



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

17 September 2014

Our Ref: D1/1C

The Chief Executive
All Scheme Members

Dear Sir/Madam,

Compliance with the Representation Rules – Issues and Good Practices

This circular shares with member institutions of the Deposit Protection Scheme (“Scheme members”) some common issues and good practices in relation to representations about the protection status of deposits identified during compliance reviews and on-site examinations.

The Deposit Protection Scheme (Representation on Scheme Membership and Protection of Financial Products under Scheme) Rules (“the Representation Rules”) govern representations made by Scheme members about their membership and the protection status of the financial products offered by them. In order to monitor the compliance of Scheme members with the Representation Rules, Scheme members are required to conduct a self-assessment review on an annual basis. This is supplemented by on-site examinations carried out by the Hong Kong Monetary Authority to ascertain the level of Scheme members’ compliance with the Representation Rules.

While it is observed that Scheme members in general have put in place policies and procedures to ensure compliance with the Representation Rules, some common issues and good practices identified from the assessments and examinations, warrant greater attention by Scheme members. The details are set out in Annex. Scheme members should take note of the issues highlighted and review and strengthen their existing controls to ensure compliance with the representation requirements. Scheme members are also strongly encouraged to adopt the good practices highlighted, where applicable.

Non-compliance with the requirements in the Representation Rules may expose Scheme members to legal as well as reputational risks and could lead to prosecution under section 51 of the Deposit Protection Scheme Ordinance. The Hong Kong Deposit Protection Board (“the Board”) will continue to monitor Scheme members’ compliance with the representation requirements and take appropriate actions against those found in breach of such requirements.

Should you have any questions on this circular, please contact Ms Eve Law at 2878 1197 or Ms Kennis Hui at 2878 1320.

Yours faithfully,

(Meena Datwani)
Chief Executive Officer

Encl.

Compliance with the Representation Rules - Issues and Good Practices

Negative disclosure as to financial products not protected by the Deposit Protection Scheme (“DPS”)

Issues

- Some Scheme members wrongly assumed that the negative disclosure requirements for non-protected deposits were not applicable to private banking customers whom the Scheme members classified as professional investors.
- Some Scheme members wrongly considered that deposits taken by their staff members for placement with overseas branches (i.e. offshore deposits) were not subject to the Representation Rules. Similarly, some Scheme members mistakenly thought that the representation requirements could be waived for financial products (e.g. certificates of deposits (“CDs”)) issued by third parties (e.g. their overseas affiliates).
- Some Scheme members relied on monthly statements to satisfy the requirement that a written reminder should be sent to customers shortly before or within seven business days after a telephone transaction has taken place to remind the customers of the non-protection status of the products. However, in some cases, the monthly statements were issued more than seven business days from the transactions. In addition, in some cases, the products in question matured before issuance of the monthly statements and therefore the required disclosure was not met.
- Scheme members are allowed under the Representation Rules to rely on a negative disclosure made in the first of a series of automatic rollover deposit transactions to avoid repeating the same disclosure prior to the same (rollover) transactions in that series. However, some Scheme members failed to properly document the disclosure made in the first transaction, casting doubt on their compliance with the requirements.

Expected standards by the Board

Negative disclosure and customers' acknowledgements should be made and obtained before each transaction of non-protected deposits unless the exemption requirements under sections 6B-6D of the Representation Rules can be satisfied. The DPS negative disclosure given to customers must be acknowledged by customers in writing

or by the means by which the notice was given. Where a negative disclosure and the corresponding acknowledgement is made through telephone, Scheme members should take further steps to remind the customers in writing about the non-protection status of the deposit shortly before or within seven business days after the transaction takes place. Proper documentation to evidence the appropriate applicability of the exemption requirements under sections 6B-6D of the Representation Rules should be kept.

Good practices

Examples of good practices include:

- The Scheme members' policies and procedures prohibit the execution of non-protected deposit transactions if a staff member does not make the negative disclosure and / or obtain the customer's acknowledgement before a transaction. The control is carried out by middle office which is independent from the frontline staff.
- Negative disclosure and acknowledgements are incorporated into appropriate documentation (e.g. product order forms) to reduce the possibility of staff oversight in making the negative disclosure and obtaining customers' acknowledgements before transactions. Where a negative disclosure and the corresponding acknowledgement is made through telephone, written reminders on the non-protection status of the relevant financial products are printed on transaction / confirmation advices to ensure compliance with the representation requirements within the specified timeframe.
- A detailed sales script facilitates the frontline staff to make negative disclosure of non-protected deposit transactions and obtain customer's acknowledgement. Acknowledgement of the DPS negative disclosure is separate from other risk disclosures and specific enough to ensure that the customer concerned understands that a non-protected financial product is not protected by the DPS.

Positive disclosure as to deposits protected by the DPS

Issues

- Some Scheme members wrongly considered that the provision of an information leaflet issued by the Board to customers or a generic statement (e.g. “certain deposits are protected by the DPS”) was sufficient to comply with the positive disclosure requirement under the Representation Rules.

- Some Scheme members relied on other parties (e.g. overseas branches which collected account opening documents of customers for Hong Kong office) to make positive disclosure to customers without actively monitoring compliance with the Representation Rules. As a result, some customers were not notified that their deposits were protected by the DPS.

Expected standards by the Board

The depositor receiving the positive disclosure must be able to associate, based on the information in the disclosure, that the subject deposit is protected by the DPS. Where a Scheme member relies on other parties to make the positive disclosure, it should establish adequate controls to ensure that the disclosures are properly made in accordance with the representation requirements.

Good practices

Some Scheme members have incorporated the positive disclosure requirements in their relevant documentation (e.g. account opening documents or deposit confirmation advices) to avoid any possible oversight and provide proper audit trail.

Membership representation

Issues

- Some Scheme members only displayed their DPS membership signs at their official websites without including the full details of the DPS membership and scope of deposit protection. Similarly, a few Scheme members only mentioned that they were members of the DPS in some of their advertisements and promotional materials but failed to make full disclosure of their DPS membership and scope of deposit protection in accordance with the representation requirements.
- Some Scheme members solely relied on external service providers to replace or maintain the DPS membership sign without sufficient monitoring. Hence, they wrongly displayed a membership sign with reference to outdated deposit protection limit or omitted to display a membership sign after completion of branch renovation / relocation. Sometimes, the DPS membership sign was not reasonably visible to persons entering the branch or office. Some Scheme members included unofficial names (e.g. non-registered Chinese names) in the DPS membership sign.

Expected standards by the Board

- Scheme members are not obliged to display a DPS membership sign or mention that they are DPS members in their official websites, advertisements or promotional materials. However, if a Scheme member chooses to do so, full disclosure in respect of its DPS membership and scope of deposit protection should be made to avoid any possible confusion to its customers or the general public. Any marketing information containing outdated information relating to the DPS should be completely removed from Scheme members' websites.
- The DPS membership sign should always be displayed at the relevant place of business to which customers ordinarily have physical access for carrying out banking transactions. The sign should be in accordance with the specifications (e.g. style, content and margins) set out in the DPS Membership Sign Guideline and the full name of the Scheme member should be displayed on the sign. In case external service providers are engaged in handling the DPS membership signs, proper monitoring should be exercised.

Policies and procedures

Issues

- Some Scheme members overlooked the applicability of the DPS representation requirements when introducing new business activities (e.g. launch of a new deposit product, setting up of a new business unit which takes deposits, and migration of deposit accounts from an overseas branch to a Hong Kong branch) and therefore failed to ensure compliance with the related requirements.
- Some Scheme members did not comprehensively review and update all policies and procedures in relation to compliance with the DPS representation requirements on a regular basis. Hence, outdated information (e.g. reference to the deposit guarantee provided by the Exchange Fund from Oct 2008 to end-Dec 2010) was referred to in the Scheme members' policies and procedures and even disseminated to bank customers.

Expected standards by the Board

Scheme members should give due consideration to compliance with the DPS representation requirements before launching any new products or business activities. The relevant policies and procedures should be formally documented. These should

be reviewed from time to time to ensure consistency with the latest requirements. These reviews should also cover the disclosure documentation to bank customers (e.g. terms and conditions and disclosure notice, etc.) to ensure that the communication to bank customers is accurate.

Good practices

Examples of good practices include:

- A standardised checklist endorsed by the senior management or the Compliance Department is prepared to facilitate an assessment of the new business activity and to identify the applicable DPS representation requirements which the Scheme member should comply with.
- The policies and procedures are established on a firm-wide basis to help ensure consistency and completeness in making the DPS disclosure and handling customer enquiries.

Training for staff

Issues

- Some staff members did not fully understand the DPS representation requirements. For example, some frontline staff members were not aware that they were required to respond to customers' enquiries on the protection status of a deposit within a specified timeframe. Some wrongly thought that negative disclosure requirement could be waived after obtaining consent from the customers concerned.

Expected standards by the Board

Scheme members should ensure that their staff are fully aware of and understand their duty in relation to compliance with the DPS representation requirements. Adequate training and guidance should be provided to the relevant staff on the details of the requirements and refresher training should be provided from time to time.

Monitoring and review mechanism

Issues

- A few Scheme members did not implement any monitoring mechanism (e.g. regular test checks of transactions) to ascertain compliance with the DPS

representation requirements by their staff. In other instances, the monitoring process adopted by some Scheme members was not effective due to inappropriate allocation of responsibility, sample size, monitoring frequency or reporting arrangements.

- Some Scheme members did not adopt a reliable source of information to assess the level of compliance with the DPS representation requirements (e.g. check on call reports instead of voice record). Mistakes in these indirect records were also found which casted doubt on the reliability and accuracy of the records.

Expected standards by the Board

Scheme members should adopt a sound and independent monitoring process, managed by parties other than the frontline staff, to ensure that any non-compliance can be identified and reported in a timely manner to the appropriate manager. When non-compliance is identified, Scheme members should take appropriate remedial actions and assess the number of depositors affected, the cause of the non-compliance, the level of similar non-compliance and the impact on the interest of depositors.

Record keeping

Expected standards by the Board

Scheme members should ensure that the relevant disclosure and acknowledgements are properly documented and available for review by the Board and other regulatory bodies for assessment of the level of compliance with the DPS representation requirements. Maintenance of proper records of disclosure is particularly important in cases where Scheme members rely on certain disclosure for exempting a series of automatic rollover deposit transactions from the representation requirements.