

# **Hong Kong Deposit Protection Board**

## **Report on the public consultation on the first phase of the review of the Deposit Protection Scheme**

### **Questions and Answers**

#### **A. General Issues**

*Q1. What were the responses to the consultation?*

A1. During the two-month consultation period, the Board received over 800 comments from the general public. Comments were also received from key stakeholder groups, including the industry, professional bodies, consumer interest groups, academics and the legislature. The keen responses indicate that the consultation has achieved its objective of triggering extensive community discussion on the subject.

*Q2. What was the overall response to the recommendations?*

A2. In general, the consultation concluded that there was broad public support for the Board's recommendations.

*Q3. How is the Board going to take forward the recommendations concluded in the consultation?*

A3. Save for the further discussions with the industry required to finalise the adjustments to be made to the DPS charging scheme, the Board will proceed with the development of the legislative amendments to raise the DPS protection limit, extend its coverage to include secured deposits and effect corresponding changes to the priority claim for depositors under the Companies Ordinance (CO).

*Q4. When will the recommendations concluded from the consultation take effect?*

A4. The Board intends to submit the legislative proposals on the recommendations to the Legislative Council in the first quarter of 2010. The Board intends to introduce the enhancements as soon as possible, preferably before the end of 2010, so that the public will benefit from an enhanced DPS when the full deposit guarantee of the Government expires.

## **B. Protection Limit**

*Q5. What were the responses to the recommendation on raising the DPS protection limit to HK\$500,000?*

A5. The public and the major stakeholder groups generally agreed that there is a need to raise the protection limit of the DPS.

The proposed limit of HK\$500,000 was endorsed by the major stakeholder groups consulted, including the banking industry and the Consumer Council. The higher level of protection was generally welcomed by the public, though many indicated a wish to raise the limit even above HK\$500,000 or remove the cap entirely. Nevertheless, about 80% of the respondents to the opinion survey found the proposed limit acceptable.

Some academics suggested that the limit should be set at a level below HK\$500,000 to mitigate cost and moral hazard. Some suggested raising the limit further and controlling the increased moral hazard by providing protection on a partial basis.

*Q6. Why does the Board think it not appropriate to raise the limit above HK\$500,000?*

A6. Raising the protection limit above HK\$500,000 will result in a disproportionately higher cost and higher moral hazard.

*Q7. Why does the Board think the cost and moral hazard under the proposed limit of HK\$500,000 are manageable?*

A7. As the limit proposed by the Board is generally in line with the level of protection available in other major countries, the Board believes that the moral hazard accompanying the limit should be manageable given the robust prudential banking regulation and supervision in place in Hong Kong. At the same time, cost mitigating measures will be implemented to alleviate the cost impact of raising the limit.

*Q8. Why does the Board think it not appropriate to provide partial protection to deposits?*

A8. The reform experience in the UK after the Northern Rock incident indicates that, although the co-insurance element under the partial protection arrangement may help mitigate moral hazard, it is not helpful in preventing rumour-driven bank runs.

### **C. Compensation Calculation Basis**

*Q9. What were the responses to the recommendation on keeping the basis for compensation calculation unchanged?*

A9. Most of the comments received were supportive of the recommendation. Nevertheless, the Board was reminded to continue monitoring international developments in this area.

### **D. Product Coverage**

*Q10. What were the responses to the recommendation on protecting secured deposits?*

A10. The public and the major stakeholder groups consulted were generally supportive of the recommendation as it is expected to enhance clarity and thus the effectiveness of the DPS.

As expected, some members of the public wished the coverage of the DPS can be expanded further to cover non-protected deposits or even non-deposit investments.

The Board were reminded by legal and accounting professionals on the potential complexity of defining secured deposits for conferring protection and the importance of preserving consistence of the meaning of deposit in the various ordinances sharing the definition.

*Q11. What were the responses to the recommendation on not protecting structured deposits?*

A11. The recommendation was supported by major stakeholder groups, though the Board was reminded to continue monitoring the popularity of such deposits among small depositors and assessing the need to bring them under the protection of the DPS. Some members of the public wished structured deposits can be protected. Nevertheless, over half of the respondents to the opinion survey found it acceptable not protecting structured deposits at this stage.

*Q.12 Why does the Board think it not appropriate to protect non-protected deposits?*

Q.12 As the non-protected deposits are not common among small depositors, protecting them will add little to the effectiveness of the DPS but would require making changes not only to the DPS but also to the

priority claim for depositors under the CO. The Board therefore does not see any merit in bringing them under the protection of the DPS at this stage.

Nevertheless, the Board will continue to monitor the popularity of such deposits, especially among small depositors, to assess whether it is necessary to review their protection status.

*Q13. Why does the Board think it not appropriate for the DPS to protect non-deposit investments?*

A13. The protection of non-deposit investments is not consistent with the objective and mandate of the DPS of protecting small and unsophisticated depositors. It is uncommon for deposit insurance schemes in other countries to cover investment products other than deposits. Investors are usually covered by other types of compensation schemes.

#### **E. Types of Institution Covered**

*Q14. What were the responses to the recommendation on not protecting deposits at RLBs and DTCs?*

A14. Except for the DTC Association, the public and the other stakeholder groups were generally supportive of the continued exclusion of RLBs and DTCs from DPS membership. Nevertheless, the Board was requested to review the issue in the light of the results of the HKMA's review of the three-tier authorization system.

The DTC Association requested to allow those of its members that could demonstrate the use of deposits in the normal course of banking business to join the DPS.

*Q15. Why does the Board think it not appropriate to extend the coverage of the DPS to include deposits at RLBs and DTCs, and deposits at credit unions?*

A15. As RLBs and DTCs cannot take deposits of less than HK\$500,000 and HK\$100,000 respectively, very few of their depositors will become fully protected even after the DPS protection limit is raised to HK\$500,000. Protecting deposits held with them will not be helpful in preventing rumour-driven run on them.

Credit unions in Hong Kong are not part of the banking system and,

unlike some of their counterparts in other countries, are not subject to prudential regulation and supervision. The Board does not see any merit, in terms of enhancing banking stability, in bringing them under the protection of the DPS.

## **F. Funding Arrangements**

*Q16. What were the responses to the cost mitigating measures for relieving the financial burden on banks due to the implementation of the enhancements?*

A16. Few comments were received from the general public, possibly because the issue is more technical in nature. The banking industry appreciated the Board's intention to relieve financial burden on banks, but indicated that the premium rates should be reduced by 75%, instead of 50% as proposed by the Board, in order to fully offset the cost impact of implementing the enhancements.

There were concerns about the impact of the reduction in the premium rates and the deferral of the DPS Fund achieving its target fund size on the effectiveness of the DPS, the potential confusion caused by the option of allowing banks to report protected deposits on a net deposit basis for contribution assessment, and the fairness of the arrangement to banks less capable of performing netting.

*Q17. Is the Board going to concede to the request of the industry and cut the premium rates by 75%?*

A17. The Board is mindful of the impact of the costs on banks and that these costs, if substantial, may increase the likelihood of the cost of protection being passed on to depositors. If it turns out that the actual costs due to the enhancements will be more significant than expected, the Board is prepared to explore with the industry ways to further contain the cost impact, subject to the condition that the accumulation of the capital required for backing the DPS will not be unduly delayed.

*Q18. Will the reduction of premium rates and deferral of the DPS Fund achieving its target fund size have an adverse impact on the overall effectiveness of the DPS?*

A18. The target size of the DPS Fund is estimated to grow to HK\$2.8 billion in absolute terms due to a larger base of protected deposits under the higher protection limit of HK\$500,000. In terms of effectiveness, it will deliver the same level of capital adequacy for meeting payout

expenses under the higher protection limit.

Nevertheless, the Board is fully aware that a prolonged time frame for the completion of the accumulation of the required capital in the DPS Fund can erode confidence in the DPS.

*Q19. Will the option of reporting protected deposits on a net deposit basis be unfair to banks less capable of netting? How to avoid any possible confusion?*

A19. As the arrangement for reporting protected deposits on a net deposit basis is an option rather than a mandatory requirement, Scheme members finding it not economical to perform netting can stay with the existing gross reporting approach. Clear guidance will be given to Scheme members to avoid confusion in adopting the net approach.

#### **G. Other Comments**

*A20. How is the Board going to address the Consumer Council's concern about the confusion caused by banks using the name "structured deposits" for protected deposits?*

A20. The Board shares the Council's views that the representation arrangements for structured deposits should be enhanced. Separate recommendations will be made by the Board in the second phase of the review to address the issue.

*A21. How will the Board draw to the attention of the public that RLBs and DTCs will not come under the protection of the DPS after the full deposit guarantee expires?*

A21. The issue will be appropriately highlighted in the Board's publicity campaign for explaining the changes to the DPS.

Hong Kong Deposit Protection Board  
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