立法會
Legislative Council

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Bills Committee on Deposit Protection Scheme (Amendment) Bill 2015

Background brief

Purpose

This paper provides background information on the Deposit Protection Scheme ("DPS") in Hong Kong and a summary of the major views and concerns expressed by members when related issues were discussed by the Panel on Financial Affairs ("the Panel") in 2014-2015 session.

Background

Deposit Protection Scheme Ordinance and the Deposit Protection Scheme

2. The Deposit Protection Scheme Ordinance (Cap. 581) ("DPSO") was enacted in May 2004, and the Hong Kong Deposit Protection Board[1] ("HKDPB") was formed in July 2004. DPS commenced operation in September 2006 with a view to providing protection to depositors and contributing to general banking stability by reducing the risks of bank runs and potential contagion during a banking crisis.

3. The major features of DPS are as follows:

(a) All licensed banks are DPS members unless exempted by HKDPB[2];

(b) A Deposit Protection Scheme Fund ("DPS Fund") is established through contributions collected from DPS members. The target size of the DPS Fund is 0.25% of the total amount of protected deposits maintained with all DPS members, or approximately $4.3 billion;

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1 HKDPB is a statutory body established under DPSO to establish and maintain DPS.
2 Restricted licence banks and deposit-taking companies are not members of DPS.

(c) Deposits denominated in Hong Kong dollar, renminbi or any other currencies are protected[3];

(d) The compensation limit under DPS is $500,000[4] per depositor per bank, provides full coverage for around 90% of depositors in Hong Kong. Compensation from the DPS Fund should be paid to depositors of a DPS member if a winding up order has been made against the DPS member or the Hong Kong Monetary Authority ("HKMA") has decided that compensation should be paid by DPS and has served notice on HKDPB accordingly;

(e) A depositor's entitlement to compensation will be calculated on a net basis, that is, the liability of the depositor to a bank will be deducted from the protected deposits he or she maintains with the bank in determining compensation (i.e. the net payout approach); and

(f) When compensation under DPS becomes payable in respect of a DPS member, DPS will borrow from the Exchange Fund ("EF") under a standby liquidity facility to pay compensation to depositors. The size of the facility offered by EF is $40 billion. DPS will seek reimbursement from the liquidation of the failed bank for the compensation paid to depositors and repay the borrowings from EF. The cost of borrowing from EF, any compensation paid that cannot be recovered from the liquidation, and the administration cost incurred by DPS in making compensation payments, will be charged to the DPS Fund.

<u>Review of the Deposit Protection Scheme</u>

4. Depositors' confidence in the banking system hinged on the effectiveness of the deposit protection mechanism among other safeguards in the market regulatory framework. According to the Administration, since the global financial crisis in 2007-2008, there is a trend for more overseas jurisdictions, in particular member jurisdictions of the Financial Stability Board ("FSB") (e.g. the United Kingdom ("UK"), the Netherlands, Singapore

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3 According to section 34 of DPSO, compensation payable shall be paid in Hong Kong dollars regardless of the currency in which the protected deposit concerned is denominated. Certain types of deposit are not protected by DPS, including time deposits with a maturity longer than five years, structured deposits (such as foreign currency-linked and equity-linked deposits), bearer instruments (such as bearer certificates of deposit) and offshore deposits. DPS members are required to notify customers if a financial product has been described as a deposit but is not protected by DPS.

4 The protection limit of DPS was originally $100,000 and was raised to $500,000 with effect from 1 January 2011 with enactment of the Deposit Protection Scheme (Amendment) Ordinance 2010.

and Australia), to adopt directly or change from a net payout to a gross payout approach to speed up the payout process when making compensation to depositors. In 2013, the Financial Sector Assessment Program led by the International Monetary Fund completed a review of crisis management and bank resolution framework in Hong Kong and recommended Hong Kong to consider, among other things, changing the present rule of netting in compensation determination to achieve a swifter payout.

5. The Financial Services and the Treasury Bureau and HKMA launched a three-month consultation in September 2014 to seek public views on the proposals for enhancing the operation of DPS to achieve a faster and more effective payout for depositors. According to the Administration, responses received during the consultation indicated broad support for the proposals.

Legislative Proposals under the Deposit Protection Scheme (Amendment) Bill 2015

6. The Deposit Protection Scheme (Amendment) Bill 2015 ("the Bill") was gazetted on 13 November 2015, and received its First Reading at the Legislative Council meeting of 25 November 2015. The major proposals in the Bill include:

(a) adopting a gross payout approach to determine DPS compensation (i.e. depositors will be compensated an amount up to the DPS protection limit without setting off the depositors' liabilities to the same bank);

(b) providing more certainty for the determination of the quantification date[5] ("QD") to facilitate the calculation of the deposit compensation amount; and

(c) enabling the use of electronic communication by HKDPB, in addition to the conventional paper-form communication, to notify depositors of the compensation arrangements, in case DPS is triggered.

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[5] The quantification date is currently defined in section 25 of DPSO as the date of the appointment of a provisional liquidator in respect of a failed bank, unless HKDPB specifies QD as the DPS trigger date if HKDPB –
(a) has knowledge that a provisional liquidator will not be appointed;
(b) is of the opinion that it is uncertain whether a provisional liquidator will be appointed; or
(c) is of the opinion that an appointment of a provisional liquidator will take so long as to unduly delay the payment of compensation to the depositors of the Scheme member by HKDPB.

7. Details of the main provisions of the Bill are set out in paragraph 10 of the Legislative Council Brief (File Ref: B9/2/2C issued on 11 November 2015), and paragraphs 4 to 11 of the Legal Service Division Report on the Bill (LC Paper No. LS14/15-16). The Bill, if passed, would come into operation on the day when the Amendment Ordinance is published in the Gazette.

Major concerns and views expressed by members

8. The Administration briefed the Panel on the legislative proposals to enhance DPS on 4 May 2015. The major concerns and views expressed by members are summarized in the ensuing paragraphs.

Gross payout approach

9. In response to members' enquiries about the benefits for depositors in adopting the gross payout approach for determining the compensation amount under DPS, the Administration explained that under the existing net payout approach, all liabilities owed by a depositor to a failed bank had to be set off against his/her aggregate balance of deposits with the bank. The net payout approach was a relatively complicated and time-consuming process as it involved detailed calculations and extensive checking of the relevant records, and was therefore a major hurdle to achieving a speedy payout. It was envisaged that, by adopting the gross payout approach, HKDPB would be able to make full compensation payments in around one week as compared to six weeks under the net payout approach. Hence, the gross payout approach would provide affected depositors with more ready access to liquid funds, and strengthen their confidence in the banking system thus reducing any contagion effect during a banking crisis.

10. As regards latest international developments in deposit protection regimes, the Administration advised that a number of member jurisdictions of FSB, including Australia, Canada, France, Singapore, Switzerland and the UK, had already changed from a net payout to a gross payout approach in order to speed up the compensation payout process. The European Union had issued a directive in 2014 to adopt the gross payout approach in the near future. In addition, the deposit insurance scheme launched in the Mainland in May 2015 had adopted the gross payout approach for compensation determination.

11. Some members expressed concern on the impact of the gross payout approach on the insolvency of a bank. In particular if the compensated depositors became default and could not settle their outstanding debts and liabilities owed to the bank, the liquidation assets for distribution to creditors of the bank would be reduced. The Administration explained that adoption of the gross payout approach would not extinguish a depositor's liabilities to the bank. The depositor was still obliged to settle any outstanding debt owed to

the bank or its liquidator after receiving the deposit compensation. Moreover, any deposit in excess of $500,000 would still be set-off against the depositor's liabilities owed to the bank. As not many depositors had liabilities in the same bank, the creditor hierarchy in the insolvency of a bank would remain unchanged, and the charge off rates of liabilities was chronically low in Hong Kong; the impact of the gross payout approach on insolvency arising from the potential reduction in liquidation assets for distribution to creditors would be marginal.

Impact on the Deposit Protection Scheme Fund

12. Some members raised concern about whether the existing $2.4 billion DPS Fund would be sufficient to cover potential compensation payments under the gross payout approach. The Administration advised that as not many depositors had liabilities with the same bank, it was expected that the amount of compensation payments required under the gross payout approach would not increase significantly. In fact, the DPS Fund was mainly to cover the costs incurred during the payout process. HKDPB had in place a standby credit facility from EF to meet the funding requirement for compensation payments.

Determination of the Quantification Date

13. Members enquired how the proposal relating to determination of QD would enhance protection for depositors. The Administration advised that the deposit compensation was the aggregated amount of the principal balance and interest accrued on the protected deposits. Where deposits were denominated in foreign currencies, the deposits would need to be converted into Hong Kong dollars according to the relevant market exchange rates. Hence, a QD would be required for determining the amount of interest accrued on the protected deposits and the exchange rate adopted for converting a foreign currency deposit into Hong Kong dollars. However, the existing definition of QD might create some uncertainties in determining a QD and could cause delay in making compensation payments to the depositors. To ensure that the compensation payments could be made in an expeditious manner, the Government proposed to amend the definition of QD by defining QD as the date a winding-up order had been made by the Court or the date on which HKMA had served a notice to HKDPB to trigger DPS, whichever was the earlier.

Issuance of electronic notices

14. Members enquired about Administration's measures to ensure the reliability, safety and effectiveness of electronic notices issued by HKDPB to depositors regarding DPS compensation arrangement. The Administration pointed out that technological safeguards like encryption and password

protection would be used to ensure the reliability and safety of electronic communications. Electronic notices would only be issued to depositors with valid email addresses and who were used to receiving electronic communications from the bank. In addition to electronic notices, the depositors concerned would still receive conventional paper notices.

Compensation level of the Deposit Protection Scheme

15. Members asked if the Government had plans to review the current compensation limit of $500,000 under DPS and develop a mechanism for reviewing the compensation limit at regular intervals. The Administration advised that the compensation limit was $100,000 per depositor per bank when DPS was implemented in 2006, and the limit was raised to $500,000 in 2011. The present limit already provided full protection for around 90% of depositors in Hong Kong. In considering whether to adjust the compensation limit, the Government would take into account various factors, including the level of full coverage provided to depositors, stability of the banking system, other initiatives contributing to financial stability, and the latest developments in deposit protection regimes in major international financial markets. The Government considered that the current compensation limit was appropriate and had no plan to adjust the limit for the time being.

Latest development

16. At the House Committee meeting on 27 November 2015, Members agreed to form a Bills Committee to study the Bill.

Relevant papers

17. A list of relevant papers is in the **Appendix**.

Council Business Division 1
Legislative Council Secretariat
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Appendix

List of relevant papers

Date	Event	Paper/Minutes of meeting
1 February 2010	Meeting of the Financial Affairs Panel	Background brief (LC Paper No. CB(1)997/09-10 Paper prepared by FSTB and HKDPB (LC Paper No. CB(1)978/09-10(04)) Minutes (paragraphs 39-52) (LC Paper No. CB(1)1493/09-10)
30 June 2010	The Legislative Council passed the Deposit Protection Scheme (Amendment) Bill 2010	Hansard The Bill passed Report of the Bills Committee (LC Paper No. CB(1)2344/09-10)
10 November 2010	The Subcommittee on Deposit Protection Scheme (Representation on Scheme Membership and Protection of Financial Products under Scheme) (Amendment) Rules 2010 submitted its report to the House Committee	Report (LC Paper No. CB(1)391/10-11)
September 2014	Public consultation on Enhancements to the Deposit Protection Scheme	Press release Consultation paper

Date	Event	Paper/Minutes of meeting
May 2015	Consultation Conclusions on Enhancements to the Deposit Protection Scheme Released	Press release Consultation conclusions
4 May 2015	Meeting of the FA Panel	Paper prepared by FSTB and HKMA (LC Paper No. CB(1)780/14-15(05)) Minutes (paragraphs 50-64) (LC Paper No. CB(1)1070/14-15)
25 November 2015	Introduction of the Deposit Protection Scheme (Amendment) Bill 2015	The Bill Legislative Council Brief (File Ref: B9/2/2C) Legal Service Division report (LC Paper No. LS14/15-16)