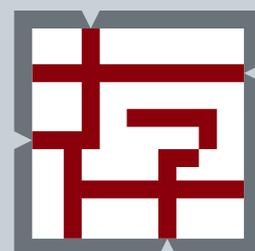


香港存款保障委員會  
HONG KONG DEPOSIT  
PROTECTION BOARD

Annual Report 2009-2010



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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.

Hong Kong Deposit Protection Board

78th Floor, Two International Finance Centre, 8 Finance Street, Central, Hong Kong

Telephone: (852) 1831 831

Facsimile: (852) 2290 5168

E-mail: [dps\\_enquiry@dps.org.hk](mailto:dps_enquiry@dps.org.hk)

Website: [www.dps.org.hk](http://www.dps.org.hk)

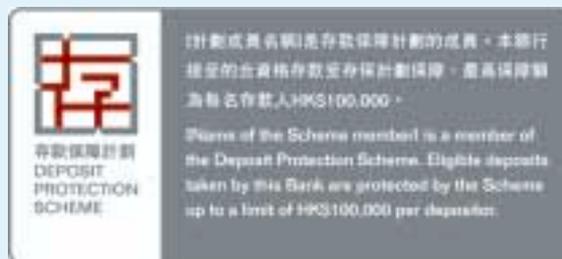
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## CONTENTS

Main features of the Deposit Protection Scheme	2
Key achievements in 2009-2010	3
Message from the Chairman	4
Review of operations by the Chief Executive Officer	6
About the Hong Kong Deposit Protection Board	9
Corporate governance	16
Report on activities in 2009-2010	20
Plans for 2010-2011	34
Independent auditor's report	37
Statement of accounts of the Deposit Protection Scheme Fund	39
Annex	64

## 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.



The compensation limit of the DPS is set at HK\$100,000 per depositor per Scheme member. The limit will be increased to HK\$500,000 in 2011.

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. Secured deposits will come under the protection of the DPS in 2011.

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

A Deposit Protection Scheme Fund (DPS Fund) with a target fund size of 0.3% of the total amount of protected deposits held with all Scheme members (translating into a fund size of approximately HK\$1.5 billion) is being built up through collecting contributions from members. The target fund size will be changed to 0.25% of the total amount of protected deposits in 2011, which is estimated to be about HK\$2.8 billion.

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

### ADMINISTRATION OF THE DPS

- The Board collected on schedule HK\$377 million in contributions from Scheme members for the DPS Fund in January 2010.
  - The assets of the DPS Fund totalled HK\$1,284 million at the end of March 2010.
  - The DPS Fund achieved an investment return of 0.6%.
- 

### ADEQUACY OF THE DPS COVERAGE

- The Board completed a review of the DPS and concluded, after extensive consultation, to make a number of enhancements to the DPS, including raising its protection limit and expanding its coverage.
  - The Board assisted in completing the drafting of an amendment bill to implement the major enhancements concluded in the DPS review. The bill was introduced into the Legislative Council (LegCo) in April 2010.
  - The Board assisted in drafting the legislative rules for implementing the remaining enhancements concluded in the DPS review, which will be introduced into the LegCo after the amendment bill is passed.
- 

### READINESS OF THE DPS PAYOUT PROCESSES

- The Board conducted a payout rehearsal and six simulation tests to maintain and enhance the readiness of its payout infrastructure, including its network of payout agents.
  - The Board completed six reviews on selected Scheme members' compliance with an information system guideline issued by the Board, to verify and promote the readiness of their information systems and customer databases to payout.
- 

### PUBLIC AWARENESS AND UNDERSTANDING OF THE DPS

- The Board continued to monitor Scheme members' compliance with the DPS representation requirements through a self-assessment exercise.
- The Board launched publicity activities to promote and enhance public awareness and understanding of the deposit protection arrangements in place in Hong Kong, and to invite public participation in the consultation on the review of the DPS.
- A Hong Kong-wide opinion survey in December 2009 revealed public awareness of the DPS was at a reasonably high level of 70%.



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

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

“Deposit protection in Hong Kong is  
about to enter a new era”

The year 2009 was a busy and fruitful year for the Board. As the turbulence in global financial markets caused by the financial tsunami gradually subsided, the Board focused its effort on strengthening the DPS, which forms part of the financial safety net in Hong Kong. During the year, the Board completed the project of reviewing the DPS that started in late 2008 as well as the public consultation on the enhancement proposals identified in the review. We are glad that our proposals for enhancing the DPS have received broad public support. Taking this opportunity, I would like to express my heartiest gratitude to all those who have submitted contributions in response to the consultation, including members of the public, the Consumer Council, the industry and other professional and interested parties. On the back of the public endorsement, the Board proceeded to put the proposals into effect by actively assisting in the completion of the relevant legislative process, with a view to ensuring the enhanced DPS can commence operation at the start of 2011 as scheduled.

We are confident the implementation of these enhancement proposals will bring Hong Kong to the forefront of deposit insurers in the international community in terms of the level and the scope of deposit protection provided, transparency of the coverage of protection, and efficiency in making compensation to depositors in a payout.

Following the expiry of the full deposit guarantee provided by the Government by the end of 2010 and the commencement of the enhanced DPS at the beginning of 2011, deposit protection in Hong Kong will enter a new era. I am glad to have been able to witness and participate in the process of launching the DPS back in 2006 and bringing it to a new threshold in the coming year. The remarkable progress made by



The Board's Chairman (left) and former CEO (right) launching the public consultation at a press conference

the Board is due to the dedication of the Management Team and my fellow Board members and, more importantly, to the support of the public. The Board will continue to administer the Scheme in the best interests of the people of Hong Kong. I sincerely hope the public can continue to give full support to the Board's work, under the steer of my successor.

A handwritten signature in black ink that reads 'c F Chan'.

**Andrew Chan Chi-fai**  
*Chairman*



**Ms Meena Datwani**  
*Chief Executive Officer*

**“Getting ready for the transition”**

The Board met the key business objective set for 2009-2010, that is, completing the review of the DPS. Under the guidance of the Board, good progress was also made in other areas aimed at maintaining an efficient and effective DPS. Highlights of our achievements during the year include:

### **ADMINISTRATION OF THE DPS**

The collection of contributions from Scheme members was completed on schedule. The Board collected a total of HK\$377 million in contributions for 2010, which brought the total assets of the DPS Fund to HK\$1,284 million by the end of March 2010. As global interest rates continued to remain low due to abundant liquidity in the market, the Fund achieved an investment return of 0.6% for the year.

The Board continued to monitor the accuracy of the returns filed by Scheme members for contribution assessment purposes by reviewing auditors' reports submitted by the members. The results were satisfactory and no reporting error with a significant impact on the total contributions receivable was noted.

### **ENSURING ADEQUACY OF THE COVERAGE OF THE DPS**

The Board completed the review of the DPS and the consultation exercise on the findings of the review in two phases. The first and second phases of the review were concluded in August and November 2009, respectively, as marked by the publication of the respective consultation reports. The enhancement proposals concluded in the review, including raising the protection limit of the DPS and expanding its coverage, received broad public support during consultation. The Board assisted in making legislative changes to effect the enhancement proposals.

The Board conducted a survey on the popularity of structured deposits in late 2009. The findings of the survey confirmed that the popularity of structured deposits remained below the threshold set by the Board for triggering a review of their protection status.

### **MAINTAINING AND IMPROVING THE READINESS OF THE DPS TO PAYOUT**

The Board refined the guideline on the maintenance of information systems and customer records of Scheme members to facilitate a payout, in order to enhance its effectiveness and clarity, and promote compliance. Six compliance reviews were conducted to monitor selected Scheme members' compliance with the guideline. Concurrently, the Board performed six simulation tests to maintain the readiness of Board personnel and payout agents.

In the fourth quarter of 2009, the Board conducted a payout rehearsal to maintain and enhance the readiness of its payout infrastructure. Based on the experience gained from the simulation tests and payout rehearsal, the Board identified and initiated refinements to its payout system and processes.

### ENHANCING PUBLIC AWARENESS, UNDERSTANDING AND CONFIDENCE IN THE DPS

The Board undertook on-going educational and promotional activities to maintain and enhance public awareness and understanding of the deposit protection arrangements in Hong Kong. In addition, a focused publicity drive was conducted to promote public participation in the consultation on the DPS review. The year-end opinion survey conducted by the Board suggested that public awareness of the DPS had continued to stand at a reasonably high level of 70%.

The Board continued to review self-assessment reports compiled by Scheme members on their compliance with the requirements of statutory rules on disclosure of their membership status and the protection status of their financial products to customers. The reports indicated the compliance status of Scheme members was satisfactory.

### PLANS FOR 2010-2011

The Board is fully aware that the enhanced deposit protection to be provided in the coming year will naturally need to be realised by enhanced administration and communication to depositors. In parallel with assisting in the completion of the legislative process for implementing the enhancement proposals concluded in the DPS review, preparations will need to be made by the Board on all fronts to get itself, the banking industry and the public ready for the transition.

I would like to 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. Lastly, I would also like to thank my predecessor, Mr Raymond Li, for his leadership in steering the DPS through the turbulent market conditions of the past couple of years, and for his contribution to the significant progress made by the Board in enhancing the DPS.



**Meena Datwani**

*Chief Executive Officer*

# ABOUT THE HONG KONG DEPOSIT PROTECTION BOARD

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## 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 (FS). 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 FS, 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.

# ABOUT THE HONG KONG DEPOSIT PROTECTION BOARD

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## MEMBERS OF THE BOARD

### 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.

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### Members



**Mr Ian CHAPMAN**

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

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**Professor David CHEUNG Wai-lok**

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

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**Mr Nicholas Peter ETCHES**

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

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**Ms Eleanor WAN Yuen-yung**

Ms Wan is the Chief Executive Officer of the Institute of Financial Planners of Hong Kong.



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**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.



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**Miss AU King-chi, JP**

Miss Au is the Permanent Secretary for Financial Services and the Treasury (Financial Services). She is an ex officio member of the Board representing the Secretary for Financial Services and the Treasury.



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**Mr Arthur YUEN Kwok-hang, JP**

(from 1 January 2010)

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



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**Mr CHOI Yiu-kwan, JP**

(until 31 December 2009)

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



## 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**

Chief Executive Officer, the Institute of Financial Planners of Hong Kong

### Members

#### **Mr Francis CHU Siu-chuen**

Executive Director (Reserves Management), Hong Kong Monetary Authority

#### **Mr Nicholas Peter ETCHES**

Former partner of KPMG

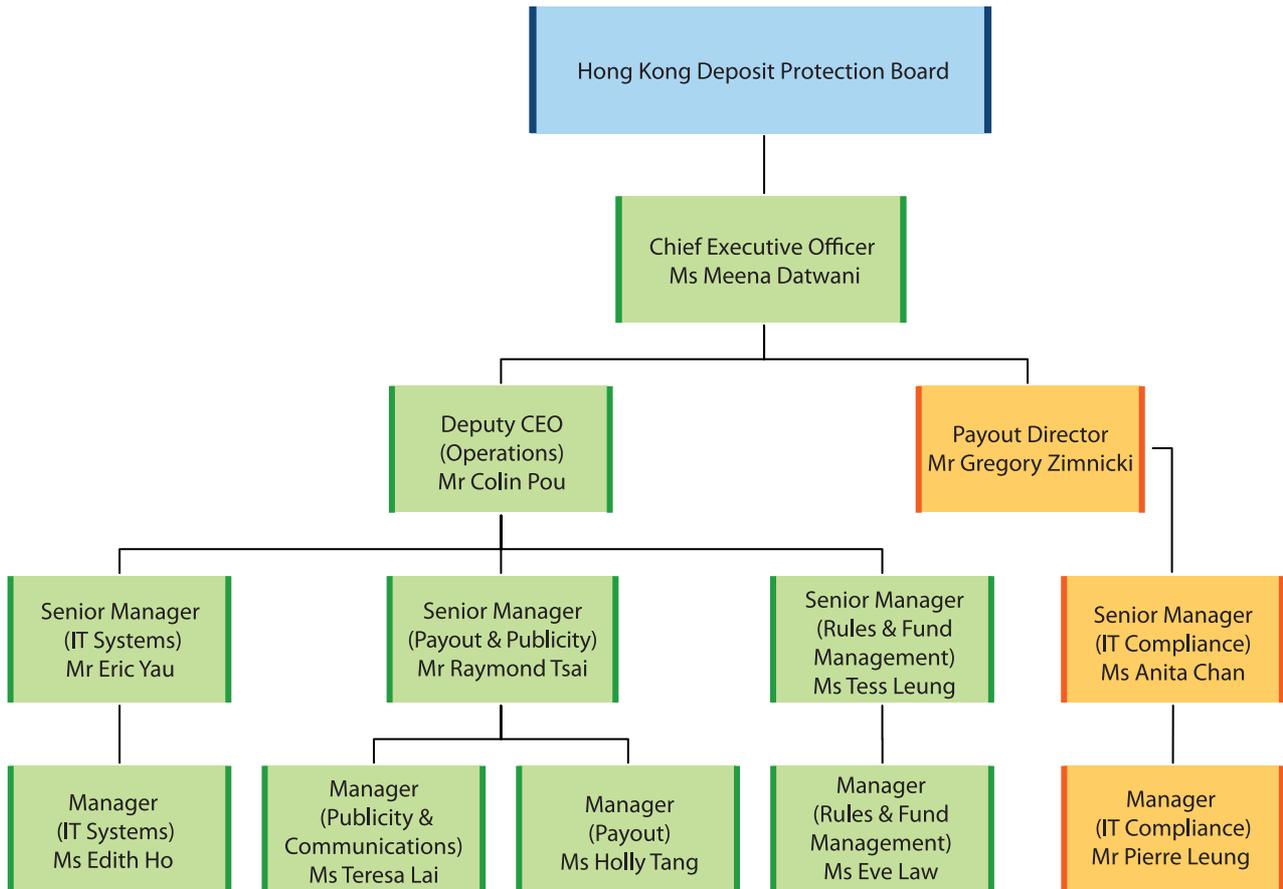
#### **Professor YEUNG Yuet-bor**

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 APRIL 2010)



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

Note: Ms Meena Datwani took over the position of CEO of the Board from Mr Raymond Li on 1 April 2010.

## ABOUT THE HONG KONG DEPOSIT PROTECTION BOARD

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### 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:

**Mr CHOW Chak-chee**, Bank of China (Hong Kong) Limited

**Mr TONG Hon-shing**, The Bank of East Asia Limited

**Mr Ron LEUNG**, 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

**Mr Steve CHOI**, The Hongkong and Shanghai Banking Corporation Limited

**Mr David CHENG**, Industrial and Commercial Bank of China (Asia) Limited

**Mr Dennis CHAN**, JPMorgan Chase Bank, Hong Kong Branch

**Ms Maggie CHEUNG**, Mizuho Corporate Bank Limited, Hong Kong Branch

**Mr Peter HUI**, 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.

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## 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 FS 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 FS 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 on policy issues crucial to the operation and development of the DPS. In 2009-2010, the Board met three times. On average, 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.

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## EXECUTIVE MANAGEMENT

Pursuant to section 6 of the DPS Ordinance, the Board shall perform its functions through the MA unless otherwise directed by the FS. 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 plan for auditing the operation of the DPS.

The IAD performs regular audits 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 and recommendations directly to a meeting of the Board. The IAD reported satisfactory results on the audit conducted in 2009. The IAD will carry out the next internal audit review in 2011.

The appointment of the external auditor of the DPS Fund requires the approval of the FS. 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 2009-2010, 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 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 2009-2010, the website registered close to 160,000 visits. The Board also publishes an annual report.



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## **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 FS 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. Refinements will be made between individual reviews as and when necessary as the Board gains experience with operating the DPS. The next review is scheduled to be conducted in 2011.

### OUR OPERATING ENVIRONMENT

The Hong Kong economy, for the first time in over a decade, dipped into recession in 2009 in the aftermath of the financial tsunami, with real GDP contracting by 2.7%. Nevertheless, the economy quickly bottomed out towards the end of the year as economic activity picked up amid signs of improvement in major developed economies. Nevertheless, considerable uncertainty has remained over the pace and impact of the withdrawal of unconventional rescue measures introduced by central banks worldwide at the height of the financial tsunami.

The banking sector of Hong Kong, which has demonstrated a strong resilience to the negative spillover of overseas financial woes, remained stable in 2009. The capital position of banks strengthened. Deterioration in loan quality was much milder than expected. Delinquency ratios remained at a low level compared with historical standards. Statistics released by the HKMA show the aggregate pre-tax operating profits of retail banks' Hong Kong offices rebounded by 14.9% in 2009. The post-tax return on average assets increased, to 0.98% in 2009 from 0.88% a year ago. The classified loan ratio increased mildly to 1.35% from 1.24% at the end of 2008, which was still at a relatively low level compared with historical figures. Retail banks generally remained liquid with the quarterly average liquidity ratio standing at 47.8% in the final quarter of 2009, well above the statutory minimum of 25%. The consolidated capital adequacy ratio of locally incorporated authorized institutions rose to 16.9% at the end of 2009 from 14.7% a year earlier. Tier-1 capital ratio increased to 12.9% in 2009 versus 11.0% in 2008.

On the back of the subsiding concern about the health of the banking sector, which has probably been helped by the availability of the full deposit guarantee provided by the Government, the Board could focus its efforts on strengthening the DPS as part of the financial safety net in Hong Kong. Significant progress was made by the Board on reviewing the DPS and initiating the enhancement process. Meanwhile, the Board continued to ensure the efficient and effective operation of the DPS under its existing framework.

### Profile of Scheme Members

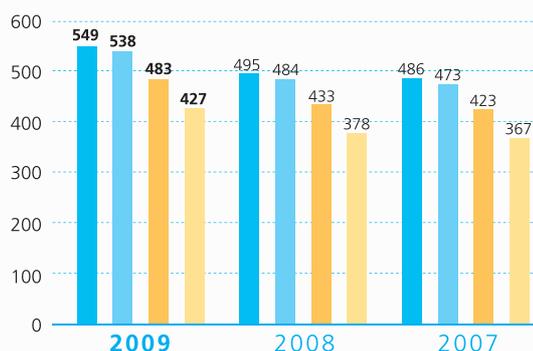
At the end of March 2010, there were 145 Scheme members, compared with 140 a year ago. During the year, seven new members joined, one of which was upgraded from a restricted licence bank to a licensed bank; two ceased to be members because of organisational restructuring and streamlining of operations. Of the 145 Scheme members, 23 are locally incorporated banks and 122 are foreign bank branches. This is roughly in line with the number of retail banks and wholesale banks in Hong Kong, respectively.

Based on the returns of relevant deposits submitted by Scheme members in 2009, the total amount of relevant deposits in the industry continued to grow, expanding to HK\$549 billion from HK\$495 billion a year earlier. On the back of strong inflows of funds into Hong Kong, the growth rate (at 11%) was much higher than the 2% increment recorded in 2008. As in previous years, the top 20 members by size of relevant deposits are all retail banks, accounting for more than 95% of the total relevant deposits in the industry.

Statistics show that large retail banks recorded a much higher growth of relevant deposits (at 12%) compared with their small to medium-sized counterparts (at 6%). Nevertheless, the split of relevant deposits among the retail banks remained stable: large retail banks accounted for 87% of the total relevant deposits of the industry, and small to medium-sized retail banks held 11%.

### Relevant deposits held with Scheme members

(in HK\$ billion)



% of total	2009	2008	2007
Top 5	78%	76%	76%
Top 10	88%	87%	87%
Top 20	98%	98%	98%
Total	100%	100%	100%

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

(in HK\$ billion)	2009	2008	±%
Large retail banks	480.2	430.6	12%
Small to medium-sized retail banks	58.8	55.4	6%

## ADMINISTRATION OF THE DPS

The Board smoothly completed the key tasks in different operational areas of the DPS in accordance with the applicable requirements, based on past experience and under the guidance of well established policies and procedures.

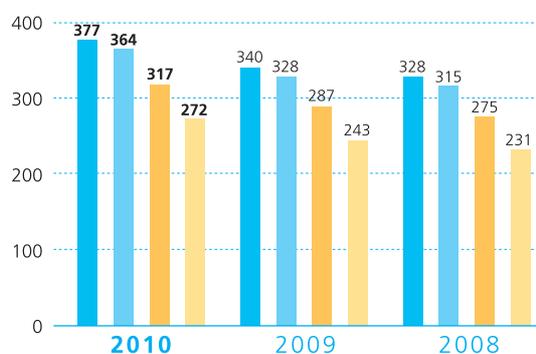
### Assessment and Collection of Contributions

The Board assessed and collected HK\$377 million in contributions from Scheme members in 2010, representing an increase of 11% from the HK\$340 million collected in 2009. Similar to the distribution of relevant deposits, over 95% of the total contributions were collected from the top 20 Scheme members. The distribution pattern has been stable since the DPS commenced operation. All contributions were paid by Scheme members on time in January 2010.

The contribution payable by a Scheme member each year is assessed by the Board based on an annual return submitted by the member. In order to ensure the accuracy of the figures reported by Scheme members in their returns, the Board continued to review auditors' reports submitted by Scheme members for certifying the correctness of their returns, as required by a policy introduced by the Board in 2007. In 2009, 34 Scheme members were required to submit an auditor's report. The results of the review were satisfactory and no reporting error having a material impact on the total amount of contributions was noted. After the completion of the review, more than 90 Scheme members, accounting for about 95% of relevant deposits in the industry, have had the accuracy of their returns verified by an auditor. This has provided a strong assurance over the correctness of the total amount of contributions payable by the industry.

**Contribution paid by Scheme members by relevant deposits held**

(in HK\$ million)



% of total	2010	2009	2008
Top 5	72%	72%	70%
Top 10	84%	84%	84%
Top 20	97%	97%	96%
Total	100%	100%	100%

## Investment of the DPS Fund

During the year, the Board continued to invest the DPS Fund in accordance with the DPS Ordinance and the Board's investment policy, which set out clear guidelines on the risk assessment and control measures, and the segregation of duties required for the investment activities.

As US dollar interest rates continued to stay above their Hong Kong dollar counterparts during the year, the Board switched most of the assets of the DPS Fund into US Treasury papers and US dollar deposits to take full advantage of the yield enhancement offered by US dollar assets. This brought the share of US dollar assets in the DPS Fund up to 90% at the end of March 2010. In terms of investment mix, cash and investment

securities accounted for about 40% and 60% of the DPS Fund respectively, compared with 20% and 80% a year ago. The investment return of the DPS Fund edged lower with the easing in global interest rates. The DPS Fund achieved an investment return of 0.6% for the year (0.8% in 2008-09).

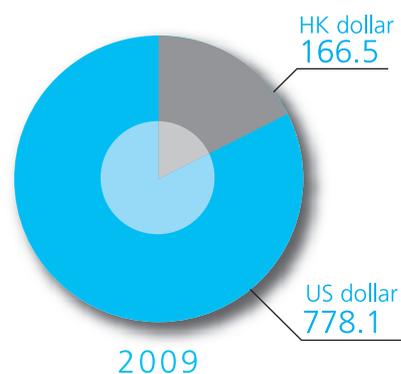
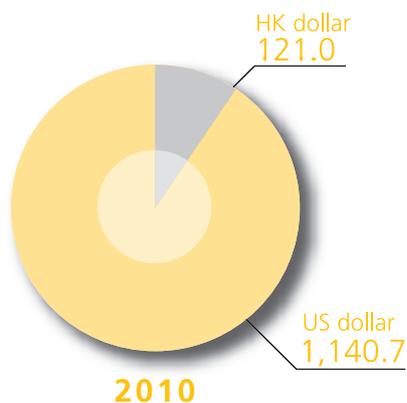
### Mix of cash and investments of the DPS Fund (as at 31 March)

(in HK\$ million)	2010	2009
Cash and deposit balance*	<b>479.1</b>	168.9
Investment securities	<b>782.6</b>	775.7
Total	<b>1,261.7</b>	944.6

\* Net of securities commitment payable

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

(in HK\$ million)



### ENSURING ADEQUACY OF THE DPS COVERAGE

#### Enhancement of the DPS

The Board completed the review of the DPS that commenced in the fourth quarter of 2008 and the consultation on the findings of the review in two phases. After completing the review in each phase, the Board published a consultation paper on the findings and the recommendations from the review. The consultation papers for the first and second phases of the review were issued in April and August 2009, respectively. After collecting and analysing the comments received from the public and various stakeholder groups, the Board published a consultation report to conclude each phase of the review. The consultation reports for the two phases of the review were issued in August and November 2009, respectively.

The review concluded that the existing design features of the DPS in Hong Kong were already in substantial compliance with international best practice. Nevertheless, a number of enhancements to the DPS were identified to address the latest developments in international and local financial markets, especially to meet heightened public expectation for better deposit protection. Enhancements concluded in the first phase of the review focused on improving deposit protection and mitigating the cost of providing better protection. Enhancements in the second phase, on the other hand, focused on expediting the payout process and enhancing transparency of the DPS coverage.

Keen responses and wide public support were registered during the consultation on the review's findings and recommendations. As a result, the Board decided to proceed with the implementation of the recommendations. The Board assisted the Department of Justice (DoJ) in completing the drafting of an amendment bill, the Deposit Protection Scheme (Amendment) Bill 2010 (the Bill), for amending the DPS Ordinance to give effect to the recommendations on improving deposit protection, mitigating the cost of providing the additional protection and improving payout efficiency. The Bill was introduced into the LegCo in April 2010. The Board also assisted the DoJ in drafting legislative amendments to implement the remaining recommendations concluded in the review, mainly those for enhancing transparency of the DPS coverage concluded in the second phase of the review. These amendments will be promulgated in the form of subsidiary legislation and will be submitted to LegCo for negative vetting after the Bill is passed. Subject to the completion of the relevant legislative processes, all the enhancements are expected to take effect on 1 January 2011, immediately after the expiry of the Government's full deposit guarantee at the end of 2010.

## Enhancement of the DPS – Summary of recommendations

### 1. Providing better deposit protection

- Raising the DPS protection limit from HK\$100,000 to HK\$500,000
- Expanding DPS coverage to protect secured deposits

### 2. Eliminating the potential for cost transfer

- Reducing the rates for charging annual contributions on Scheme members and the total amount of contributions relative to the total amount of protected deposit in the industry, that is, the target size of the DPS Fund
- Allowing Scheme members to report protected deposits on a net basis for contribution assessment purposes
- Aligning priority claims for depositors in bank liquidations to protection under the Scheme to ensure the Scheme can continue to fully recover the compensation it pays to depositors

### 3. Facilitating the Board to make fast payment

- Empowering the Board to make reasonable estimate of values relevant for compensation determination but are uncertain at the time of a payout
- Empowering the Board to make different amounts of interim payment to different depositors to expedite the payout process
- Allowing the Board's businesses to be conducted by electronic means to ensure that time-critical decisions in a payout can be dealt with promptly

### 4. Improving transparency of the DPS coverage

- Revising existing disclosure rules and making additional ones to enhance the DPS representation regime, including rules to improve negative disclosures, introduce positive disclosures and impose requirements on the prominence of disclosures and restrictions on the description of deposit products

## Popularity of structured deposits

In addition to enhancing the coverage of the DPS through the DPS review, the Board continued to pay close attention to market developments that may have an impact on the adequacy of its coverage. The Board conducted a survey in December 2009 to monitor the popularity of structured deposits and assess whether it is necessary to bring them under the protection of

the DPS, with reference to the existing protection limit of HK\$100,000 as well as the new limit of HK\$500,000. The findings were similar to those of the 2007 survey, concluding that structured deposits were not popular among small depositors and the percentage of depositors holding various structured deposits remained well below the quantitative benchmarks set for reviewing the protection status of such products.

### ENSURING READINESS OF THE DPS TO PAYOUT

As part of a continuous programme to improve the Board's capacity to make accurate and fast compensation payments, a number of tasks were

undertaken during the year to enhance – (a) its payout processes and technology resources; (b) its co-ordination with other financial safety net players; (c) the knowledge and abilities of its payout agents; and (d) the reliability of the data to be obtained from a failed Scheme member.

#### Background on payout readiness

"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. The Board regularly undertakes activities to ensure the elements as described in the following Payout Process diagram are sufficiently developed and can operate effectively.

#### Payout Process

Compensation is triggered when (i) the Court issues a winding-up order to a Scheme member, or (ii) the MA, after consultation with the Financial Secretary, instructs the Board to pay compensation

The Board sets up an operation team in an offsite location and calls on the external service providers (payout agents) to help handle the payout

The Board obtains depositor information from the failed Scheme member and activates the Payout System for calculation of deposit compensation payment

The Board makes payment to depositors by cheque or funds made available through other Scheme members. Interim payment will be made where appropriate

The Board makes use of a virtual organisation of external service providers (collectively referred to as payout agents) to assist in the calculation and payment of compensation to depositors in the event of a payout, so it ensures 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 high volume of data and complex processing necessary to arrive at determinations of depositors' balances on which compensation payments are based.

Integral to payout readiness is the Guideline on Information Required for Determining and Paying Compensation (ISG), issued by the Board in 2006 and amended in 2009, which provides directions to Scheme members on how data in 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 the Board will rely on those records obtained in making its determinations of entitlement to compensation payments.

### **Compliance with the ISG**

The Board continued its compliance review programme to verify Scheme members' compliance with the ISG. Six compliance reviews were conducted during the year. The scope of each review covered verification of the correctness of the format, and the completeness and accuracy in which the Scheme member made the required data available to the Board. The compliance levels of the Scheme members reviewed were generally satisfactory. Scheme members were required to provide remedial action plans on any variances from the ISG specifications identified in the review.

Amendments to the ISG and an explanatory note were issued in March 2009 to refine some of the requirements in the ISG to enhance payout efficiency, and to provide supplementary guidance to improve Scheme members' understanding of the ISG to promote compliance. The Board has been monitoring Scheme members' progress on achieving compliance

with the amended ISG by regular surveys. The progress has been satisfactory with most Scheme members having reported to have met the amended requirements. Full compliance is required by July 2010.

### **Payout Rehearsal and simulation tests**

Having satisfied itself during the previous rehearsals that its payout agents have sufficient knowledge of payout processes and can perform payout procedures as a well-organised team, the Board conducted its third payout rehearsal in November and December 2009 with a narrower focus. The rehearsal objectives concentrated on testing processes and procedures relevant to making an interim payment within 14 calendar days under realistic payout conditions. Included in these processes were several proposed protocols for co-ordination with the HKMA and the Manager appointed to take control of the failed Scheme member.

The results of the rehearsal were satisfactory and gave the Board confidence that an interim payment could be performed within 14 days in a real payout situation. Recommendations from the payout agents arising from the rehearsal have been applied to work plans for future enhancements to payout procedures and the Payout System, as well as to the protocols for discussion with the HKMA.

Information received from Scheme members on the ISG compliance review was also used for conducting simulation tests to maintain the readiness of Board personnel and payout agents to payout. The Board increased the number of simulation tests conducted during the year from three to six. The simulation tests increased the Board's confidence level that it can rely on, and promptly utilise, data provided by Scheme members for compensation determinations.

### **Updating payout policies, procedures and processes**

Building on its experience from previous simulations and rehearsals, and changes in the landscape arising from the global financial crisis, the Board reviewed its payout policies, procedures and processes. The Board continued to monitor key market developments to ensure its payout processes remained relevant in meeting the changing expectations of stakeholders. Based on this review and previous plans, changes were made to streamline payout procedures and workflows. Areas were also identified for improving operational efficiency, notably interest and principal valuations and differential treatment of depositors in making interim payments, resulting in proposed amendments to the DPS Ordinance in the review of the DPS.

The Board also progressed on the development of protocols with the HKMA on activities prior to, at the time of, and following the triggering of the making of a compensation payment, to give greater confidence that the various financial safety net players in the failure of a Scheme member will act in a co-ordinated and consistent manner.

## MAINTAINING AND ENHANCING PUBLIC AWARENESS AND UNDERSTANDING

### Promotion and public education

With advice of a professional public relations consultant and an advertising agency, together with the support of various government departments, private and public organisations, the Board conducted promotional and educational activities to maintain and enhance public

awareness and understanding of the deposit protection arrangement in Hong Kong, covering the DPS and the full deposit guarantee provided by the Government. The message was communicated through different channels, including conventional media such as TV and newspapers, and interactive approaches like drama performance, to ensure it could reach the intended recipients.



DPS educational comics published in newspapers



Community outreach programmes: roving exhibitions by student ambassadors and drama performances by professional artists

# REPORT ON ACTIVITIES IN 2009-2010

Apart from ongoing publicity activities to maintain general awareness and understanding, the Board rolled out targeted activities in the second and third quarters of 2009 to draw public attention to the consultation exercise on the results and recommendations of the first and second phases of the DPS review, respectively.

Multiple communication channels, involving TV, newspaper, internet, public transport and roving exhibitions, were employed to invite public participation in the consultation. Public comments were also collected through the DPS enquiry hotline.



▶ TV commercials encourage the public to express views and to announce the completion of the consultation



▶ Full-page newspaper advertisements invite comments from the public



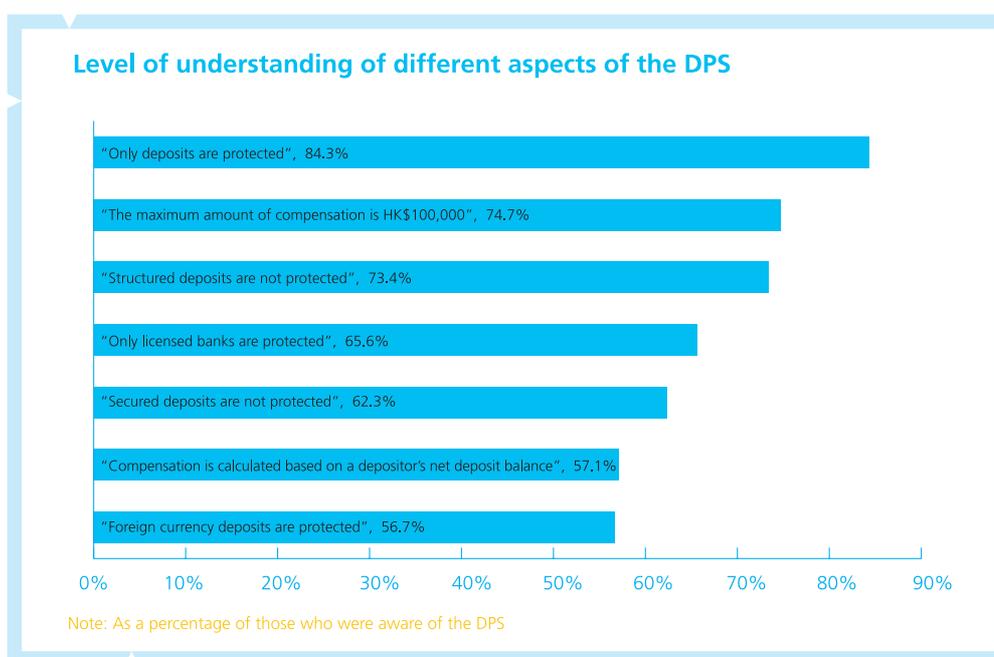
▶ Weekly roving exhibitions inspire participation in the DPS review consultation process

A list of major promotional and educational activities is at Annex 2.

## Effectiveness of the publicity campaigns

Since the DPS commenced operation in 2006, the Board has engaged an independent research agency to conduct half-yearly opinion surveys to measure the level of public awareness and understanding of the DPS, and to assess the effectiveness of its publicity campaigns.

According to the findings of the survey in December 2009, general public awareness of the DPS continued to stand at a satisfactory level of about 70%. Improvements were seen in the understanding of certain key features of the DPS, for example, the fact that structured deposits and secured deposits are not protected by the DPS. The Board would continue to make use of the findings of the surveys to enhance its future communications and publicity strategies.



## DPS membership and product representations

Since the launch of the DPS, Scheme members have had to observe the requirements set out in a set of statutory rules on how to disclose their DPS membership status and the protection status of their financial products to the public. To monitor Scheme members' compliance with the relevant requirements, the Board started collecting and reviewing self-assessment reports from Scheme members in 2007. The review exercise conducted in 2009, covering the compliance status of Scheme members during the

period from 1 October 2008 to 30 September 2009, was completed in early 2010. The findings shared by the HKMA on its on-site examinations of authorized institutions' compliance with representation requirements on the full deposit guarantee has also helped the Board in monitoring Scheme members' compliance with the requirements applicable to the DPS. The results of the self-assessment exercise and the findings shared by the HKMA indicate that the overall compliance level of Scheme members was satisfactory.

### 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 and 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, especially in areas common to the operation of the DPS and the full deposit guarantee provided by the Government.

#### 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) have agreed on a set of arrangements on co-ordination and exchange of information between the parties. The detailed arrangements have been 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. Specifically, the MoU 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.

## INTERNATIONAL CO-OPERATION

As a member of the International Association of Deposit Insurers (IADI), the Board continued to participate in forums organised by IADI, its member deposit insurers and other international organisations to exchange knowledge and ideas on issues relevant to deposit protection in an international context. In 2009-2010, the Board's personnel took part in a number of international meetings including:

- the IADI 8th Annual Conference and Annual General Meeting in Basel, Switzerland;
- a seminar on claims management organised by Malaysia Deposit Insurance Corporation and IADI in Kuala Lumpur, Malaysia;



Manager Pierre Leung (fifth from right, third row) at the seminar in Kuala Lumpur, Malaysia

- the 8th Asia Regional Committee Annual Meeting and International Conference of IADI in Goa, India;

- a seminar on cross border banking resolution issues organised by Financial Stability Institute and IADI in Basel, Switzerland;
- the 5th Round Table meeting hosted by the Deposit Insurance Corporation of Japan in Tokyo, Japan; and



Former CEO Raymond Li is a guest speaker of the event

- a conference on strengthening deposit insurance system in crisis and post crisis situations organised by the Philippine Deposit Insurance Corporation and IADI in Cebu, Philippines.



Senior Manager Anita Chan (first from right, third row) at the conference in Cebu, Philippines

### THE OUTLOOK

At the start of 2009, the global economy was clouded by widespread concerns of a full-blown recession. Probably due to the unprecedented market rescue measures and financial stimulus packages introduced by central banks worldwide, major economies managed to turn the corner by the end of 2009. Stepping into 2010, many economies around the world have experienced some growth. However, concerns have begun to loom on whether the nascent growth can last if emergency measures are withdrawn even though it is recognised that such withdrawal is inevitable given the undesirable effects of leaving the measures in place for too long. The outbreak of the European debt crisis also triggered renewed concern about whether there will be a double dip recession. In the light of the uncertainty in the external environment, the path to recovery for the domestic economy is not without risk. The operating environment for banks in Hong Kong will therefore remain challenging.

The Board's top priority in the coming year is to implement the enhancements to the DPS concluded in the DPS review in 2009 at the beginning of 2011 as scheduled. Significant effort will need to be expended on drafting the legislation and assisting the LegCo in the enacting process. The Board plans to make preparations on all fronts, including engaging the industry and the public as early as possible to ensure the readiness of all the relevant parties for the transition. Despite the heavy workload anticipated for launching the enhanced DPS, the Board cannot lose sight of its paramount function to maintain the efficient and effective operation of the DPS under its existing framework.

### ADMINISTRATION OF THE DPS

The Board is scheduled to assess and collect contributions from Scheme members for 2011 in January, based on the returns of relevant deposits submitted by Scheme members and their supervisory ratings provided by the HKMA. Subject to the passage of the amendment bill to implement the enhanced DPS in time, contributions will be assessed based on the new protection limit and scope that will take effect in 2011. Scheme members will also be allowed to report the amounts of their relevant deposits on a net deposit basis, that is, after deducting the liabilities of depositors to Scheme members from their relevant deposits. To give effect to the new reporting basis, the Board is in the process of amending the return of relevant deposits and will provide clear and early guidance to facilitate the industry to adopt the new reporting standards. The accuracy of the returns of relevant deposits compiled by Scheme members under the new basis will continue to be monitored through reviewing auditors' reports submitted by Scheme members.

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## ENSURING ADEQUACY OF THE COVERAGE OF THE DPS

In collaboration with the relevant government departments, the Board will assist in the completion of the legislative process for implementing the enhancements to the DPS and putting them into effect as scheduled. The LegCo has formed a Bills Committee to scrutinise the amendment bill introduced into the LegCo in April 2010, which is mainly for improving deposit protection, mitigating the cost of providing additional protection and enhancing the payout efficiency of the DPS. The Board will render full support to the Bills Committee with a view to ensuring that the Bill can be passed as early as possible. In parallel, the Board is assisting the DoJ in completing the drafting of the legislative amendments to effect the remaining enhancements concluded in the DPS review last year, mainly those to enhance the DPS representation regime. The Board aims to submit the amendments, which will be promulgated in the form of subsidiary legislation, to LegCo immediately after its summer recess, so that their negative vetting can be completed in time for the rules to take effect at the start of 2011.

The Board will continue to monitor the adequacy of the DPS coverage by analysing statistics collected from regular simulation tests with Scheme members and studying relevant market developments. The Board will also be watchful for developments and reform experience in other countries that may help improve the effectiveness of the DPS in Hong Kong.

## ENSURING READINESS OF THE DPS TO PAYOUT

With a significant amount of practice and lessons learnt from previous payout readiness simulation activities, the Board will consolidate this knowledge and apply it to initiatives to ensure the Board's ability to make compensation payments in changing circumstances. Modifications to the payout procedures and processes will be made to cope with the amended features of the DPS due to the implementation of the enhanced DPS. Protocols for collaboration and detailed modules for estimating compensation entitlements of depositors will be developed with the help of relevant counterparties.

Payout rehearsals will continue to be conducted, albeit in a more focused manner. They will focus on rehearsing those procedures that require more in-depth manual processing. These targeted rehearsals will give the Board the opportunity to assess the extent of work that will be required during a payout when dealing with complex issues.

The Board will continue to conduct compliance reviews combined with simulations to ensure the readiness of Scheme members' systems and its own Payout System. In anticipation of the commencement of the enhanced DPS in 2011, the simulations are planned to include in their scope the enhanced features of the DPS. Scheme members' compliance with the revised ISG, as well as Scheme members' remediation of non-conformity issues identified in past compliance reviews will continue to be monitored.

### **MAINTAINING AND ENHANCING PUBLIC AWARENESS AND UNDERSTANDING**

In anticipation of the paradigm shift for deposit protection in Hong Kong in 2011, which will involve the expiry of the Government's full deposit guarantee and the launch of the enhanced DPS, the focus of the publicity activities for the year will fall on communicating the impending changes to the public in time so as to enable them to be better prepared for the changes. An extensive publicity campaign will be launched immediately after the amendment bill for enhancing the DPS is passed, which will be followed by targeted publicity activities immediately before and after the change-over to reinforce public understanding of the changes. The effectiveness of the publicity campaigns will continue to be monitored through regular opinion surveys.

The DPS review in 2009 concluded the need to make a number of enhancements to the DPS representation regime. Specifically, the enhancements involve improving negative disclosures, introducing positive disclosures, improving prominence of disclosure statements and restricting the use of the term "structured deposit". The Board will finalise the legislative amendments for implementing the revised and new requirements in consultation with the industry. Subject to the timely completion of the negative vetting process for the relevant legislative amendments, the requirements are targeted to take effect at the beginning of 2011 together with the other enhancements to the DPS. Issuance of guidance notes as well as briefings will be arranged well in advance to engage Scheme members to prepare for meeting the new standards. In parallel, the Board will explore additional means to monitor Scheme members' compliance with the DPS representation requirements, including seeking the assistance of the HKMA in performing on-site compliance checks for the Board.

# 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 39 to 63, which comprises the balance sheet as at 31 March 2010, and the income and expenditure account, statement of comprehensive income, statement of changes in equity 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.

## INDEPENDENT AUDITOR'S REPORT

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 entity'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 2010 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, 17 June 2010

# STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

## INCOME AND EXPENDITURE ACCOUNT

for the year ended 31 March 2010

(Expressed in Hong Kong dollars)

	Note	2010	2009
<b>Income</b>			
Contributions		\$ 349,009,372	\$ 330,756,596
Interest income from cash and balances with bank and the Exchange Fund		129,221	1,777,490
Interest income from available-for-sale securities		4,055,271	6,090,884
Exchange (losses)/gains		1,173,808	(1,870,743)
Other income		60,000	30,907
		\$ 354,427,672	\$ 336,785,134
<b>Expenditure</b>			
Staff costs	5	\$ 5,756,941	\$ 5,216,167
Premises costs		2,748,909	2,343,627
Depreciation and amortisation		5,066,164	4,075,685
Office supplies		70,751	19,622
Overseas travel		190,565	91,592
Transport and travelling		2,961	5,093
Operating expenses reimbursable to the HKMA		18,188,716	14,710,143
Hire of services		11,111,009	9,994,681
Communications		94,990	65,375
Printing and publicity		19,209,647	19,955,869
Other expenses		3,077,655	1,903,682
		\$ 65,518,308	\$ 58,381,536
<b>Surplus for the year</b>		\$ 288,909,364	\$ 278,403,598

# STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

## STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 March 2010

(Expressed in Hong Kong dollars)

	2010	2009
Surplus for the year	\$ 288,909,364	\$ 278,403,598
Other comprehensive income		
Change in fair value of available-for-sale securities	(36,345)	(201,319)
<hr/>		
Total comprehensive income for the year	\$ 288,873,019	\$ 278,202,279

# STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

## BALANCE SHEET

as at 31 March 2010  
(Expressed in Hong Kong dollars)

	Note	2010	2009
<b>Non-current assets</b>			
Fixed assets	6	\$ 5,089,008	\$ 6,211,528
Intangible assets	7	10,218,095	10,899,398
		\$ 15,307,103	\$ 17,110,926
<b>Current assets</b>			
Other receivables	8	\$ 1,284,186	\$ 875,963
Available-for-sale securities	9	782,565,686	775,730,067
Cash and balances with bank and the Exchange Fund	11	484,736,196	631,524,035
		\$ 1,268,586,068	\$ 1,408,130,065
<b>Current liabilities</b>			
Contributions received in advance		\$ 282,639,918	\$ 254,765,057
Other payables	10	22,128,598	480,224,298
		\$ 304,768,516	\$ 734,989,355
<b>Net current assets</b>		<b>\$ 963,817,552</b>	<b>\$ 673,140,710</b>
<b>Net assets</b>		<b>\$ 979,124,655</b>	<b>\$ 690,251,636</b>
<b>Represented by</b>			
Accumulated surplus		\$ 979,082,045	\$ 690,172,681
Investment revaluation reserve		42,610	78,955
		\$ 979,124,655	\$ 690,251,636

Approved and authorised for issue by the Hong Kong Deposit Protection Board on 17 June 2010

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

# STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

## STATEMENT OF CHANGES IN EQUITY

for the year ended 31 March 2010

(Expressed in Hong Kong dollars)

	2010	2009
Fund balance as at 1 April	\$ 690,251,636	\$ 412,049,357
Surplus for the year	288,909,364	278,403,598
Change in fair value of available-for-sale securities	(36,345)	(201,319)
Fund balance as at 31 March	\$ 979,124,655	\$ 690,251,636

# STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

## CASH FLOW STATEMENT

for the year ended 31 March 2010

(Expressed in Hong Kong dollars)

	2010	2009
Operating activities		
Surplus for the year	\$ 288,909,364	\$ 278,403,598
Interest income	(4,184,492)	(7,868,374)
Exchange (gains)/losses	(1,173,808)	1,870,743
Depreciation and amortisation	5,066,164	4,075,685
Cash inflow from operating surplus before changes in operating assets and liabilities	\$ 288,617,228	\$ 276,481,652
Changes in operating assets and liabilities		
Increase in other receivables	\$ (408,223)	\$ (55,938)
Increase in contributions received in advance	27,874,861	9,035,764
(Decrease)/increase in other payables	(458,095,700)	462,682,879
Net cash inflow from operating activities	\$ (142,011,834)	\$ 748,144,357
Investing activities		
Purchase of intangible assets	\$ (2,612,000)	\$ (3,023,569)
Purchase of fixed assets	(650,341)	(4,049,509)
Interest received	129,221	1,777,490
Purchase of available-for-sale securities	(826,574,218)	(1,318,383,312)
Redemption of available-for-sale securities	824,931,333	859,477,082
Net cash outflow from investing activities	\$ (4,776,005)	\$ (464,201,818)
Net (decrease)/increase in cash and cash equivalents	\$ (146,787,839)	\$ 283,942,539
Cash and cash equivalents at 1 April	631,524,035	347,581,496
Cash and cash equivalents at 31 March	\$ 484,736,196	\$ 631,524,035
Analysis of balance of cash and cash equivalents		
Cash and balances with bank and the Exchange Fund	\$ 484,736,196	\$ 631,524,035

# 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” or the “DPS”). 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.

The Board completed a review of the Scheme, in the light of recent developments in international and local financial markets following the outbreak of the global financial crisis in 2007. The major enhancements concluded from the review include raising the DPS protection limit from the current HK\$100,000 per depositor to HK\$500,000, improving the clarity of the DPS coverage by protecting secured deposits and realigning the target fund size of the DPS Fund from 0.3% of total relevant deposits held with the industry to 0.25%. In order to avoid the additional cost required from being transferred to depositors, the Board also introduced cost mitigating measures under which the annual contribution rates of Scheme members will be cut by 65% and Scheme members will be allowed to report their amounts of relevant deposits for contribution assessment purposes on a net deposit basis (i.e. after deducting the liabilities of depositors to Scheme members from their relevant deposits). The Deposit Protection Scheme (Amendment) Bill 2010 (the “Bill”), which seeks to implement the enhancements concluded from the review, was introduced into the Legislative Council in April 2010. Subject to the passage of the Bill by the legislature, the enhancements will take effect on 1 January 2011.

### 2 SIGNIFICANT ACCOUNTING POLICIES

#### (a) Basis of preparation

The statement of accounts of the Fund has been prepared in accordance with Hong Kong Financial Reporting Standards (“HKFRSs” is a collective term which includes 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.

## 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### (a) Basis of preparation *(continued)*

The Fund makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments 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.

- (i) Standards, amendments and interpretations effective in 2009 which are relevant to the Fund

HKFRS 7 (Amendment) "Financial Instruments: Disclosures"; and  
HKAS 1 (Revised) "Presentation of financial statements"

These amendments and revisions result in additional disclosures and revisions on presentation of financial statements. They do not otherwise have any impact on the Fund's statement of accounts.

- (ii) Standards, amendments and interpretations that are not yet effective and have not been early adopted by the Fund

The Fund has chosen not to early adopt the following new and revised HKFRSs which have been issued but are not yet effective. The Fund is in the process of making an assessment of what the impact of these amendments, new standards and interpretations is expected to be in the period of initial adoption. So far it has concluded that the adoption of them is unlikely to have a significant impact on the Fund's results of operations and financial position.

HKAS 1 (Amendment) "Presentation of financial statements";  
HKAS 38 (Amendment) "Intangible Assets";  
HK(IFRIC) 17 "Distribution of non-cash assets to owners"  
HKAS 24 (Revised) "Related party disclosures"; and  
HKFRS 9 "Financial instruments"

# 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.

## 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.

# STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

## NOTES TO THE STATEMENT OF ACCOUNTS

### 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

#### (e) Financial assets

(i) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and for which the Fund has no intention of trading.

(ii) Available-for-sale securities

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 the 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.

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. Other changes in the carrying amount are recognized 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.

## 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### (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. Intangible assets include expenditures on development of the Payout System. Such expenditure 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.

### (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 loans and receivables, an impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the income and expenditure account.

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.

# STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

## NOTES TO THE STATEMENT OF ACCOUNTS

### 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

#### (i) 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.

#### (j) Other payables

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

#### (k) 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.

## **2 SIGNIFICANT ACCOUNTING POLICIES (continued)**

### **(l) 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.

### **(m) 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.

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.

# STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

## NOTES TO THE STATEMENT OF ACCOUNTS

### 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

#### **(n) 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.

#### **(o) 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.

### 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 conduct the day-to-day investment management and risk management of the Fund.

# STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

## NOTES TO THE STATEMENT OF ACCOUNTS

### 3 RISK MANAGEMENT *(continued)*

#### (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;
- US Treasury Bills; and
- any other investment approved by the Financial Secretary.

In December 2008, the Financial Secretary approved an expansion of the investment scope of the Fund to cover Exchange Fund Notes and US Treasury Notes with remaining term to maturity of not more than 2 years, and Hong Kong dollar and US dollar deposits of up to 3 months in tenor with financial institutions.

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, types of financial instruments held and limit exposures are regularly submitted to the Investment Committee for control purpose.

### 3 RISK MANAGEMENT *(continued)*

#### (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 which 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 that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Since the tenor of the Exchange Fund Bills and Notes and US Treasury Bills and Notes held by the Fund do not exceed 2 years, any impacts 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 2010, if interest rates increased by 25 basis points with all other variables remaining constant, the increase in net assets of the Fund for the year would amount to approximately HK\$1,162,299 (2009: HK\$461,311), 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.

##### *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.

# 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 (continued)*

Given that the Fund can only make deposits with the MA for the account of the Exchange Fund or with financial institutions approved by the Investment Committee or invest in the highly liquid Exchange Fund Bills and Notes and US Treasury Bills and Notes, 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 financial institutions approved by the Investment Committee 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 Notes and US Treasury Bills and Notes, 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 and the country risk of financial institutions approved by the Investment Committee 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.

##### *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.

### 3 RISK MANAGEMENT *(continued)*

#### (c) Financial risk management *(continued)*

##### *Fair value of financial assets and financial liabilities (continued)*

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

**3 RISK MANAGEMENT (continued)**

**(c) Financial risk management (continued)**

*Fair value of financial assets and financial liabilities (continued)*

(iv) Fair value hierarchy

HKFRS 7 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Fund’s market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1 – Quoted prices in active markets for identical assets or liabilities;
- Level 2 – Those involving inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices); and
- Level 3 – Those with inputs for the asset or liability that are not based on observable market data (unobservable inputs)

Available-for-sale securities are measured at fair values which are based on quoted market prices in active markets and therefore classified as Level 1 of the fair value hierarchy. The Fund has no financial instruments measured at fair value which are classified as Level 2 or Level 3 of the fair value hierarchy.

**4 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.

for the year ended 31 March 2010

(Expressed in Hong Kong dollars)

## 5 STAFF COSTS

	2010	2009
Salaries	\$ 5,109,474	\$ 4,594,406
Gratuity	428,927	412,056
Other employee benefits	218,540	209,705
	<b>\$ 5,756,941</b>	<b>\$ 5,216,167</b>

## 6 FIXED ASSETS

	Office equipment, furniture and fixtures	Computer hardware/ software	Total
<b>Cost</b>			
As at 1 April 2009	\$ 1,032,294	\$ 7,797,786	\$ 8,830,080
Additions	—	650,341	650,341
As at 31 March 2010	\$ 1,032,294	\$ 8,448,127	\$ 9,480,421
<b>Accumulated depreciation</b>			
As at 1 April 2009	\$ 470,143	\$ 2,148,409	\$ 2,618,552
Charge for the year	206,459	1,566,402	1,772,861
As at 31 March 2010	\$ 676,602	\$ 3,714,811	\$ 4,391,413
<b>Net book value</b>			
As at 31 March 2010	\$ 355,692	\$ 4,733,316	\$ 5,089,008
As at 31 March 2009	\$ 562,151	\$ 5,649,377	\$ 6,211,528

# STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

## NOTES TO THE STATEMENT OF ACCOUNTS

### 7 INTANGIBLE ASSETS

	Development costs of Payout System
<b>Cost</b>	
As at 1 April 2009	\$ 15,923,056
Additions	2,612,000
<hr/>	
As at 31 March 2010	\$ 18,535,056
<hr/>	
<b>Accumulated amortization</b>	
As at 1 April 2009	\$ 5,023,658
Charge for the year	3,293,303
<hr/>	
As at 31 March 2010	\$ 8,316,961
<hr/>	
<b>Net book value</b>	
As at 31 March 2010	\$ 10,218,095
<hr/>	
As at 31 March 2009	\$ 10,899,398
<hr/>	

for the year ended 31 March 2010  
(Expressed in Hong Kong dollars)

## 8 OTHER RECEIVABLES

	2010	2009
Prepayment	\$ 1,230,864	\$ 858,790
Interest receivables	36,822	673
Others	16,500	16,500
	<u>\$ 1,284,186</u>	<u>\$ 875,963</u>

## 9 AVAILABLE-FOR-SALE SECURITIES

	2010 HK\$	2009 HK\$
Debt securities:		
- Unlisted US Treasury Bills	\$ 782,565,686	\$ 775,730,067

## 10 OTHER PAYABLES

	2010 HK\$	2009 HK\$
Hire of services (a)	\$ 20,621,810	\$ 15,827,948
Staff expenses	530,072	456,397
Unsettled securities trades	—	462,645,033
Others	976,716	1,294,920
	<u>\$ 22,128,598</u>	<u>\$ 480,224,298</u>

(a) This amount include operating expenses reimbursed to the HKMA HK\$18,188,716 (2009: HK\$14,701,143), services fee for payout rehearsal HK\$2,293,094 (2009: Nil) and others HK\$140,000 (2009: HK\$1,126,805).

# STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

## NOTES TO THE STATEMENT OF ACCOUNTS

### 11 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.

The related party transactions with the HKMA are as follows:

	Note	2010	2009
Aggregate amounts outstanding at the year end			
Balances with the Exchange Fund	(a)	\$ 121,014,292	\$ 163,992,879
Interest income from balances with the Exchange Fund	(a)	91,908	1,776,240
Operating expenses reimbursed to the HKMA	(b)	\$ 18,188,716	\$ 14,701,143

## 11 MATERIAL RELATED PARTY TRANSACTIONS *(continued)*

- (a) During the year, the Fund placed deposits with the Exchange Fund amounting to HK\$121,014,292 (2009: HK\$163,992,879) and earned interest amounting to HK\$91,908 (2009: HK\$1,776,240) at a rate which is referenced to the market interest rates.
- (b) Certain operating expenses are reimbursed to the HKMA on a cost recovery basis in accordance with the provisions set out in the Ordinance.
- (c) During the year, the HKMA 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 (2009: HK\$40,000,000,000) of which nil (2009: nil) was drawn during the year.

## 12 APPROVAL OF STATEMENT OF ACCOUNTS

The statement of accounts was approved by the Board on 17 June 2010.

## ANNEX 1: LIST OF SCHEME MEMBERS AS OF 31 MARCH 2010

ABN AMRO BANK N.V.  
AGRICULTURAL BANK OF CHINA LIMITED  
ALLAHABAD BANK  
AUSTRALIA AND NEW ZEALAND BANKING GROUP LIMITED  
AXIS BANK LIMITED  
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 MELLON (THE)  
BANK OF NOVA SCOTIA (THE)  
BANK OF SCOTLAND PLC  
BANK OF SINGAPORE LIMITED  
BANK OF TAIWAN  
BANK OF TOKYO-MITSUBISHI, UFJ LTD. (THE)  
BANK SARASIN & CIE AG  
BANK SINOPAC  
BARCLAYS BANK PLC  
BAYERISCHE LANDESBANK  
BNP PARIBAS  
BNP PARIBAS SECURITIES SERVICES  
BNP PARIBAS WEALTH MANAGEMENT  
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 DEVELOPMENT 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 AGRICOLE CORPORATE AND INVESTMENT BANK  
CREDIT SUISSE AG  
DAH SING BANK, LIMITED  
DBS BANK (HONG KONG) LIMITED  
DBS BANK LTD.  
DZ BANK AG DEUTSCHE ZENTRAL-GENOSSENSCHAFTSBANK, FRANKFURT AM MAIN  
E.SUN COMMERCIAL BANK, LTD.  
EAST WEST BANK  
EFG BANK LTD  
ERSTE GROUP BANK AG  
FALCON PRIVATE BANK LTD  
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  
HDFC BANK LIMITED  
HONG LEONG BANK BERHAD  
HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED (THE)  
HSBC BANK INTERNATIONAL LIMITED  
HSBC BANK PLC  
HSBC BANK USA, NATIONAL ASSOCIATION  
HSBC PRIVATE BANK (SUISSE) SA

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 LIMITED (THE)  
INDUSTRIAL BANK OF KOREA  
INDUSTRIAL BANK OF TAIWAN CO., 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.  
LLOYDS TSB BANK PLC  
MALAYAN BANKING BERHAD  
MEGA INTERNATIONAL COMMERCIAL  
BANK CO., LTD.  
MELLI BANK PLC  
MEVAS BANK LIMITED  
MITSUBISHI UFJ TRUST AND BANKING  
CORPORATION  
MIZUHO CORPORATE BANK, LTD  
NANYANG COMMERCIAL BANK, LIMITED  
NATIONAL AUSTRALIA BANK, LIMITED  
NATIONAL BANK OF ABU DHABI  
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  
PUNJAB NATIONAL BANK  
RBS COUTTS BANK AG  
ROYAL BANK OF CANADA  
ROYAL BANK OF SCOTLAND N.V. (THE)

ROYAL BANK OF SCOTLAND PUBLIC LIMITED  
COMPANY (THE)  
SHANGHAI COMMERCIAL & SAVINGS BANK,  
LTD. (THE)  
SHANGHAI COMMERCIAL BANK LIMITED  
SHIGA BANK LIMITED (THE)  
SHINHAN 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  
UNICREDIT BANK AG  
UNICREDIT, 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 2009-2010

Commencement Date	Activities
11 April 2009	Launched the DPS roving exhibition programme for 2009 - 2010. In all, 48 weekly exhibitions with the theme "Know Your DPS Day" were held during the year at public housing estates and shopping malls operated by The Link Management Limited.
16 April 2009	Commenced a series of 25 skit performances at non-government organisations and schools to promote awareness of the DPS.
27 April 2009	Hosted a press conference and a media luncheon to announce the launch of the public consultation on the first phase of the review of the DPS.  A 9-week TV advertising campaign got under way on major channels on the public consultation on the first phase of the review of the DPS.
28 April 2009	A 3-week print advertising campaign in newspapers was launched with full page advertisements relating to the public consultation on the first phase of the review of the DPS being inserted in selected newspapers, including free dailies.
1 May 2009	The first MTR network advertising campaign, lasting for 3 weeks, was launched. The TV advertisement on the public consultation on the first phase of the review of the DPS was placed in TVs in the MTR lines.
4 May 2009	A 2-week internet advertising campaign on the public consultation on the first phase of the review of the DPS was launched on mass-appeal portals.
25 May 2009	A 3-week radio advertising campaign on the public consultation on the first phase of the review of the DPS was launched. Radio "Announcements in the Public Interest" (APIs) were broadcasted in major radio channels.
13 Jun 2009	The second MTR network advertising campaign, lasting for 2 weeks, was launched. The TV advertisement on the public consultation on the first phase of the review of the DPS was placed in TVs in the MTR lines.

<b>Commencement Date</b>	<b>Activities</b>
15 June 2009	The second print advertising campaign in newspapers, lasting for 2 weeks, was launched with full page advertisements relating to the public consultation on the first phase of the review of the DPS being inserted in selected newspapers, including free dailies.
20 June 2009	The second internet advertising campaign on the public consultation on the first phase of the review of the DPS, lasting for 1 week, was launched on mass-appeal portals.
16 July 2009	Issued a press release in the Hong Kong Monetary Authority (HKMA) column on the completion of the public consultation on the first phase of the review of the DPS.
18 August 2009	Issued a press release to publish the report on the public consultation on the first phase of the review of the DPS and the consultation paper of the second phase of the review of the DPS.
19 August 2009	The third print advertising campaign in newspapers, lasting for 2 weeks, was launched with full page advertisements relating to the public consultation on the second phase of the review of the DPS being inserted in selected newspapers, including free dailies.
25 September 2009	Issued a press release on Annual Report to highlight the key accomplishments of the year.
5 October 2009	The fourth print advertising campaign in newspapers, lasting for 2 weeks, was launched with full page advertisements relating to the public consultation on the second phase of the review of the DPS being inserted in selected newspapers, including free dailies.

## ANNEX 2: LIST OF MAJOR PUBLIC EDUCATION AND PUBLICITY ACTIVITIES FOR YEAR 2009-2010

<b>Commencement Date</b>	<b>Activities</b>
16 November 2009	<p>The second TV advertising campaign, lasting for 4 weeks, for the year was launched on major TV channels. TV APIs on the protection provided by the DPS and the full deposit guarantee were broadcast on major TV channels.</p> <p>The fifth print advertising campaign, lasting for 4 weeks, was launched with DPS educational comics being inserted in selected newspapers, including free dailies.</p> <p>The third MTR network advertising campaign, lasting for 3 weeks, was launched. The TV advertisement of the DPS was placed in TVs in the MTR lines.</p>
30 November 2009	<p>Issued a press release to publish the report on the public consultation on the second phase of the review of the DPS.</p>
1 December 2009	<p>Issued a press release in the HKMA column on the completion of the review of the DPS.</p>
1 March 2010	<p>A 4-week TV advertising campaign got under way on major channels on the completion of the review of the DPS and the expiry of the full deposit guarantee by end 2010.</p>