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**Paper for House Committee meeting on 12 November 2010**

**Report of the Subcommittee on Deposit Protection Scheme  
(Representation on Scheme Membership and Protection of  
Financial Products under Scheme) (Amendment) Rules 2010**

**Purpose**

This paper reports on the deliberations of the Subcommittee on Deposit Protection Scheme (Representation on Scheme Membership and Protection of Financial Products under Scheme) (Amendment) Rules 2010 (the Subcommittee).

**Background**

Deposit Protection Scheme Ordinance and Hong Kong Deposit Protection Board

2. The Deposit Protection Scheme Ordinance (Cap. 581) (DPSO) was enacted in May 2004, and the Hong Kong Deposit Protection Board<sup>1</sup> (the Board) was formed in July 2004 to oversee the operation of the Deposit Protection Scheme (the Scheme) in Hong Kong, and the Scheme commenced operation in September 2006. The Deposit Protection Scheme (Representation on Scheme Membership and Protection of Financial Products under Scheme) Rules (Cap. 581 sub. leg. A) (Representation Rules) were made by the Board under section 51 of DPSO. These Rules provide for the disclosure requirements in relation to the protection status of financial products offered by Scheme members<sup>2</sup> and the offences for non-compliance of the requirements under the Rules.

The Deposit Protection Scheme (Amendment) Ordinance 2010

3. The Board completed a review of the Scheme in 2009 and consulted the public on a number of enhancements to the Scheme. In this connection, the

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<sup>1</sup> The Hong Kong Deposit Protection Board is a statutory body established under the DPSO to establish and maintain the Scheme.

<sup>2</sup> Unless exempted by the Board, all licensed banks are Scheme members. Restricted licence banks and deposit-taking companies are not members of the Scheme.

Administration introduced the Deposit Protection Scheme (Amendment) Bill 2010 into the Legislative Council on 9 April 2010. The Bill was passed on 30 June 2010. As provided in the Deposit Protection Scheme (Amendment) Ordinance 2010 (Amendment Ordinance), various enhancements to the Scheme, including raising the protection limit of the Scheme from HK\$100,000 to HK\$500,000 per depositor, expanding its coverage to include secured deposits and the implementation of cost mitigating measures to avoid cost transfer to depositors, will take effect on 1 January 2011. In addition, the Amendment Ordinance also amended section 51 of the DPSO (covering the power of the Board to make rules) to empower the Board to make additional rules to prescribe the representation, disclosure and acknowledgment requirements relating to protected and non-protected deposit products.

### **Deposit Protection Scheme (Representation on Scheme Membership and Protection of Financial Products under Scheme) (Amendment) Rules 2010**

4. The Deposit Protection Scheme (Representation on Scheme Membership and Protection of Financial Products under Scheme) (Amendment) Rules 2010 (Amendment Rules) are made by the Board under section 51(1) of the DPSO to amend the Representation Rules to -

- (a) replace all references to the protection limit of the Scheme from HK\$100,000 to HK\$500,000 per depositor to reflect the new protection limit introduced by the Amendment Ordinance;
- (b) require disclosures by Scheme members as to financial products not protected by the Scheme on a transaction basis except for automatic re-investment of financial products, transactions with institutional customers and money invested into financial products for payment purpose (the proposed sections 6A to 6D);
- (c) restrict the use of the term "structured deposit" by Scheme members (the proposed section 6E);
- (d) require disclosures by Scheme members as to the deposits maintained or to be taken by them that are qualified for protection under the Scheme (the proposed sections 6F to 6K);
- (e) require Scheme members to reply to depositors' enquiries on the protection status of their deposits in specified manner and within a specified timeframe (the proposed section 7A); and
- (f) impose standards on the representations given under the Representation Rules to ensure that they are prominent and legible (the proposed section 7B).

5. The Amendment Rules were gazetted on 15 October 2010 and will come into operation on 1 January 2011 except for the proposed section 6E, which will not have effect in relation to any financial product that is described as a structured deposit before 1 July 2011 in order to allow sufficient time for Scheme members to make relevant changes to their product nomenclatures.

6. According to the relevant LegCo Brief (Ref: B9/2/2C) issued by the Administration, the Board has conducted extensive public consultation on the proposals for enhancing the representation arrangements. It has proactively approached interested parties for comments on the scope of the enhancement proposals, including industry associations, statutory advisory committees, the Consumer Council and professional bodies. In addition, in accordance with section 51 of the DPSO, the Board has consulted The Hong Kong Association of Banks and the Financial Secretary on the Amendment Rules.

### **The Subcommittee**

7. At the House Committee meeting held on 22 October 2010, Members agreed to form a Subcommittee to study the Amendment Rules. The Subcommittee was formed on 4 November 2010. Hon CHAN Kam-lam was elected chairman of the Subcommittee, and the membership list of the Subcommittee is in the **Appendix**. The Subcommittee held one meeting on 4 November 2010 to discuss with the Administration.

### **Deliberations of the Subcommittee**

8. The Subcommittee is in support of the policy objective of the Amendment Rules, i.e. to enhance the disclosure requirements in relation to the protection status of financial products offered by Scheme members.

#### Negative disclosure requirements

9. The proposed sections 6A to 6D provide that, for a financial product offered by a Scheme member on or after 1 January 2011 which is not a protected deposit but has been described as a deposit in any advertisement, promotional material or document, the Scheme member is required to notify a person and obtain the person's acknowledgment before the person invests in the financial product. The notice must be prominent and comply with the specified requirements. It is an offence if a Scheme member contravenes the disclosure requirements. However, a Scheme member does not need to give the notice before a person invests in the financial product if—

- (a) the investment in the financial product is an automatic re-investment of a preceding investment (commonly referred to as "automatic rollover");
- (b) the person is not a natural person (whether being a company, partnership, sole proprietorship or otherwise); or
- (c) the money invested in the financial product is used for payment in relation to any banking or financial services.

10. The proposed section 6A also prescribes the manner in which the disclosure requirements are to be complied with. If the financial product is offered to a person by telephone, electronic mail transmission or through the Internet, the Scheme member must -

- (a) notify the person in writing, or by the means the offer is made, that the financial product is not a protected deposit and is not protected by the Scheme; and
- (b) obtain the person's acknowledgment of the notice, which must be made in writing or by the means the notice is given.

If the financial product is offered by any other means, the notice and the acknowledgment must be made in writing.

11. The Subcommittee considers that for non-protected financial products, it is important to remind investors the non-protection status of the products even if a notification is made by telephone before the transaction takes place. The Subcommittee therefore suggests that where the financial product is offered by telephone, the Scheme member should, in addition to the telephone notification made before the transaction is made, also serve a written notice on the non-protection status of the financial product to the client concerned after the transaction is made.

12. Regarding the exemption of automatic rollovers from the disclosure requirement, the Administration has explained that investors have been given and have acknowledged the negative disclosure when the previous transaction of the financial product was conducted, and no direct communication is necessary between the Scheme member and the investor during subsequent automatic rollover transactions. Therefore, no further negative disclosure is provided for in the Amendment Rules. The Subcommittee considers that it is preferable to keep reminding the investors concerned of the non-protected status of the financial product by issuing a written notice to that effect after each transaction.

13. The Subcommittee has considered whether the suggested additional requirement of serving a written notice on negative disclosure after each transaction should be specified in the Representation Rules. While agreeing that the additional requirement would help ensure that investors are fully aware of the non-protection status of the relevant financial products, the Administration has pointed out that as substantial changes to Scheme members' existing operations may be required, Scheme members may not be ready to implement the additional requirement by 1 January 2011 when the Amendment Rules come into operation. The Administration has counter-proposed to include the additional requirement in the relevant guidelines for Scheme members, and undertakes to see to it that the additional requirement will be implemented by Scheme members without unnecessary delay. The Subcommittee has accepted the Administration's proposed arrangement.

#### Request for information as to whether deposits are protected by Scheme

14. The proposed section 7A requires a Scheme member to reply within a specified time limit to a request by a person holding a financial product, which is described as a deposit in any advertisement, promotional material or document, offered by the Scheme member for confirmation as to whether the financial product is protected by the Scheme. If the request is made orally, the Scheme member must either give an oral reply within 5 business days, or a written reply within 10 business days. If the request is made in writing or by electronic or other means, the Scheme member must give a written reply within 10 business days.

15. The Subcommittee has sought explanation for the proposed response time limits. The Administration has explained that a Scheme member may need time to verify details of a request and to ensure that the reply complies with the relevant statutory requirements. Besides, if a Scheme member receives many such requests at the same time or within a short period of time, it would need some time to clear the backlog.

16. The Subcommittee is however of the view that such requests are simple in nature and a Scheme member should be able to confirm readily whether a financial product held by a client is protected by the Scheme. The Subcommittee considers that a sudden increase in the number of enquiries about a financial product probably signals problems in the market. It is then all the more important for Scheme members to respond quickly to fortify clients' confidence. The Subcommittee suggests that the time limits should be reduced to 3 business days for giving an oral reply, and 7 business days for a written reply. In this connection, the Subcommittee notes that a contravention of the requirement in proposed section 7A is not an offence. The Administration accepts the Subcommittee's suggestion and will move amendments accordingly.

#### Representation in account or transaction statements

17. The Subcommittee notes that Scheme members normally issue statements to clients regarding their accounts and transactions, and suggests that the Board should develop standard wording on the protection status of different financial products, so that Scheme members could attach such wording in the form of a label or explanatory note in the statements to remind clients whether or not the products they are holding are protected by the Scheme. For addressing the comments of the Subcommittee, the Administration has undertaken to review the guidelines to ensure that standard wording will be provided to Scheme members.

Other technical amendments

18. The Subcommittee notes that the Administration will move a technical amendment to replace "the commencement of these Rules" in section 6(4)(b)(i) of the Representation Rules by "25 September 2006".

**Recommendation**

19. The Subcommittee supports the Amendment Rules and the amendments to be moved by the Administration as mentioned in paragraphs 16 and 18 above.

**Advice sought**

20. Members are invited to note the deliberations and recommendation of the Subcommittee.

Council Business Division 1  
Legislative Council Secretariat  
10 November 2010

**Subcommittee on Deposit Protection Scheme  
(Representation on Scheme Membership and Protection of  
Financial Products under Scheme) (Amendment) Rules 2010**

**Membership list**

**Chairman** Hon CHAN Kam-lam, SBS, JP

**Members** Hon Albert HO Chun-yan  
Hon Audrey EU Yuet-mee, SC, JP  
Hon WONG Ting-kwong, BBS, JP  
Hon CHIM Pui-chung

(Total: 5 members)

**Clerk** Ms Anita SIT

**Legal Adviser** Ms Clara TAM