as the case may be, appointed in respect of that institution.
- (2) A variation under section 52(3A) of a direction given under section 52(1)(C) shall—
 - (a) be in writing;
 - (b) be served on—
 - (i) the authorized institution specified in the direction at its principal place of business in Hong Kong except that, in the case of an authorized institution incorporated outside Hong Kong, it shall be served on the institution's principal place of business outside Hong Kong; and

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- (ii) the Manager of the institution; and
(c) take effect immediately it is so served, unless otherwise specified in the variation.
- (3) A direction in writing given under section 52(1)(C), and a variation in writing under section 52(3A) of such a direction, include a copy of the direction or variation, as the case may be.
- (4) Notice of a direction given under section 52(1)(C) shall be published by the Monetary Authority by notice in the Gazette and in such other ways as appear to him expedient for notifying the public.
- (5) Subsection (4) shall apply to a notice under section 52(3G) as it applies to a direction given under section 52(1)(C).
- (Added 49 of 1995 s. 15)*

53B. Effect of direction under section 52(1)(C)

- (1) Subject to subsection (2) and section 53C(3)(a)(i), (b) and (c), immediately upon a direction given under section 52(1)(C) coming into force—