

Hong Kong Deposit Protection Board

Consultation paper on the second phase of the review of the Deposit Protection Scheme

Questions and Answers

A. General Issues

Q1. Why did the Board divide the review into two phases?

A1. The items under review carry different degrees of complexity and may require different amounts of time for consultation. Priority was given to handling those items more fundamental to the effectiveness and efficiency of the DPS in the first phase to ensure that their implementations will not be delayed due to the need to cover all items at the same time.

Q2. What does the second phase of the review cover?

A2. The second phase of the review covers mainly technical amendments for improving payout efficiency and transparency of the coverage of the DPS.

Q3. When will the changes proposed in the second phase of the review take effect?

A3. Subject to the progress of the consultation, the Board intends to introduce the enhancements identified in the second phase of the review together with those concluded in the first phase, preferably before the end of 2010, so that the public will benefit from an enhanced DPS when the full deposit guarantee offered by the Government expires.

Q4. What are the major enhancements recommended in the consultation paper on the second phase of the review?

A4. The recommendations identified in the second phase of the review mainly comprise enhancements for:

- improving payout efficiency by streamlining the processes for determining compensation; and
- enhancing transparency of the coverage of the DPS by

strengthening the representation regime of the DPS.

Q5. How would the Board engage the public in the consultation?

A5. A publicity campaign will be launched to draw public attention to the consultation exercise and the channels for providing their comments. The Board will also actively engage interested and concerned parties and listen to their views on the issues covered by the consultation.

B. Processes for determining compensation

Q6. What are the enhancements that the Board suggests to make to processes for determining compensation?

A6. The enhancements include:

- i. allowing Board members outside Hong Kong to participate in Board meetings through electronic means;
- ii. giving powers to the Board to determine the amount of accrued interest on a deposit or customer liability and the value of an annuity, or future or contingent liability of a depositor if the Board considers there is uncertainty as to the amount or value, or ascertaining the amount or value can unduly delay payment of compensation ; and
- iii. articulating the Board's power to apply differential treatment to different classes of depositors when making interim payments.

Q7. Why does the Board recommend allowing Board members outside Hong Kong to participate in Board meetings through electronic means?

A7. Currently, only Board members in Hong Kong will be counted in the quorum for passing resolutions of the Board. Allowing members outside Hong Kong to participate in meetings can better ensure the Board can attend to and pass resolutions on highly time critical issues in a payout in an expeditious manner.

Q8. Why does the Board recommend giving it the power to determine the amount of accrued interest on a deposit or liability of a depositor under special circumstances?

A8. This is to ensure that payment of compensation to depositors will not

be unduly delayed due to the need to accurately ascertain the amount of accrued interest on products with a complex interest accrual pattern.

Q9. How will the Board determine the amount of accrued interest on deposits and customer liabilities with a complex interest accrual pattern under the special circumstances?

A9. As accrued interest normally accounts for only a small portion of the compensation entitlement of a depositor, the Board will adopt a “best rate” approach that marginally overestimates compensation due to accrued interest in order to eliminate any potential for residual claims. The slightly overestimated amount of compensation should be justifiable when compared to the cost of performing precise interest calculation or the cost to be incurred in handling residual claims.

Q10. Why does the Board recommend giving it the power to determine the value of an annuity, or future or contingent liability of a depositor under special circumstances?

A10. This is to ensure that payment of compensation to depositors will not be unduly delayed due to the need to accurately ascertain the value of annuities or future or contingent liabilities involving a complex valuation methodology.

Q11. How will the Board determine the value of annuities or future or contingent liabilities under the special circumstances?

A11. As the amount of liabilities deductible from the protected deposits of a depositor arising from annuities or future or contingent liabilities can significantly affect compensation entitlement, the Board will tilt to the conservative side to avoid underestimating the liabilities, and, hence, overestimating compensation entitlement. Depositors will still be entitled to compensation in liquidation in respect of the portion of priority claim in excess of the amount paid by the Board.

Q12. Why is it desirable for the Board to apply differential treatment to different classes of depositors when making interim payment?

A12. If the Board can fully pay off depositors with a small deposit balance at the interim payment stage, subsequent payout processes can be greatly simplified and payout costs can be greatly reduced due to a significant reduction in the number of depositors to attend to.

The recommendation of the Board mainly serves to articulate the power of the Board more clearly in the DPS Ordinance (DPSO).

C. Representation arrangements

Q13. What are the enhancements that the Board suggests to make to representation regime of the DPS?

A13. The enhancements include:

- i. requiring Scheme members to make negative disclosures and obtain customer acknowledgements on a transaction basis, except for automatic rollovers;
- ii. requiring Scheme members to make positive disclosures on the protection status of their deposits and respond to depositors' requests for positive disclosure within specified timeframes and in specified manners;
- iii. requiring Scheme members to meet certain standards in terms of size and location of disclosures to make them more easily noticeable by depositors; and
- iv. prohibiting Scheme members from calling financial products not meeting the definition of structured deposit in the DPSO a structured deposit.

Q14. Why does the Board recommend requiring Scheme members to make negative disclosures and obtain customer acknowledgements on a transaction basis?

A14. This is to avoid non-protected deposits from being mistaken as protected deposits because depositors fail to recall the one-off negative disclosures made by Scheme members when depositors opened the accounts for investing in the non-protected deposits.

Q15. Why does the Board recommend requiring Scheme members to make positive disclosures on the protection status of their deposits?

A15. This is to address the clear public preference for receiving positive disclosures. Formalising and standardising the positive disclosure regime will also help provide better guidance to Scheme members and promote acceptance of depositors.

Q16. Why does the Board recommend measures for increasing the prominence of the disclosure statements?

A16. This is to make the disclosures more legible and easily noticeable by

depositors.

Q17. Why does the Board recommend prohibiting Scheme members from calling financial products not meeting the definition of structured deposit in the DPSO a structured deposit?

A17. This is to eliminate the confusion caused by protected deposits being named as a structured deposit by banks. If the phenomenon becomes more pervasive, it will seriously dampen the signaling effect of the term “structured deposit” in helping depositors to identify non-protected deposits and erode confidence in the representation regime of the DPS.

Q18. What are the major differences between the existing and the revised representation regime after the recommendations are effected?

A18. The major differences between the existing and the revised representation regime are summarized in the following table:

	Existing Regime	Revised regime
Negative disclosures	<ul style="list-style-type: none">• One-off disclosure and acknowledgement on an account basis, or disclosure and acknowledgement on a transaction basis	<ul style="list-style-type: none">• Disclosure and acknowledgement on a transaction basis only
Positive disclosures	<ul style="list-style-type: none">• Not a mandatory requirement	<ul style="list-style-type: none">• One-off disclosure on an account basis, or disclosure on a transaction basis• Disclosures in response to depositors’ requests should be made within specified timeframes and in specified manners
Size and location of negative and positive disclosures	<ul style="list-style-type: none">• Determined by banks	<ul style="list-style-type: none">• Disclosure statements should be in print at least as large as other text in the document• Disclosures must be covered under a separate chapter or section, and with appropriate index key, where appropriate

	Existing Regime	Revised regime
Use of the term “structured deposit” by banks	<ul style="list-style-type: none"> • No restriction 	<ul style="list-style-type: none"> • Can describe a financial product as a structured deposit only if it fits the definition in the DPS Ordinance

Hong Kong Deposit Protection Board
August 2009