Panel on Financial Affairs
Meeting on 1 February 2010

Responses to follow-up questions

Review of the Deposit Protection Scheme

Q1. In relation to Hon Paul CHAN and Hon Regina IP's concern about the investment strategy and return of the Deposit Protection Scheme (DPS) Fund, and the expenditure of the Hong Kong Deposit Protection Board (HKDPB), the Administration is requested to provide the following information:

(a) measures to be taken by HKDPB to enhance the investment return of the DPS Fund; and

(b) details of the expenditure (about $50 million a year) of the HKDPB and ways to reduce its expenses.

A1(a) The Deposit Protection Scheme (DPS) Fund was established under section 14 of the DPS Ordinance (DPSO) (Cap. 581). It comprises mainly contributions collected from member banks of the DPS. The investment scope of the Fund has been set out in section 21 of the DPSO:-

*"**21. Investment of money***

(1) The Board may place, or invest, money of the Fund that is not immediately required by the Board for the performance of its functions in the following—

> *(a) deposits with the Monetary Authority for the account of the Exchange Fund;*
> *(b) Exchange Fund Bills;*
> *(c) US Treasury Bills;*
> *(d) subject to subsection (2), exchange rate contracts or interest rate contracts, including derivative products;*
> *(e) any other investment approved by the Financial Secretary.*

(2) The Board shall not place, or invest, money of the Fund in exchange rate contracts or interest rate contracts except for hedging purposes."

The investment scope of the DPS Fund was set after thorough deliberation during the legislative stage. In keeping with the need for capital preservation and maintaining a high level of liquidity, particularly when crises strike, the Fund is allowed to be invested only in safe and liquid financial instruments. The investment scope turned out to be very effective in meeting the capital preservation objective. Despite the turbulent market conditions in 2008, the Fund did not suffer a loss and was able to achieve a positive return for the year.

The investment of the DPS Fund is managed independently by the Deposit Protection Board (DPB). The Fund is not invested as part of the Exchange Fund under the management of the HKMA. The DPB has taken steps to ensure that the investment of the Fund is being managed in accordance with the DPSO and, at the same time, delivering best possible returns. The DPB has established an Investment Committee comprising investment experts to oversee the investment of the Fund, including the establishment of investment-related policies and procedures, and reviewing, on a regular basis, the Fund's investment performance and strategy. The DPB has been vigilant in seeking opportunities to enhance the return of the Fund, for example, after considering the associated risks and benefits, the Board sought the Financial Secretary's (FS) approval in December 2008 to lengthen the investment horizon of the Fund to include Exchange Fund Notes and US Treasury Notes of a tenor up to two years. The DPB will endeavor to explore means for enhancing the return of the Fund, subject to the investment mandate enshrined in the DPSO.

A1(b) The total expenditure of the DPS Fund amounted to HK$58 million in the year 2008-2009. The two major categories of expenditure were hire of services (representing 42% of total expenditure) and printing and publicity (representing 34% of total expenditure).

The DPB is required by section 6 of the DPSO to perform its functions through the Monetary Authority. The DPB therefore has to reimburse the HKMA the cost incurred by the HKMA in rendering support to it, including the cost of human resources and administrative supports. To minimize recurring costs, the DPB has opted to maintain a very slim structure (with less than 10 full-time staff). However, to ensure that the DPS can pay compensation to depositors expediently, which is one of the key determinants of its effectiveness, the DPB has retained a network of external service providers that it can call upon for providing assistance at short notice when a bank failure occurs. The network of service providers is subject to regular rehearsals and simulations to maintain and enhance their readiness. The costs of hiring the services provided by the HKMA and external service providers are therefore essential for maintaining the effectiveness of the DPS. The Board is also of the view that those arrangements are more cost effective than the alternative of maintaining its own staff for administration and payout purposes.

Another key determinant of the effectiveness of a deposit protection scheme is whether depositors protected by it are aware of its existence, benefits and limitations. It is therefore necessary for the Board to conduct on-going promotional and educational activities to maintain and enhance public awareness and understanding of the DPS. Based on information available to the Board, its expenditure on publicity is in line with those of the other public bodies undertaking publicity campaigns of a comparable profile.

Due processes have been put in place to ensure that the annual budgets of the DPS Fund are formulated and individual expenditures are incurred in a prudent manner. According to the DPSO, the annual budgets of the DPS Fund are subject to the approval of the FS. The DPB is also required to produce statement of accounts of the Fund for submission to the FS and for tabling to the Legislative Council. Clear procurement rules and procedures, which are in line with those commonly adopted by public bodies, have been established by the DPB to govern its procurement process.

Q2. In relation to the concern of Hon Regina IP about the possible impact of the lifting of full deposit guarantee arrangement after 2010, the Administration is requested to provide information about the deposit protection arrangements in other countries, including but not limited to Australia and New Zealand.

A2. Please see the attached table.

The deposit protection arrangements in other jurisdictions, including but not limited to Australia and New Zealand

<table>
<tr><th rowspan="2">Jurisdictions</th><th colspan="2">Limited deposit protection arrangements in place</th><th rowspan="2">Full deposit guarantee / temporary deposit protection arrangements in place</th></tr>
<tr><th>Protection limit</th><th>Foreign currency deposits</th></tr>
<tr><td>Hong Kong</td><td>HKD100,000</td><td>Protected</td><td>Full deposit guarantee until end-2010</td></tr>
<tr><td>Malaysia</td><td>MYR60,000
(equivalent to about HKD144,000)</td><td>Not protected</td><td>Full deposit guarantee until end-2010</td></tr>
<tr><td>Singapore</td><td>SGD20,000
(equivalent to about HKD110,000)</td><td>Not protected</td><td>Full deposit guarantee until end-2010</td></tr>
<tr><td>Taiwan</td><td>NTD1.5 million
(equivalent to about HKD357,000)</td><td>Not protected</td><td>Full deposit guarantee until end-2010</td></tr>
<tr><td>Australia</td><td colspan="2" rowspan="2">No explicit deposit protection arrangements before the introduction of the existing temporary measures</td><td>Partial deposit guarantee of up to AUD1 million (equivalent to about HKD6.8 million) until October 2011</td></tr>
<tr><td>New Zealand</td><td>Partial deposit guarantee of up to NZD1 million (equivalent to about HKD5.4 million) until October 2010, and up to NZD500,000 (equivalent to about HKD2.7 million) from October 2010 to December 2011 (on a voluntary basis)</td></tr>
<tr><td>US</td><td>USD250,000
(equivalent to about HKD1.9 million)
(raised temporarily from USD100,000 in October 2008)</td><td>Protected</td><td>Protection limit of existing scheme temporarily raised to USD250,000, first until end-2009 and then extended to end-2013, to return to USD100,000 in 2014</td></tr>
<tr><td>UK</td><td>GBP50,000
(equivalent to about HKD615,000)
(raised permanently from GBP35,000 in October 2008)</td><td>Protected</td><td>Nil</td></tr>
</table>