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

Enhancements to the Deposit Protection Scheme in Hong Kong

Consultation Paper

July 2023

FOREWORD

1. This consultation paper is issued by the Hong Kong Deposit Protection Board (the Board) to seek views on proposed enhancements to the Deposit Protection Scheme (DPS or the Scheme) in Hong Kong.

2. After considering the views and comments received in response to this consultation paper, the Board aims to introduce legislative amendments to the Legislative Council in early 2024.

3. Interested parties are invited to submit their comments to the Board on or before 12 October 2023 through any of the following channels:

By mail: Hong Kong Deposit Protection Board
Room 1802-1810
18/F Hopewell Centre
183 Queen's Road East
Wan Chai
Hong Kong
(Please indicate: DPS Enhancements)

By fax: (852) 2290 5168

By email: dps_enhancements@dps.org.hk

4. This consultation paper is available on the Board's website at www.dps.org.hk. Any person submitting comments on behalf of any organisation is requested to provide details of the organisation they represent.

5. In the interests of transparency, the Board may, as appropriate, reproduce, quote or summarise the submissions received, in whole or in part, in the Board's subsequent report on consultation conclusions. Where appropriate, the Board may attribute such reproductions of, quotations from, or summaries of, views received to the relevant organisations or individuals unless expressly requested in the submissions not to do so. Any personal data provided will be used only for purposes which are directly related to this consultation.

CONTENTS

EXECUTIVE SUMMARY

1. Deposit protection is a core part of the financial safety net that maintains financial stability, complementing prudential regulatory and supervisory framework, resolution regime and the lender of last resort function. The role of deposit protection is to stabilise the financial system by assuring depositors that they will have immediate access to their protected deposits even if their bank fails, thereby reducing their motives for making a run on the bank.

2. The Deposit Protection Scheme (DPS or the Scheme) in Hong Kong was established in 2006 with the primary objective of protecting small depositors and hence contributing to banking stability. Since its inception, the DPS has been effective in maintaining depositors' confidence in our banking system.

3. In order to ensure that the Scheme keeps up with international best practice and the latest developments in Hong Kong, the Hong Kong Deposit Protection Board (the Board) conducts a review of the Scheme on a regular basis. The latest review of the Scheme was conducted in 2021-2022. In other words, it was not triggered by recent banking events in other parts of the world. Nevertheless, the implications of those banking events have been taken into account when coming up with our policy recommendations on enhancing the Scheme.

4. Based on the findings of the latest review, while the DPS is substantially in compliance with international standards, there is room for enhancement in certain areas, including:

   (i) Protection limit – raising the protection limit from the current HK$500,000 to HK$800,000 (see Chapter 2);

   (ii) Levy system – switching back to the build-up levy to cater for a higher protection limit, with the build-up levy rates kept unchanged (see Chapter 3);

   (iii) Deposit protection arrangements in the event of a bank merger – providing enhanced coverage to affected depositors for six months upon a bank merger (see Chapter 4); and

   (iv) Representation regime – requiring the display of the DPS membership sign on the digital channels of Scheme members and streamlining the disclosure requirements on non-protected deposits for private banking customers (see Chapter 5).

A summary of the major proposed enhancements to the DPS is attached at the end of this consultation paper for easy reference.

5. As far as the protection limit is concerned, a higher protection limit would enhance depositor protection and further strengthen financial stability. However, the appropriateness of a protection limit cannot be considered without taking into account the additional costs involved, especially given that such costs may ultimately be borne by bank customers. The Board's aim is to strike a reasonable balance between enhancing depositor protection and minimising the costs involved.

6. In fact, the recent episodes of banking stress in the West have demonstrated that apart from deposit protection, other building blocks of the financial safety net, such as prudential regulation, sound supervision, banks' risk management, and resolution regime, also play an important (if not more important) role in preventing a bank failure and mitigating the impact of such bank failure on the financial system. Therefore, one cannot simply rely on deposit protection to address all financial stability concerns.

7. It is important to note that the recent banking events in other parts of the world have had a limited impact on Hong Kong. The banking system in Hong Kong remains stable with a high level of capital and liquidity buffers. Moreover, Hong Kong's financial safety net has been strengthened significantly over the years with the introduction of a comprehensive resolution regime in 2017. The DPS has also worked well in Hong Kong thus far.

8. In view of the above, the Board at this stage does not see a pressing need or a particular reason to change the design of the DPS or sharply increase the protection limit under the DPS in response to the banking events in the West. The Board proposes to raise the protection limit to HK$800,000 as this level will reasonably enhance depositors' protection against inflation and meet international standards by fully protecting about 92% of depositors while keeping the associated costs at a manageable level. Going forward, the Board will continue to closely monitor the international developments and will review the protection limit again in five years' time.

9. The purpose of this consultation paper is to solicit views from relevant stakeholders on the proposed enhancements to the DPS. The Board will take into account the comments received in finalising the proposed enhancements to the Scheme.

CHAPTER 1

INTRODUCTION

Financial Safety Net

10. The role of the financial safety net is to enhance the resilience of an economy against financial crises and to mitigate the impact of such crises. A robust financial safety net is therefore crucial for maintaining financial stability. Deposit insurance is a core part of the financial safety net. At the same time, there are also other important components in the financial safety net, including prudential regulatory and supervisory framework, resolution regime and the lender of last resort function, which work together with deposit insurance to guard against unexpected crises and mitigate the impact of such crises.

11. The recent banking stress in the West has put a spotlight on the operation of the financial safety net. Since March 2023, several regional banks in the US have failed, including Silvergate Bank, Silicon Valley Bank (SVB), Signature Bank and First Republic Bank. The last three banks are the largest bank failures in the US history after the collapse of Washington Mutual in 2008. These events have prompted the relevant authorities to look into the root causes and identify any lessons learnt, particularly with respect to banking regulation and supervision as well as the deposit insurance scheme.

12. According to the findings of a review of the supervision and regulation of SVB published by the US Federal Reserve (Fed) in late April[1], deficiencies were identified in SVB's risk management, especially regarding interest rate risk and concentration risk in terms of its depositor base, while the Fed's regulation and supervision should also be strengthened. In early May, the Federal Deposit Insurance Corporation (FDIC) also published a report[2] laying out a range of policy options for deposit insurance reform to address financial stability concerns stemming from recent bank failures. The report also suggested some other policies and tools that can complement changes to deposit insurance coverage.

13. These events have had a limited impact on Asia's banking system so far. The banking system in Hong Kong remains stable with a high level of capital and liquidity buffers. In particular, the Board noted that the International Monetary Fund has just completed the 2023 Article IV

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[1] Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank (April 2023) (https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf)

[2] Options for Deposit Insurance Reform (May 2023) (https://www.fdic.gov/analysis/options-deposit-insurance-reforms/report/options-deposit-insurance-reform-full.pdf)

Consultation with Hong Kong in early May and concluded that amid challenging macro-financial conditions, Hong Kong's financial system remains resilient with the support of strong institutional frameworks, in particular high-quality financial sector oversight and substantial capital and liquidity buffers.

14. In fact, the financial safety net in Hong Kong has been strengthened significantly over the years. Since the Global Financial Crisis in 2008, substantial regulatory reforms have been introduced at the global level. The Hong Kong Monetary Authority (HKMA), which is responsible for banking regulation and supervision in Hong Kong, has implemented the enhanced standards to ensure banks have effective risk management practices, thereby increasing the resilience of the banking sector against unexpected shocks. In addition, a comprehensive resolution regime[3] that is compliant with international standards was established in 2017, which arms the HKMA with powers necessary to deal with, in an orderly manner, the failure of banks which poses risks to the financial system, so as to safeguard the stability of Hong Kong's financial system. The HKMA may use resolution powers to, among other things, write-down the failing bank's liabilities, or convert them into equity, thereby giving it an equity 'boost', with a view to ensuring its critical financial functions can continue, and deposits are protected to no less than an extent than they would be protected under the DPS. Therefore, the DPS is not the only line of defence. DPS seeks to complement other financial safety net components by making compensation to small depositors should a bank go into insolvency procedures instead of resolution upon failure (See **Diagram 1** for an overview of the key building blocks of the financial safety net in Hong Kong). The Board has been in close co-ordination with other safety net players to ensure the actions will be well-coordinated and smooth when responding to a crisis situation.

[3] Resolution is an administrative process which enables the relevant authorities to manage the failure of a financial institution in an orderly manner without significant adverse consequences for the financial system or wider economy. It differs from insolvency procedures in that it is designed to preserve the continued provision of critical financial services by the failing financial institution while imposing the costs of failure on the shareholders and creditors of the financial institution.

Diagram 1: Key Building Blocks of Financial Safety Net in Hong Kong

15. The rest of this chapter will provide the background and primary objective of the DPS, and explain the reasons for the latest review of the Scheme. As elaborated below, the latest review exercise was initiated in 2021 as part of the Board's regular practice of reviewing the Scheme to ensure its effectiveness in serving its public policy objectives and in maintaining banking stability in Hong Kong. While this review was not triggered by recent banking events in the West, the implications of those events have been taken into account when coming up with the policy recommendations on enhancing the DPS.

Deposit Protection Scheme (DPS)

16. The DPS in Hong Kong was established in September 2006 under the Deposit Protection Scheme Ordinance (DPSO) (Cap. 581) with the primary objective of protecting small depositors and hence contributing to banking stability. The Scheme is administered by the Board, which is a statutory body established under the DPSO.

17. The DPS protects depositors by paying compensation to them in the event of a bank failure. The rationale is that depositors, knowing their deposits are protected, should be less likely to overreact to rumours and rush to withdraw their deposits. This will help reduce the likelihood of a rumour-driven bank run or bank failure, thereby promoting banking stability. Since the launch of the DPS, Hong Kong has not experienced any bank failure.

18. Currently, the protection limit under the DPS is HK$500,000 per depositor

per bank, which has been in place since 2011. The DPS covers most of the commonly placed deposits, be they denominated in Hong Kong dollars, renminbi or any other currencies. Only certain types of deposits are not protected by the DPS, including time deposits with a maturity longer than five years, structured deposits such as foreign currency-linked or equity-linked deposits, bearer instruments like bearer certificates of deposit, and offshore deposits.

19. The DPS is funded by contributions from around 150 Scheme members, which comprise all licensed banks, unless exempted by the Board. Each Scheme member pays an annual contribution to the DPS Fund based on the amount of protected deposits held with the Scheme member and the supervisory rating assigned by the HKMA to the member. As at end-March 2023, the net asset size of the DPS Fund was HK$6.2 billion. The target size of the DPS Fund is 0.25% of the aggregate amount of protected deposits maintained with all Scheme members, and is reached this year.

20. When compensation under the DPS becomes payable in respect of a Scheme member, the Board will borrow from the Exchange Fund under a standby liquidity facility to pay compensation to depositors[4], and then seek to recover the payout from the liquidation of the failed Scheme member. The cost of borrowing from the Exchange Fund, any compensation paid that cannot be recovered from the liquidation, and the administrative cost incurred by the DPS in making compensation payments will all be charged to the DPS Fund.

21. The target time frame for making full compensation payment to depositors is within seven days in most cases in the event of failure of a Scheme member. To expedite the compensation process, the Board introduced new electronic channels in 2021 as avenues of compensation, in addition to traditional paper cheques. This means that depositors can receive compensation either by direct bank transfer if they hold accounts with the Board's designated payout agent bank, or via the Faster Payment System.

22. In order to assist members of the public to readily ascertain the DPS membership status of a bank and distinguish between DPS-protected and non-DPS-protected financial products, the Board put in place a representation regime in 2006, which governs the representations that Scheme members should make regarding their membership status and the protection status of their financial products.

[4] Currently, the size of the facility offered by the Exchange Fund to the DPS is HK$120 billion.

Need for Review

23. Since the DPS commenced operation in 2006, two major rounds of enhancements have been made. The first round of enhancements took effect in 2011, including raising the protection limit from HK$100,000 to HK$500,000, expanding the scope of coverage to secured deposits, and reducing the target DPS Fund size from 0.3% to 0.25% of total protected deposits. The representation regime was also enhanced at that time in response to a clear public demand for greater clarity on the protection status of financial products following the outbreak of the Global Financial Crisis in 2008.

24. The second enhancement was made in 2016. A review conducted at the time found that most key features of the DPS, including the protection limit, remained appropriate, but it was necessary to simplify the basis for determining compensation payment in order to allow a swift disbursement of compensation to depositors. Therefore, the payout approach was changed to a gross basis by removing the need to set off liabilities against protected deposits held by depositors. This enhancement significantly reduced the time required to disburse compensation to depositors from 42 days to just seven days.

25. It has been the Board's practice to conduct regular reviews of the DPS to ensure that it remains efficient and effective in serving its public policy objectives and is well aligned with international best practice. Since the last two rounds of major enhancements, the financial and banking landscape has undergone significant changes, both globally and locally. Moreover, the International Association of Deposit Insurers (IADI)[5] updated its Core Principles for Effective Deposit Insurance Systems (Core Principles) in 2014[6]. These Core Principles set out international best practice relating to the key features of deposit insurance systems, such as governance, deposit coverage, funding arrangements and reimbursement speed.

26. Against this backdrop, the Board initiated a comprehensive review of the DPS in 2021 once again to ensure the Scheme keeps up with international best practice and the latest developments in Hong Kong. As part of the review, the Board conducted a self-assessment against the Core Principles, which concluded that the DPS was substantially in compliance with the Core Principles, although a few areas including depositor protection in the event of a bank merger would warrant further study. The Board also commissioned a consultancy study to examine the funding cost of the DPS

[5] IADI is an international organisation with an objective to contribute to the stability of financial systems by promoting international cooperation in the field of deposit insurance and providing guidance for establishing new, and enhancing existing, deposit insurance systems, and to encourage wide international contact among deposit insurers and other interested parties.

[6] https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf

at different protection limits and the latest practices of other major jurisdictions.

27. Taking into account the findings of the self-assessment and consultancy study, the Board performed a more in-depth policy research and analysis on different aspects of the design of the DPS, including the protection limit, target fund size, levy system, product coverage, institution coverage, as well as deposit protection arrangements in the event of a bank merger. The Board also took this opportunity to review the existing representation regime in Hong Kong, which has been in operation for more than a decade since the 2011 enhancement, to make sure that the representation requirements remain appropriate and keep pace with the latest market developments.

28. Based on the findings of the comprehensive review, the Board considers that certain aspects of the DPS, such as product coverage and institution coverage, remain appropriate and largely in line with other major jurisdictions, but there is room for enhancing the following aspects:

    (i) Protection limit;

    (ii) Levy system;

    (iii) Deposit protection arrangements in the event of a bank merger; and

    (iv) Representation regime in respect of the display of the DPS membership sign and the negative disclosure requirements.

29. The Board has set out its specific policy recommendations on enhancements to the DPS in the following chapters.

CHAPTER 2

PROTECTION LIMIT

30. At present, the DPS provides protection of up to HK$500,000 on a per depositor per bank basis, and this has been in effect since 2011. There are two important questions: Is the current protection limit still adequate? If not, to what level should it be raised?

31. A host of factors determine the protection limit of a deposit insurance scheme. In general, a higher protection limit would enhance depositor protection and raise public confidence in the banking system. This would help minimise the possibility of a rumour-driven bank run and hence strengthen banking stability. However, the appropriateness of a protection limit cannot be considered without taking into account the additional costs and risk of moral hazard involved.

Guiding principles

32. As there is always a trade-off between the benefits and costs of providing deposit protection, the Board's aim is to strike a reasonable balance between enhancing depositor protection and minimising the additional costs and risk of moral hazard when considering a protection limit. More specifically, the Board is guided by the following principles:

    (a) The protection limit should be adequate in protecting depositors and hence contributing to banking stability. Three indicators are commonly used in assessing the adequacy of a protection limit:

    (i) the coverage ratio by depositor, which refers to the percentage of depositors whose deposits are fully protected at a certain protection limit. The protection limit should cover the large majority of depositors, and the IADI has provided a guidance of at least 90% as a reference for assessing whether the large majority of depositors is covered;

    (ii) the real value of the protection limit, adjusted for inflation. The nominal value of the protection limit should keep pace with cumulative inflation over time such that its real value can be preserved; and

    (iii) the protection limit as a percentage of per capita GDP, which should be comparable to other major jurisdictions.

(b) Additional costs should be reasonable and the risk of moral hazard manageable in terms of the following three aspects:

  (i) potential loss to the DPS;

  (ii) financial impacts on the industry and potential cost pass-through to bank customers; and

  (iii) risk of moral hazard.

33. Based on the overarching objective and guiding principles above, the Board **proposes** to raise the protection limit of the DPS to HK$800,000, as this level (representing an increase of 60% from the existing protection limit of HK$500,000) would suitably enhance protection to depositors while keeping additional costs and the risk of moral hazard at manageable levels. The detailed considerations are set out below.

Coverage ratios

34. According to the IADI's Core Principles, coverage should be limited and credible, covering the large majority of depositors and at the same time leaving a substantial amount of deposits exposed to market discipline[7]. While acknowledging that setting the extent of coverage is jurisdiction-specific and needs to cater for the different circumstances of individual jurisdictions, the IADI cited a guidance of at least 90% of depositors as a reference for assessing whether a deposit insurance scheme is able to cover the large majority of depositors[8].

35. When the protection limit in Hong Kong was raised from HK$100,000 to HK$500,000 in 2011, the DPS was able to fully cover around 91% of depositors. Over the passage of time, this coverage ratio has declined to around 88-89% in recent years, mainly due to inflation as well as increased income and savings over time.

36. As the coverage ratio by depositor has been lower than the IADI's guidance for some time, there is a strong case for raising the DPS protection limit to bring the coverage ratio back in line with the international guidance. Based on a regular survey of major Scheme members, raising the protection limit to HK$800,000 would achieve a coverage ratio of 92.2%, which is in

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[7] When part of the deposits are uninsured, depositors would have greater incentive to monitor the riskiness of the bank, and when warranted, they could reallocate their uninsured deposits to other banks, hence imposing discipline on the bank's risk taking behaviour.

[8] Enhanced Guidance for Effective Deposit Insurance Systems: Deposit Insurance Coverage Guidance Paper (2013) (https://www.iadi.org/en/assets/File/Papers/Approved%20Guidance%20Papers/IADI_Coverage_Enhanced_Guidance_Paper.pdf)

line with the IADI's guidance with a reasonable buffer from the minimum of 90% (see **Chart 1**). The number of fully protected depositors would increase by around 830,000. The percentage of total deposits covered by the DPS would also increase to 25.2% from the current 20%. It is worth noting in **Chart 1** that beyond the HK$800,000 level, the marginal gains in the coverage ratio by depositor would start to diminish. This suggests that any further increase in the protection limit beyond HK$800,000 would not be as effective as within HK$800,000 in terms of the additional number of depositors who can be fully protected under the DPS (see **Table 1**).

Chart 1: Coverage ratios at different protection limits

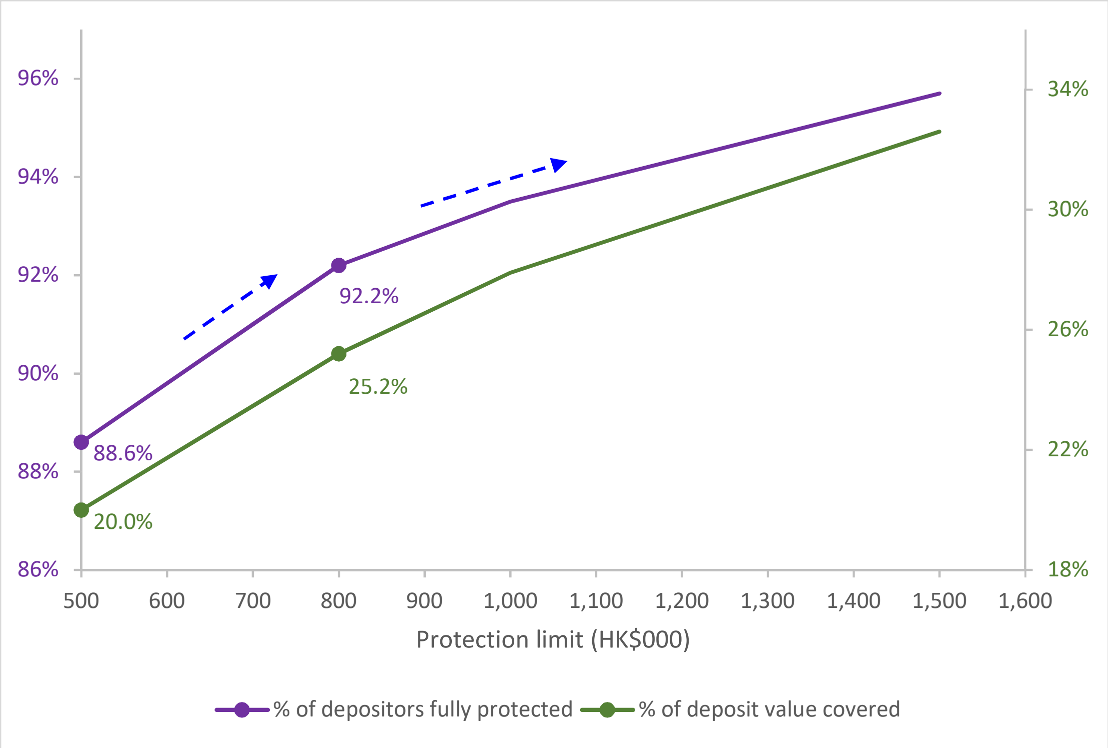


Table 1: Additional number of fully protected depositors

Protection limit	Additional number of fully protected depositors for each HK$100,000 increase in the protection limit
Between HK$500,000 and HK$800,000	~280,000
Beyond HK$800,000	~120,000

Real value of protection limit

37. Another important consideration is whether the value of protection offered to depositors is able to keep up with inflation over time. As pointed out by the IADI[9], increases in general price levels will erode the real value of a deposit protection limit. Therefore, inflation should be taken into account when reviewing the protection limit. As at March 2023, Hong Kong's consumer price index had increased by 39% since the DPS protection limit was last raised in early 2011. This means that the real value of the current HK$500,000 protection limit, adjusted for inflation, has effectively declined by 39% over the years.

38. In order to preserve the value of protection offered to depositors in real terms, the protection limit will need to be raised to an extent that can at least compensate for cumulative inflation over time. This suggests that the protection limit has to be raised to at least HK$700,000. However, an 40% increase in the nominal protection limit can barely catch up with the cumulative inflation, and hence there will be virtually no enhancement in real protection to depositors. If the protection limit is to be raised by 60% to HK$800,000, the real value of protection to depositors will be reasonably enhanced by 21% (see **Table 2**).

Table 2: Increase in real value of protection limit

At the protection limit of HK$800,000	
Increase in nominal value of protection limit	+60%
Cumulative inflation since January 2011	+39%
Increase in real value of protection limit	+21%

Protection limit as a percentage of per capita GDP

39. From a broader perspective, it is important to ensure that the protection limit in Hong Kong is in line with international norms. When comparing different jurisdictions, a commonly used indicator is protection limit as a percentage of per capita GDP. If the protection limit is to be raised to HK$800,000, Hong Kong's protection limit as a percentage of per capita

[9] Enhanced Guidance for Effective Deposit Insurance Systems: Deposit Insurance Coverage Guidance Paper (2013) (https://www.iadi.org/en/assets/File/Papers/Approved%20Guidance%20Papers/IADI_Coverage_Enhanced_Guidance_Paper.pdf)

GDP will jump from the current 129% to 206%, lifting Hong Kong's position from ninth to sixth among the 12 jurisdictions selected for the purpose of the review[10] (see **Table 3**, which ranks jurisdictions according to protection limit as a percentage of per capita GDP).

Table 3: Protection limit as a percentage of per capita GDP

Jurisdiction	Protection limit		Protection limit as a percentage of per capita GDP
	In local currency	In USD*	
Mainland China	RMB500,000	72,240	575%
Malaysia	MYR250,000	56,767	511%
United States	USD250,000	250,000	356%
United Kingdom	GBP85,000	102,853	221%
Germany	EUR100,000	107,044	209%
Hong Kong	**HKD800,000 (proposed)**	**102,459**	**206% (ranked 6th)**
Japan	JPY10 mn	76,268	194%
Denmark	EUR100,000	107,044	157%
Canada	CAD100,000	73,815	142%
Hong Kong	**HKD500,000 (current)**	**64,037**	**129% (ranked 9th)**
South Korea	KRW50 mn	39,632	113%
Ireland	EUR100,000	107,044	107%
Singapore	SGD75,000	55,947	77%

** The protection limits in USD terms are calculated based on exchange rates as at end-2022.*

Potential loss to the DPS

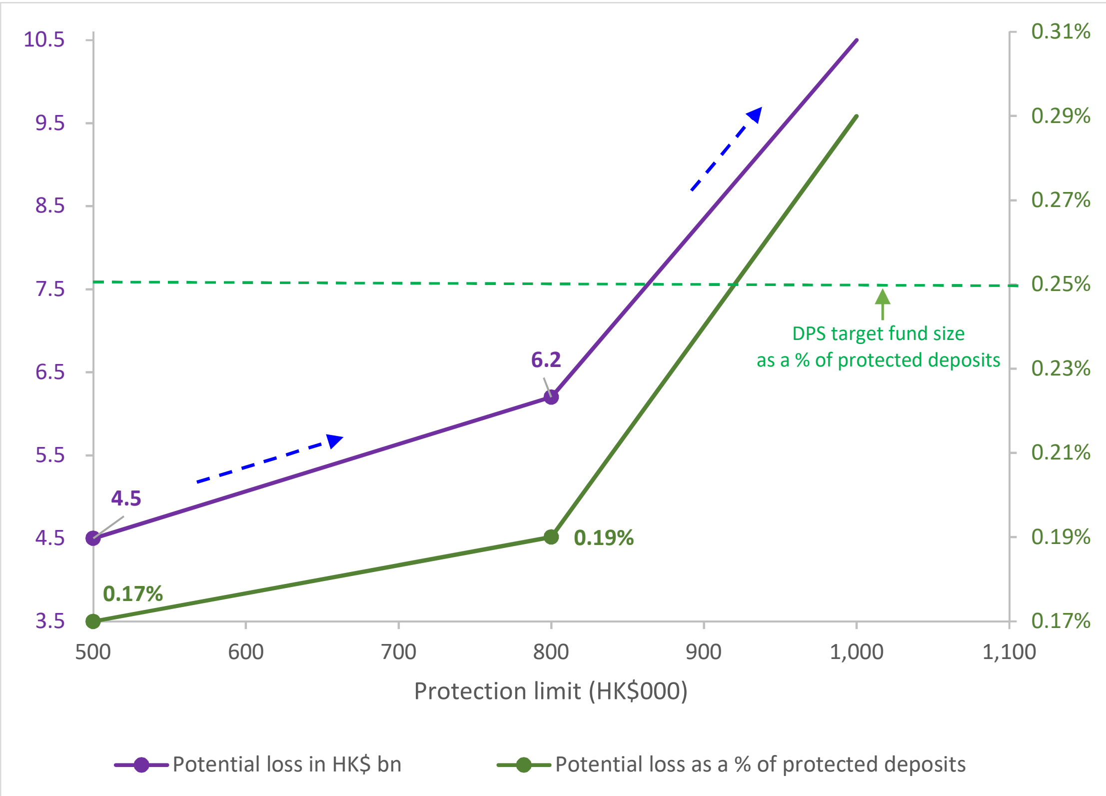
40. Deposit protection comes at a cost. When compensation under the DPS is triggered, the Board will borrow from the Exchange Fund to meet its payment obligations to depositors, and then seek recovery of the compensation paid to depositors from the liquidated assets of the failed bank so as to repay the money borrowed from the Exchange Fund. If the DPS fails to fully recover the compensation paid to depositors from the

[10] The other 11 jurisdictions were selected for comparison based on the economy size, funding mechanism, mandate, levy system and availability of information.

liquidation, it will suffer the shortfall as a loss, i.e. the shortfall loss. Furthermore, the DPS will need to pay interest on the borrowing from the Exchange Fund, i.e. the financing cost. The shortfall loss and the financing cost are therefore the two major sources of the cost of providing deposit protection, and are collectively referred to as potential loss to the DPS in the paragraphs below.

41. To assess how an adjustment to the protection limit will affect the potential loss to the DPS and whether the existing target size of the DPS Fund would be sufficient to cover the potential loss, the external consultant engaged by the Board has updated the DPS funding model, taking into account the latest market developments. The estimated potential loss to the DPS with 99.97% confidence level[11] at different protection limits based on the model simulation is shown in **Chart 2**.

Chart 2: Potential loss to the DPS at different protection limits



42. As shown in **Chart 2**, the potential loss to the DPS will rise along with the protection limit, and such an increase will be more prominent beyond the HK$800,000 level. If the protection limit is to be raised to HK$800,000, the potential loss to the DPS will increase by 38%, equivalent to 0.19% of total protected deposits. This suggests that the existing target size of the DPS Fund, which is 0.25% of total protected deposits, would be sufficient

[11] Estimated potential loss with 99.97% confidence level can cover 99.97% of simulated outcomes.

to cover the potential loss.

43. However, if the protection limit were to increase further beyond HK$800,000, say HK$1 million, the potential loss to the DPS would increase at a disproportionately faster rate, and the existing 0.25% target fund size would not be sufficient to cover the potential loss. In such a scenario, the target size of the DPS Fund would need to be raised to at least 0.3% of total protected deposits. In other words, the cost of increasing the protection limit would rise much more substantially should it be raised to a level beyond HK$800,000.

Financial impacts on banking industry and bank customers

44. In general, raising the protection limit would enhance depositors' confidence in the banking system, which should in turn lower the risk of a rumour-driven bank run and potential contagion in a banking crisis. Therefore, the banking industry should be supportive of a higher protection limit.

45. On the other hand, a higher protection limit would also have financial implications on the industry, as Scheme members would have to pay more contributions to match the higher deposit protection. The estimated increases in annual contributions payable by Scheme members at different protection limits are shown in **Table 4**.

46. The aggregate amount of annual contributions payable by the industry is determined by the total protected deposits and the applicable levy rates. As shown in **Table 4**, if the protection limit is to be raised to HK$800,000, the total protected deposits will increase by 26%, and therefore the annual contributions payable by Scheme members will also rise by the same magnitude of 26% on average, even if the applicable levy rates remain unchanged. Assuming that the new protection limit will take effect at the beginning of 2025, Scheme members shall pay the increased contributions starting from that year, and it is expected to take around three years to reach the new target fund size based on 0.25% of total protected deposits.

47. However, if the protection limit were to increase further beyond HK$800,000, say HK$1 million, the annual contributions payable by Scheme members would increase by 40% on average. As mentioned in paragraph 43, the target fund size would need to rise to at least 0.3% of total protected deposits under this scenario. The DPS Fund is expected to take around seven to nine years to reach the new target fund size.

Table 4: Financial impacts on Scheme members at different protection limits

Protection limit (in HK$)	**500,000 (Current)**	**800,000**	**>800,000 (e.g. 1 mn)**
Estimated protected deposits (in HK$ bn)	2,609	3,298	3,649
Estimated annual contribution (in HK$ mn)	581	734	813
Increase in annual contribution vs status quo		**+26%**	**+40%**
No. of years needed to reach the new target fund size *(counting from the beginning of 2025)**		**~3 years**	**~7-9 years**

** The underlying assumption is that the new protection limit will take effect at the beginning of 2025 and Scheme members will continue to pay annual contributions based on the existing build-up levy rates. The actual time needed to reach the new target fund size would also depend on the actual rates of deposit growth.*

48. The Board is mindful of the possibility that the higher the protection limit, the larger the financial impact on the banking industry, and the more likely that banks would pass such additional costs to their customers. Such consequences would be undesirable at this juncture, as the economy is still at a nascent stage of recovery from the COVID-19 pandemic.

Moral hazard

49. Moral hazard refers to the risk of inducing excessive risk-taking behaviour by banks and depositors due to the provision of deposit protection. In general, moral hazard increases with the level of protection limit. Taking the extreme case of providing full deposit guarantee as an example, banks may be inclined to take on more risk in order to offer high interest rates to attract depositors as the threat of depositors withdrawing their funds is very low. This may distort competition amongst banks and increase systemic risk in the banking system. That is the rationale behind the IADI's recommendation to set deposit coverage at a limited and credible level which will protect the large majority of depositors while leaving a substantial amount of deposits exposed to market discipline.

50. Therefore, a deposit insurance scheme should be appropriately designed to

strike a reasonable balance between enhancing depositor protection and minimising the associated moral hazard. At the protection limit of HK$800,000, the coverage ratio will be within the IADI's guidance and hence the risk of moral hazard should be manageable. The risk of moral hazard would become more significant at higher protection limits.

Summary of considerations on the protection limit

51. Having carefully considered the factors described above, the Board is of the view that raising the protection limit to HK$800,000 will strike a better balance between enhancing protection to depositors and keeping additional costs and the risk of moral hazard at manageable levels. In particular:

    (i) the percentage of depositors fully covered will be restored to 92.2%, which is in line with the international guidance with a reasonable buffer;

    (ii) the real value of the protection limit will increase by 21%, providing a reasonable enhancement in protection to depositors;

    (iii) the protection limit as a percentage of per capita GDP will be comparable to many other major jurisdictions;

    (iv) the 38% increase in potential loss to the DPS is kept at a manageable level, so there is no need to raise the existing target fund size of 0.25% of total protected deposits, and hence the increase in the annual contributions payable by Scheme members can be contained at about 26%; and

    (v) the increase in moral hazard should be manageable since the percentage of fully protected depositors is within the IADI's recommended range.

52. Raising the protection limit to a level below HK$800,000 is not desirable given that:

    (i) the percentage of depositors fully covered by the DPS would only be marginally higher than the minimum of the IADI's guidance. The limit is likely to need another review again soon if the coverage ratio falls consistently below 90% in the near term. Making too frequent changes to the protection limit may not be conducive to building public awareness and understanding of the DPS; and

    (ii) there would be minimal enhancement in the real value of the protection limit.

53. On the other hand, the marginal benefits of raising the protection limit to a level beyond HK$800,000 in terms of increasing depositor coverage would

diminish, and these improvements would be disproportionately costly to make as the potential loss to the DPS is estimated to rise sharply. The existing target fund size would not be sufficient to cover the potential loss and would need to be raised to at least 0.3% of total protected deposits. This increase would exert a larger financial impact on the banking industry, which would be more likely to pass on the additional cost to bank customers. Such an outcome is undesirable given that many bank customers, in particular small and medium enterprises, are just having some breathing space from the economic stress caused by the pandemic.

Implications of recent banking events in the West

54. Following the recent events in the US as mentioned in paragraph 11, the Board noted that the FDIC has proposed a few options to reform the deposit insurance system in the US with a view to addressing financial stability concerns stemming from recent bank failures:

    (i) The first option is Limited Coverage which maintains the current structure of deposit insurance with the possibility of an increased, but finite, deposit insurance limit. The FDIC, however, noted that even with much higher deposit insurance, there are likely to remain large uninsured deposits that can pose financial stability concerns.

    (ii) The second option is Unlimited Coverage which is a significant departure from the existing system by providing unlimited deposit insurance. The FDIC noted that this option would effectively remove run risks but may have large effects on bank risk-taking, the level of deposit insurance assessments on banks, and broader financial markets.

    (iii) The third option is Targeted Coverage which increases the protection limit for business payment accounts only as the inability to access these accounts can result in broader economic effects. The FDIC noted that, of the three options, this option has the greatest potential for yielding large financial stability benefits relative to its costs. But it also recognised challenges in defining what accounts qualify and keeping depositors and banks from trying to circumvent the rules and obtain coverage for which they should not be eligible.

55. As to whether any of the above reform measures in the US would be useful in the context of Hong Kong, the Board is mindful that there is no one-size-fits-all approach, as each jurisdiction has its own circumstances and unique structure of the banking sector. Hong Kong's banking system remains sound and stable. The current design of the DPS, which provides a finite deposit protection limit applicable to all types of depositors, is simple, easy

to understand, and can also achieve the primary objective of protecting small depositors in Hong Kong. It has worked well in Hong Kong so far. Therefore, the Board considers that the current design of the DPS remains appropriate for Hong Kong and does not see a pressing need or particular reason to change its design at this stage. The Board will continue to closely monitor the international developments and review the Scheme from time to time.

56. Further, as illustrated in **Diagram 1** in Chapter 1, it is important to note that in the bigger scheme of things, deposit protection is not the only building block in the financial safety net. In fact, the deposit protection limit in the US is already among the highest in the world. The recent bank failures in the US demonstrated that deposit insurance alone cannot fully address all financial stability concerns and eliminate the risk of bank failures. Even more important is having robust banking regulation and sound supervision to ensure effective risk management by banks and enhance the resilience of the banking system, and putting in place a credible resolution regime to deal with, in an orderly manner, those banks which may have systemic impact on the financial system should they indeed fail.

57. In view of the above, it is not advisable to sharply increase the protection limit simply in the hope of eliminating the risk of bank runs or failures. As rightly pointed out by the FDIC, regardless of the protection limit, there likely remains substantial portion of deposits which are uninsured. In addition, deposit insurance is not free. The costs should be taken into account and weighed against the benefits of a higher protection limit, especially given that such costs may be passed on to bank customers ultimately. Therefore, the Board considers that the proposed protection limit of HK$800,000 is appropriate, as this level will meet international standards and provide an appropriate degree of protection to small depositors while keeping the associated costs at a manageable level.

58. Given the highly uncertain outlook in the next few years with regard to the international deposit insurance developments, the Board will stay agile and review the protection limit again as and when necessary, and in any case, no later than five years later, to ensure that the DPS remains effective in protecting depositors and contributing to banking stability in Hong Kong.

Question 1:

Do you agree with the proposal to increase the protection limit of the DPS from the current HK$500,000 to HK$800,000, at which the target size of the DPS Fund will remain at 0.25% of total protected deposits?

CHAPTER 3

LEVY SYSTEM

59. The DPS adopts a differential levy system, whereby the annual contribution payable by each Scheme member is determined with reference to the supervisory rating assigned to it by the HKMA. This differential levy system is designed to limit moral hazard by providing incentives for banks to better manage their risks. The levy rates fall under two categories: (i) the build-up levy, which is the levy paid by Scheme members before the target fund size is reached; and (ii) the expected loss levy, which is the levy paid by Scheme members after the target fund size is reached (see **Table 5**)[12].

Table 5: Levy system

Supervisory rating assigned by the HKMA	Build-up levy	Expected loss levy
	(as % of protected deposits of individual banks)	
1	0.0175%	0.0075%
2	0.028%	0.01%
3	0.0385%	0.015%
4 or 5	0.049%	0.02%

60. Since the launch of the DPS in 2006, Scheme members have been paying the build-up levy as the target fund size has yet to be reached. As at March 2023, the net asset size of the DPS Fund stood at HK$6.2 billion. The target fund size, which is equivalent to 0.25% of total protected deposits, is reached this year. The DPSO stipulates that once the target fund size is reached, Scheme members will contribute the expected loss levy instead starting from the first quarter of the following year (i.e. 2024).

61. Under the existing DPSO, the build-up levy can be charged again if the target fund size **as a percentage of protected deposits** is amended. This switch-back mechanism aims to make sure the timeframe for reaching the new target fund size would be reasonable.

62. If the protection limit is to be raised to HK$800,000 as recommended in this consultation paper, the existing target fund size **as a percentage of total protected deposits** (currently at 0.25%) is expected to be sufficient to cover the potential loss to the DPS, as explained in paragraph 42. Notwithstanding this, as the total protected deposits would increase as a

[12] After the target fund size is reached, the Board may impose surcharges or give out rebates, if there is a need, in order to maintain the actual size of the DPS Fund within 70-115% of the target size.

result of the higher protection limit, the **monetary amount** of the target fund size would rise correspondingly from HK$6.3 billion to HK$8.2 billion (See **Table 6**). If Scheme members' contributions remain based on the expected loss levy rates, which amount to only around 40% of the build-up levy rates, the DPS Fund is likely to take more than 10 years to reach the new target size, as opposed to around three years under the build-up levy as shown in **Table 4**. A protracted build-up period would have a negative impact on the credibility of the DPS and the public confidence in the Scheme.

Table 6: Target fund size

Protection limit (in HK$)	**500,000 (Current)**	**800,000**
Target fund size as % of protected deposits	0.25%	0.25%
Target fund size (in HK$ bn) = 0.25% x total protected deposits	6.3	8.2

63. To ensure the new target fund size can be reached within a reasonable timeframe, the Board **proposes** a technical amendment to the existing legislation such that the circumstances under which the build-up levy can be charged again be broadened to cover the situation where the protection limit is raised regardless of whether the target fund size as a percentage of protected deposits is changed or not. Since the Board does not see the need to change the build-up levy rates at this stage, the existing build-up levy rates (as shown in **Table 5**) would continue to apply[13].

Question 2:

Do you agree with the proposal to keep the levy rates unchanged while broadening the circumstances under which the build-up levy becomes chargeable again to cover the situation where the protection limit is raised regardless of whether the target fund size as a percentage of protected deposits is changed or not?

[13] As indicated in Table 4 and explained in paragraph 46, assuming that Scheme members continue to pay annual contributions based on the existing build-up levy rates, the total annual contributions are expected to increase by 26%, which is the same magnitude as the increase in total protected deposits if the protection limit is to be raised to HK$800,000.

CHAPTER 4

DEPOSIT PROTECTION ARRANGEMENTS IN THE EVENT OF A BANK MERGER

64. As deposit protection under the DPS is on a per depositor per bank basis, a merger of two or more banks may result in a depositor's total deposits with the consolidated bank exceeding the standard protection limit. Should the DPS provide separate coverage for a period of time to depositors in each of the banks involved – as if the banks were still operating separately – the affected depositors would have time to adjust their deposit portfolios if they wish (e.g. reallocating part of their deposits to another bank) to bring their deposit balances under the standard protection limit.

65. According to the IADI's updated Core Principles, in the event of, or prior to, a merger[14] of separate banks that are members of the same deposit insurance system, depositors of the merged banks should enjoy separate coverage up to the protection limit for each of the banks for a limited and publicly stated period, as defined in law or regulation.

66. As there are bank mergers in Hong Kong from time to time, the Board **proposes** to introduce an enhanced arrangement in line with the Core Principles to strengthen the effectiveness of the DPS in maintaining banking stability. Some jurisdictions, including Canada, Malaysia, Singapore and the US, have put in place such arrangements, with the enhanced protection period (called "grace period") varying from six months to two years. In Malaysia and Singapore, such arrangements also cover a scheme member's acquisition of another scheme member's deposit-taking business.

67. In fact, similar arrangements are in place in Hong Kong to cater for the case where deposits are transferred from a problem Scheme member to another Scheme member under a resolution strategy pursuant to the Financial Institutions (Resolution) Ordinance (FIRO) (Cap. 628). Specifically, an additional coverage of up to the protection limit will be provided to the deposits transferred from the problem Scheme member for six months after the transfer. As a result, the total protection for each depositor concerned could be up to twice the standard protection limit during the six-month period.

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[14] Merger refers to a consolidation of two or more entities into a single entity, which may be an existing entity or a new entity.

Proposed enhancements to depositor protection in the event of a bank merger

68. With reference to the approaches taken in other major jurisdictions and the relevant arrangements under FIRO, the Board **proposes** that the enhanced arrangements for depositor protection in the event of a bank merger contain the following key features.

Scope

69. To avoid overlapping with the relevant arrangements under FIRO, the enhanced arrangements in the context of DPSO are proposed to apply to cases where there is (a) a merger of two or more Scheme members, or (b) an acquisition of a Scheme member's deposit-taking business by another Scheme member, both on a commercial basis, i.e. for reasons other than resolution which is already covered under FIRO as explained in paragraph 67. Scenario (b) differs from scenario (a) in that a Scheme member may acquire only part of the business of another Scheme member, instead of all its assets and liabilities as in scenario (a).

70. The general principle is that as long as there is a transfer of deposits between Scheme members in a merger or acquisition for reasons other than a resolution strategy, the enhanced arrangements as described in paragraphs 71-74 will apply automatically. There is no need for Scheme members or depositors to apply for the enhanced protection.

Enhanced coverage

71. For depositors who have deposits with more than one of the Scheme members involved before the merger or acquisition, each affected depositor will be entitled to compensation in respect of his/her protected deposits with each of the original Scheme members up to the DPS protection limit during the grace period, as if the merger or acquisition had not occurred. In determining the total protection limit of the affected depositor, the Board will combine the separate coverage at each of the merging Scheme members, which is the lower of the standard protection limit and insured deposits, at the time of merger or acquisition, with the combined coverage subject to a minimum equal to the standard protection limit[15] (see **Example**).

[15] For this purpose, the consolidated Scheme member will be required to maintain related deposit records and information of all relevant Scheme member(s) as at the date of merger or acquisition, so that the Board can calculate the additional coverage and hence the compensation amount if needed.

72. Some jurisdictions like Canada and Malaysia specify that the additional coverage will be reduced by subsequent withdrawals of deposits, while Singapore and FIRO arrangements allow it to remain in force irrespective of any subsequent changes in the deposit balance during the grace period. As the enhanced arrangements are only temporary in nature, the Board considers it appropriate to keep the additional coverage unchanged throughout the grace period to avoid confusion to depositors and to minimise the administrative burden on the Scheme members concerned, thereby enabling a faster payout if needed.

Duration of enhanced coverage

73. With reference to practices adopted by the US and the arrangements under FIRO, the Board recommends the grace period of the separate coverage be set at six months from the date of merger or acquisition or, in the case of a time deposit maturing after the end of the six-month period, until its original maturity date. Where a term deposit matures within the six months and is renewed with the relevant Scheme member, the additional coverage will continue to apply only up to the end of the original six-month grace period.

74. While the IADI has not prescribed the duration of the enhanced coverage, its Handbook[16] points out that the longer the time period, the more the purposes of limited coverage will be undermined. Given the availability of various banking channels in Hong Kong, such as physical branches, online banking and mobile banking, the proposed six-month period is considered sufficient for depositors to manage their deposit portfolios.

Notification

75. According to the IADI's Core Principles, merging banks must be responsible for notifying the affected depositors, including informing them of the date on which the separate coverage will expire. The Board therefore recommends that Scheme members involved in a merger or acquisition should notify affected depositors of the arrangements including the continued separate coverage arrangements and duration (e.g. via the website of the Scheme members involved, major newspapers or by other means which the Board considers appropriate), as soon as practicable after obtaining relevant approval of the merger or otherwise.

[16] Handbook for the Assessment of Compliance with the Core Principles for Effective Deposit Insurance Systems (2016) (https://www.iadi.org/en/assets/File/Core%20Principles/IADI_CP_Assessment_Handbook_FINAL_14May2016.pdf)

76. Scheme members concerned should also inform the Board of any transfer of deposits in a merger or acquisition as soon as practicable so that the Board can get prepared for the corresponding arrangements and any enquiries from the public.

<u>Example:</u> Illustration of depositor protection in the event of a bank merger

This scenario assumes Bank A will merge with Bank B, and all deposits in Bank A will be transferred to Bank B on the date of merger. The standard protection limit is assumed to be HK$800,000 per depositor per bank as proposed in Chapter 2 of this consultation paper.

(a) If a depositor has HK$800,000 at Bank A and HK$800,000 at Bank B, the depositor will be entitled to a maximum compensation of HK$1.6 million at the consolidated Bank B.

(b) If another depositor has HK$500,000 at Bank A and HK$500,000 at Bank B, the depositor will be entitled to a maximum compensation of HK$1 million at the consolidated Bank B.

For cases above, the latest protection limit is the sum of the lower of the standard protection limit and insured deposits at each bank originally[17]. The depositors can effectively enjoy the same protection as before the merger. The enhanced protection limit will remain in place for a grace period of six months, irrespective of any changes in the depositors' total deposit balance during that time. After the grace period expires, the maximum protection available at the consolidated Bank B for each of the depositors will revert to HK$800,000.

[17] In case there is another depositor who has HK$100,000 at Bank A and HK$200,000 at Bank B, the sum of the lower of the standard protection limit and insured deposits at each bank originally would be HK$300,000 only, lower than the standard protection limit. In that case, the depositor will be entitled to the standard protection limit of HK$800,000 at the consolidated Bank B, same as other unaffected depositors.

Question 3:

Do you support the proposal to introduce enhanced arrangements for depositor protection for a limited period of time in the event of a bank merger? If so, do you agree with the proposed key features of the enhanced arrangements?

CHAPTER 5

REPRESENTATION REGIME

77. Under the Deposit Protection Scheme (Representation on Scheme Membership and Protection of Financial Products under Scheme) Rules (Representation Rules) (Cap. 581A), Scheme members are required to make representations regarding their DPS membership status and the protection status of their financial products. For non-protected deposits, a Scheme member is required to make a negative disclosure and obtain the customer's acknowledgement before each transaction of non-protected deposits. A Scheme member is also required to make a one-off positive disclosure as to which deposits qualify for protection under the DPS before opening an account for a customer.

78. The objective of the Representation Rules is to assist members of the public to readily ascertain the DPS membership status of a bank and distinguish between DPS-protected and non-DPS-protected financial products, so that they can make an informed decision in selecting financial products suitable for them.

79. Since the last enhancement to the Representation Rules in 2011, the operating environment of the banking sector has undergone significant changes. The Board considers that it is time to review the representation regime in Hong Kong holistically and to look into the current practices of other major jurisdictions, to make sure the representation requirements remain appropriate and keep pace with the latest market developments.

80. Based on the findings of the review, the Board is of the view that the positive disclosure requirement remains appropriate, as similar requirements are observed in other major jurisdictions and the overall compliance of Scheme members with this requirement has been satisfactory generally. However, the Board considers that there is scope for enhancement to the display of the DPS membership sign, and to the negative disclosure requirements.

Requirements on display of DPS membership sign

81. Section 3 of the Representation Rules requires Scheme members to display the DPS membership sign, in accordance with the format prescribed in the Representation Rules, at their relevant places of business where they conduct banking business and to which members of the public ordinarily have physical access for carrying out banking transactions. The sign, reproduced below, should be displayed in such a manner that is clearly visible to customers entering the Scheme member's place of business, such

as the customer entrance.

82. The Representation Rules do not oblige a Scheme member to display a DPS membership sign on digital channels, such as its website or mobile app, unless it shares a website with a company which is not a Scheme member and the website contains information that the Scheme member is a member of the DPS or its deposits are protected by the DPS, in which case the Scheme member is required to display the membership sign on the website in such a manner that a person would not be under the impression that the non-DPS-member institution is also a Scheme member.

83. In recent years, digital channels have become key to delivering banking services, and this trend has accelerated during the pandemic. For example, personal accounts opened via digital channels accounted for 46% of all new personal accounts opened in retail banks in the first half of 2022. Moreover, virtual banks (VBs) had opened more than 1.8 million accounts for customers by the end of 2022 since they commenced operation in 2020 in Hong Kong. In other words, website and mobile app have effectively become important places of business in electronic form for Scheme members.

84. However, since Scheme members currently have the discretion to consider whether and how to display a membership sign on digital channels, inconsistent practices have been observed among some Scheme members, which may confuse the public as to the DPS membership status of certain banks, especially VBs which do not have physical branches and primarily provide banking services through digital channels. In view of the risk that any misunderstanding among the public may undermine the effectiveness of the DPS, especially in times of crisis, the Board **proposes** that Scheme members be required to display the DPS membership sign on their digital channels, in addition to their physical branches. The proposed arrangement is expected to help enhance the public confidence in Scheme members, thus benefitting both depositors and the banking industry at large.

85. Specifically, having regard to the practices of jurisdictions including Canada, Malaysia and the UK, which have put in place similar requirements, as well

as the Code of Banking Practice in Hong Kong, the Board **proposes** that a Scheme member should display the DPS membership sign prominently on the following pages of its digital channels in respect of its banking business in Hong Kong, with the accompanying hyperlink to the home page of the DPS website:

- the home pages of the Scheme member's website and principal Internet banking platform(s)[18]; and
- the page that appears immediately after logging on to online banking or mobile banking for operating a bank account with the Scheme member.

86. The home page and the page following the customer login are similar to the customer entrance to a physical branch. Therefore, the new requirement is proposed to apply to these two pages only, leaving Scheme members an option on whether to display the membership sign on other pages of its website and principal Internet banking platform(s) as well[19]. In terms of the size of the membership sign, it will be difficult to specify a display requirement on digital channels, and therefore the general principle is that the membership sign should be shown prominently on the relevant pages, and contain a hyperlink to the DPS website so that a customer can know more details about the DPS by clicking on the logo.

87. This new requirement will also apply to the case where a Scheme member shares its website or principal Internet banking platform(s) with another entity. In such a scenario, the membership sign should be displayed in such a manner that any person accessing the website or the principal Internet banking platform(s) should reasonably be aware that the Scheme member, but not any other entity, is a member of the Scheme.

[18] Principal Internet banking platform generally refers to a platform operated by a Scheme member to which customers have access for carrying out online or mobile banking business, e.g. fund transfers, deposit-taking, etc., via the Internet across electronic devices including computers and mobile phones.

[19] Currently, under section 4 of the Representation Rules, a Scheme member which displays the membership sign on its digital channels may be required to include a statement that it is a member of the DPS and eligible deposits taken by it are protected by the DPS up to a limit of HK$500,000 per depositor. Considering that the membership sign already contains the same information as that required under section 4 of the Rules, the Board will review the relevant provisions to avoid unnecessary duplication of the information.

> ***Question 4:***
>
> *Do you support the proposal to require Scheme members to display the DPS membership sign on their digital channels in addition to their physical branches? If so, do you agree with the specific proposed arrangements?*

Negative disclosure requirements

88. Section 6A(3) of the Representation Rules requires Scheme members to make a negative disclosure and to obtain an acknowledgement from the customer before completing each transaction of a non-protected financial product that has been described as a "deposit" in any advertisement, promotional material or document.

89. A streamlined process, however, is allowed under certain circumstances, whereby the negative disclosure and customer's acknowledgement can be made and obtained on a one-off basis rather than on a transactional basis. Among other circumstances, Scheme members may apply this streamlined treatment when they enter into non-protected deposit transactions with institutional customers, because institutional customers are generally in a better position than retail depositors to understand the risks of their investments, including bank deposits.

90. In recent years, some private banks have suggested streamlining the negative disclosure requirements for their private banking customers (PB customers)[20] to bring them in line with the treatment for institutional customers. They indicated that PB customers frequently enter into non-protected deposit transactions. Many of them find it unnecessary to listen to or acknowledge the same disclosure before each transaction, especially given that they generally have richer investment knowledge and experience and hence have a better understanding of the risks of their investments as compared with ordinary retail depositors.

91. The Board has also reviewed the disclosure requirements of other major jurisdictions. The findings suggest that while many jurisdictions such as the UK and the US require negative disclosures on non-protected deposit products, they only require such disclosure to be made on a one-off basis when opening an account. Some other jurisdictions do not even require negative disclosure. Such differences may risk undermining Hong Kong's status as a regional asset and wealth management hub in the long run.

[20] PB customers refer to the customers of a private bank or the dedicated private banking unit of a bank.

92. Having regard to the above factors, the Board considers it appropriate to introduce flexibility in the negative disclosure regime to ensure the relevant requirements in Hong Kong are proportionate and commensurate with the sophistication level and investment experience of PB customers. Specifically, given the similarity between PB customers and institutional customers, the Board **proposes** that PB customers be treated in the same way as institutional customers in terms of negative disclosure requirements, so a Scheme member may choose to apply the streamlined approach as follows when dealing with a PB customer on a deposit product not protected by the DPS:

- make a one-off negative disclosure, meaning that a disclosure is not required if the Scheme member has previously made a negative disclosure and obtained an acknowledgement from the PB customer for the same product invested under the same account; and
- provide an annual reminder to the PB customer that the product is not protected by the DPS.

93. For the avoidance of doubt, no change is proposed to the transaction-based negative disclosure regime for ordinary retail customers, considering that they are generally less sophisticated than PB customers and should therefore continue to receive an appropriate degree of protection.

Question 5:

Do you support the proposal to treat PB customers in the same way as institutional customers in terms of the negative disclosure requirements?

SUMMARY OF MAJOR PROPOSALS