

香港存款保障委員會
HONG KONG DEPOSIT
PROTECTION BOARD

Annual Report 2007-2008

The Hong Kong Deposit Protection Board is a statutory body established under the Deposit Protection Scheme Ordinance to oversee the operation of the Deposit Protection Scheme. The Scheme is designed to protect depositors and to help maintain the stability of Hong Kong's banking system.

The Board's mission is to maintain an effective and efficient deposit protection scheme in accordance with the Ordinance and in line with international practices.

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MAIN FEATURES OF THE DEPOSIT PROTECTION SCHEME

All licensed banks, unless otherwise exempted by the Board, are required to participate in the Deposit Protection Scheme (DPS) as a Scheme member. They are required to display a membership sign prominently at their places of business.



[計劃成員名稱]是存款保障計劃的成員。本銀行接受的合資格存款受存款保障計劃保障，最高保障額為每名存款人HK\$100,000。

[Name of the Scheme member] is a member of the Deposit Protection Scheme. Eligible deposits taken by this Bank are protected by the Scheme up to a limit of HK\$100,000 per depositor.

The compensation limit of the DPS is set at HK\$100,000 per depositor per Scheme member.

Depositors are not required to apply for protection or compensation, eligible deposits held with Scheme members are automatically protected by the DPS.

Both Hong Kong dollar and foreign currency deposits are protected.

The DPS protects eligible deposits held with Scheme members. It does not protect term deposits with a maturity longer than five years, structured deposits, secured deposits, bearer instruments, off-shore deposits and non-deposit products, such as bonds, stocks, warrants, mutual funds, unit trusts and insurance policies.

A depositor's entitlement to compensation will be calculated on a net basis, that is, the liability of the depositor will be deducted from the amount of protected deposits in determining compensation.

A Deposit Protection Scheme Fund (DPS Fund) with a target fund size of 0.3% of the total amount of relevant deposits held with all Scheme members (translating into a fund size of approximately HK\$1.5 billion) will be built up through collecting contributions from members.

Differential contributions will be assessed based on the supervisory ratings of individual Scheme members for building up the DPS Fund.

KEY ACHIEVEMENTS IN 2007-08

ADMINISTRATION OF THE DPS

- The Board collected HK\$328 million in contributions to the DPS Fund for 2008 from Scheme members on schedule.
- The assets of the DPS Fund totalled HK\$661 million at the end of March 2008.
- The DPS Fund achieved an investment return of 3.8% in 2007-08.

MONITORING COVERAGE OF THE DPS

- The percentage of depositors fully covered by the DPS remained above 80% as shown by simulation tests with retail Scheme members completed during the year.

READINESS OF THE DPS PAYOUT PROCEDURES

- The Board conducted four simulation tests on the readiness of its information systems and those of Scheme members.
- A rehearsal was also held to test the adequacy of the Board's payout procedures, including the readiness of its payout agents.

PUBLIC AWARENESS AND UNDERSTANDING OF THE DPS

- The Board continued its widespread publicity activities to maintain and improve public awareness and understanding of the DPS, including the use of multi-media advertising campaigns.
- A Hong Kong-wide opinion survey in December 2007 revealed about 70% of the public were aware of the DPS.

MESSAGE FROM
THE CHAIRMAN



香港存款保障委員會
HONG KONG DEPOSIT
PROTECTION BOARD

Professor
Andrew Chan Chi-fai, SBS, JP
Chairman

“We are pleased to see
confidence in the Deposit
Protection Scheme
growing.”

The Deposit Protection Scheme celebrated its first anniversary in September 2007. During that first year, we witnessed the onset of global financial troubles on a scale rarely seen over the past decade. The sub-prime crisis, which began in the US in August 2007, sent a shockwave across international financial markets, resulting in a global liquidity and credit crunch that contributed to severe distress among financial institutions worldwide.

Fortunately, due to the limited exposure of most Hong Kong banks to sub-prime assets, the local banking system has been relatively less affected. Nevertheless, the speed at which the sub-prime crisis spread and the severity of its impact on other financial markets reminded us of the close integration between international and local markets, especially in an open economy like Hong Kong, and our susceptibility to developments overseas. It also highlighted the need to ensure that proper safeguards are in place to shelter local market participants from financial storms in the international marketplace. This is precisely one of the major reasons why we introduced the Deposit Protection Scheme in Hong Kong.

No doubt there were a host of economic and regulatory factors contributing to the US sub-prime crisis and the subsequent turmoil in other markets. A lack of understanding and confidence

in the ability of the financial safety net in weathering such market turbulence has certainly played a part in facilitating the rapid spread of the crisis. For example, a consultation paper issued by the UK authorities in response to a bank run last year reported that a majority of bank customers were not aware of the protection available to depositors under the UK scheme for compensating depositors.

The Board fully understands that public confidence is crucial to the effectiveness of the DPS in promoting banking stability in Hong Kong. After successfully launching the DPS in 2006, the Board has invested substantial time and effort in improving confidence in the DPS. Good progress was made in the first year and we are pleased to see confidence in the DPS growing.

According to the findings of two territory-wide opinion surveys conducted by the Board last year, a majority of Hong Kong residents are now aware of the DPS. This indicates the Board has met its communications objectives in its first year to bring the existence of the DPS to the public's attention. Supported by this high level of public awareness, we can now turn our attention to improving public understanding of how the DPS operates, especially those features crucial to fostering banking stability.

MESSAGE FROM THE CHAIRMAN



Chairman (right) and CEO (left) of the Board at a ceremony to celebrate the first anniversary of the launch of the DPS

Of course, building confidence in the DPS does not simply mean making the public aware of the availability of the DPS and its key features. More importantly, the Board must be able to demonstrate that the operation of the DPS is governed by a credible framework, and in the hands of a trustworthy administrator. As you will see in this annual report, the Board has invested a great deal of effort in enhancing the effectiveness and efficiency of the DPS during the past year. The Board also undertook a review of its corporate governance structure to ensure it continues to adhere to sound governance practices in administering the DPS. Indeed, the experience gained in the past year has significantly reinforced the confidence of all of us in the Board's ability to live up to the public's expectations.

I am truly thankful to the diligence of the Management Team in meeting the challenges faced by the Board in the past year. The Board also continued to receive support from various government departments and public and private bodies, without which the smooth operation of the DPS would not have been possible. And, I would like to take this opportunity to express my heartiest gratitude to my fellow Board members and to those organisations that have extended their support to the Board.

Rome was not built in a day. Deposit protection remains a relatively new concept to the people of Hong Kong and there is certainly abundant room for improving the operation of the DPS and building confidence in it. I believe that the Board's accomplishments over the past 12 months have already laid a solid foundation for the DPS to contribute meaningfully to banking stability in Hong Kong.

A handwritten signature in black ink, reading "cF Chan". The "c" and "F" are stylized and connected, and "Chan" is written in a cursive script.

Andrew Chan Chi-fai

Chairman

REVIEW OF OPERATIONS BY THE CHIEF EXECUTIVE OFFICER



Mr Raymond Li, JP
Chief Executive Officer

The launch of the DPS in 2006 marked the end of the start-up phase of the Scheme's implementation. After the Scheme became fully operational, the Board's focus shifted to its maintenance and enhancement.

Under the guidance of the Board, the Management Team was able to meet the new challenges confidently and achieve all the operational targets set for the year. Highlights of the achievements in 2007-08 include:

ADMINISTRATION OF THE DPS

The collection of contributions from Scheme members was completed on schedule. The Board collected a total of HK\$328 million in contributions for 2008, which brought the total assets of the DPS Fund up to HK\$661 million by the end of March 2008. Despite the fact that the DPS Fund can only be invested in short term government bills and Exchange Fund deposits, the Fund achieved an investment return of 3.8% for 2007-08.

During the year, the Board streamlined the contribution collection and rebate processes. It developed a system for requiring Scheme members to submit auditor's reports to certify the accuracy of the returns of relevant deposits submitted by them for the purpose of contribution determination.

The Board developed a self-assessment mechanism for monitoring and promoting Scheme members' compliance with the requirements of the DPS (Representation on Scheme Membership and

Protection of Financial Products under Scheme) Rules, which govern how Scheme members should disclose their membership status and the protection status of their financial products to their customers.

ENSURING ADEQUACY OF THE COVERAGE OF THE DPS

The Board continued to monitor the coverage of the DPS by collecting and analysing statistics from simulation tests with retail Scheme members. The percentage of depositors fully covered by the DPS as observed from the tests completed in 2007-08 remained above 80%.

The Board also conducted a survey to monitor the popularity of structured deposits and the practice of offering credit facilities under an integrated banking service package, and their impacts on the coverage of the DPS.

IMPROVING THE READINESS OF THE DPS TO PAYOUT

The Board conducted four simulation tests on the readiness of the information systems of the Board and Scheme members to make a payout. In the fourth quarter of 2007, a payout rehearsal was held to test the payout procedures of the Board and the readiness of the network of service

REVIEW OF OPERATIONS BY THE CHIEF EXECUTIVE OFFICER

providers for assisting the Board in a payout. Based on the experience gained from these exercises, the Board identified and initiated refinements to its systems and processes to further improve payout efficiency.

The Board has also developed a compliance review programme to monitor and promote Scheme members' compliance with the requirements in a guideline on how members should maintain customer information, and provide such information to the Board. This will help the Board to determine and pay compensation to depositors in a payout. The Board also conducted a survey to gather information on certain technical aspects of Scheme members' information systems crucial to ensuring payout efficiency.

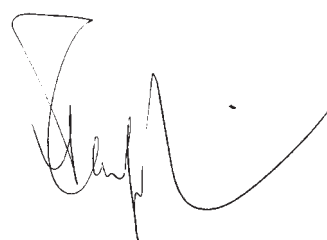
ENHANCING PUBLIC AWARENESS, UNDERSTANDING AND CONFIDENCE IN THE DPS

The Board continued to initiate educational and promotional activities to maintain and improve public awareness and understanding of the DPS. To monitor the effectiveness of the publicity campaign and identify areas of improvement, the Board commissioned an independent research agency to conduct two opinion surveys to measure the level of public awareness and understanding of the DPS. According to their findings, about 70% of the people in Hong Kong were aware of the DPS, and of these, about 77% knew of the Scheme's HK\$100,000 protection limit.

The Board conducted a comprehensive review of its corporate governance structure to ensure it continues to adhere to sound practices in administering the DPS.

In the coming year, the Management Team will continue to assist the Board in improving the operation of the DPS. As set out in the Board's 2008-09 business plan, priorities will be given to implementing the various surveillance mechanisms developed last year, refining the payout systems and processes to further enhance the readiness of the DPS to make payments during a payout, and improving public understanding of the DPS' key features.

I also take this opportunity to thank members of the Board for their support and advice over the past year, as well as my colleagues for their outstanding performance in assisting the Board in discharging its duties.



Raymond Li
Chief Executive Officer

ABOUT THE HONG KONG DEPOSIT PROTECTION BOARD

INTRODUCTION

Launched in September 2006, the DPS is a key building block in Hong Kong's financial safety net. Through the provision of a measure of protection to depositors, the DPS contributes to the stability of the banking system. The Board is a statutory body established under section 3 of the DPS Ordinance to oversee the operation of the DPS.

FUNCTIONS OF THE BOARD

Under section 5 of the DPS Ordinance, the Board's functions include assessing and collecting contributions payable by Scheme members, managing the DPS Fund, making payments to depositors in the event of a failure of a Scheme member and recovering payments made to depositors from the assets of the failed Scheme member.

PERFORMANCE OF FUNCTIONS THROUGH THE MONETARY AUTHORITY

Pursuant to section 6 of the DPS Ordinance, the Board shall perform its functions through the Monetary Authority ("MA") unless indicated otherwise by the Financial Secretary. This means the MA will act as an executive arm of the Board in administering the DPS.

The Hong Kong Monetary Authority ("HKMA") has assigned a team of staff to assist the Board

in discharging its functions. The team is headed by an Executive Director of the HKMA, who is designated as the Chief Executive Officer of the Board. The HKMA also supports the Board on aspects such as accounting, administration, human resources and information technology. Detailed arrangements regarding the extent of support provided by the HKMA are set out in a Memorandum of Understanding between the two organisations.

COMPOSITION OF THE BOARD

Members of the Board are appointed by the Financial Secretary, with power delegated from the Chief Executive. They come from different professions such as accounting, banking, consumer protection, insolvency law, investment, information technology and public administration. The Board currently comprises eight members including two ex-officio members representing the MA and the Secretary for Financial Services and the Treasury. Except for the two ex-officio members, all existing members were appointed or re-appointed for a two-year term on 1 July 2008.

ABOUT THE HONG KONG DEPOSIT PROTECTION BOARD



Members of the Board

Professor Andrew Chan Chi-fai

Mr Ian Chapman



Professor David Cheung Wai-lok

Mr Nicholas Peter Etches

Mr Nam Lee-yick

Chairman

Professor Andrew CHAN Chi-fai, SBS, JP

Professor Chan has been Chairman of the Board since 1 July 2004. He is Professor in Marketing and Director of the Executive MBA Programme, The Chinese University of Hong Kong.

Members

Mr Ian CHAPMAN

Mr Chapman is a Senior Consultant of Mayer Brown JSM specialising in restructuring and insolvency law.

Professor David CHEUNG Wai-lok

Professor Cheung is Head of the Department of Computer Science, The University of Hong Kong.

Mr Nicholas Peter ETCHES

Mr Etches is a former partner of KPMG with experience in accounting and insolvency practice.

Mr NAM Lee-yick

(until 30 June 2008)

Mr Nam is former Executive Director of Chong Hing Bank Limited and Vice President of Citibank N.A. He is currently Independent Non-Executive Director of Hopewell Holdings Limited and Hopewell Highway Infrastructure Limited.



Ms Elisabeth Charlotte Scott



Ms Eleanor Wan Yuen-yung



Professor Yeung Yuet-bor



Mr Y K Choi



Mr Kevin Ho Chi-ming

Ms Elisabeth Charlotte SCOTT

(until 30 March 2008)

Ms Scott is former Managing Director of Schroder Investment Management (Hong Kong) Limited and Chairman of the Hong Kong Investment Funds Association.

Ms Eleanor WAN Yuen-yung

(from 1 July 2008)

Ms Wan is Chief Executive Officer of Allianz Global Investors Hong Kong Limited and Vice Chairman of the Hong Kong Investment Funds Association.

Professor YEUNG Yuet-bor

Professor Yeung is the former Head of Information Technology of HSBC and is currently Professor of Information Systems, City University of Hong Kong.

Mr Y K CHOI, JP

Mr Choi is Deputy Chief Executive of the Hong Kong Monetary Authority. He is an ex officio member of the Board representing the Monetary Authority.

Mr Kevin HO Chi-ming, JP

Mr Ho is the Permanent Secretary for Financial Services and the Treasury (Financial Services). He is an ex officio member of the Board representing the Secretary for Financial Services and the Treasury.

ABOUT THE HONG KONG DEPOSIT PROTECTION BOARD

INVESTMENT COMMITTEE OF THE BOARD

The Investment Committee is established in accordance with section 7 of Schedule 2 to the DPS Ordinance. It consists of the following members:

Chairperson

Ms Eleanor WAN Yuen-yung

(from 1 July 2008)

Chief Executive Officer of Allianz Global Investors Hong Kong Limited and Vice Chairman of the Hong Kong Investment Funds Association

Mr NAM Lee-yick

(until 30 June 2008)

Former Executive Director of Chong Hing Bank Limited and Vice President of Citibank N.A.

Members

Mr Francis CHU Siu-chuen

Executive Director (Reserves Management),
Hong Kong Monetary Authority

Mr Nicholas Peter ETCHES

(from 1 July 2008)

Former partner of KPMG

Ms Elisabeth Charlotte SCOTT

(until 30 March 2008)

Former Managing Director of Schroder Investment (Hong Kong) Limited and Chairman of the Hong Kong Investment Funds Association

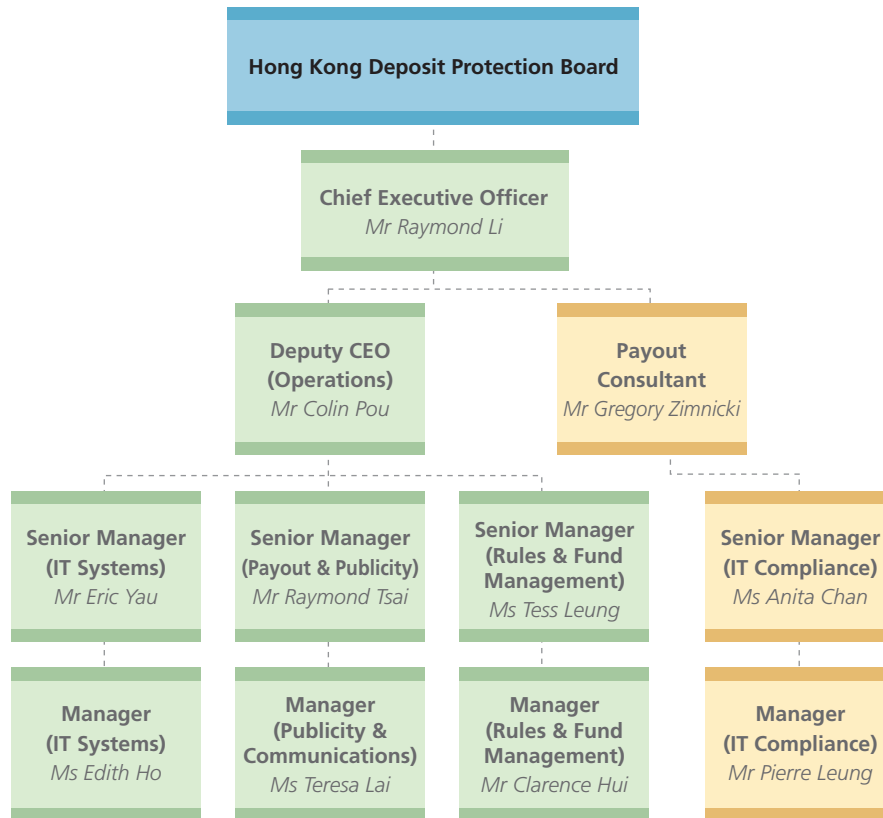
Professor YEUNG Yuet-bor

Professor, Department of Information Systems,
City University of Hong Kong

The terms of reference of the Investment Committee are:

- to make recommendations on the investment policy and strategy in respect of the DPS Fund;
- to monitor the investment performance of the DPS Fund and to establish proper risk management controls for the investment activities of the Board; and
- to work on any other matters as determined from time to time by the Board.

ORGANISATIONAL STRUCTURE OF THE BOARD (1 JULY 2008)



HKMA staff seconded to assist the Board. The emoluments of these staff members are reimbursed by the Board to the Exchange Fund.



Front row, from left to right:
Mr Gregory Zimnicki, Mr Raymond Li, Mr Colin Pou

Back row, from left to right:
Ms Edith Ho, Mr Pierre Leung, Mr Eric Yau, Mr Raymond Tsai, Mr Clarence Hui, Ms Tess Leung,
Ms Anita Chan, Ms Teresa Lai

ABOUT THE HONG KONG DEPOSIT PROTECTION BOARD

CONSULTATIVE COMMITTEE ON DEPOSIT PROTECTION SCHEME

To keep the industry informed of the development of the DPS, the Board has established a Consultative Committee comprising 13 representatives of the banking industry. The Committee serves as a useful forum for the Board and the banking industry to exchange views on issues of common interest. Members of the Committee are:

Ms YIP Wai-man,

Bank of China (Hong Kong) Limited

Mr TONG Hon-shing,

The Bank of East Asia Limited

Mr Johnson LIN,

BNP Paribas, Hong Kong Branch

Mr C Y LING,

CITIC Ka Wah Bank Limited

Ms Francesca SO,

Dah Sing Bank Limited

Ms Sinna HO,

DBS Bank (Hong Kong) Limited

Mr Joseph CHO,

Hang Seng Bank Limited

Ms Diana CESAR,

The Hong Kong and Shanghai Banking Corporation Limited

Mr David CHENG,

Industrial and Commercial Bank of China (Asia) Limited

Mr Andrew LAU,

JPMorgan Chase Bank, Hong Kong Branch

Ms Maggie CHEUNG,

Mizuho Corporate Bank Limited, Hong Kong Branch

Ms TAI Kwai-heung,

Nanyang Commercial Bank Limited

Mrs Pauline LAI,

Standard Chartered Bank (Hong Kong) Limited

The Committee's terms of reference are:

- to advise the Board on the formulation of the approach and strategy to engage the banking industry in the project of establishing the DPS;
- to consider and give comments on specific policy and operational initiatives proposed by the Board that may have an impact on the banking industry; and
- to assist the Board in maintaining effective communication with the banking industry.

DEPOSIT PROTECTION APPEALS TRIBUNAL

Under the DPS Ordinance, certain decisions of the Board and the MA can be the subject of an appeal to the Deposit Protection Appeals Tribunal. These include the Board's decisions on whether a foreign bank branch can be exempted from participation in the DPS, the amount of contribution payable by a Scheme member, and the amount of compensation payable to a depositor, as well as the MA's decision to impose an asset maintenance requirement on a Scheme member.

The Tribunal was established in January 2005. Mr Simon Herbert Mayo, a former Vice-President of the Court of Appeal of the High Court, was appointed by the Chief Executive as Chairman of the Tribunal. Members of the Tribunal are appointed by the Financial Secretary from a panel of six people. The panel members are:

Chairman

Mr Simon Herbert MAYO, GBS

Members

Professor Charles David BOOTH

Professor Simon HO Shun-man

Miss Winnie LUN Pong-hing

Mrs Mabel LUI FUNG Mei-yee

Mr Rupert James PURSER

Mr James WARDELL

The current appointment of the Chairman and panel of members is for a period of three years from 14 January 2008 to 13 January 2011. Sittings of the Tribunal are convened when required.

Whether the DPS can be effective in promoting banking stability depends to a large extent on the confidence of the public in the DPS to honour its commitments when a bank failure occurs. Apart from putting in place an efficient payout infrastructure and engendering a high level of public awareness and understanding of the DPS, public perception of the integrity of the Board is also critical to building up confidence in the DPS. The Board is therefore fully aware that it must subscribe to sound corporate governance practices in administering the DPS. Given the nature of the Board and the functions of the DPS, the corporate governance structure of the Board shares the characteristics of both a public organisation and a deposit insurer.

COMPOSITION AND PROCEEDINGS OF THE BOARD

The Board is an independent statutory body formed under the DPS Ordinance. It is, however, subject to the oversight of the Financial Secretary who is responsible for approving the Board's annual budget and tabling the Board's annual report to the Legislative Council.

The functions and composition of the Board are defined by the DPS Ordinance and, as such, the Board shall comprise between six to nine members, all of whom are non-executive members. Except for the two ex-officio members, all other members are appointed for a fixed, but renewable term. These members are appointed mainly because they possess professional or occupational experience relevant to the operation of the DPS.

The proceedings of the Board are governed by the relevant provisions in the DPS Ordinance. The Board meets three to four times every year to deliberate policy issues crucial to the operation and development of the DPS. In 2007-08, the Board met three times. On average, over 75% of members were present at each meeting.

Under the DPS Ordinance, the Board may appoint committees to assist in performing its functions. An Investment Committee comprising members with experience and expertise in banking and investment matters has been formed to advise the Board on the investment of the DPS Fund. The Chairman and a majority of the members of the Committee are also members of the Board.

EXECUTIVE MANAGEMENT

Pursuant to section 6 of the DPS Ordinance, the Board shall perform its functions through the MA unless otherwise directed by the Financial Secretary. This means the MA, acting as the executive arm of the Board, is responsible for managing the day-to-day operation of the DPS and assisting the Board in developing and implementing corporate policies and strategies.

The powers that can be exercised by the Board in administering the DPS are detailed in the DPS Ordinance. The Board has established clear guidelines on the division of responsibilities between the Board, the Management Team and other supporting divisions of the HKMA, and between the posts of the Chairman and the Chief Executive Officer, which have been separated in

line with good corporate governance practice. In general, strategic decisions relating to the operation and development of the DPS and those decisions requiring an exercising of the Board's powers under the DPS Ordinance have to be taken by the Board. The Management Team, on the other hand, is responsible for maintaining the day-to-day operation of the DPS according to the policies and principles endorsed by the Board.

INTERNAL CONTROLS AND AUDITS

Assisted by the Internal Audit Division (IAD) of the HKMA, which is a division independent of the department in the HKMA supporting the Board, the Management Team performs an annual assessment of the risks inherent in different operational areas of the Board, and evaluates whether appropriate controls are in place to safeguard the Board against the potential risks identified. The findings of the risk assessment will form the basis for the IAD to formulate its annual plan for auditing the operation of the DPS.

The IAD performs an annual audit of the DPS to ensure that the various internal control procedures of the Board have been properly adhered to, especially on activities posing a relatively high level of risk to the Board. The IAD will report its findings directly to a meeting of the Board. The IAD reported satisfactory results on the audit conducted in 2007.

The appointment of the external auditor of the DPS Fund requires the approval of the Financial Secretary. The external auditor is responsible for auditing the annual statement of accounts of the

DPS Fund prepared by the Board. The external auditor will report its findings directly to the Board. The external auditor for the year under review was PricewaterhouseCoopers (PwC). Apart from auditing the statement of accounts for 2007-08, PwC did not offer any non-audit service to the Board.

CONFLICTS OF INTEREST AND CODE OF CONDUCT

In line with the good corporate governance standards applicable to deposit insurers, government representatives, including those of the HKMA, account for only a minority of the members of the Board. This allows the government and the banking supervisor to contribute to the operation of the DPS from the public administration and financial regulatory perspectives, but prevents the Board from overtly exposing itself to the influence of the government and other financial safety-net players. The Management Team assigned by the HKMA to assist the Board is not responsible for banking supervisory matters. The operation of the Board is insulated from the influence of the banking industry as no employees or directors of banks and banks' related companies can be appointed as a Board member.

The Board has established clear guidelines and procedures for disclosing interests and avoiding conflicts of interest. The relevant guidelines and procedures are set out in the DPS Ordinance and the Codes of Conduct for members and staff of the Board. Board members are required to register in writing their personal interests when

CORPORATE GOVERNANCE

they first join the Board or its committees, and annually thereafter, to the secretary of the Board. The register of Members' interests is kept by the secretary and is available for public inspection. Senior staff members of the Board are required to make a declaration to the Chairman of the Board annually. Specific procedures are available on how members and staff of the Board should report their interests and be excused from a decision-making process.

COMMUNICATION AND TRANSPARENCY

The Board is committed to open communication with the public and other stakeholders. It has set up an enquiry hotline to answer questions from the public, and maintains a website to facilitate access to information on different aspects of the DPS operations. In 2007-08, the website registered close to 100,000 visits. The Board also publishes an annual report.



APPEAL MECHANISM

Certain decisions made by the Board and the MA under the DPS Ordinance can be the subject of an appeal to the Deposit Protection Appeals Tribunal. The Tribunal is chaired by a High Court judge appointed by the Chief Executive. Members of the Tribunal are appointed by the Financial Secretary from a panel of six people appointed by the Chief Executive.

REGULAR REVIEW OF THE CORPORATE GOVERNANCE STRUCTURE

The Board has set a policy of reviewing its corporate governance structure regularly to ensure that it continues to adhere to sound corporate governance standards, despite any expansion or change in the scope of the Board's operation driven by the development of the DPS. The review conducted by the Board in 2007-08 indicates the governance structure remains in substantial compliance with the best practices adopted by comparable public organisations and other deposit insurers. In between reviews, refinements will be made as and when necessary as the Board gains experience with operating the DPS.

REPORT ON ACTIVITIES IN 2007-08

OUR OPERATING ENVIRONMENT

A key characteristic of the operating environment of the DPS is that the banking sector of Hong Kong is highly internationalised. Of the 141 Scheme members, 118 are foreign bank branches, many of which are top tier international banking institutions. These foreign incorporated banks are mainly providing wholesale or specialised banking services to corporations and premier customers. The retail segment of the banking sector is mainly served by 23 locally incorporated banks, including some that also belong to international banking groups or have a strong global presence. With the aim of improving banking stability, it is logical for the Board to prioritise its effort on the retail segment, as this accounts for the bulk of the deposits protected by the DPS and covers the majority of depositors. Nevertheless, the high level of foreign participation in the local banking system suggests the Board should also pay close attention to driving forces in the international marketplace.

Major developments in international financial markets

In 2007, international financial markets experienced significant turbulence triggered by the US sub-prime crisis, which began last August and led to a general tightening of global credit and liquidity that was felt in major financial centres. For example, in September a run on a major mortgage lender in the UK came amid reports of difficulties experienced by banks in borrowing from the interbank market. The crisis also contributed directly to substantial losses reported by major international banking institutions, many of which have a presence in Hong Kong. The pessimism generated by the crisis also affected other financial sectors, especially stock markets.

Local economic and banking environment

The Hong Kong economy remained strong in 2007 with real GDP growing by 6.4% on the back of 7.0% growth in 2006¹. This was mainly driven by strong domestic demand and service exports. Monetary conditions eased in line with successive US interest rate cuts that began in September 2007. Rising inflationary pressures were seen in the strong growth in domestic demand, increasing imported food prices and the weakening of the US dollar, to which the Hong Kong dollar is pegged. Significant gains were recorded by the stock market in the first three quarters of 2007 in parallel with an optimistic economic outlook and hopes of a near term expansion of the Mainland's Qualified Domestic Institutional Investor scheme. But fears of a contagion effect of the sub-prime crisis prompted major corrections in the stock market in the fourth quarter.

Supported by the buoyant economic conditions, the effective banking supervision exercised by the HKMA and the reportedly small sub-prime exposure of local banks, the Hong Kong banking sector was well able to withstand the turbulence. According to HKMA statistics, the banking sector had a solid year in 2007, with retail banks remaining highly profitable and local banks well capitalised. The aggregate pre-tax operating profits of retail banks' Hong Kong offices increased by 31.1% from a 10.2% increase in 2006 on the back of expanding assets, improving net interest margins and robust growth in fees and commission income associated with equity-related businesses. Consistent with the strong 7.5% growth in relevant deposits reported by Scheme members to the Board, retail

¹ According to figures published by the Hong Kong Census and Statistics Department

REPORT ON ACTIVITIES IN 2007-08

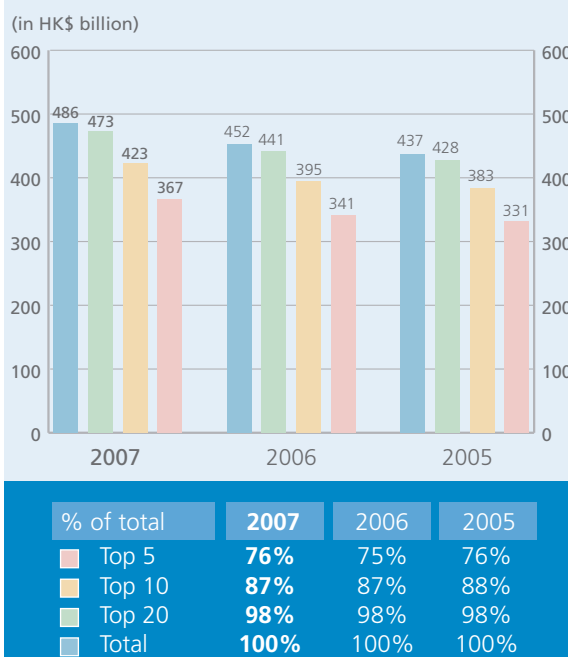
banks' customer deposits reported by the HKMA increased by 18.4%, compared with 15.6% in 2006. Retail banks also remained highly liquid as the growth in customer deposits outpaced loan growth. The asset quality of retail banks remained good, notwithstanding a worsening in the quality of investment in debt securities, mainly due to the sub-prime crisis. Despite a continued decline in the capital adequacy ratio observed for local banks, the capital position of the banking industry remained strong and well above the international minimum of 8%. The implementation of Basel II, a new capital adequacy framework for banks has further enhanced the resilience of the banking system in Hong Kong during the year.

Profile of Scheme members

At 31 March 2008, there were 141 Scheme members, compared with 135 a year earlier. During the year, eight new members joined and two ceased to be members because of mergers and acquisitions. Of the 141 members, 23 are locally incorporated banks and 118 are foreign bank branches, which are roughly in line with the number of retail banks and wholesale banks respectively.

Based on the returns of relevant deposits submitted by Scheme members in 2007, the top 20 members by size of relevant deposits are all retail banks and they accounted for more than 95% of total relevant deposits in the industry.

Relevant deposits held with Scheme members



An analysis of the changes in the amount of relevant deposits held with Scheme members in the retail segment from 2006 to 2007 shows that the growth recorded by small to medium-sized retail banks was generally higher than that recorded by large retail banks. On average, the deposits held with the smaller banks recorded a 10% year-on-year increase while the average increase recorded by the larger banks was 7%. In general, higher growth rates were recorded by those members who pursued a relatively more aggressive marketing strategy. This demonstrates that the DPS has contributed to fostering a more competitive banking environment.

Relevant deposits held with large retail banks and small to medium-sized retail banks

(in HK\$ billion)	2007	2006	± %
Large retail banks	420	393	7%
Small to medium retail banks	55	50	10%

Responses to trends and changes in the operating environment

As a deposit insurer, the Board must stay alert to changes or emerging trends in its operating environment to identify challenges and, where necessary, take appropriate actions to address any potential risks.

While Hong Kong's banking sector remains sound and robust, and has been little affected by the sub-prime crisis, valuable lessons have been learnt by the Board, including the measures taken and planned by overseas authorities to tackle the crisis or reinforce the resilience of their systems. Following the UK bank run in September, the Board conducted a review of the incident and any implications it might have for the DPS in Hong Kong. The review identified notable differences between the design features of Hong Kong's DPS and the scheme for protecting depositors in the UK. Given that there were so many factors at play, it is difficult to conclude whether the bank run incident could have been avoided had there been better deposit protection in the UK. The review, however, highlighted a few key factors for the success of the DPS, including the need to regularly assess and ensure the adequacy of the coverage of the Scheme, securing a readiness to make compensation in a reasonably expeditious manner and maintaining a high level of public awareness and understanding of the DPS.

The Board has also been keeping abreast of reforms to financial regulatory and deposit insurance regimes on the international scene in the aftermath of the sub-prime crisis. For example, in January 2008, the UK authorities issued, for public consultation, a package of recommendations for reforming the UK financial regulatory and deposit insurance arrangements. The US Treasury released in March a blueprint for modernising the US financial regulatory structure. In response to the turmoil on global markets, the Financial Stability Forum, a prominent international forum of national financial regulators, central banks and international financial institutions also issued, in April, recommendations to improve financial market and institutional resilience. In addition, the Board noted the HKMA had completed a review of its work on banking stability, which may have a bearing on the various financial safety net arrangements in Hong Kong, including the DPS. The Board will carefully review the recommendations of these reports and proposals, and monitor the progress of their implementation by the relevant authorities to see whether they may be appropriate to the DPS in Hong Kong.

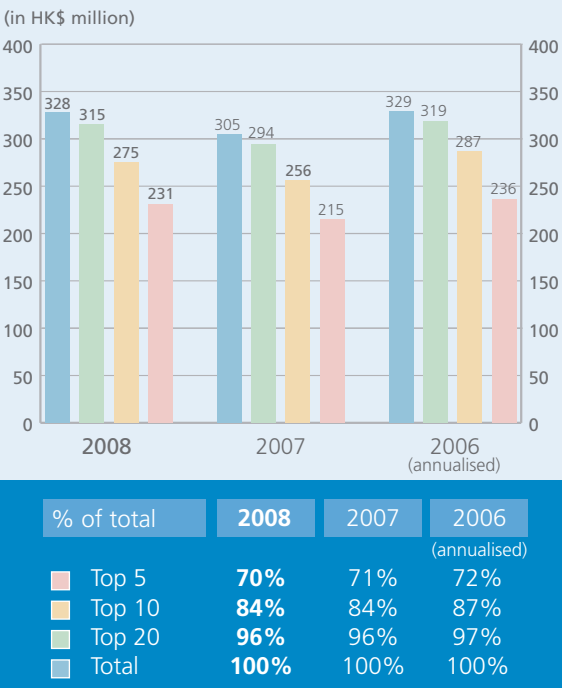
ADMINISTRATION OF THE DPS

Since the DPS commenced operation in 2006, one of the main operational objectives of the Board has been to maintain and improve the efficiency and effectiveness of the administration of the DPS. Notable achievements were made last year in the assessment and collection of contributions, investment of the DPS Fund and ensuring compliance with the DPS (Representation on Scheme Membership and Protection of Financial Products under Scheme) Rules. (Representation Rules).

Assessment and collection of contributions

Each Scheme member is required to make an annual contribution to the DPS Fund in the manner specified in the DPS (Payment of Contributions, Late Payment Fees and Rebates) Rules (Contribution Rules) issued by the Board. Under Schedule 4 to the DPS Ordinance, the Board assessed and collected HK\$328 million in contributions from Scheme members in 2008. This represented a 7.5% increment from the HK\$305 million collected in 2007. From the amount of relevant deposits held, over 95% of the total contributions were paid by the top 20 Scheme members. The distribution pattern was similar to those observed for the past two years. All contributions were paid by Scheme members on time in January 2008 in the manner prescribed in the Contribution Rules.

Contributions paid by Scheme members by relevant deposits held



The amount of contribution payable by a Scheme member for a year is assessed by the Board based on an annual return submitted by the member on the amount of relevant deposits held with it on 20 October of the previous year. To ensure the accuracy of the returns, the Board introduced a policy to require members to submit an auditor’s report to certify the correctness of their returns on a rotational basis. In early 2008, 34 Scheme members submitted an auditor’s report on their returns for 2007. The results were satisfactory and no reporting errors with a significant impact on the total contributions were noted. As the amount of relevant deposits held with the 34 members accounted for over 90% of the relevant deposits of all Scheme members, the exercise was successful in assuring the correctness of the aggregate amount of those deposits and, therefore, the aggregate amount of the industry’s contributions.

Investment of the DPS Fund

During the year, the Board invested the DPS Fund in accordance with the DPS Ordinance and the Board's investment policy, which sets out strict guidelines on the risk assessment and control measures, and the segregation of duties required for the investment activities.

To take advantage of the relatively higher US dollar interest rates, the Board increased the weight of US Treasury Bills in its investment portfolio. At the end of March 2008, cash and investment securities accounted for about 52% and 48% of the investment assets of the DPS Fund respectively, compared with 91% and 9% a year ago. In terms of currency mix, the proportion of US dollar assets increased to 48% from 9% during the same period. Despite the significant easing of Hong Kong dollar and US dollar interest rates last year, the Board was able to achieve an investment return of 3.8% on the DPS Fund in 2007-08, compared with 4.1% the previous year.

Mix of cash and investment securities of the DPS Fund (as at 31 March)

(in HK\$ million)	2008	2007
Cash and deposit balances	347.6	329.7
Investment securities	321.8	31.0
Total	660.4	360.7

Note: Scheme members started making contribution to the DPS Fund in 2007

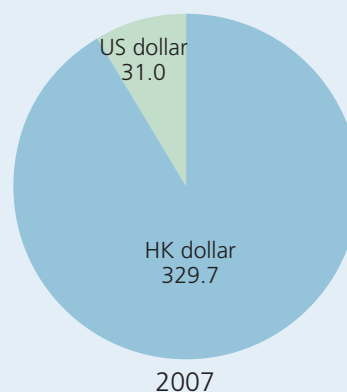
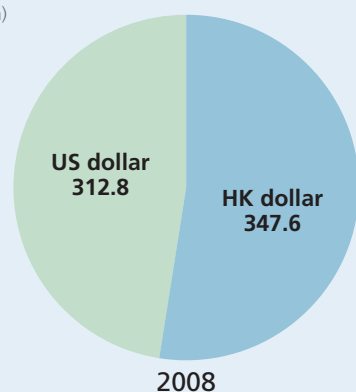
Compliance of Scheme members with the Representation Rules

To assist the public in distinguishing between financial products protected and not protected by the DPS, the Board issued the Representation Rules in June 2006. The Representation Rules govern the representations made by Scheme members regarding their member status and the protection status of their financial products.

In 2007, the Board introduced a self-assessment framework to assess the level of compliance of Scheme members with the Representation Rules. The framework took into account the experience of a focus review on selected Scheme members in 2006. The first self-assessment covered the period from 25 September 2006 (the DPS commencement date) to 30 September 2007. According to the assessment reports received by the Board, the overall compliance level of all Scheme members was satisfactory.

Currency mix of cash and investments of the DPS Fund (as at 31 March)

(in HK\$ million)



REPORT ON ACTIVITIES IN 2007-08

MONITORING COVERAGE OF THE DPS

To be effective in maintaining stability of the banking system, the DPS must be able to provide full protection to the majority of depositors. The Board continued to monitor the coverage of the DPS through statistics collected in regular simulation tests with Scheme members. The statistics collected from the tests completed in 2007-08 suggested the percentage of depositors fully protected should remain above 80%.

In addition to analysing these statistics, the Board has been paying attention to market developments that may have an impact on the coverage of the DPS. In 2007, the Board conducted a survey on the popularity of structured deposits and integrated banking service packages with a secured credit facility. The findings concluded that structured deposits were not popular among small depositors. The percentage of those holding such deposits remained well below the quantitative benchmarks set for reviewing their protection status when they were removed from the protection of the DPS in July 2006. Similarly, it was concluded that the popularity of integrated banking service packages with a secured credit facility had not reached the stage that warrants immediate action by the Board to bring the deposits pledged under such packages under the protection of the DPS.

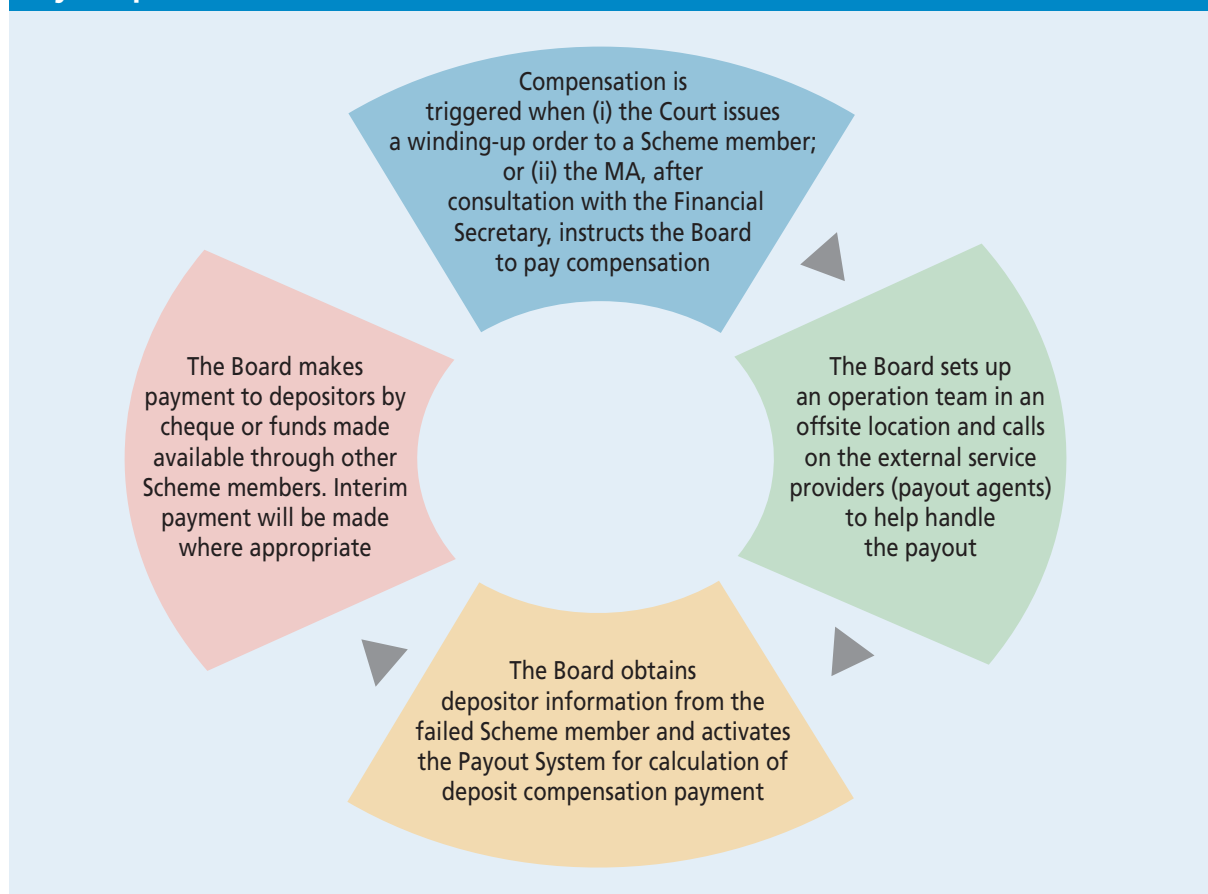
READINESS OF THE DPS TO PAYOUT

“Payout readiness” refers to the Board’s ability to deliver on its mandate of making compensation payments to affected depositors in the event of a bank failure (a process that is commonly referred to as a payout). This generally relates to having the appropriate people, processes and systems in place to be brought into action on short notice if payment of compensation from the DPS Fund is triggered. As suggested by the diagram on the following page, a number of elements need to be already in place for the Board to promptly begin and expeditiously complete a payout.

Since the Board makes use of a virtual organisation of external service providers (collectively referred to as payout agents) to assist with the calculation and payment of compensation to depositors in the event of a payout, this readiness extends to ensuring these payout agents are able to work in a co-ordinated and efficient manner and that they are familiar with the Board’s payout processes and systems.

The Management Team and these payout agents (the Payout Team) rely on a comprehensive set of procedures, documented in the Board’s Payout Procedure Manual as well as other reference materials, to guide them in performing the activities required to complete a payout. These procedures relate not only to manual processes performed during a payout, but also to the operation of the Board’s Payout System that was developed to handle the volumes of data and complex processing necessary to arrive at determinations of depositors’ balances on which compensation payments are based.

Payout process



The Board has also implemented a Guideline on Information Required for Determining and Paying Compensation (ISG), which provides direction to Scheme members on how data from their information systems should be made available or retrievable by the Board in the event of a payout. The ISG is necessary to ensure the Board can quickly use data from a failed Scheme member in its payout processing, as it will rely on those records obtained in making its determinations of entitlement to compensation payments.

To ensure an appropriate level of payout readiness during the year, the Board focused its attention on a number of areas, which are described in more detail below.

Improving payout policies, procedures and processes

In continuing to update its payout procedures and improve the Payout System, the Board has undertaken simulation tests, rehearsals and periodic reviews of operational requirements. The Payout System's functionality was expanded for production of statements for depositors and for handling enquiries of depositors in a payout. Upgrades to the System's hardware were also undertaken to ensure the Board's ability to efficiently handle and process a range of volumes for the data used in making compensation determinations. A manual was also developed to provide assistance to the Board's information

REPORT ON ACTIVITIES IN 2007-08

technology payout agents in handling unusual situations arising from Scheme member data processed by the Payout System.

Additional improvements also began later in the year to allow the Board to pursue different payout strategies depending on the particular circumstances of the failure of the Scheme member, and to transform Scheme member data that may be at variance with the Board's expectations as described in the ISG. In addition, the Board began revising its Payout Procedure Manual to include these changes; provide greater clarity for complex situations that may be encountered in a payout; and to streamline processes based on the experience gained from the payout rehearsal.

First payout rehearsal

The first payout rehearsal was conducted by the Board in November and December 2007. It involved Board members and personnel, and payout agents providing accounting, information technology consultancy, business recovery, security printing, and call centre services. The objectives of the rehearsal were to test the capacity of the Board's payout agents to perform payout processes while working in an efficient and co-ordinated manner as a team. In preparation for the rehearsal, the Board provided training to the agents on payout processes and the use of the Payout System to familiarise them with the relevant policies and tools before applying them in a payout scenario.

At the start of the rehearsal, a subset of the Payout Team, comprised mainly of accounting and information technology payout agents as well as Board personnel, assembled at the payout operation centre and quickly began making

determinations for compensation payments. The team applied procedures in the Payout Procedure Manual and processed data on the Payout System to verify the correctness and completeness of the "live" data provided to them from a Scheme member that was masked and safeguarded to protect any personal information. The team sorted through and grouped depositors' information into balances on which determinations of eligibility for compensation payments could be made, and prepared the payment files that would allow interim and final payments of compensation with explanatory payment statements to be produced. Call centre operators responded to simulated calls about the "payout", and the security printing company prepared cheques and statements using the payment files prepared by the other members of the Payout Team. Board members held event management meetings to keep informed of the progress of the "payout" and to make decisions at key junctures during the rehearsal. Sample statements were also drafted for release to the public in an actual payout, including updates to the Board's intervention website, designed to provide prompt communications updates on a payout.

The rehearsal was completed successfully, with compensation payment being determined on an appropriate basis. The payout agents performed their work within the service standards set out in their agreements with the Board. The rehearsal proved to be an invaluable exercise to test the Board's payout processes and the payout agents' capabilities in a situation that was designed to be as close as possible to an actual payout. The payout agents made several suggestions on improvements to make the payout processes even more efficient for their own co-ordination as well as certain payout processes that could be streamlined.



Board members discussing rehearsal activities at the payout operation centre



Members of the Payout Team receiving instructions at the start of the rehearsal



Operators at the call centre responding to simulated enquiries



Board members caught up in the activities of the call centre

The Board will conduct regular rehearsals involving its virtual organisation, focusing on different objectives to test specific payout issues and to continue to familiarise the payout agents with the payout processes, using any feedback from the rehearsal to continually develop the Board's payout system and tools.

Engagement of payout agents

The Board completed the engagement of all the payout agents required for a payout by entering into contractual arrangements with a security printing company and two accounting firms, one of which was appointed to provide project management services in the payout rehearsal. As well, the Board engaged several Scheme members to provide compensation payment disbursement services so the Board could properly monitor the

cheques issued and to handle the logistical issues when dealing with large volumes of cheques for clearing and settling. To minimise the possibility of delays in disbursing compensation payments, sufficient cheque and statement stock has been pre-printed and securely stored.

The Board also worked with its existing payout agents to ensure they could properly deliver their services when called on to do so. For example, this included working with the call centre service provider in updating the set of frequently asked questions for payout, and providing training to the call operators on the use of the question and the Payout System so they could be more effective in responding to enquiries; and with the security printing company in developing a programme to allow more efficient processing of the payment file from the Payout System into cheques and statements to depositors.

REPORT ON ACTIVITIES IN 2007-08

Payout funding secured

The Board has secured a credit facility from the Exchange Fund to pay compensation to depositors in the event of a bank failure. The size of the credit facility is sufficient to cope with the simultaneous failure of two medium-sized banks. This is consistent with international standards promulgated by the Financial Stability Forum. The Board has, so far, not had to draw on the credit facility from the Exchange Fund.

Compliance with the ISG

This statutory guideline, issued by the Board in June 2006, sets out the requirements on information systems and customer records to be followed by Scheme members. Having data available to, or retrievable by, the Board that conforms to particular requirements allows the Board to quickly begin its work in the event of a payout.

Compliance with the guideline was expected to be achieved by all Scheme members by the end of 2007. The Board has been monitoring progress of their compliance with the ISG using bi-monthly surveys in which the members self-report their level of compliance. In the December 2007 survey, all Scheme members reported compliance with the guideline. With this milestone achieved, the Board has moved to the next stage of checking the reported compliance through the development of a Compliance Review Programme. This verifies Scheme members' level of compliance and involves up to six compliance reviews being held each year. A risk-based approach will be adopted to identify Scheme members to be subject to a review. The selection of members will be made with reference to various factors such as the size and complexity

of their information systems in terms of data volume, variety and level of sophistication. The Programme is ready for implementation in 2008-09.

While developing the Programme, the Board has continued its simulation tests in which it obtains data from Scheme members; processes the data on the Payout System; and applies payout processes and procedures to assess specific payout issues that the Board may encounter, as well as to maintain the knowledge and readiness to perform a payout involving Board personnel and its network of payout agents. During the simulation tests, the Board also worked with Scheme members to assist them in complying with the ISG. Three simulation tests were completed during the year and a fourth was commenced in February 2008. A number of interpretation issues of the ISG were observed during the tests, which prompted the Board to issue an IT survey to Scheme members to understand the pervasiveness of these issues.

The results of the IT survey indicated a need for amendments to the ISG as well as an explanatory note for certain complex areas that will provide clarity on the issues and facilitate members' comprehension of the ISG. Consultations with the Consultative Committee on Deposit Protection Scheme will be held in the second quarter of 2008 to allow Scheme members to effectively implement the measures. The Board will take into consideration the impact of any changes to information systems or customer records that may be required of members when it conducts its compliance reviews.

PUBLIC AWARENESS AND EDUCATION

The Board fully recognises that the effectiveness of the DPS in maintaining banking stability relies heavily on a high level of public awareness and understanding of the Scheme. With the advice of a professional public relations consultant and an

advertising agency, together with the support of government departments, and private and public organisations, the Board continued to conduct a wide variety of promotional and educational activities to maintain and expand public awareness and understanding of the DPS.

During the year, the Board:

- hosted a media luncheon to mark the first anniversary of the launch of the DPS



Chairman Professor Andrew Chan reviewed the DPS operations at the media luncheon



The DPS publicity marking the first anniversary

- launched five advertising campaigns in major transportation systems, including the MTR network and on buses



Keeping the public aware of the DPS on public transport

REPORT ON ACTIVITIES IN 2007-08

- launched six advertising campaigns on TV and in newspapers



Scene from the DPS TV commercial



Catchy newspaper advertisements emphasise key features of the DPS

- collaborated with non-government organisations and labour unions on the promotion of the DPS



NGOs and labour unions help promote the DPS

- inaugurated two advertising campaigns on the internet, including on-line advertisements and advertisements in e-news letters



Advertising campaign in the internet

- held 48 "Know Your DPS Day" exhibitions in public housing estates



Roving exhibitions reinforce the DPS message in the community

A list of major public education and publicity activities is in Annex 2.

REPORT ON ACTIVITIES IN 2007-08

Effectiveness of the publicity campaign

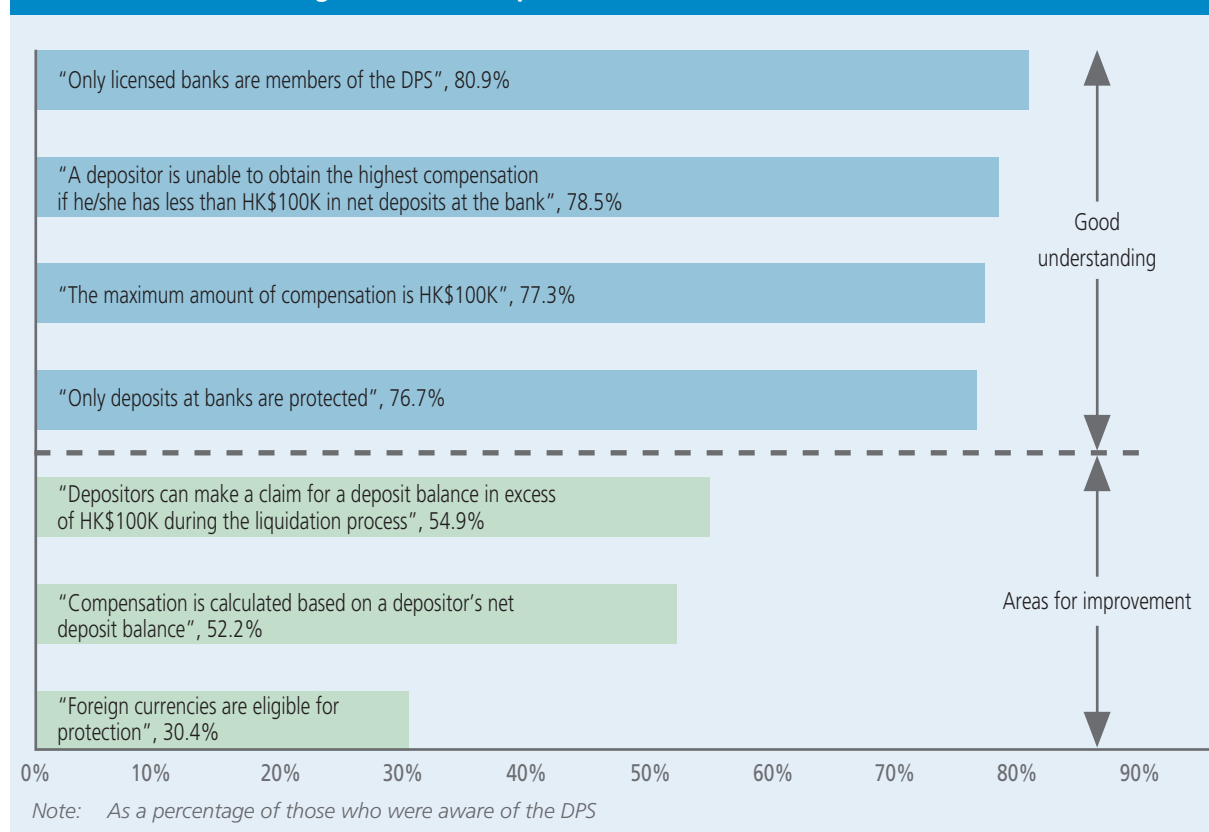
The Board engaged an independent research agency to conduct two Hong Kong-wide opinion surveys on the DPS in 2007, one in June and the other in December, to monitor whether its communications objectives had been met and to identify improvements for the publicity plan.

The findings show that about 70% of Hong Kong people are aware of the DPS, indicating the Board met its objective for the year in fostering and maintaining a high level of public awareness. More importantly, the surveys found that public confidence in the banking system in general

has improved since the introduction of the DPS. Positive responses were seen in areas including the perceived level of security of deposits in banks, and increased confidence in small to medium-sized banks.

As expected, the findings of the surveys also indicated that people have not yet been able to understand fully some of the key features of the newly introduced Scheme. In addition, people on low-incomes, who generally fall into the category the DPS aims to protect, were relatively less aware of the Scheme. These two observations have provided useful information to the Board in formulating its future publicity strategy.

Level of understanding of different aspects of the DPS



RELATIONSHIP WITH OTHER SAFETY NET PLAYERS

Co-operation with the Hong Kong Monetary Authority

Both the Board and the HKMA are financial safety net players in Hong Kong. They share a common aim of promoting the stability of the banking system. To ensure this is accomplished, the Board and the HKMA have agreed on how the two organisations should co-operate with each other in the performance of their respective functions. In addition, as the Board is required by the DPS Ordinance to perform functions through the MA, the Board and the HKMA have agreed on the extent of support provided by the HKMA. The Board has also secured a standby facility from the Exchange Fund to provide the necessary liquidity required for payment of compensation in the event of a bank failure. The detailed arrangements on how the two organisations should co-operate have been set out in a Memorandum of Understanding (MoU). In the past year, the Board and the HKMA closely co-operated with each other under the terms of the MoU.

Relationship with the Securities and Futures Commission and the Investor Compensation Company

Under certain circumstances in the event of a bank failure, the funds of a depositor or a portion of those funds is simultaneously covered by the DPS and the Investor Compensation Fund (ICF) established under the Securities and Futures Ordinance for compensating securities or futures investors. To ensure that no person receives double compensation, the Board and the Securities and Futures Commission (SFC) agreed that a set of arrangements on co-ordination and exchange of information between the parties should be developed and documented in an MoU between the Board, the SFC and the Investor Compensation Company (ICC), the company recognised by the SFC for administering the ICF. During the year, the Board completed drafting the MoU with the SFC and ICC. Specifically, it recognises that the DPS will normally pay the depositors first in the event of a bank failure and, to avoid double compensation, the parties should inform each other when compensation is paid to a depositor that has lodged a claim with the ICF.

REPORT ON ACTIVITIES IN 2007-08

INTERNATIONAL CO-OPERATION

As a member of the International Association of Deposit Insurers (IADI), the Board continued to participate in forums organised by both IADI and its member deposit insurers to exchange knowledge and ideas on issues relevant to deposit protection in an international context. In 2007-08, Board personnel took part in a number of international meetings including:

- the IADI 6th Annual Conference and Annual General Meeting in Kuala Lumpur, Malaysia;



- the Deposit Insurance Corporation of Japan 3rd Round Table in Tokyo, Japan; and



Manager Clarence Hui (third from left, back row) at the Deposit Insurance Corporation of Japan 3rd Round Table in Tokyo

- the 6th Asia Regional Committee Annual Meeting of IADI and International Conference of Deposit Insurance in Bali, Indonesia



Payout Consultant Gregory Zinmicki (sixth from left, second row), at the 6th Asia Regional Committee Annual Meeting of IADI in Bali

PLANS FOR 2008-09

THE OUTLOOK

The near term risk profile of Hong Kong's banking sector should remain favourable as the US sub-prime crisis has had little effect on the sector; banks' financial positions are strong; and the outlook for the Hong Kong economy remains positive. However, there are uncertainties and risks over the longer term because of the difficulties in forecasting whether the sub-prime crisis will end soon or intensify and trigger further turbulence, which might have a more direct impact on Hong Kong's banking system. Of course, given the highly integrated nature of world financial markets, the banking sector may also be subject to other unexpected external shocks, for example, a sharper-than-expected slowdown in the US economy. The Board will closely monitor international market developments and assess their impact on the risk profile of the banking sector. The Board will also watch the progress of overseas authorities in reforming their financial regulatory and deposit insurance regimes to see if any measures can be usefully applied to the DPS in Hong Kong.

On the operation of the DPS, the Board will continue to increase the effectiveness and efficiency of the Scheme. Priorities will be given to implementing the various surveillance mechanisms introduced last year for monitoring Scheme members' compliance with DPS rules and guidelines, refining the payout systems and processes in the light of the experience of

simulation tests and payout rehearsals to further improve the readiness of the DPS to payout, and improving public understanding of the main features of the DPS.

ADMINISTRATION OF THE DPS

Based on the returns of relevant deposits to be submitted by Scheme members in relation to their positions on 20 October 2008 and the supervisory ratings to be supplied by the HKMA, the Board will assess and collect the contributions payable for 2009 in January of that year. A second batch of Scheme members will be required to submit an auditor's report certifying the correctness of their returns. After upgrading the contribution collection system last year, the Board will improve the contribution database to streamline the contribution rebate and refund processes in 2008-09.

The DPS Fund will continue to be invested in accordance with the Ordinance and the investment policy of the Board. The Board will also explore options for increasing the returns on the Fund.

To ensure compliance with the Representation Rules, the Board will share findings and common errors identified in the first self-assessment exercise with Scheme members to improve the overall compliance level of the industry. Members will be required to conduct another self-assessment and submit reports to the Board for review in the coming year.

MONITORING COVERAGE OF THE DPS

The Board will maintain its monitoring of DPS coverage through statistics collected in simulation tests. Based on observations from tests completed in 2007-08, the Board believes the percentage of depositors fully covered by the Scheme for the industry remains above 80%. However, as the customer profile of individual members may differ, it is possible the percentage observed for different banks in subsequent simulation tests may be higher or lower than 80%. The Board will study any anomalies and, where it is evident that the percentage for the industry as a whole will be lower than 80%, it will consider improving the protection offered by the DPS.

PAYOUT READINESS

Payout readiness involves a process of continuous improvement and preparation based on testing and experience. The Board will apply the lessons learnt from the rehearsal conducted in 2007 to enhance its payout policies, processes, procedures and tools. For 2008-09, this will involve:

- completing an upgrade of the Payout System to allow for flexible payout strategies and easier transformation of data
- undertaking additional improvements to the efficiency of Payout System functions relating to interest calculations, aggregation of customers' balances, and cheque and statement production
- incorporating suggestions from the rehearsal into streamlining the Payout Procedure Manual

This work will be completed in time for the next rehearsal scheduled by the Board for the fourth quarter of 2008. This rehearsal will include a number of payout agents not involved in the previous one so the Board can broaden its knowledge base for performing payouts across its agent network, and to maintain a solid foundation from the previous experience.

The Board will also review its payout agent requirements, particularly in the light of some contractual arrangements approaching expiry; the need to reassess existing payout agents to ensure they remain up to date with current changes that may affect the banking sector and techniques that may improve the efficiency of payout processes; and to expand the payout agents network, where appropriate, to mitigate any risks regarding resource availability.

The Board will issue an amended ISG together with an explanatory note to strengthen the understanding of Scheme members in fully complying with the guideline and ensure the Board is able to obtain information which it can promptly use for making a payout. This action follows completion of the consultation with the Consultative Committee on Deposit Protection Scheme in the second quarter of 2008. The Board will also begin formal reviews of Scheme members' compliance with the ISG in the second quarter of 2008. Concurrent with some of these reviews, the Board will continue to conduct simulation tests to assess the Payout System's capabilities in handling varying data structures and volumes and analyse specific issues that may be encountered in a payout.

PUBLIC AWARENESS AND EDUCATION

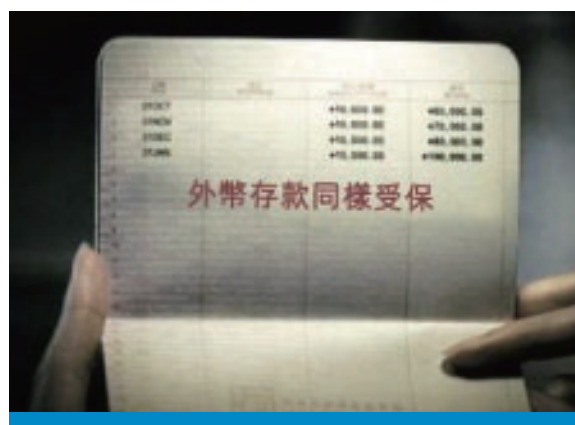
In the light of the findings of the opinion surveys conducted in 2007-08, the focus of the Board's publicity plan for the new year will be on increasing public understanding of the main features of the DPS, especially among small depositors whom the DPS aims to protect. Under the 2008-09 publicity plan, the Board will continue to use diversified and creative channels

to deliver DPS messages to the public. The scope of each promotional campaign will be structured to maximise its reach within the small depositor target group.

In measuring the effectiveness of the publicity campaigns in achieving their objectives, the Board will again conduct regular opinion surveys to monitor the level of public awareness and understanding of the DPS.



Practical souvenirs help promote the DPS



Highlighting the protection status of foreign currency deposits in a revamped TV campaign

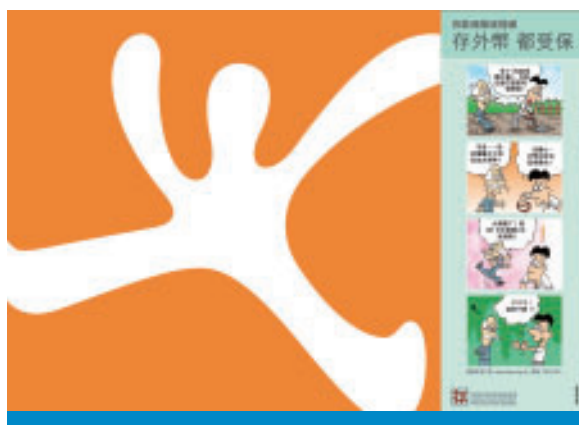


Table-mat advertising campaign proposed for 2008-09



Extending the campaign to the East Rail Line

INDEPENDENT AUDITOR'S REPORT

TO THE HONG KONG DEPOSIT PROTECTION BOARD

We have audited the statement of accounts of the Deposit Protection Scheme Fund (the "Fund") established under section 14 of the Deposit Protection Scheme Ordinance (the "Ordinance") set out on pages 42 to 62, which comprises the balance sheet as at 31 March 2008, and the income and expenditure account, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

THE BOARD'S RESPONSIBILITIES FOR THE STATEMENT OF ACCOUNTS

The Ordinance requires the Hong Kong Deposit Protection Board (the "Board") to keep and maintain proper accounts and records of all transactions of the Fund. The Board is responsible for the preparation and the true and fair presentation of the statement of accounts in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants.

This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of statement of accounts that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on the statement of accounts based on our audit and to report our opinion solely to you, as a body, in accordance with section 19 of the Ordinance and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the statement of accounts is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the statement of accounts. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the statement of accounts, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the statement of accounts in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board, as well as evaluating the overall presentation of the statement of accounts.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the statement of accounts gives a true and fair view of the state of affairs of the Fund as at 31 March 2008 and of the surplus and cash flows of the Fund for the year then ended in accordance with Hong Kong Financial Reporting Standards and has been properly prepared in accordance with the Ordinance.

PricewaterhouseCoopers

Certified Public Accountants

Hong Kong, 25 June 2008

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND INCOME AND EXPENDITURE ACCOUNT

for the year ended 31 March 2008 (Expressed in Hong Kong dollars)

	Notes	2008	2007
Income			
Contributions		\$ 310,950,193	\$ 164,510,998
Interest income from cash and balances with bank and the Exchange Fund		5,852,386	2,652,397
Interest income from available-for-sale securities		8,683,701	465,925
Exchange gains		282,198	179,157
Other income		60,000	90,000
		\$ 325,828,478	\$ 167,898,477
Expenditure			
Staff costs	6	\$ 5,473,024	\$ 4,209,933
Premises costs		2,336,172	1,039,968
Depreciation and amortisation		2,962,048	569,665
Financial information services		12,276	11,160
Office supplies		96,076	202,778
Overseas travel		32,054	170,934
Transport and travelling		4,003	5,793
Hire of services		22,495,039	9,492,894
Communications		65,961	20,639
Printing and publicity		15,485,853	10,934,145
Other expenses		1,012,385	193,312
		\$ 49,974,891	\$ 26,851,221
Surplus for the year		\$ 275,853,587	\$ 141,047,256

The note on page 46 to 62 form part of this statement of accounts.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND BALANCE SHEET

as at 31 March 2008 (Expressed in Hong Kong dollars)

	Notes	2008	2007
Non-current assets			
Fixed assets	7	\$ 3,663,231	\$ 3,617,442
Intangible assets	8	10,450,302	9,767,400
		\$ 14,113,533	\$ 13,384,842
Current assets			
Other receivables	9	\$ 820,025	\$ 303,056
Available-for-sale securities	10	312,805,015	30,975,635
Cash and balances with bank and the Exchange Fund	12	347,581,496	329,667,874
		\$ 661,206,536	\$ 360,946,565
Current liabilities			
Contributions received in advance		\$ 245,729,293	\$ 228,701,515
Other payables	11	17,541,419	9,714,208
		\$ 263,270,712	\$ 238,415,723
Net current assets		\$ 397,935,824	\$ 122,530,842
Net assets		\$ 412,049,357	\$ 135,915,684
Represented by			
Accumulated surplus		\$ 411,769,083	\$ 135,915,496
Investment revaluation reserve		280,274	188
		\$ 412,049,357	\$ 135,915,684

Approved and authorised for issue by the Hong Kong Deposit Protection Board on 25 June 2008.

Professor Andrew Chan Chi-fai, *SBS, JP*
Chairman

The note on page 46 to 62 form part of this statement of accounts.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND STATEMENT OF CHANGES IN NET ASSETS

for the year ended 31 March 2008 (Expressed in Hong Kong dollars)

	2008	2007
Fund balance as at 1 April	\$ 135,915,684	\$ (5,131,760)
Surplus for the year	275,853,587	141,047,256
Change in fair value of available-for-sale securities	280,086	188
Fund balance as at 31 March	\$ 412,049,357	\$ 135,915,684

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND CASH FLOW STATEMENT

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for the year ended 31 March 2008 (Expressed in Hong Kong dollars)

	2008	2007
Operating activities		
Surplus for the year	\$ 275,853,587	\$ 141,047,256
Interest income	(14,536,087)	(3,118,322)
Exchange gains	(282,198)	(179,157)
Depreciation and amortisation	2,962,048	569,665
Cash inflow from operating surplus before changes in operating assets and liabilities	\$ 263,997,350	\$ 138,319,442
Changes in operating assets and liabilities		
Increase in other receivables	(516,969)	(239,855)
Increase in contributions received in advance	17,027,778	228,701,515
Increase in other payables	7,827,211	9,143,085
Decrease in loan from the HKMA	—	(10,600,000)
Net cash inflow from operating activities	\$ 288,335,370	\$ 365,324,187
Investing activities		
Increase in intangible assets	\$ (2,798,487)	\$ (4,716,800)
Purchase of fixed assets	(892,252)	(3,752,829)
Interest received	5,852,386	2,620,375
Purchase of available-for-sale securities	(412,554,233)	(30,330,365)
Redemption of available-for-sale securities	139,970,838	—
Net cash outflow from investing activities	\$ (270,421,748)	\$ (36,179,619)
Net increase in cash and cash equivalents	\$ 17,913,622	\$ 329,144,568
Cash and cash equivalents at 1 April	329,667,874	523,306
Cash and cash equivalents at 31 March	\$ 347,581,496	\$ 329,667,874
Analysis of balance of cash and cash equivalents		
Cash and balances with bank and the Exchange Fund	\$ 347,581,496	\$ 329,667,874

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND NOTES TO THE STATEMENT OF ACCOUNTS

1 PURPOSE AND ACTIVITIES

The Deposit Protection Scheme Fund (the “Fund”) is established under the Deposit Protection Scheme Ordinance (the “Ordinance”) for the purpose of providing compensation to depositors under certain circumstances in respect of deposits maintained with banks that are members of the Deposit Protection Scheme (the “Scheme”). The Hong Kong Deposit Protection Board (the “Board”) manages the Fund in accordance with the provisions of the Ordinance. The Fund mainly consists of contributions collected from Scheme members and returns on investments of the Fund. Expenditure incurred in the establishment and maintenance of the Scheme, as well as the management and administration of the Fund are paid from the Fund.

2 SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of preparation

The statement of accounts has been prepared in accordance with Hong Kong Financial Reporting Standards (“HKFRSs” which is a collective term including all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (“HKASs”) and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”), and accounting principles generally accepted in Hong Kong. The statement of accounts has been prepared under the historical cost convention, as modified by the revaluation of available-for-sale securities.

The preparation of statement of accounts in conformity with HKFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Fund’s accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the statement of accounts, are disclosed in Note 4.

The HKICPA has issued a number of new/revised HKFRSs, which are effective for the Fund’s accounting periods beginning on or after 1 April 2007. The Fund adopted “HKFRS 7, Financial Instruments: Disclosures” which introduces certain new disclosures relating to the statement of accounts and is relevant to its operations.

for the year ended 31 March 2008 (Expressed in Hong Kong dollars)

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(a) Basis of preparation (Continued)

Standards, amendments and interpretations effective in 2007 but not relevant to the Fund's operations

The following standards, amendments and interpretations are mandatory for the Fund's accounting periods beginning on or after 1 April 2007 but either did not result in substantial changes to the Fund's accounting policies or are not relevant to the Fund's operations.

- HKAS 1 (Amendment), Presentation of Financial Statements – Capital Disclosures;
- HK(IFRIC) – INT 7, Applying the Restatement Approach under HKAS 29, Financial Reporting in Hyperinflationary Economies;
- HK(IFRIC) – INT 8, Scope of HKFRS 2;
- HK(IFRIC) – INT 9, Reassessment of Embedded Derivatives;
- HK(IFRIC) – INT 10, Interim Financial Reporting and Impairment; and
- HK(IFRIC) – INT 11, HKFRS 2 Group and Treasury Share Transactions

Standards, amendments and interpretations that are not yet effective and have either not been early adopted by the Fund or not relevant to the Fund

The Fund has chosen not to early adopt the following standards, amendments and interpretations to existing standards that were issued but not yet effective for the Fund's accounting periods beginning on 1 April 2007:

- HKFRS 8, Operating Segment;
- HK(IFRIC) – INT 12, Service Concession Arrangements;
- HK(IFRIC) – INT 13, Customer Loyalty Programmes;
- HK(IFRIC) – INT 14, HKAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and Their Interaction;
- HKAS 1 (Revised), Presentation of Financial Statements;
- HKAS 23 (Revised), Borrowing Costs; and
- HKAS 27 (Revised), Consolidated and Separate Financial Statements

The Board is in the process of assessing the impact of these amendments, new standards and interpretations and so far no significant impact is expected.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND NOTES TO THE STATEMENT OF ACCOUNTS

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Revenue recognition

Revenue is recognised in the income and expenditure account when it is probable that economic benefits will flow to the Fund and the revenue can be measured reliably.

Contributions and exemption fees are collected from Scheme members as specified in Schedule 4 to the Ordinance. They are accounted for on an accrual basis.

Contributions are calculated based on the amount of relevant deposits and the respective supervisory rating of each non-exempted bank applicable at a specified date. Contributions are collected annually in advance for each calendar year.

Interest income is recognised in the income and expenditure account using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Fund estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

(c) Expenses

All expenses are recognised in the income and expenditure account on an accrual basis.

for the year ended 31 March 2008 (Expressed in Hong Kong dollars)

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) Fixed assets

Fixed assets are stated at cost less accumulated depreciation and impairment losses. Depreciation is calculated on a straight-line basis to write off the assets over their estimated useful lives as follows:

	Years
Computer hardware/software costs:	
• Servers	5
• Others, e.g. personal computers, printers and accessories	3
Office furniture, equipment and fixtures	5

Only items costing HK\$10,000 or more are capitalised. Gains or losses arising from the disposal of a fixed asset are determined as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the income and expenditure account in the month of disposal.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount exceeds its estimated recoverable amount. The recoverable amount is the higher of the asset's net selling price and value in use.

(e) Financial assets

The Fund classifies its investments in debt securities as available-for-sale securities. Available-for-sale securities are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or market prices.

Purchases and disposal of available-for-sale securities are recognised on trade-date – the date on which the Fund commits to purchase or dispose of the securities. They are initially recognised at fair value plus transaction costs and subsequently held at fair value.

Unrealised gains and losses arising from changes in the fair value are recognised directly in reserve, until the available-for-sale securities are derecognised or impaired at which time the cumulative gain or loss previously recognised in the reserve should be recognised in the income and expenditure account. However, interest calculated using the effective interest method is recognised in the income and expenditure account.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND NOTES TO THE STATEMENT OF ACCOUNTS

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Financial assets (Continued)

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale are analysed between translation differences resulting from changes in amortised cost of the securities and other changes in the carrying amount of the securities. The translation differences on monetary securities are recognised in the income and expenditure account; translation differences on non-monetary securities are recognised in reserve. Changes in the fair value of monetary and non-monetary securities classified as available-for-sale are recognised in reserve.

When the available-for-sale securities are disposed, the difference between the net sale proceeds and the carrying value, and the accumulated fair value adjustments in the reserve are treated as gains or losses on disposal.

(f) Fair value measurement principles

The fair value of quoted investments in active markets is based on current bid prices. If the market for a financial asset is not active, the Fund establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and other valuation techniques commonly used by market participants.

(g) Intangible assets

Costs that are directly associated with the development of identifiable and unique systems controlled and used by the Fund, and that will probably generate economic benefit exceeding costs beyond one year, are recognised as intangible assets. Expenditure on development of the Payout System is capitalised if the systems are technically and commercially feasible. The expenditure capitalised includes the direct labour and costs of materials. Intangible assets are stated at cost less accumulated amortisation and any impairment losses.

Amortisation of intangible assets with definite life is charged to the income and expenditure account on a straight-line basis over the assets' estimated useful life of 5 years.

for the year ended 31 March 2008 (Expressed in Hong Kong dollars)

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(h) Impairment of financial assets

The Fund assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. If any such evidence exists for available-for-sale securities, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in income and expenditure account – is removed from reserve and recognised in the income and expenditure account. If, in a subsequent period, the fair value of a debt securities classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income and expenditure account, the impairment loss is reversed through the income and expenditure account.

(i) Impairment of other assets

Assets that have an indefinite useful life or are not yet available for use are not subject to amortisation, but are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. Assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

(j) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of transaction including: cash at bank and on hand, demand deposits with banks, other financial institutions and the Monetary Authority ("MA") for the account of the Exchange Fund, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

(k) Other payables

Other payables are initially recognised at fair value and thereafter stated at amortised cost.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND NOTES TO THE STATEMENT OF ACCOUNTS

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(l) Translation of foreign currencies

(i) *Functional and presentation currency*

Items included in the statement of accounts are measured using the currency of the primary economic environment in which the Fund operates ("the functional currency"). The statement of accounts is presented in Hong Kong dollars, which is the Fund's functional and presentation currency.

(ii) *Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income and expenditure account.

(m) Operating leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income and expenditure account on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

(n) Provisions and contingent liabilities

Provisions are recognised when the Fund has a present legal or constructive obligation as a result of past events where it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated.

Provisions are measured at the present value of the expenditure expected to be required to settle the obligation that reflects current market assessments of the time value of money and the risks specific to the obligation.

for the year ended 31 March 2008 (Expressed in Hong Kong dollars)

2 SIGNIFICANT ACCOUNTING POLICIES (Continued)

(n) Provisions and contingent liabilities (Continued)

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(o) Employee benefits

(i) *Employee leave entitlements*

Employee entitlements to annual leave are recognised when they accrue to employees. An accrual is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave and maternity leave are recognised when the absence occurs.

(ii) *Pension obligations*

The Fund offers a mandatory provident fund scheme, the assets of which are generally held in separate trustee – administered funds. These pension plans are generally funded by payments from employees and by the Fund. The Fund's contributions to the mandatory provident fund scheme are expensed as incurred.

(p) Related parties

Related parties are those parties which have the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or entities.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND NOTES TO THE STATEMENT OF ACCOUNTS

3 RISK MANAGEMENT

(a) Governance

The Fund is established under the Ordinance for the purpose of providing compensation to depositors under certain circumstances in respect of deposits maintained with banks which are members of the Scheme. Under Part 4 of the Ordinance, the Fund is to consist of:

- contributions and late payment fees collected from Scheme members;
- money recovered by the Board from, or out of the assets of, failed Scheme members;
- returns on investments;
- money borrowed by the Board for the purpose of performing its functions; and
- any other money lawfully paid into the Fund.

The Board established an Investment Committee and delegated its power to the Committee to place, or invest, money of the Fund that is not immediately required by the Board for the performance of its functions. In particular, the Investment Committee:

- makes recommendations on the investment policy and strategy in respect of the Fund;
- monitors the investment performance of the Fund and establishes proper risk management controls for the investment activities of the Board; and
- works on any other matters as determined from time to time by the Board.

Operating within the requirements under the Ordinance and policies endorsed by the Investment Committee, the Board's staff conducts the day-to-day investment management and risk management of the Fund.

(b) Investment management and control

Under section 21 of the Ordinance, the Fund or any part of it may be invested in the following investment instruments:

- deposits with the MA for the account of the Exchange Fund;
- Exchange Fund Bills; and
- US Treasury Bills.

for the year ended 31 March 2008 (Expressed in Hong Kong dollars)

3 RISK MANAGEMENT (Continued)

(b) Investment management and control (Continued)

Investment activities of the Fund are conducted in accordance with the requirements set out in the Ordinance and the policies endorsed by the Investment Committee to ensure the investment objectives of capital preservation and maintaining sufficient liquidity are met.

The Board's Management Team is responsible for the day-to-day investment management of the Fund. Investment reports showing the latest market values, rate of return, maturity profile and types of financial instruments held are regularly submitted to the Investment Committee for control purpose.

(c) Financial risk management

Market risk

Market risk is the risk that changes in market variables such as interest rates, equity prices and exchange rates may affect the fair value or cash flows of a financial instrument. Market risk to the Fund mainly comprises interest rate risk and currency risk.

(i) Interest rate risk

Interest rate risk refers to the risk of loss arising from changes in market interest rates. Since the tenors of the Exchange Fund Bills and US Treasury Bills held by the Fund do not exceed 12 months, any impact of interest rate fluctuations on the Fund are considered minimal.

(ii) Currency risk

Currency risk is the risk of loss arising from changes in foreign exchange rates. The investments held by the Fund are denominated either in Hong Kong dollars or US dollars. Because of the linked exchange rate with the US dollar, the exchange risk to the Fund is considered minimal.

As at 31 March 2008, if interest rates increased by 25 basis points with all other variables remaining stable, the increase in net assets of the Fund for the year would amount to approximately HK\$839,354 (2007: HK\$810,254), arising substantially from the increase in interest receivable from cash balances with bank and the Exchange Fund. Conversely, if interest rates decreased by 25 basis points, the effect would be a decrease in net assets of the Fund of the same amount.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND NOTES TO THE STATEMENT OF ACCOUNTS

3 RISK MANAGEMENT (Continued)

(c) Financial risk management (Continued)

Liquidity risk

Liquidity risk refers to the risk that the Fund may not have sufficient funds available to meet its liabilities as they fall due. In addition, the Fund may not be able to liquidate its financial assets at a price close to the fair value within a short period of time.

Given that the Fund can only make deposits with the MA for the account of the Exchange Fund or invest in the highly liquid Exchange Fund Bills and US Treasury Bills, the liquidity of the Fund is maintained at a high level at all times.

Credit risk

The Fund is exposed to credit risk as a borrower or a counterparty may not be able or willing to perform its contractual obligations in full when due. The credit risk of the Fund can be broken into (i) counterparty risk from placement activities; (ii) counterparty risk from investment transactions; (iii) issuer risk arising from debt securities holdings; and (iv) country risk.

Counterparty credit exposures arise mainly from the Fund's deposit placements with the MA for the account of the Exchange Fund and securities transactions with financial institutions. In this respect, the Fund will only conduct securities transactions with counterparties approved by the Investment Committee. Issuer risk arises from investments in debt securities. The types of investment securities of the Fund are limited to Exchange Fund Bills and US Treasury Bills, both with minimal default risk. In addition to the counterparty and issuer risks, the Fund is exposed to country risk, which is confined to the sovereign risk of Hong Kong and the US given the Fund's limited types of investments. The Fund's credit exposures are reported regularly to the Investment Committee based on its delegated authority from the Board.

for the year ended 31 March 2008 (Expressed in Hong Kong dollars)

3 RISK MANAGEMENT (Continued)

(c) Financial risk management (Continued)

Fair value of financial assets and financial liabilities

The fair value of the financial instruments traded in active markets is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Fund is the current bid price. In the absence of such quoted market prices, fair values are estimated using present value or other valuation techniques, with inputs based on market conditions existing at the balance sheet date.

The fair values of financial assets and liabilities not presented on the Fund's balance sheet at their fair value are estimated as follows:

(i) Bank balances and balances with the Exchange Fund

The fair values of bank balances and balances with the Exchange Fund are their carrying amounts.

(ii) Other receivables

The estimated fair value of other receivables, which are non-interest bearing balances, is their carrying value.

(iii) Other payables

The estimated fair value of other payables, which are non-interest bearing balances, is their carrying value.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND NOTES TO THE STATEMENT OF ACCOUNTS

4 CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

The Fund makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The estimates and assumptions made in the preparation of these accounts do not have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

5 TAXATION

No provision for Hong Kong Profits Tax has been made as the Board is exempt from Hong Kong Profits Tax pursuant to section 10 of the Ordinance.

6 STAFF COSTS

	2008	2007
Salaries	\$ 4,549,274	\$ 3,620,007
Gratuity	414,055	313,440
Payment in lieu of leave	274,580	115,621
Other employee benefits	235,115	160,865
	\$ 5,473,024	\$ 4,209,933

for the year ended 31 March 2008 (Expressed in Hong Kong dollars)

7 FIXED ASSETS

	Office equipment, furniture and fixtures	Computer hardware/ software	Total
Cost			
As at 1 April 2007	\$ 836,969	\$ 3,051,350	\$ 3,888,319
Additions	171,005	721,247	892,252
As at 31 March 2008	\$ 1,007,974	\$ 3,772,597	\$ 4,780,571
Accumulated depreciation			
As at 1 April 2007	\$ 82,881	\$ 187,996	\$ 270,877
Charge for the year	185,262	661,201	846,463
As at 31 March 2008	\$ 268,143	\$ 849,197	\$ 1,117,340
Net book value			
As at 31 March 2008	\$ 739,831	\$ 2,923,400	\$ 3,663,231
As at 31 March 2007	\$ 754,088	\$ 2,863,354	\$ 3,617,442

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND NOTES TO THE STATEMENT OF ACCOUNTS

8 INTANGIBLE ASSETS

	Development costs of Payout System
Cost	
As at 1 April 2007	\$ 10,101,000
Additions	2,798,487
As at 31 March 2008	\$ 12,899,487
Accumulated amortisation	
As at 1 April 2007	\$ 333,600
Charge for the year	2,115,585
As at 31 March 2008	\$ 2,449,185
Net book value	
As at 31 March 2008	\$ 10,450,302
As at 31 March 2007	\$ 9,767,400

9 OTHER RECEIVABLES

	2008	2007
Prepayment	\$ 779,133	\$ 250,693
Interest receivables	4,043	32,022
Contribution receivables	20,349	—
Others	16,500	20,341
	\$ 820,025	\$ 303,056

for the year ended 31 March 2008 (Expressed in Hong Kong dollars)

10 AVAILABLE-FOR-SALE SECURITIES

	2008	2007
Debt securities:		
– Unlisted US Treasury Bills	\$ 312,805,015	\$ 30,975,635

11 OTHER PAYABLES

	2008	2007
Hire of services	\$ 14,896,238	\$ 7,276,684
Staff expenses	534,487	418,954
Others	2,110,694	2,018,570
	\$ 17,541,419	\$ 9,714,208

12 MATERIAL RELATED PARTY TRANSACTIONS

Pursuant to section 6 of the Ordinance, the Board shall perform its functions through the MA unless indicated otherwise by the Financial Secretary. The Hong Kong Monetary Authority (“HKMA”) has assigned a team of staff to assist the Board in discharging its functions. The team is headed by an Executive Director of the HKMA, who is designated as the Chief Executive Officer of the Board. The HKMA also supports the Board on aspects such as accounting, administration, human resources, and information technology.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND NOTES TO THE STATEMENT OF ACCOUNTS

for the year ended 31 March 2008 (Expressed in Hong Kong dollars)

12 MATERIAL RELATED PARTY TRANSACTIONS (Continued)

The related party transactions with the HKMA are as follows:

	Note	2008	2007
Aggregate amounts outstanding at the year end			
Balances with the Exchange Fund	(a)	\$ 343,215,625	\$ 329,238,768
Interest income from balances with the Exchange Fund	(a)	\$ 5,785,908	\$ 2,593,189
Operating expenses reimbursed to the HKMA	(b)	\$ 12,589,792	\$ 6,961,240

- (a) During the year, the Fund placed deposits with the Exchange Fund amounting to HK\$343,215,625 (2007: HK\$329,238,768) and earned interest amounting to HK\$5,785,908 (2007: HK\$2,593,189) at a rate which makes reference to the market interest rates.
- (b) Certain operating expenses are reimbursed to the HKMA on a cost recovery basis in accordance with the provision set out in the Ordinance.
- (c) During the year, the MA provided the Board a standby facility from the Exchange Fund for meeting the necessary liquidity required for payment of compensation in the event of a bank failure. The maximum amount which may be drawn under the facility is HK\$40,000,000,000 (2007: HK\$40,000,000,000) of which nil (2007: nil) was drawn during the year.

13 APPROVAL OF STATEMENT OF ACCOUNTS

The statement of accounts was approved by the Board on 25 June 2008.

ANNEX 1: LIST OF SCHEME MEMBERS AS OF 31 MARCH 2008

ABN AMRO BANK N.V.
 AGRICULTURAL BANK OF CHINA
 AIG PRIVATE BANK LIMITED
 ALLAHABAD BANK
 AMERICAN EXPRESS BANK LIMITED
 AUSTRALIA AND NEW ZEALAND BANKING
 GROUP LIMITED
 AXIS BANK LIMITED
 BANCA DI ROMA, SOCIETA' PER AZIONI
 BANCA MONTE DEI PASCHI DI SIENA S.P.A.
 BANCO BILBAO VIZCAYA ARGENTARIA S.A.
 BANCO DE ORO UNIBANK, INC.
 BANCO SANTANDER, S.A.
 BANGKOK BANK PUBLIC COMPANY LIMITED
 BANK OF AMERICA, NATIONAL ASSOCIATION
 BANK OF BARODA
 BANK OF CHINA (HONG KONG) LIMITED
 BANK OF CHINA LIMITED
 BANK OF COMMUNICATIONS CO., LTD.
 BANK OF EAST ASIA, LIMITED (THE)
 BANK OF INDIA
 BANK OF MONTREAL
 BANK OF NEW YORK (THE)
 BANK OF NOVA SCOTIA (THE)
 BANK OF SCOTLAND PLC
 BANK OF TAIWAN
 BANK OF TOKYO-MITSUBISHI, UFJ LTD.(THE)
 BANK SINOPAC
 BARCLAYS BANK PLC
 BAYERISCHE HYPO-UND VEREINSBANK
 AKTIENGESELLSCHAFT
 BAYERISCHE LANDESBANK
 BNP PARIBAS
 BNP PARIBAS PRIVATE BANK
 CALYON
 CANADIAN IMPERIAL BANK OF COMMERCE
 CANARA BANK
 CATHAY BANK
 CATHAY UNITED BANK COMPANY, LIMITED
 CHANG HWA COMMERCIAL BANK, LTD.

CHIBA BANK, LTD (THE)
 CHINA CONSTRUCTION BANK (ASIA)
 CORPORATION LIMITED
 CHINA CONSTRUCTION BANK CORPORATION
 CHINA MERCHANTS BANK CO., LTD.
 CHINATRUST COMMERCIAL BANK, LIMITED
 CHIYU BANKING CORPORATION LIMITED
 CHONG HING BANK LIMITED
 CHUGOKU BANK, LTD (THE)
 CITIBANK (HONG KONG) LIMITED
 CITIBANK, N.A.
 CITIC KA WAH BANK LIMITED
 COMMONWEALTH BANK OF AUSTRALIA
 COOPERATIEVE CENTRALE RAIFFEISEN-
 BOERENLEENBANK B.A.
 CREDIT SUISSE
 DAH SING BANK, LIMITED
 DBS BANK (HONG KONG) LIMITED
 DBS BANK LTD.
 DEPFA BANK PLC
 DZ BANK AG DEUTSCHE ZENTRAL-
 GENOSSENSCHAFTSBANK,
 FRANKFURT AM MAIN
 E.SUN COMMERCIAL BANK, LTD.
 EAST WEST BANK
 EFG BANK
 ERSTE BANK DER OESTERREICHISCHEN
 SPARKASSEN AG
 FAR EASTERN INTERNATIONAL BANK
 FIRST COMMERCIAL BANK, LTD.
 FORTIS BANK
 FUBON BANK (HONG KONG) LIMITED
 HACHIJUNI BANK, LTD (THE)
 HANA BANK
 HANG SENG BANK, LIMITED
 HONG LEONG BANK BERHAD
 HONGKONG AND SHANGHAI BANKING
 CORPORATION LIMITED (THE)
 HSBC BANK INTERNATIONAL LIMITED
 HSBC BANK PLC

ANNEX 1: LIST OF SCHEME MEMBERS AS OF 31 MARCH 2008

HSBC BANK USA, NATIONAL ASSOCIATION
 HSBC PRIVATE BANK (SUISSE) SA
 HSH NORDBANK AG
 HUA NAN COMMERCIAL BANK, LTD.
 ICICI BANK LIMITED
 INDIAN OVERSEAS BANK
 INDUSTRIAL AND COMMERCIAL BANK OF CHINA
 (ASIA) LIMITED
 INDUSTRIAL AND COMMERCIAL BANK OF CHINA
 (THE)
 ING ASIA PRIVATE BANK LTD
 ING BANK N.V.
 INTESA SANPAOLO S.P.A.
 IYO BANK, LTD. (THE)
 JPMORGAN CHASE BANK, NATIONAL
 ASSOCIATION
 KBC BANK N.V.
 KOREA EXCHANGE BANK
 LAND BANK OF TAIWAN CO., LTD.
 MALAYAN BANKING BERHAD
 MEGA INTERNATIONAL COMMERCIAL BANK CO.,
 LTD.(THE)
 MELLI BANK PLC
 MEVAS BANK LIMITED
 MITSUBISHI UFJ TRUST AND BANKING
 CORPORATION (THE)
 MIZUHO CORPORATE BANK, LTD
 NANYANG COMMERCIAL BANK, LIMITED
 NATIONAL AUSTRALIA BANK, LIMITED
 NATIONAL BANK OF PAKISTAN
 NATIXIS
 NEWEDGE GROUP
 OVERSEA-CHINESE BANKING CORPORATION LTD.
 PHILIPPINE NATIONAL BANK
 PT. BANK NEGARA INDONESIA (PERSERO) TBK.
 PUBLIC BANK (HONG KONG) LIMITED
 PUBLIC BANK BERHAD
 PUNJAB NATIONAL BANK
 RBS COUTTS BANK AG
 ROYAL BANK OF CANADA

ROYAL BANK OF SCOTLAND PUBLIC LIMITED
 COMPANY (THE)
 SHANGHAI COMMERCIAL & SAVINGS BANK,
 LTD. (THE)
 SHANGHAI COMMERCIAL BANK LIMITED
 SHIGA BANK LIMITED (THE)
 SHINKIN CENTRAL BANK
 SHIZUOKA BANK, LTD. (THE)
 SOCIETE GENERALE
 SOCIETE GENERALE BANK & TRUST
 STANDARD BANK ASIA LIMITED
 STANDARD CHARTERED BANK
 STANDARD CHARTERED BANK (HONG KONG)
 LIMITED
 STATE BANK OF INDIA
 STATE STREET BANK AND TRUST COMPANY
 SUMITOMO MITSUI BANKING CORPORATION
 SVENSKA HANDELSBANKEN AB (PUBL)
 TAI SANG BANK LTD.
 TAI YAU BANK LTD.
 TAIPEI FUBON COMMERCIAL BANK CO., LTD.
 TAISHIN INTERNATIONAL BANK CO., LTD
 TAIWAN BUSINESS BANK
 TAIWAN COOPERATIVE BANK, LTD.
 TORONTO-DOMINION BANK
 UBS AG
 UCO BANK
 UNICREDITO ITALIANO SOCIETA' PER AZIONI
 UNION BANK OF INDIA
 UNITED COMMERCIAL BANK
 UNITED OVERSEAS BANK LTD.
 WELLS FARGO BANK, NATIONAL ASSOCIATION
 WESTLB AG
 WESTPAC BANKING CORPORATION
 WING HANG BANK, LIMITED
 WING LUNG BANK LIMITED
 WOORI BANK

ANNEX 2: LIST OF MAJOR PUBLIC EDUCATION AND PUBLICITY ACTIVITIES FOR YEAR 2007-2008

Commencement Date	Activities
2 April 2007	Launched a 6-week TV advertising campaign. TV Announcements in the Public Interest (APIs) of the DPS were broadcast on major TV channels.
7 April 2007	Launched the DPS roving exhibition programme for 2007-08. A total of 48 weekly exhibitions titled "Know Your DPS Day" were held at public housing estates during the year.
8 April 2007	Launched the first series of educational comics. A total of 8 weekly episodes were published on Apple Daily.
9 April 2007	Launched a 7-week on-line advertising campaign. On-line advertisements were issued on mass appeal portals and through e-news letters.
14 May 2007	Radio Television Hong Kong launched a radio educational series on the DPS. A total of 9 weekly episodes were broadcast on Radio Two.
21 May 2007	Launched a 4-week print advertising campaign on newspapers. Advertisements of the DPS were put on selected newspapers, including free dailies.
21 May 2007	Launched a 12-week bus body advertising campaign. Advertisements of the DPS were placed on the body of double-decker buses.
14 June 2007	Launched an 8-week MTR advertising campaign. Advertisements of the DPS were displayed at LED panels inside MTR car apartments and broadcast on TVs at MTR stations.
10 September 2007	Launched the second TV advertising campaign for the year, lasting for 5 weeks. TV APIs of the DPS were broadcast on major TV channels.
24 September 2007	Hosted a media luncheon to mark the first anniversary of the launch of the DPS.
27 October 2007	Launched a 6-month print advertising campaign on publications of labour unions. Advertisements of the DPS were put on the monthly or bi-monthly member newsletters of major labour unions.
29 October 2007	Launched the second print advertising campaign on newspapers for the year, lasting for 4 weeks. Advertisements of the DPS in form of educational comics were put on selected newspapers, including free dailies.
4 November 2007	Launched the second series of educational comics. A total of 5 weekly episodes were published on Apple Daily.

ANNEX 2: LIST OF MAJOR PUBLIC EDUCATION AND PUBLICITY ACTIVITIES FOR YEAR 2007-2008

Commencement Date	Activities
7 December 2007	Launched the second bus body advertising campaign for the year, lasting for 6 weeks. Advertisements of the DPS were placed on the body of double-decker buses.
13 December 2007	Launched the second MTR advertising campaign for the year, lasting for 7 weeks. Advertisements of the DPS in form of educational comics were placed inside MTR cart apartments.
2 January 2008	Launched the second on-line advertising campaign for the year, lasting for 4 weeks. On-line advertisements were issued on mass appeal portals and through e-news letters.
4 January 2008	Launched a 4-week bus seatback advertising campaign. Advertisements of the DPS in form of educational comics were put on bus seatbacks.
18 February 2008	Launched the third TV advertising campaign for the year, lasting for 6 weeks. TV APIs of the DPS were broadcast on major TV channels.
	Launched the third print advertising campaign on newspapers, lasting for 4 weeks. Advertisements of the DPS in form of educational comics were put on selected newspapers, including free dailies.