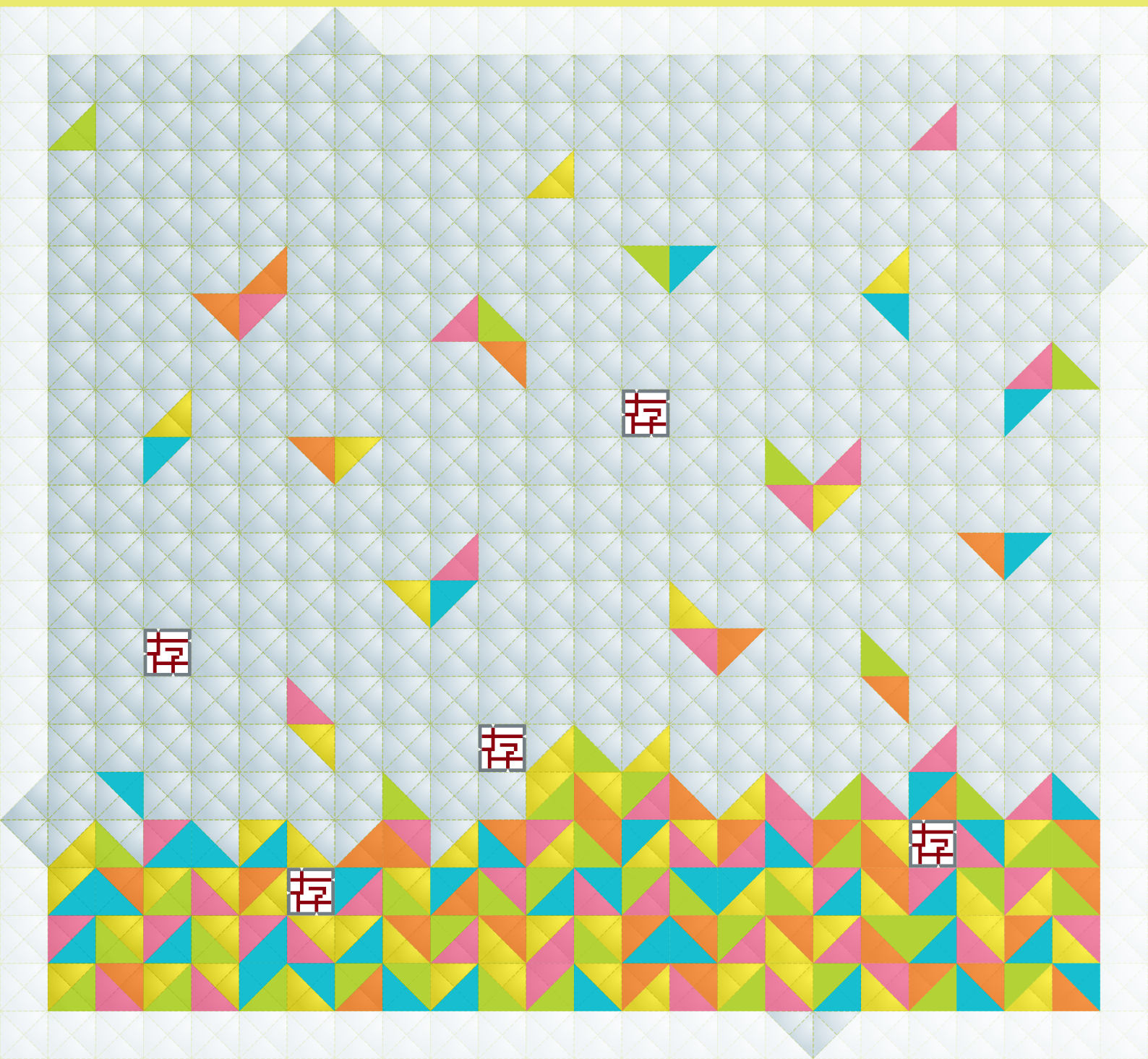


香港存款保障委員會
HONG KONG DEPOSIT
PROTECTION BOARD

ANNUAL REPORT 2011-2012



The Hong Kong Deposit Protection Board (the Board) is a statutory body established under the Deposit Protection Scheme Ordinance to oversee the operation of the Deposit Protection Scheme. The Scheme is designed to protect depositors and to help maintain the stability of Hong Kong's banking system.

The Board's mission is to maintain an efficient and effective deposit protection scheme in accordance with the Ordinance and in line with international best practice.

**Hong Kong Deposit
Protection Board**

78th Floor, Two International Finance Centre,
8 Finance Street,
Central,
Hong Kong
Telephone: (852) 1831 831
Facsimile: (852) 2290 5168
E-mail: dps_enquiry@dps.org.hk
Website: www.dps.org.hk

CONTENTS

2	Deposit Protection Scheme at a glance
3	Accomplishments in 2011-2012
4	Message from the Chairperson
7	Message from the Chief Executive Officer
10	About the Hong Kong Deposit Protection Board
18	Corporate governance
22	Review of operations and achievements in 2011-2012
39	Plans for 2012-2013
42	Independent auditor's report
44	Statement of accounts of the Deposit Protection Scheme Fund
63	Annex

DEPOSIT PROTECTION SCHEME AT A GLANCE

- The Deposit Protection Scheme (DPS) is a statutory scheme established to protect bank depositors. All licensed banks, unless otherwise exempted by the Board, are required to participate in the DPS as a Scheme member. All Scheme members display a membership sign prominently at their places of business.



- The DPS protects deposits up to a limit of HK\$500,000 per depositor per Scheme member.
- Depositors are not required to apply or pay for protection or compensation. Eligible deposits held with Scheme members are automatically protected by the DPS.
- Deposits denominated in Hong Kong dollar, Renminbi or any other currencies are protected. Secured deposits are also protected.
- The DPS does not protect term deposits with a maturity longer than five years, structured deposits, bearer instruments, offshore deposits and non-deposit products such as bonds, stocks, warrants, mutual funds, unit trusts and insurance policies.
- A depositor's entitlement to compensation will be calculated on a net basis, that is, the liability of the depositor to a Scheme member will be deducted from the protected deposits he or she maintains with the Scheme member in determining compensation.
- A Deposit Protection Scheme Fund (DPS Fund) is being built up through collecting contributions from Scheme members. The target fund size is 0.25% of the total amount of protected deposits held with all Scheme members, or approximately HK\$3.5 billion.
- Contributions payable by Scheme members for building up the DPS Fund are assessed on a differential premium basis. Assessment is made annually with reference to the supervisory rating of each Scheme member.

ACCOMPLISHMENTS ^{IN} 2011-2012

Towards a better deposit protection regime

- In view of the changing global financial markets, the Board closely watched the latest developments and reform experiences of other overseas deposit insurance systems to ensure the ongoing effectiveness of the DPS in Hong Kong.
- The Board actively participated in the peer review of deposit insurance systems hosted by the Financial Stability Board in contributing to the development of better international guidance on effective deposit insurance systems.

In full readiness to payout

- The Board progressively consolidated its efforts to ensure operational effectiveness and readiness to manage a payout. The payout policies and procedures were enhanced; and new guidance notes were developed for the effective exercise of the new powers given in the enhanced DPS to streamline payout efficiency.
- During the year, two payout rehearsals and a procedure walkthrough were conducted. These provided the Board members, staff and payout agents of the Board with a clear understanding of their roles and responsibilities, and the key processes on undertaking a payout.
- Determination of compensation payment for a payout is dependent on the depositor records maintained and provided by Scheme members. The Board remained vigilant in monitoring the compliance of Scheme members with the information system requirements by conducting compliance reviews and payment simulations using records submitted by Scheme members.

Increased public awareness and confidence

- The Board launched extensive publicity campaigns to promote public awareness of the DPS. In addition, targeted community outreach activities were held to enhance understanding and knowledge of the specific features of the DPS.
- A territory-wide opinion survey in December 2011 revealed that over 75% of the respondents were aware of the enhanced DPS implemented at the start of 2011. The high awareness level of the DPS is conducive to the maintenance of public confidence and contribution to banking stability.
- The Board continued to closely monitor Scheme members' compliance with the DPS representation requirements to depositors through a self-assessment exercise and on-site examinations.

Sufficiency and investment of the DPS Fund

- The Board collected HK\$330 million in contributions from Scheme members, bringing the total assets of the DPS Fund to an aggregate of HK\$1.8 billion at the end of March 2012.
- The Board secured a HK\$120 billion standby credit facility with the Exchange Fund to meet the liquidity required for payment of compensation in the event of a bank failure.
- The main investment objective of the DPS Fund is to preserve capital and ensure sufficient liquidity to meet the financial obligation of the Board. The DPS Fund achieved a positive investment return despite the highly volatile investment environment.

MESSAGE FROM THE CHAIRPERSON



Mrs CHAN WONG Shui,
Pamela, BBS, JP
Chairperson

“From scratch to fruition,
in growth and enhancement”

The Deposit Protection Scheme (DPS) celebrated its fifth anniversary in September 2011. Five years from the day of establishment on 25 September 2006, the evolvement of the DPS has endowed the Board and the general public with unprecedented experience in deposit protection.

The foremost important element of a DPS is the level of coverage provided to the general depositors. The enhanced DPS, raising the level of protection fivefold from HK\$100,000 at the inception of the scheme in 2006 to HK\$500,000 since 2011, effectively means 90% of all depositors are now covered.

The value – and ongoing effectiveness – of the DPS could only be fully realised with the support and confidence of an informed public aware of the protection under the DPS. It is most gratifying that the public awareness of the DPS has now grown to over 75% from scratch at the time of the DPS launch - comparing most favourably with other jurisdictions. We will however not be complacent with the present achievement. The results of an independent opinion survey revealed that the degree of understanding among the public varies, with room for better communication with certain groups such as the elderly, the less educated and the lower income. This illustrates the need to enhance the reach of our messages to sectors of the community.

In order to maximise our publicity effect and pursue new initiatives to interact with specific target groups who are less acquainted with the DPS, we have established an Advisory Panel on Communication and Public Education by inviting experts specializing in formulation and implementation of public education strategy to lead the Board's work



A cake cutting ceremony to celebrate the fifth anniversary of the launch of the DPS

*From left to right:
Professor Yeung Yuet-bor, Professor Andrew Chan, Mrs Pamela Chan, Ms Meena Datwani and Professor Francis Chin*

in this realm. In addition, the Board has also embarked to recruit a new team to focus on the development of public education and outreach programs. Because of the importance of this area of work, no effort will be spared in our continuous endeavor to build public awareness and confidence.

The Board is fully conscious of the immensity of responsibility entrusted us to protect our people's hard-earned money in the banks. To this end, the Board, with additional powers available under the enhanced DPS, has continued to streamline and strengthen our entire payout infrastructure and system to the greatest extent possible. As we brace ourselves for any potential eventuality that might arise in a turbulent economic and financial environment, we will adopt a more forward looking approach in the forthcoming payout readiness rehearsals that can better equip us to deal with crisis scenarios of different scales and intricacies. Also in the pipeline is a systematic review of the latest reform experiences taken place in other overseas jurisdictions and the strength of our own DPS in keeping up with widely accepted international practices on effective deposit insurance system around the world.

As a statutory body established under the Deposit Protection Scheme Ordinance to oversee the operation of the DPS, the Board is fully committed to strong and sound corporate governance. I am delighted to report that the latest review by internal auditors has positively affirmed the corporate governance standard adopted by the Board was in line with the best practices promoted by international organisations and local professional bodies.

Looking ahead in planning for the way forward, we have identified a number of priorities to focus on, notably in the areas of public education, better transparency by our Scheme members in terms of representation, and payout readiness consistent with the latest international developments. In vigilance of the volatile global financial markets, we will continue to play an active role in the international forum. Such exchanges are particularly important for better co-operation with our counterparts in a crisis situation, and in providing insights and an impetus for change to ensure a robust DPS in Hong Kong.

MESSAGE FROM THE CHAIRPERSON

The Board is indebted to many for their selfless service in contribution to deposit protection. In particular, I am grateful to all my fellow Board members, and the members of the Investment Committee, the Advisory Panel on Communication and Public Education, and the Consultative Committee on DPS. My special thanks are also due to Ms Eleanor Wan, who served as the Chairperson of the Investment Committee before her retirement, and Ms Kerry Ching, who succeeded her. I also wish to thank the government and the Hong Kong Monetary Authority for their advice and support all along. I am also blessed to have a capable Chief Executive Officer and her Management Team whose commitment and professionalism made possible the success the Board was able to achieve: to protect depositors and help maintain the stability of Hong Kong's banking.



CHAN WONG Shui, Pamela
Chairperson

MESSAGE FROM THE CHIEF EXECUTIVE OFFICER



Ms DATWANI Meena, JP
Chief Executive Officer

The year 2011-12 marked the fifth anniversary of the DPS. Time has proven that we have now a robust financial safety net firmly in place that has given confidence to the public on the strength and stability of the Hong Kong banking sector and the protection afforded them by the new scheme. The massive preparatory work put in to ensure a smooth transition to the enhanced regime, we believe, made the difference.

There is however no room for complacency as we strive to consistently increase the effectiveness of the DPS particularly as it has never actually been triggered since its establishment. To this end, we have vastly expanded and strengthened external network of service providers, including legal, accounting and IT professionals, ready to be called into action, at a moment's notice. More importantly, with additional powers of the Board under the enhanced DPS, we have progressively streamlined the entire DPS infrastructure and system to ensure that should there be a bank failure, we will be in full readiness to compensation payout to depositors, efficiently and effectively.

I would like to highlight and share with you the progress we have made in the key operational areas during the year under review.

Building up Public Confidence through Raising Public Awareness of the DPS

The building up of public confidence in the DPS through publicity and educational programs continued to be our focus during the year. We made use of a wide diversity of mass communication media and channels to drive home our messages. The results of an opinion survey, conducted by an independent research agency in December 2011, were encouraging with over 75% of the respondents being aware of the enhanced DPS. Among them, more than 70% had knowledge of the increased protection limit to \$500,000. The awareness of the various key features of the new DPS was generally at high levels. This is very high by international standards. Nevertheless, the findings will provide useful pointers to guide our future communication and publicity strategies.

Increasingly, in a new initiative, we have endeavoured to outreach and interact with the public at large to broaden our reach at the community level. For this, we are very fortunate to have experts in the public education field joining our newly established Advisory Panel on Communication and Public Education to provide advice to the Board in the development of its strategy in publicity and outreach activities.



MESSAGE FROM THE CHIEF EXECUTIVE OFFICER

Contributing to More Effective Deposit Insurance System

In a year of lingering concerns over the deepening Euro zone sovereign debt crisis and the sluggish fiscal recovery of advanced economies, the Board placed great importance on keeping abreast with the latest developments and reforms of deposit insurance systems overseas, to ensure a robust DPS in Hong Kong. The Board participated in a peer review organized by the Financial Stability Board (FSB), an international financial standard setting body. By joining the peer review, the Board contributed to collection of information and analysis on practices or reforms recently implemented by FSB members 24 jurisdictions to promote greater compliance with the Core Principles for Effective Deposit Insurance Systems (Core Principles) jointly issued by the Basel Committee on Banking Supervision and the International Association of Deposit Insurers. The Board treasured the experience gained from the peer review exercise and has developed a concrete plan to thoroughly evaluate the DPS in Hong Kong with the latest international best practices in the coming year.

In Full Readiness to Payout

With the additional powers of the Board under the enhanced DPS, the payout policies and procedures have been considerably strengthened and new guidance notes were issued to further enhance the operational effectiveness and readiness to manage a payout in the event of a bank failure. We have vastly expanded our network of payout agents who are engaged under contractual arrangements to provide needed professional service when called upon. The whole payout infrastructure and system was tested during the year through two subject-specific rehearsals and no fewer than six simulation tests, which were all conducted to the satisfaction of the Board. Such exercises are essential to provide the Board, the management team and its payout agents with clear understanding of their roles and responsibilities, and the key processes involved on undertaking a payout. This will enable the Board to discharge its obligation to make compensation to affected depositors, as swiftly and accurately as practicable.

Sufficient Liquidity for Payout in a Bank Failure

The Board is in a sound financial position. During the year, the Board collected a total of HK\$330 million in contributions from Scheme members bringing the total assets of the DPS Fund to HK\$1.8 billion by the end of March 2012. For contribution assessment, the Board monitored the accuracy of the returns on relevant deposits compiled by Scheme members and discovered no material errors that would impact on the total contributions received. Capital preservation is the investment objective of the Fund to ensure sufficient liquidity to meet the Board's financial obligations. The Fund was able to achieve a positive investment return amid the volatile investment environment. The Fund continued to be strongly supported by a standby credit facility of HK\$120 billion, which the Board secured from the Exchange Fund under the management of the Hong Kong Monetary Authority (HKMA), to meet the liquidity needs of compensation payout in case of a bank failure.

Compliance with the Rules and Guidelines of the Deposit Protection Scheme

The Board conducted checks to ensure the compliance of Scheme members with the requirements under the Representation Rules which enable depositors to be better informed of the protection status of various deposit products. On the other hand, the Board carried out six compliance reviews in relation to the Information System Guidelines (ISG) to verify conformity of data maintenance - the format, completeness and accuracy to ensure that Scheme members can make available to the Board the essential information

required for determination of compensation where necessary. The level of compliance with the ISG was generally satisfactory; where variance was identified, the Board monitored the implementation of remedial actions required of the Scheme members.

Outlook and Plans for 2012 – 2013

The outlook for the global economy and financial markets in the year ahead is shrouded in uncertainty and fraught with downside risks. Therefore much will remain to be done. In planning for the way forward, we have identified a number of areas of priority. We will follow up on the findings of the FSB's peer review on deposit insurance system. In light of the findings, a thorough review of the design of the existing DPS will be undertaken to ensure compliance with the Core Principles and to identify potential areas for improvement. We must continually keep abreast of the latest global developments to be in line with international best practices.

In a turbulent economic and financial environment, we must stay vigilant and be prepared for any crisis situation. To this end, we will continue to adopt a forward-looking rehearsal approach that will enable the Board to anticipate and handle compensation payouts of different scales, and under different crisis scenarios.

We will continue to pursue the objective of engendering a high level of public awareness of the existence and features of the DPS. We will reach out to our targeted segments of the community to heighten their awareness and understanding of the protection available under the DPS. We will initiate more focused publicity activities in our new public education strategy. And to maintain the adequacy of transparency of DPS, we will continue to monitor Scheme members' performance through self-assessment exercises and compliance checks in respect of their compliance with the representation requirements.

A Vote of Thanks

It would hardly be possible for the Board to undertake and achieve such considerable amount of tasks without a good deal of outside help from a great many individuals and organizations. I would like to take this opportunity to express my most sincere appreciation, in particular, to the payout agents, the Scheme members, the HKMA and the government for their ready assistance and unfailing support in our work. My personal gratitude is reserved for the Chairperson and Members of the Board, its Committee and Advisory Panel, whose staunch support and invaluable guidance has set us on a course of continued progress from strength to strength. Last but not the least, I would like to thank my colleagues for helping to make every one of our endeavours achievable in the operation of DPS, with dedication and diligence.



DATWANI Meena
Chief Executive Officer

ABOUT THE HONG KONG DEPOSIT PROTECTION BOARD

Introduction

The Board is a statutory body established under section 3 of the DPS Ordinance (DPSO) to oversee the operation of the DPS. Launched in September 2006, the DPS is a key building block in Hong Kong's financial safety net. Through the provision of a measure of protection to depositors, the DPS contributes to the stability of the banking system.

Mission and functions of the Board

The Board's mission is to maintain an efficient and effective DPS in accordance with the DPSO and in line with international best practice. Under section 5 of the DPSO, the Board's functions include the following:

- Assessing and collecting contributions payable by Scheme members;
- Managing the DPS Fund;
- Making payments to depositors in the event of a failure of a Scheme member; and
- Recovering payments made to depositors from the assets of the failed Scheme member.

Composition of the Board

Members of the Board are appointed by the Financial Secretary (FS), with the power delegated from the Chief Executive of the HKSAR (CE/HKSAR). They come from different professions such as accounting, banking, consumer protection, legal (insolvency), investment, information technology and public administration, and have rich experience in public service.

The Board currently comprises nine members including two ex officio members representing the Monetary Authority (MA) and the Secretary for Financial Services and the Treasury.

Performance of functions through the Monetary Authority

Pursuant to section 6 of the DPSO, the Board shall perform its functions through the MA unless indicated otherwise by the FS. This means the MA will act as an executive arm of the Board in administering the DPS.

The Hong Kong Monetary Authority (HKMA) has assigned a team of staff to assist the Board in discharging its functions. The team is headed by an Executive Director of the HKMA, who is designated as the Chief Executive Officer of the Board. The HKMA also supports the Board on aspects such as accounting, administration, human resources and information technology. Detailed arrangements regarding the extent of support provided by the HKMA are set out in a Memorandum of Understanding (MoU) between the two organisations.

Members of the Board

Chairperson

Mrs CHAN WONG Shui, Pamela, BBS, JP
*Former Chief Executive,
The Consumer Council of Hong Kong*



Members

Miss CHAN Wai-hing, Annie
*Managing Director,
Mazars Corporate Recovery & Forensic
Services Limited*



Professor CHIN Yuk-lun, Francis
*Taikoo Professor of Engineering,
Chair of Computer Science,
Associate Dean of Engineering,
Department of Computer Science,
The University of Hong Kong*



Ms CHING Kim-wai, Kerry
*(from November 2011)
Country Head, Hong Kong,
FIL Investment Management
(Hong Kong) Limited
Chairman,
Hong Kong Investment Funds Association*



Mr HO Eugene
*Former Chief Executive,
ICBC International Holdings Limited*



ABOUT THE HONG KONG DEPOSIT PROTECTION BOARD

Members

Mr KIDD David

*Head of Asian Business Restructuring
Group,
Allen & Overy*



Ms WAN Yuen-yung, Eleanor

*(until October 2011)
Former Chief Executive Officer,
The Institute of Financial Planners of
Hong Kong*



Professor YEUNG Yuet-bor

*Professor, Department of Information
Systems,
City University of Hong Kong
Former Head of Information Technology,
HSBC*



Miss AU King-chi, JP

*Permanent Secretary,
Financial Services and the Treasury
(Financial Services)
Ex officio member of the Board
representing the Secretary for
Financial Services and the Treasury*



Mr YUEN Kwok-hang, Arthur, JP

*Deputy Chief Executive,
Hong Kong Monetary Authority
Ex officio member of the Board
representing the Monetary Authority*



Investment Committee of the Board

The Investment Committee is established in accordance with section 7 of Schedule 2 to the DPSO. It consists of the following members:

Chairperson

Ms CHING Kim-wai, Kerry

(from November 2011)

Country Head,

Hong Kong, FIL Investment Management (Hong Kong) Limited
Chairman,

Hong Kong Investment Funds Association

Ms WAN Yuen-yung, Eleanor

(until October 2011)

Former Chief Executive Officer,

The Institute of Financial Planners of Hong Kong

Members

Miss CHAN Wai-hing, Annie

Managing Director,

Mazars Corporate Recovery & Forensic Services Limited

Mr CHU Siu-chuen, Francis, JP

Executive Director (Reserves Management),

Hong Kong Monetary Authority

Professor YEUNG Yuet-bor

Professor,

Department of Information Systems, City University of Hong Kong

Terms of reference

- to make recommendations on the investment policy and strategy in respect of the DPS Fund;
- to monitor the investment performance of the DPS Fund and to establish proper risk management controls for the investment activities of the Board; and
- to deal with any other matters as determined from time to time by the Board.

ABOUT THE HONG KONG DEPOSIT PROTECTION BOARD

Advisory Panel on Communication and Public Education

The Advisory Panel on Communication and Public Education is established in August 2011 in accordance with section 7 of the DPSO to advise the Board on matters relating to the development of the communication and public education strategy and its implementation by the Board on an on-going basis. It consists of the following members:

Chairperson

Mrs CHAN WONG Shui, Pamela, BBS, JP

Members

Mr FONG King-sang, Quentin

Mr NG Shui-lai, BBS, MBE, JP

Mr WONG Koon-shing

Deposit Protection Appeals Tribunal

Under the DPSO, certain decisions of the Board and the MA can be the subject of an appeal to the Deposit Protection Appeals Tribunal. These include:

- the Board's decisions on whether a foreign bank branch can be exempted from participation in the DPS;
- the amount of contribution payable by a Scheme member;
- the amount of compensation payable to a depositor; and
- the MA's decision to impose an asset maintenance requirement on a Scheme member.

In accordance with section 40 of the DPSO, the CE/HKSAR has made the following appointments to the Tribunal for the period from 14 January 2011 to 13 January 2014.

Chairman

Mr STUART-MOORE Michael, GBS

Panel of persons who may be appointed to be members of the Tribunal

Professor LAM Kit-chun

Mrs LUI FUNG Mei-yee, Mabel, JP

Ms XUEREB Maria

Sittings of the Tribunal are convened when required and members of the Tribunal will be appointed by the FS from the above panel.

ABOUT THE HONG KONG DEPOSIT PROTECTION BOARD

Consultative Committee on Deposit Protection Scheme

To keep the industry informed of the development of the DPS, the Board has established a Consultative Committee comprising 13 representatives from the banking industry. The Committee serves as a useful forum for the Board and the banking industry to exchange views on issues of common interest. Members of the Committee are:

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

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

Ms SO Yammie, BNP Paribas, Hong Kong Branch

Ms MAN Rita, CITIC Ka Wah Bank Limited

Ms SO Francesca, Dah Sing Bank Limited

Ms HO Sinna, DBS Bank (Hong Kong) Limited

Mr MOK Esmond, Hang Seng Bank Limited

Mr FU Eric, The Hong Kong and Shanghai Banking Corporation Limited

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

Ms POON Janet, JP Morgan Chase Bank, Hong Kong Branch

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

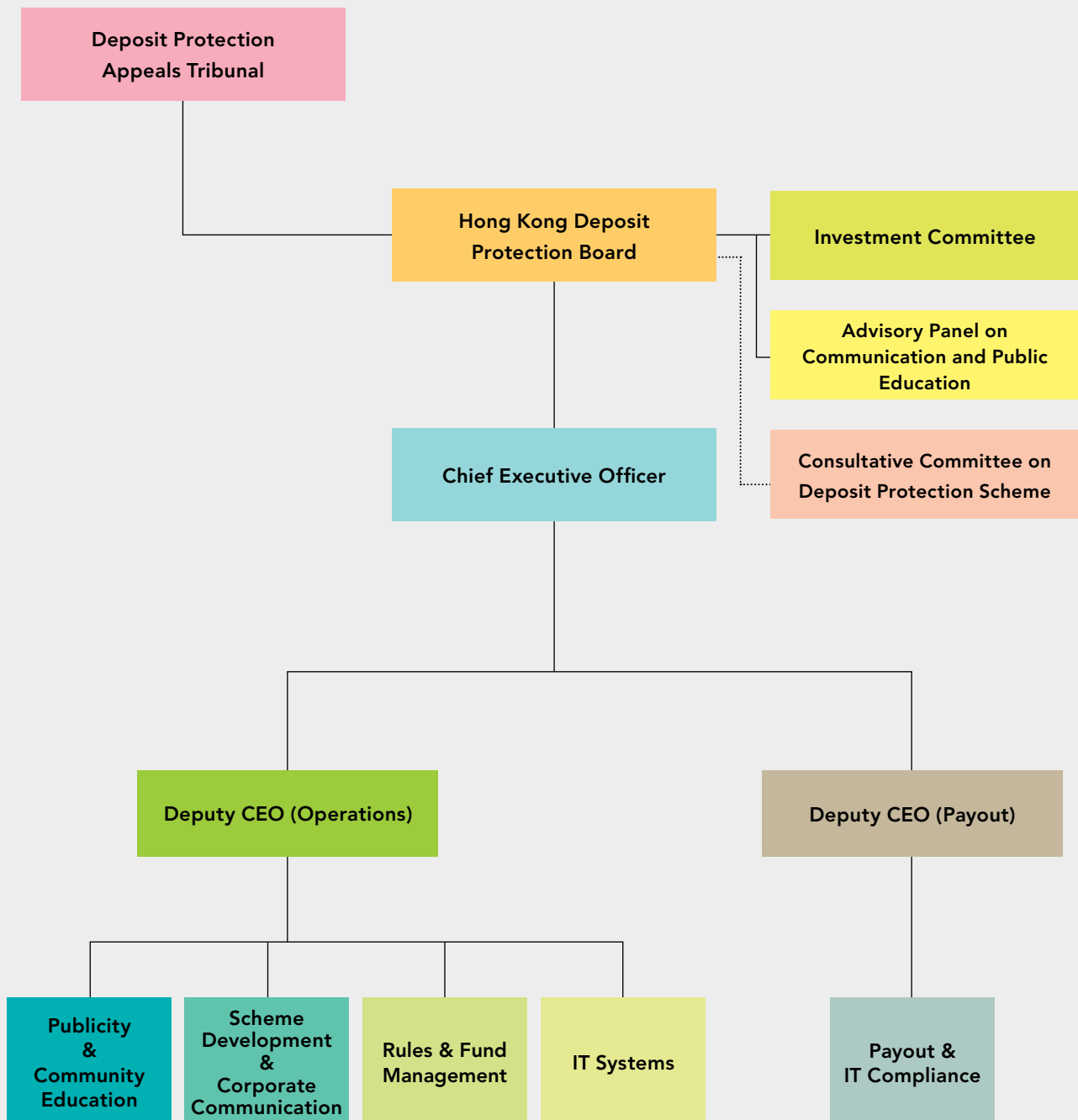
Mr HUI Peter, Nanyang Commercial Bank Limited

Mr WONG Teddy, Standard Chartered Bank (Hong Kong) Limited

Terms of reference

- to advise the Board on the formulation of the approach and strategy in relation to the development of the DPS;
- to consider and give comments on specific policy and operational initiatives proposed by the Board that may have an impact on the banking industry; and
- to assist the Board in maintaining effective communication with the banking industry.

Organisational structure



CORPORATE GOVERNANCE

A strong and sound corporate governance framework is critical to the effectiveness of a DPS as a means to provide protection to depositors and to promote general banking stability. Therefore, apart from putting in place an efficient payout infrastructure and engendering a high level of public awareness and understanding of the DPS, the Board is fully committed to subscribing to sound corporate governance practices when administering the DPS, which in turn helps instil public confidence in the ability of the DPS to honour its commitments when a bank fails.

Given the nature of the Board and the functions of the DPS, the corporate governance structure of the Board incorporates the characteristics of both a public organisation and a deposit insurer. The key elements of the Board's corporate governance structure interact and reinforce each other in supporting sound governance and are discussed in detail below.

Board governance

The Board is an independent statutory body formed under the DPSO. It is subject to the oversight of the FS who is responsible for approving the Board's annual budget and tabling the Board's annual report to the Legislative Council.

The functions and composition of the Board are set out in the DPSO which provides that the Board shall comprise between six to nine members, all of whom are non-executive members. Except for the two ex officio members, all other members are appointed for a fixed renewable term, but for not more than six years in normal circumstances. These members are appointed mainly because they possess professional or occupational experience relevant to the operation of the DPS and are committed to serving the public.

The proceedings of the Board are governed by the relevant provisions in the DPSO. The Board meets three to four times every year to deliberate policy issues crucial to the operation and development of the DPS. In 2011-2012, the Board met three times. On average, over 85% of members were present at each meeting.



Under the DPSO, the Board may appoint committees and advisory panels to assist it in performing its functions. Currently, an Investment Committee comprising members with experience and expertise in banking and investment matters has been formed to advise the Board on the investment of the DPS Fund. The Chairperson and a majority of the members of the Committee are also members of the Board.

In August 2011, the Advisory Panel on Communication and Public Education (the Advisory Panel) was formed to advise the Board in developing its communication and public education strategy and implementation plan, and in monitoring the effectiveness and quality of the related activities. The Advisory Panel consists of the Chairperson of the Board and experts with extensive experience in public relations, communication and community education strategies.

Executive management

Pursuant to section 6 of the DPSO, the Board shall perform its functions through the MA unless otherwise directed by the FS.

The HKMA has assigned a team of staff to assist the Board in discharging its functions, headed by an Executive Director of the HKMA who is designated as the Chief Executive Officer of the Board. The costs incurred by the HKMA for such purpose are reimbursed by the Board on a cost recovery basis in accordance with the provisions set out in the DPSO.

The powers that can be exercised by the Board in administering the DPS are specified in the DPSO. The Board has established clear guidelines on the division of responsibilities between the Board, the Management Team and other supporting divisions of the HKMA, and between the posts of the Chairperson and the Chief Executive Officer, which have been devised in line with good corporate governance practice. In general, strategic decisions relating to the operation and development of the DPS and those decisions requiring an exercise of the Board's powers under the DPSO have to be taken by the Board. The Management Team, on the other hand, is responsible for the day-to-day operation of the DPS according to the policies and principles endorsed by the Board.

Risk management and audits

The Board ensures that appropriate and prudent risk management systems for managing the risks in operating the DPS have been implemented and reviewed regularly. The Internal Audit Division (IAD) of the HKMA, which is a division independent of the departments in the HKMA, performs periodic assessment of the risks inherent in various operational areas of the Board, and evaluates whether appropriate controls are put in place by the Management Team to safeguard the Board against the potential risks identified. Regular audit reviews of the operation of the DPS are conducted to ensure that the various internal control procedures of the Board have been properly adhered to, especially in relation to activities posing a relatively high level of risk to the Board. In 2011-2012, the IAD conducted an internal audit review on the Board's internal control

CORPORATE GOVERNANCE

Risk management and audits

policies and procedures for its operations. The review confirmed the adequacy and effectiveness of the internal control policies and procedures put in place by the Board to manage its operation.

The IAD reports its findings and recommendations directly to the Board to ensure independence of communication of its review results.

The appointment of the external auditor of the DPS Fund requires the approval of the FS. The external auditor is responsible for auditing the annual statement of accounts of the DPS Fund prepared by the Board. The external auditor reports its findings directly to the Board.

The external auditor for the year under review was Pricewaterhouse Coopers (PwC). Apart from auditing the statement of accounts for 2011-2012, PwC has also been engaged by the Board to provide advisory services for enhancing the efficiency of payout procedures and is eligible for appointment as a project co-ordinator for managing payout services.

To ensure the independence and objectivity of the external auditor, the Board has put in place policies that restrict engaging PwC for non-audit services during the financial audit period to avoid compromising the independence of the financial audit.

Standards of behaviour and ethics

In line with the good corporate governance standards applicable to deposit insurers, government and the MA representatives account for only a minority of the members of the Board. This allows the government and the banking supervisor to contribute to the operation of the DPS from the public administration and financial regulatory perspectives, but prevents the Board from overly exposing itself to the influence of the government and other financial safety net players. The Management Team assigned by the HKMA to assist the Board is not responsible for prudential supervisory matters. The operation of the Board is insulated from the influence of the banking industry as no employees or directors of banks and banks' related companies can be appointed as a Board member.

The Board has established clear guidelines and procedures for declaration of interests and avoiding conflicts of interest. The relevant guidelines and procedures are set out in the DPSO and the Codes of Conduct for members and staff of the Board. Board members are required to declare in writing their personal interests when they first join the Board or its committees, and annually thereafter, to the secretary of the Board. The register of Members' interests is kept by the secretary and is available for public inspection. Senior staff members of the Board are required to make a declaration to the Chairperson of the

Board annually. Specific procedures are available on how members and staff of the Board should report their interests and be excused from a decision making process.

Communications and transparency

The Board is committed to open communication with the public and other stakeholders. It has set up an enquiry hotline to answer questions from the public, and maintains a website to facilitate access to information on different aspects of the DPS operations. In 2011-2012, the website registered close to 150,000 visits. The Board also makes its annual report publicly available. To keep the banking industry informed of the developments of the DPS, the Board consults the banking industry through the Consultative Committee on the Deposit Protection Scheme and the industry associations on policies and initiatives relating to the operation of the DPS that may have an impact on the industry.



Appeal mechanism

Certain decisions made by the Board and the MA under the DPSO can be the subject of an appeal to the Deposit Protection Appeals Tribunal. The Tribunal is chaired by a High Court judge appointed by the CE/HKSAR. Members of the Tribunal are appointed by the FS from a panel of three people appointed by the CE/HKSAR. In the year under review, no case was required to be reviewed by the Tribunal.

Review of the corporate governance structure

The Board has set a policy of reviewing its corporate governance structure regularly to ensure that it continues to adhere to sound corporate governance standards, despite any expansion or change in the scope of the Board's operations as a result of the development of the DPS. Refinements are made between individual reviews as and when necessary as the Board keeps up with local and international best practices. In 2011-2012, the IAD conducted a review of the Board's corporate governance practices against applicable standards promoted by international organisation and local professional body and authority. The review reconfirmed that corporate governance standards adopted by the Board were generally in line with the best practices promoted by international organisations and local professional bodies.

REVIEW OF OPERATIONS AND ACHIEVEMENTS IN 2011-2012

Economic situation

Despite an increasingly austere global economic environment, the Hong Kong economy remained sound and stable with a moderate growth of 5.0% over the course of 2011, after a 7.0% growth in 2010. The Hong Kong economy entered 2011 on strong growth momentum. But the economic growth was dampened from the second half of 2011, reflecting a slackening in the external sector amid, in particular, the deepening Eurozone sovereign debt crisis and sluggish recovery in the US and other advanced markets. The domestic sector, however, continued to be resilient with remarkable private consumption growth at 8.6% on account of continued improvement in the labour market conditions, rising household incomes and solid consumer confidence. Government consumption growth remained steady at 1.8%. Growth in the domestic sector had the effect of partially offsetting the drag from the weaker performance of merchandise exports due to faltering demand.

Inflationary pressures continued unabated in the first half of 2011 but began to show signs of easing off towards the end of the year. Inflation averaged at 5.3% for the whole of 2011, up from 1.7% in 2010. The Hong Kong stock market was subject to considerable volatility throughout the year, with prices generally drifting downwards broadly in line with movements in the major global financial markets. The local property market remained buoyant, continuing its uptrend in the first half of 2011 before cooling down in the second half of the year on impact of stabilising policy measures, a weaker global growth outlook, and tighter mortgage loan terms.

Banking environment in Hong Kong

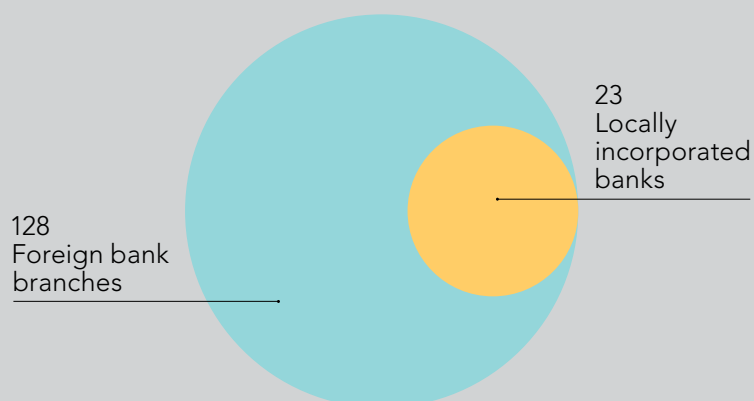
The Hong Kong banking sector remained robust in 2011 in face of a looming European sovereign debt crisis. The average liquidity ratio of retail banks (at 38.0%) was well above the statutory minimum (25%). The asset quality of retail banks was healthy with a low classified loan ratio at 0.59% at the end of 2011, compared with 0.77% at the end of 2010. All locally incorporated authorized institutions were well capitalised with a consolidated capital adequacy ratio of 15.8% at the end of 2011. The tier-1 capital adequacy ratio edged up to 12.4% from 12.2% a year ago. On profitability growth, the aggregate pre-tax operating profits of retail banks' Hong Kong offices grew by 18.0% in 2011; the post-tax return on average assets remained similar to that of the preceding year at 1.01% in 2011.

The accommodative monetary conditions continued in 2011. The Hong Kong dollar interbank interest rates (HIBORs) remained low, with the three-month HIBORs hovering at 0.33% at the end of 2011. Yet the composite interest rate, which reflects the average cost of funds of retail banks, edged up more than double to about 0.5% towards the end of 2011 as retail banks offered higher interest rates to attract larger and longer-term deposits. Under the Linked Exchange Rate System, movements in the Hong Kong dollar exchange rate largely mirrored the US dollar against other major currencies.

Profile of Scheme members

At the end of March 2012, there were 151 Scheme members, compared with 145 a year ago. During the year, seven new members joined the scheme upon being authorized as licensed banks. One member was revoked because of a merger and acquisition. Of the 151 Scheme members, 23 are locally incorporated banks and 128 are foreign bank branches. This is largely in line with the number of retail banks and wholesale banks in Hong Kong respectively.

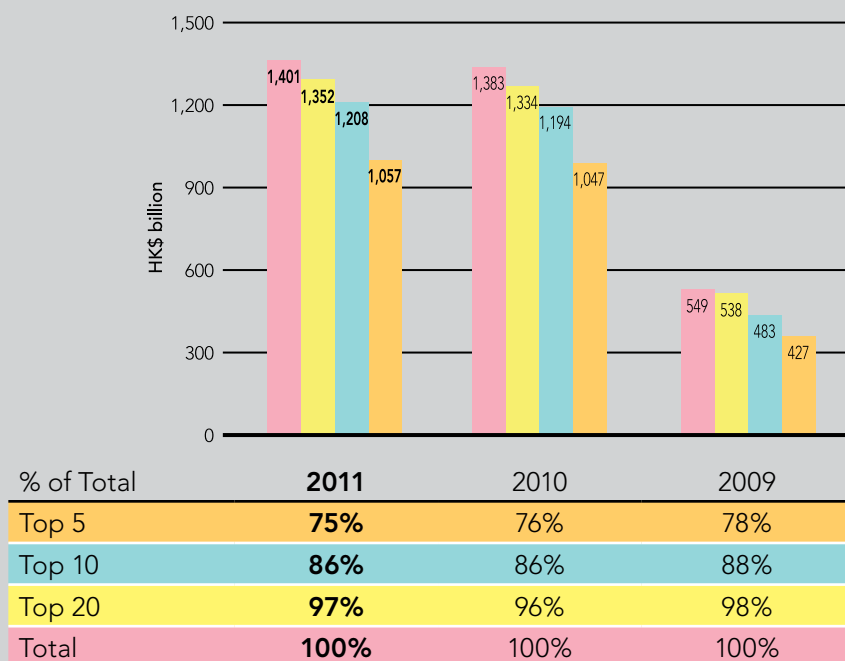
Number of Scheme members as at 31 March 2012



Based on the returns of relevant deposits submitted by Scheme members, the aggregate amount of relevant deposits increased by 1.3% to HK\$1,401 billion in 2011, compared with HK\$1,383 billion in 2010. According to statistics provided by Scheme members, about 90% of depositors were fully protected by the DPS.

REVIEW OF OPERATIONS AND ACHIEVEMENTS IN 2011-2012

Relevant deposits held with Scheme members



The distribution of relevant deposits among Scheme members remained similar to that of last year, with large retail banks holding 85% of the industry's aggregate relevant deposits, small-to-medium-sized retail banks holding 12% of the industry total and the wholesale banks holding the remaining 3%. Similar to previous years, the top 20 Scheme members continued to account for more than 95% of the total relevant deposits in the industry. In terms of growth, the small-to-medium-sized retail banks recorded a much higher growth of relevant deposits (at 5%) than their large counterparts (at 1%).

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

(in HK\$ billion)	2011	2010	±%
Large retail banks	1,197	1,187	1%
Small-to-medium-sized retail banks	160	153	5%

Contributing to better protection

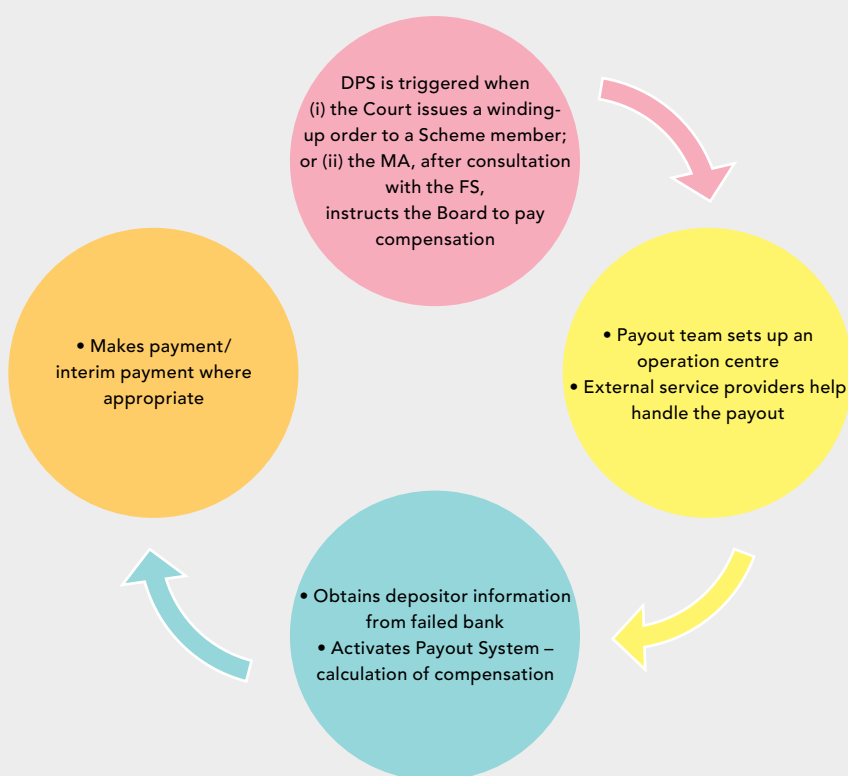
The Board actively participated in a peer review of deposit insurance systems of the FSB member jurisdictions under the FSB framework for strengthening adherence to international standards. The peer review used the Core Principles jointly developed by the Basel Committee on Banking Supervision and the International Association of Deposit Insurers (IADI) as a benchmark to take stock of deposit insurance systems in FSB member jurisdictions and draw lessons about the effectiveness of reforms in response to the 2008 global financial crisis. Through participation in the work of the FSB peer review team, the Board contributed to the promotion of greater compliance with the Core Principles internationally, and to the identification of areas requiring further guidance to achieve more effective compliance or to better reflect leading practices. The Board also consolidated the experience gained from the peer review exercise to prepare for a comprehensive assessment of the design of the DPS in Hong Kong against the Core Principles.

REVIEW OF OPERATIONS AND ACHIEVEMENTS IN 2011-2012

Ensuring payout readiness of the DPS

Background on Payout Readiness

"Payout readiness" refers to the Board's ability to deliver on its mandate of making compensation payments to affected depositors promptly in the event of a bank failure (a process that is commonly referred to as a payout). This generally relates to having the appropriate people, processes and systems in place to be brought into action on short notice if payment of compensation from the DPS Fund is triggered. As depicted in the diagram below, the payout process requires a number of elements to be in place for promptly starting and completing a payout.



Payout framework

The Board adopts a virtual organisation structure. It retains a small number of core staff with in-depth knowledge to administer the DPS, and develops flexibility, by contractual arrangements, to call upon a network of external service providers (collectively referred to as payout agents) to form a payout team to assist with calculation and payment of compensation to depositors should there be a bank failure.

Payout policies and a comprehensive set of procedures are developed and maintained to guide the payout team to effectively manage and undertake the payout to meet the Board's operational objectives. The payout system is designed according to the payout processes and

is built to a capacity to enable the processing of a large volume of depositors' records and calculate their compensation payment.

Central to payout readiness is the guideline on information system requirements which require Scheme members to maintain depositors' records in their information systems and to promptly provide the required information to the Board for payment determination.

A significant achievement during the year was the Board's successful completion of a major revision to the payout policies and procedures to enhance its payout efficiency, based on the experience gained from conducting payout rehearsals and simulations. As part of the revision, guidance notes were developed to set out the principles and approaches on applying the new powers conferred on the Board by the enhanced DPS for the purpose of streamlining payment calculations.

Payout policies, procedures and processes

A payout is a multi-disciplinary operation involving various payout agents working concurrently on a series of interrelated activities. When the DPS is triggered, the Board's goal is to calculate the compensation payment and pay depositors as quickly and accurately as practicable. The payout agents are guided by the payout policies and a comprehensive set of procedures, documented in the Payout Procedure Manual as well as other reference materials, to achieve a seamless payout operation. Leveraging on the experience gained from previously conducted rehearsals, the Board has endeavoured to develop an event management plan to guide the time-critical activities immediately before and after the DPS is triggered, and set out the key management control at essential stages of a payout. The Board has also conducted several simulations focusing on payout processes, which are technically complex in terms of the collection of supplementary information and the identification of persons entitled to receive payment. Based on the results of the simulations, new procedures have been developed to define the additional steps necessary for compensation determination of trust accounts, client deposits, and depositors providing guarantees.

To achieve accountability and transparency in exercising the Board's new powers given under the enhanced DPS, two guidance notes have been developed to set out the principles and approaches to be taken by the Board in making reasonable estimates of accrued interest and contingent liabilities to streamline the compensation determination process. The Board consulted the banking industry and insolvency practitioners before finalising the guidance notes for incorporation into the Board's policies and procedure manual.

REVIEW OF OPERATIONS AND ACHIEVEMENTS IN 2011-2012

Ensuring payout readiness of the DPS

Payout infrastructure

The effective use of information technology is an important element of a robust payout infrastructure. Therefore, the payout system is reviewed regularly to ensure it has adequate capacity, processing power and up-to-date operating software. During the year, system enhancements were implemented to accelerate the data loading function, provide more reporting features, and improve its usability to facilitate the Board in expediting the calculation process of compensation payments.

One of the methods for paying depositors is by mailing a cheque to them accompanied by a statement listing the accounts used for the calculation. The readiness and co-ordination arrangements of cheque and statement printing firms have been reviewed and strengthened by ensuring that they have the capability of handling large volumes of printing and mailing in a secure and prompt manner within short notice.

The Board further improved the network of payout agents available to be engaged in a payout by establishing contractual arrangements with several accounting firms and law firms. This arrangement mitigates the risk of the unavailability of resources for the provision of services to the Board.

Rehearsal and procedure walkthrough activities

The Board conducted two subject-specific rehearsals in 2011, which focused on the event management immediately before and after the DPS trigger, the process to decide and distribute an interim payment to depositors, and the co-ordination required between the Board and the payout agents. The rehearsals involved new payout agents such as accounting firms, statement printing firms, as well as other payout agents which had participated in previous rehearsals (for example, the IT firms, call centres, and business continuity service providers). Procedures and system training were given to the participants in advance. The rehearsals provided an opportunity for the payout agents to act on crisis-simulated scenarios, and the results verified that the Board is capable of operating a payout with its network of payout agents in accordance with the Board's standard policies and procedures.

As an accounting firm will take the overall project management role in a payout under the guidance of the Board to supervise other payout agents, it is important to ensure accounting firms are familiar with the payout policies and procedures. During the year, the Board conducted a payout walkthrough for an accounting firm that did not participate in last year's rehearsals, to refresh its understanding of responsibilities and key processes of a payout.



The Chairperson and the Chief Executive Officer participate in the rehearsal

Compliance reviews and simulation tests

The capability of the Board to make compensation payment effectively places great reliance on the timeliness of obtaining the complete set of accurate depositor records from a failed Scheme member. The Board uses regular compliance reviews to verify the ability of Scheme members to comply with the information system requirements. Six compliance reviews were conducted during the year and the scope of each review covered the verification of the correctness of data format, and the completeness and accuracy in which Scheme members made the required information available to the Board. Based on the reviews conducted so far, the level of compliance was generally satisfactory. Scheme members were required to provide action plans to resolve any variance from the guideline identified in the reviews. The Board monitored the progress of implementation of the remedial actions by the Scheme members to ensure gaps were duly filled.

Full sets of customer records obtained from Scheme members for compliance reviews were concurrently used in conducting simulation tests. The simulations ensure the payout infrastructure is continuously maintained at a ready state to process the volume and specific combination of products and depositors of any Scheme members, as well as providing a platform to verify the detailed execution of certain payout procedures by payout agents. For example, an accounting firm was involved in one of the simulation tests to assess the effectiveness of procedures on applying the new guidance note on accrued interest estimations.



Regular simulation exercises help to ensure payout readiness

REVIEW OF OPERATIONS AND ACHIEVEMENTS IN 2011-2012

Ensuring payout readiness of the DPS

Access to pre-established funding facilities

Once payment is triggered under the DPS, the Board is obliged to make compensation to the depositors of the failed Scheme members as soon as practicable. To this end, the Board has secured a standby credit facility with the Exchange Fund of an amount up to HK\$120 billion to meet the funding requirements of the DPS in a payout. The costs and losses that may be incurred in the payout process will be absorbed by the DPS Fund.

Building up the DPS Fund

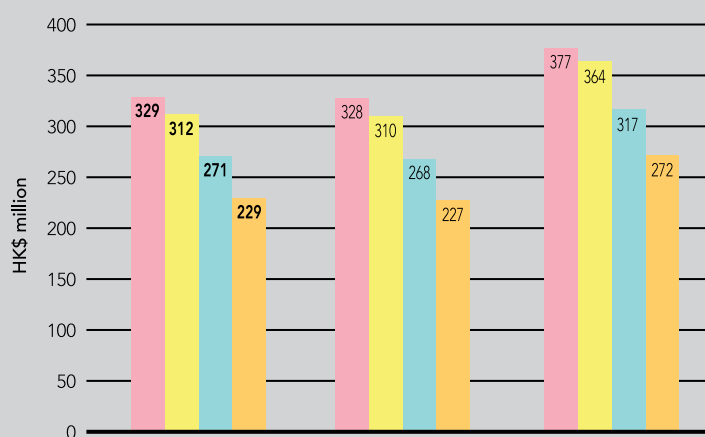
Composition of the DPS Fund

The DPS Fund mainly consists of two components, namely the annual contributions made by Scheme members to the Board, and the returns generated from the investments of the DPS Fund.

Reporting of relevant deposits

Scheme members are required to report the amount of relevant deposits held with them in the fourth quarter each year and the reported figure, together with the supervisory rating provided by the HKMA, serves as the basis for determination of the amount of contribution payable by a Scheme member in the coming year.

Contribution paid by Scheme members
by relevant deposits held



% of Total	2012	2011	2010
Top 5	70%	69%	72%
Top 10	82%	82%	84%
Top 20	95%	95%	97%
Total	100%	100%	100%

Assessment and collection of contributions

The amount of contributions collected from Scheme members for the year amounted to HK\$329 million, reflecting an increase of 0.6% over the previous year. All contributions were paid by Scheme members in accordance with the DPS Contribution Rules in the first quarter of 2012. Similar to the distribution of relevant deposits, the amount of contributions collected from the top 20 Scheme members continued to account for 95% of the total contributions.

To ensure the relevant deposit data reported in the returns submitted by Scheme members are correctly compiled, the Board has been requesting Scheme members since 2007 to conduct regular audit reviews of their Returns of Relevant Deposits in accordance with the policy for reviewing returns. As a result of the change in the deposit profile of Scheme members under the increased protection limit of HK\$500,000 and the basis for reporting the amount of relevant deposits, the Board re-examined the policy on review of returns of relevant deposits in 2011 and updated the policy to ensure that an appropriate basis be used for commissioning audit reviews to verify the correctness of the returns.

A total of 40 Scheme members were requested to submit an audit report to the Board on the correctness of their returns in 2012. The results of the review were generally satisfactory and no reporting error leading to a material impact on the amount of contributions collected by the Board was noted. After the completion of the review, over 99% of the relevant deposits reported based on the HK\$500,000 protection limit have been verified by an auditor. This assurance gives the Board confidence in the correctness of the total amount of contributions payable by the industry.

Investment of the DPS Fund

Given the volatility of financial markets and the primary investment objective of the Fund being capital preservation, the Board was fully mindful of the need to exercise extra caution during the year. A conservative investment strategy was adopted in accordance with the investment restrictions set out in the DPSO and investment policies of the DPS Fund to guard against any possible losses that might arise from any sudden change in market sentiment. The investment operation was in strict accordance with the investment control policies, which set out clear guidelines on risk assessment and control measures, and the segregation of duties required for investment activities.

REVIEW OF OPERATIONS AND ACHIEVEMENTS IN 2011-2012

Ensuring payout readiness of the DPS

As the Hong Kong dollar moved on the weak side of the Convertibility Undertaking for most of the year, and in view of the persistently low interest rates offered by the short-term Exchange Fund and US Treasury papers, the DPS Fund's assets were predominantly held as deposits and almost all were denominated in Hong Kong dollars with only minimal balance in US dollars. For the year as a whole, the DPS Fund managed to make a positive investment return of 0.2%, despite the highly volatile investment environment.

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

(in HK\$ million)	2012	2011
Cash and deposit balance	1,811.3	1,535.9
Investment securities	0.0	0.0
Total	1,811.3	1,535.9

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

(in HK\$ million)	2012	2011
HK dollar	1,810.9	1,535.5
US dollar	0.4	0.4
Total	1,811.3	1,535.9

Enhancing public awareness and understanding

Establishment of the Advisory Panel on Communication and Public Education

A high level of public awareness and understanding of the features of the DPS is crucial to gaining depositors' confidence in the DPS and thus the effectiveness of the DPS in contributing to general banking stability.

Based on the foundation built in the last few years, there is a high recognition of the availability of protection under the DPS by the public. Nevertheless, to extend this to audiences not readily accessible to mass advertising media and, at the same time, to raise awareness and understanding of specific messages that may not be so readily known, the Board has initiated new measures to reach out to the community.

As part of this approach, the Board established an Advisory Panel comprising experts with experience in the relevant fields to advise the Board on its communication and public education strategy and implementation. The Panel also advises to the Board on the effective allocation of its resources in delivering its messages to the widest possible audience, including the target population.

Publicity campaigns to reach mass audiences

Two successive large-scale multi-media publicity programmes were launched during the year to maintain high public awareness of the DPS and its key features, using television as the major advertising media. A new thematic TV commercial was produced focusing on the protection of deposits denominated in different currencies. This was considered an important message and one that was less well known as revealed in the findings of an opinion survey. In addition, a series of advertisements in a popular quiz-show format was broadcast concurrently to supplement the thematic TV commercial in providing a comprehensive picture of the enhanced DPS.



A snapshot of the TV commercial reminding the public about the key features of the DPS

Other mass media outlets, including radio, newspapers and print material, public transport and the internet, were used to promote the DPS.



Iron piggy bank, the icon of the DPS, is widely used in different advertising media

REVIEW OF OPERATIONS AND ACHIEVEMENTS IN 2011-2012

Enhancing public awareness and understanding

Outreach activities in dialogue with the public

With the advice of the Panel, a series of public education and outreach activities were organised during the year. The activities included lively short dramas, community talks, the distribution of education kits to schools, textbook publishers and newspaper editors, and sponsoring different RTHK channels for the broadcast of DPS messages in the form of short dramas specially designed for more targeted audiences, such as young people and students, new immigrants and the elderly. In addition, advertorial publications were included in selected circulars issued by labour unions and non-government organisations (NGOs) to allow more detailed DPS messages to be disseminated to different groups within the community to deepen their knowledge of the DPS.



Different outreach activities are held in schools and at the community level

The Board is also in the process of establishing a new team to carry out community education and outreach activities directed at different target groups in a bid to deepen their understanding of the DPS.



Advertisements placed on the NGO publications to extend the reach to different niche groups

To further expand the reach of the DPS, the Board also collaborated with Scheme members to promote the DPS to their customers. Indeed, there has been strong support from Scheme members to make the information leaflets and other seasonal souvenirs available for distribution at their branches.



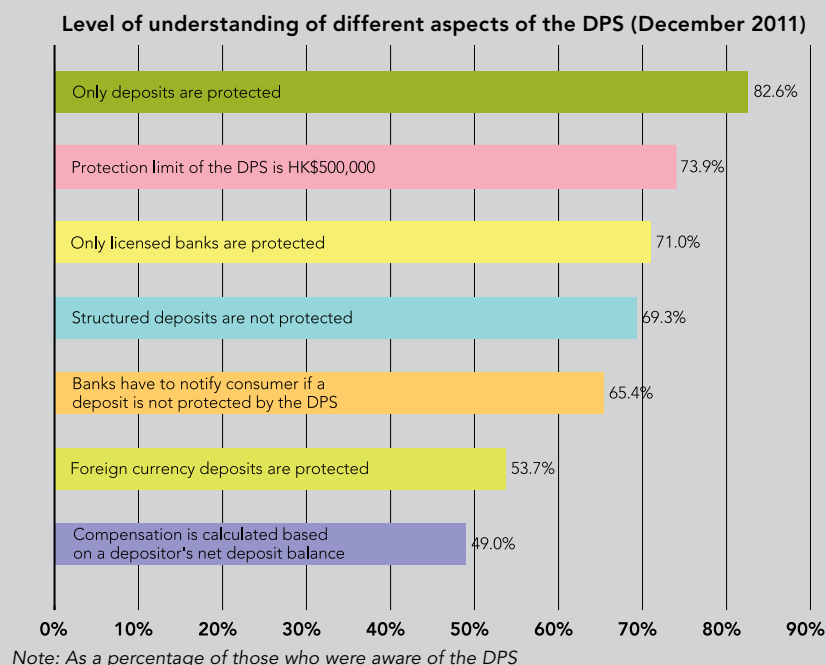
Festive souvenirs distributed to the public through Scheme members

Effectiveness of the publicity campaign

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

The findings of the survey conducted in December 2011 were encouraging with over 75% of the respondents indicating their awareness of the scheme. More than 70% of the respondents who were aware of the enhanced DPS also had knowledge of the new HK\$500,000 protection limit, which became effective in January 2011. The awareness levels of various key features were also kept at good levels. Going forward, more focus will be put on publicising the scope and coverage of the DPS to provide depositors with a more comprehensive understanding of the scheme. The Board will continue to make use of the findings of surveys to revise and enhance its future communications and publicity strategies.

REVIEW OF OPERATIONS AND ACHIEVEMENTS IN 2011-2012



DPS membership and strengthened product representations by Scheme members

The DPS Representation Rules governing the representations made by Scheme members about their DPS membership and the protection status of the financial products offered by them were first issued by the Board in 2006. The enhancements to the DPS Representation Rules took effect on 1 January 2011 when the increased protection limit was introduced. The major enhancements include:

- requiring Scheme members to give notification to customers of non-protected deposits on a transaction basis;
- making positive disclosures in respect of the deposits protected by the DPS;
- restricting the use of the term “structured deposit”; and
- responding to customers’ enquiries on the protection status of financial products in a specified manner and within a specified timeframe.

To monitor Scheme members’ compliance with the enhanced representation requirements, a self-assessment review covering the period from 1 January 2011 to 30 June 2011 was conducted by Scheme members. In addition, a series of on-site examinations was also undertaken during the year to ascertain the level of Scheme members’ compliance with the Representation Rules in greater detail. The Board reviewed the self-assessment reports and on-site examination findings. The results indicated that the overall compliance level of Scheme members was satisfactory in general and, so far, no significant incidence of non-compliance was identified.

Relationship with other safety net players

Co-operation with the Hong Kong Monetary Authority

Both the Board and the HKMA are financial safety net players in Hong Kong and share a common objective of promoting the stability of the banking system. To ensure this is accomplished, the Board and the HKMA have signed a MoU setting out how the two organisations are to co-operate with each other in the performance of their respective functions. In addition, as the Board is required by the DPSO to perform functions through the HKMA, the Board and the HKMA have agreed on the extent of support provided by the HKMA to the Board on a day-to-day basis. The Board has also secured a standby facility from the Exchange Fund to provide the necessary liquidity required for payment of compensation in the event of a bank failure. During the year, the Board and the HKMA closely co-operated with each other in accordance with the terms of the MoU.

Relationship with the Securities and Futures Commission and the Investor Compensation Company

Under certain circumstances in the event of a bank failure, the funds of a depositor or a portion of those funds may be simultaneously covered by the DPS and the Investor Compensation Fund (ICF) established under the Securities and Futures Ordinance for compensating securities or futures investors. To ensure that no person receives double compensation, the Board and the Securities and Futures Commission (SFC) have agreed on a set of arrangements to co-ordinate and exchange information between the parties. The detailed arrangements have been documented in a MoU between the Board, the SFC and the Investor Compensation Company (ICC), the company recognised by the SFC for administering the ICF. Specifically, the MoU recognises that the DPS will normally pay the depositors first in the event of a bank failure and, to avoid double compensation, the parties should exchange relevant information.

International cooperation

As a member of the IADI, the Board actively participated in conferences and seminars organized by the IADI, its member deposit insurers and other international organizations, and exchanged knowledge and views on issues relevant to deposit protection in the international forum. This is particularly important for keeping up-to-date with the international developments, for better coordination both in times of financial crisis as well as in the aftermath of the crisis where sharing of experience on the effectiveness of reform measures overseas provides insights and an impetus for change to ensure a robust DPS in Hong Kong.

REVIEW OF OPERATIONS AND ACHIEVEMENTS IN 2011-2012

International cooperation

In 2011-2012, the Board's personnel took part in a number of international meetings including:

- a seminar on methodology for assessing Core Principles for Effective Deposit Insurance Systems organised by the IADI and the Financial Stability Institute in Basel, Switzerland;



CEO Meena Datwani (sixth from left, first row) at the seminar in Basel, Switzerland

- the IADI 10th Annual Conference and Annual General Meeting in Warsaw, Poland;
- a seminar on deposit insurance assessments and fund management organised by the IADI in Taipei, Taiwan;



CEO Meena Datwani (third from left) is a moderator at the event

- the Deposit Insurance Corporation of Japan 6th Round Table in Osaka, Japan; and
- a seminar on assessment of compliance with the Core Principles for Effective Deposit Insurance System organised by the Malaysia Deposit Insurance Corporation in Kuala Lumpur, Malaysia



Chairperson Pamela Chan (fifth from left, first row) and CEO Meena Datwani (fourth from left, first row) at the seminar in Kuala Lumpur, Malaysia

The outlook

Heightened uncertainties and downside risks will continue to beset the global economy and its outlook for 2012. The growth prospects in many advanced economies will in all probability remain dim, as the sovereign debt crisis in the Eurozone remains unresolved. There are also worrying signs that funding difficulties faced by some European governments are spreading to the banking sector and the wider economy. Should that unfortunately be the case, it could lead to potentially damaging repercussions to the global financial markets. As an international financial centre, Hong Kong can hardly stay unscathed and will inevitably be affected by the ensuing market fluctuations.

Despite the volatile external environment, the medium-term prospect of Hong Kong remains generally optimistic. The Hong Kong economy is expected to continue to benefit from the, albeit moderate, economic growth in Mainland China. But any hopes for strong and lasting growth will in all likelihood be dashed by the anaemic economic performance in the developed countries and the new jolts emerged from the Eurozone. While the local banking sector does not have any significant exposures to the European countries experiencing with sovereign debt problems, the risk of spill over cannot be underestimated if the fiscal woes of certain European countries implode in a renewed turmoil. Hong Kong must stay vigilant and be prepared for any eventualities that might arise in a turbulent global economic and financial environment. The DPS has therefore the important mission to protect depositors and help maintain the stability of Hong Kong's banking system.

Business plan with key initiatives

Core Principles review to ensure effective coverage of the DPS

Taking into account the results of the FSB Peer Review on Deposit Insurance Systems, the Board will undertake a thorough assessment of the various design aspects of the DPS in Hong Kong in accordance with the guidance specified in the Core Principles. The Board's assessment will also make reference to the latest developments and reforms in other major overseas deposit insurance systems to evaluate whether there is any room for strengthening the effectiveness of Hong Kong's DPS or enhancing compliance with the Core Principles.

Survey on popularity of structured deposits to ensure adequate coverage of the DPS

To study whether it is necessary to bring structured deposits (which remain outside the protection net at the moment) under the ambit of the DPS, the regular survey established to monitor the implications of the popularity of structured deposits will be conducted in the second half of 2012.

Business plan with key initiatives

Ensuring high public awareness and understanding of DPS

The Board will continue to attach high importance to the coverage and effectiveness of its publicity and public education activities. In order to enhance public awareness of various protection features, in particular some new or less publicised features, more focused publicity efforts targeted at specific groups less knowledgeable about the DPS will be explored and to be carried out in coming year. This can enable the Board to establish and maintain a more direct and sustained connection with the relevant community associations, allowing the DPS to take root at the district level.

The Board will continue to broaden the awareness of the DPS among the general public. In the pipeline for development is a new creative concept that can be used in multi-advertising channels to give the DPS a fresh image and, at the same time, to focus public attention on important but less known features of the Scheme. The new campaign will not only reinforce public awareness of the key features of the DPS, but also penetrate further into different groups within the community. The overall awareness of the DPS and the effectiveness of different communication channels with the community will continue to be evaluated. A new team will be established to spearhead the efforts to promote the understanding of the DPS at the community level and in developing public education initiatives.

To facilitate the Board's monitoring of compliance by Scheme members with the requirements of the Representation Rules, all Scheme members will have to complete the second self-assessment review assessing their compliance with the enhanced representation requirements by the end of September 2012. With the assistance of the HKMA, the Board will continue to conduct on-site compliance checks to supplement the self-assessment exercise and investigate any potential non-compliance cases identified in the self-assessment review.

Ensuring efficient and effective administration of the DPS

The Board will continue to assess and collect contributions from Scheme members for 2013 under the well-established mechanism, with reference to the returns of relevant deposits submitted by Scheme members and their supervisory ratings provided by the HKMA. The accuracy of the returns of relevant deposits compiled by Scheme members will continue to be monitored by the Board through reviewing audit reports submitted by the members.

Ensuring full readiness of payout systems and processes

The Board remains vigilant in maintaining its readiness to payout and seeking opportunities to improve payout efficiency. Rehearsals, payout walkthroughs and simulation tests will continue to be held regularly to uphold the readiness of payout agents and infrastructure to support a prompt payout.

Taking into account experience accumulated in reviewing compliance of Scheme members with information system requirements, an assessment of the effectiveness of the current review programme will be conducted and, where necessary, adjustments will be made to promote the quality and timeliness of data records to be provided by Scheme members for determining compensation. To monitor the general compliance level of Scheme members, an IT survey will be conducted to collect system statistics and technical system documents from Scheme members to allow the Board to embark on a desktop assessment. Based on findings identified, Scheme members will be notified of any observed gaps for improvements in their technical implementation, and to increase their general awareness of the importance of making accurate information available in a timely manner.

New international standards for effective payouts have been established since the recent global financial crisis. The Board will make reference to these standards and reform actions being undertaken by overseas deposit insurers, and seek changes beyond incremental procedural improvement necessary to expedite paying depositors following a bank failure. Areas of focus will include obtaining adequate advance notice for pre-payout preparation and building a better framework of co-ordination with other financial system safety net participants. At the same time, a thorough review of the payout capacity and contingency planning will be commenced to develop the Board's capability to fulfil its mandate when there is more than one bank failure in a major financial crisis.

INDEPENDENT AUDITOR'S REPORT

TO THE HONG KONG DEPOSIT PROTECTION BOARD

We have audited the statement of accounts of the Deposit Protection Scheme Fund (the "Fund") established under section 14 of the Deposit Protection Scheme Ordinance (the "Ordinance") set out on pages 44 to 62, which comprises the balance sheet as at 31 March 2012, and the income and expenditure account, statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

The Board's responsibility for the statement of accounts

The Ordinance requires the Hong Kong Deposit Protection Board (the "Board") to keep and maintain proper accounts and records of all transactions of the Fund. The Board is responsible for the preparation of the statement of accounts that gives a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants, and for the internal control where the Board considers necessary to enable the preparation of the statement of accounts that is free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on the statement of accounts based on our audit and to report our opinion solely to you, as a body, in accordance with section 19 of the Ordinance and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the statement of accounts is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the statement of accounts. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the statement of accounts, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the statement of accounts that gives a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board, as well as evaluating the overall presentation of the statement of accounts.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the statement of accounts gives a true and fair view of the state of the Fund's affairs as at 31 March 2012, and of the surplus and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and has been properly prepared in accordance with the Ordinance.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 22 June 2012

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND INCOME AND EXPENDITURE ACCOUNT

for the year ended 31 March 2012
(Expressed in Hong Kong dollars)

	Note	2012 HK\$	2011 HK\$
Income			
Contributions		327,900,576	364,747,541
Interest income from cash and balances with banks and the Exchange Fund		2,379,214	566,890
Interest income from available-for-sale securities		–	4,538,535
Exchange (losses)/gains		(973)	3,781,251
Realised gains from the disposal of available-for- sale securities		–	287,111
Other income		60,000	62,268
		330,338,817	373,983,596
Expenditure			
Staff costs	5	3,684,755	5,385,949
Premises costs		3,161,530	3,442,548
Depreciation and amortisation		5,324,965	5,629,275
Office supplies		18,840	76,364
Overseas travel		243,839	91,761
Transport and travelling		7,389	2,751
Operating expenses reimbursable to the HKMA		22,055,559	16,044,004
Hire of services		8,527,836	9,296,743
Communications		86,669	93,971
Publicity and printing		17,877,278	27,985,866
Other expenses		3,427,833	3,309,492
		64,416,493	71,358,724
Surplus for the year		265,922,324	302,624,872

The notes on pages 49 to 62 form part of this statement of accounts.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 March 2012
(Expressed in Hong Kong dollars)

	2012 HK\$	2011 HK\$
Surplus for the year	265,922,324	302,624,872
Other comprehensive income		
Disposal of available-for-sale securities	—	(42,610)
Total comprehensive income for the year	265,922,324	302,582,262

The notes on pages 49 to 62 form part of this statement of accounts.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND BALANCE SHEET

as at 31 March 2012
(Expressed in Hong Kong dollars)

	Note	2012 HK\$	2011 HK\$
Non-current assets			
Fixed assets	6	2,638,014	3,257,517
Intangible assets	7	5,238,208	7,889,721
		7,876,222	11,147,238
Current assets			
Other receivables	8	1,143,308	1,131,276
Cash and balances with banks and the Exchange Fund	9	1,811,323,262	1,535,871,789
		1,812,466,570	1,537,003,065
Current liabilities			
Contributions received in advance		247,101,550	245,957,023
Other payables	10	25,612,001	20,486,363
		272,713,551	266,443,386
Net current assets		1,539,753,019	1,270,559,679
Net assets		1,547,629,241	1,281,706,917
Represented by			
Accumulated surplus		1,547,629,241	1,281,706,917
		1,547,629,241	1,281,706,917

Approved and authorised for issue by the Hong Kong Deposit Protection Board on 22 June 2012.

Mrs Chan Wong Shui, Pamela, BBS, JP
Chairperson

The notes on pages 49 to 62 form part of this statement of accounts.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

STATEMENT OF CHANGES IN EQUITY

for the year ended 31 March 2012
(Expressed in Hong Kong dollars)

	2012 HK\$	2011 HK\$
Fund balance as at 1 April	1,281,706,917	979,124,655
Surplus for the year	265,922,324	302,624,872
Disposal of available-for-sale securities	—	(42,610)
Fund balance as at 31 March	1,547,629,241	1,281,706,917

The notes on pages 49 to 62 form part of this statement of accounts.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

CASH FLOW STATEMENT

for the year ended 31 March 2012
(Expressed in Hong Kong dollars)

	2012 HK\$	2011 HK\$
Operating activities		
Surplus for the year	265,922,324	302,624,872
Interest income	(2,379,214)	(5,105,425)
Exchange losses/(gains)	973	(3,781,251)
Net realised gains	–	(287,111)
Depreciation and amortisation	5,324,965	5,629,275
Cash inflow from operating surplus before changes in operating assets and liabilities	268,869,048	299,080,360
Changes in operating assets and liabilities		
Increase in other receivables	28,253	152,910
Increase/(Decrease) in contributions received in advance	1,144,527	(36,682,895)
Increase/(Decrease) in other payables	5,125,638	(1,642,235)
Net cash inflow from operating activities	275,167,466	260,908,140
Investing activities		
Purchase of intangible assets	(980,650)	(1,424,320)
Purchase of fixed assets	(1,073,299)	(45,090)
Interest received	2,337,956	566,890
Purchase of available-for-sale securities	–	(1,103,871,358)
Proceeds from disposal and redemption of available-for-sale securities	–	1,895,001,331
Net cash inflow from investing activities	284,007	790,227,453
Net increase in cash and cash equivalents	275,451,473	1,051,135,593
Cash and cash equivalents at 1 April	1,535,871,789	484,736,196
Cash and cash equivalents at 31 March	1,811,323,262	1,535,871,789
Analysis of balance of cash and cash equivalents		
Cash and balances with banks and the Exchange Fund	1,811,323,262	1,535,871,789

The notes on pages 49 to 62 form part of this statement of accounts.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

NOTES TO THE STATEMENT OF ACCOUNTS

for the year ended 31 March 2012
(Expressed in Hong Kong dollars)

1 PURPOSE AND ACTIVITIES

The Deposit Protection Scheme Fund (the "Fund") is established under the Deposit Protection Scheme Ordinance (the "Ordinance") for the purpose of providing compensation to depositors under certain circumstances in respect of deposits maintained with banks that are members of the Deposit Protection Scheme (the "Scheme" or the "DPS"). Currently, the protection limit is set at HK\$500,000 per depositor per bank. The Hong Kong Deposit Protection Board (the "Board") manages the Fund in accordance with the provisions of the Ordinance. The Fund mainly consists of contributions collected from Scheme members and returns on investments of the Fund. Expenditure incurred in the establishment and maintenance of the Scheme, as well as the management and administration of the Fund are paid from the Fund.

2 SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of preparation

The statement of accounts of the Fund has been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs" is a collective term which includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKASs") and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), and accounting principles generally accepted in Hong Kong. The statement of accounts has been prepared under the historical cost convention.

The preparation of statement of accounts in conformity with HKFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Fund's accounting policies.

The Fund makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The estimates and assumptions made in the preparation of these accounts do not have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

(i) New and amended standards adopted by the Fund

The following new standards and amendments to standards are mandatory for the first time for the financial year beginning 1 January 2011 that would be expected to impact on the Fund.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

NOTES TO THE STATEMENT OF ACCOUNTS

for the year ended 31 March 2012
(Expressed in Hong Kong dollars)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(a) Basis of preparation *(continued)*

(i) New and amended standards adopted by the Fund *(continued)*

HKAS 24 (Revised), "Related Party Disclosures" is effective for annual period beginning on or after 1 April 2011. It introduces an exemption from all of the disclosure requirements of HKAS 24 for transactions among government related entities and the government. Those disclosures are replaced with a requirement to disclose:

- the name of the government and the nature of their relationship;
- the nature and amount of any individually significant transactions; and
- the extent of any collectively-significant transactions qualitatively or quantitatively.

It also clarifies and simplifies the definition of a related party. Upon the adoption of HKAS 24 (Revised), there is no material impact to the Fund's relevant disclosure. Further information in respect of the details of the transactions and the outstanding balances with the related parties is disclosed in Note 10.

(ii) New and amended standards have been issued but are not effective for the financial year beginning 1 April 2011 and have not been early adopted

The Fund has chosen not to early adopt the following new and revised HKFRS which have been issued but are not yet effective.

- HKFRS 9, "Financial instruments"
- HKFRS 10, "Consolidated financial statements"
- HKFRS 12, "Disclosures of interests in other entities"
- HKFRS 13, "Fair value measurement"

(iii) Up to the date of issue of the statement of accounts, the HKICPA has issued a number of amendments and interpretations and one new standard which are not yet effective for the year ended 31 March 2012 and which have not been adopted in the statement of accounts

The Fund is in the process of making an assessment of what the impact of these amendments is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have a significant impact on the Fund's results of operations and financial position.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(b) Revenue recognition

Revenue is recognised in the income and expenditure account when it is probable that economic benefits will flow to the Fund and the revenue can be measured reliably.

Contributions and exemption fees are collected from Scheme members as specified in Schedule 4 to the Ordinance. They are accounted for on an accrual basis.

Contributions are calculated based on the amount of relevant deposits and the respective supervisory rating of each non-exempted bank applicable at a specified date. Contributions are collected annually in advance for each calendar year.

Interest income is recognised in the income and expenditure account using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Fund estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

(c) Expenses

All expenses are recognised in the income and expenditure account on an accrual basis.

(d) Fixed assets

Fixed assets are stated at cost less accumulated depreciation and impairment losses. Depreciation is calculated on a straight-line basis to write off the assets over their estimated useful lives as follows:

	Years
Computer hardware/software costs:	
• Servers	5
• Others, e.g. personal computers, printers and accessories	3
Office furniture, equipment and fixtures	5

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

NOTES TO THE STATEMENT OF ACCOUNTS

for the year ended 31 March 2012
(Expressed in Hong Kong dollars)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(d) Fixed assets *(continued)*

Only items costing HK\$10,000 or more are capitalised. Gains or losses arising from the disposal of a fixed asset are determined as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the income and expenditure account in the month of disposal.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount exceeds its estimated recoverable amount. The recoverable amount is the higher of the asset's net selling price and value in use.

(e) Loans and receivables

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

(f) Intangible assets

Costs that are directly associated with the development of identifiable and unique systems controlled and used by the Fund, and that will probably generate economic benefit exceeding costs beyond one year, are recognised as intangible assets. Intangible assets include expenditures on development of the Payout System. Such expenditure is capitalised if the systems are technically and commercially feasible. The expenditure capitalised includes the direct labour and costs of materials. Intangible assets are stated at cost less accumulated amortisation and any impairment losses.

Amortisation of intangible assets with definite life is charged to the income and expenditure account on a straight-line basis over the assets' estimated useful life of 5 years.

(g) Impairment of financial assets

The Fund assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired.

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

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(g) Impairment of financial assets *(continued)*

If any such evidence exists for available-for-sale securities, the cumulative loss, measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in income and expenditure account, is removed from reserve and recognised in the income and expenditure account. If, in a subsequent period, the fair value of a debt security classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income and expenditure account, the impairment loss is reversed through the income and expenditure account.

(h) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of transaction including: cash at bank and on hand, demand deposits with banks, other financial institutions and the Monetary Authority ("MA") for the account of the Exchange Fund, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

(i) Other payables

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

(j) Translation of foreign currencies

(i) Functional and presentation currency

Items included in the statement of accounts are measured using the currency of the primary economic environment in which the Fund operates ("the functional currency"). The statement of accounts is presented in Hong Kong dollars, which is the Fund's functional and presentation currency.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income and expenditure account.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

NOTES TO THE STATEMENT OF ACCOUNTS

for the year ended 31 March 2012
(Expressed in Hong Kong dollars)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(k) Operating leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income and expenditure account on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

(l) Provisions and contingent liabilities

Provisions are recognised when the Fund has a present legal or constructive obligation as a result of past events where it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated.

Provisions are measured at the present value of the expenditure expected to be required to settle the obligation that reflects current market assessments of the time value of money and the risks specific to the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(m) Employee benefits

(i) Employee leave entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. An accrual is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave and maternity leave are recognised when the absence occurs.

(ii) Pension obligations

The Fund offers a mandatory provident fund scheme, the assets of which are generally held in separate trustee-administered funds. These pension plans are generally funded by payments from employees and by the Fund. The Fund's contributions to the mandatory provident fund scheme are expensed as incurred.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(n) Related parties

Related parties are those parties which have the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or entities.

3 RISK MANAGEMENT

(a) Governance

The Fund is established under the Ordinance for the purpose of providing compensation to depositors under certain circumstances in respect of deposits maintained with banks which are members of the Scheme. Under Part 4 of the Ordinance, the Fund is to consist of:

- contributions and late payment fees collected from Scheme members;
- money recovered by the Board from, or out of the assets of, failed Scheme members;
- returns on investments;
- money borrowed by the Board for the purpose of performing its functions; and
- any other money lawfully paid into the Fund.

The Board established an Investment Committee and delegated its power to the Committee to place, or invest, money of the Fund that is not immediately required by the Board for the performance of its functions. In particular, the Investment Committee:

- makes recommendations on the investment policy and strategy in respect of the Fund;
- monitors the investment performance of the Fund and establishes proper risk management controls for the investment activities of the Board; and
- works on any other matters as determined from time to time by the Board.

Operating within the requirements under the Ordinance and policies endorsed by the Investment Committee, the Board's staff conduct the day-to-day investment management and risk management of the Fund.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

NOTES TO THE STATEMENT OF ACCOUNTS

for the year ended 31 March 2012
(Expressed in Hong Kong dollars)

3 RISK MANAGEMENT *(continued)*

(b) Investment management and control

Under section 21 of the Ordinance, the Fund or any part of it may be invested in the following investment instruments:

- deposits with the MA for the account of the Exchange Fund;
- Exchange Fund Bills;
- US Treasury Bills; and
- any other investment approved by the Financial Secretary.

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

Investment activities of the Fund are conducted in accordance with the requirements set out in the Ordinance and the policies endorsed by the Investment Committee to ensure the investment objectives of capital preservation and maintaining sufficient liquidity are met.

The Board's Management Team is responsible for the day-to-day investment management of the Fund. Investment reports showing the latest market values, rate of return, maturity profile, types of financial instruments held and limit exposures are regularly submitted to the Investment Committee for control purpose.

(c) Financial risk management

Market risk

Market risk is the risk that changes in market variables such as interest rates, equity prices and exchange rates which may affect the fair value or cash flows of a financial instrument. Market risk to the Fund mainly comprises interest rate risk and currency risk.

(i) Interest rate risk

Interest rate risk refers to the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Since the majority of the financial assets represent the cash balances with bank and the Exchange Fund, the impact of interest rate fluctuations on the Fund is considered minimal.

3 RISK MANAGEMENT *(continued)*

(c) Financial risk management *(continued)*

(ii) Currency risk

Currency risk is the risk of loss arising from changes in foreign exchange rates. The investments held by the Fund are denominated either in Hong Kong dollars or US dollars. Because of the linked exchange rate with the US dollar, the exchange risk to the Fund is considered minimal.

Liquidity risk

Liquidity risk refers to the risk that the Fund may not have sufficient funds available to meet its liabilities as they fall due. In addition, the Fund may not be able to liquidate its financial assets at a price close to the fair value within a short period of time.

Given that the Fund can only make deposits with the MA for the account of the Exchange Fund or with financial institutions approved by the Investment Committee or invest in the highly liquid Exchange Fund Bills and Notes and US Treasury Bills and Notes, the liquidity of the Fund is maintained at a high level at all times.

Credit risk

The Fund is exposed to credit risk as a borrower or a counterparty may not be able or willing to perform its contractual obligations in full when due. The credit risk of the Fund can be broken into (i) counterparty risk from placement activities; (ii) counterparty risk from investment transactions; (iii) issuer risk arising from debt securities holdings; and (iv) country risk.

Counterparty credit exposures arise mainly from the Fund's deposit placements with the MA for the account of the Exchange Fund and financial institutions approved by the Investment Committee and securities transactions with financial institutions. In this respect, the Fund will only conduct securities transactions with counterparties approved by the Investment Committee. Issuer risk arises from investments in debt securities. The types of investment securities of the Fund are limited to Exchange Fund Bills and Notes and US Treasury Bills and Notes, both with minimal default risk. In addition to the counterparty and issuer risks, the Fund is exposed to country risk, which is confined to the sovereign risk of Hong Kong and the US and the country risk of financial institutions approved by the Investment Committee given the Fund's limited types of investments. The Fund's credit exposures are reported regularly to the Investment Committee based on its delegated authority from the Board.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

NOTES TO THE STATEMENT OF ACCOUNTS

for the year ended 31 March 2012
(Expressed in Hong Kong dollars)

3 RISK MANAGEMENT *(continued)*

(c) Financial risk management *(continued)*

Fair value of financial assets and financial liabilities

The fair value of the financial instruments traded in active markets is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Fund is the current bid price. In the absence of such quoted market prices, fair values are estimated using present value or other valuation techniques, with inputs based on market conditions existing at the balance sheet date.

The fair values of financial assets and liabilities not presented on the Fund's balance sheet at their fair value are estimated as follows:

(i) Bank balances and balances with the Exchange Fund

The fair values of bank balances and balances with the Exchange Fund are their carrying amounts.

(ii) Other receivables

The estimated fair value of other receivables, which are non-interest bearing balances, is their carrying value.

(iii) Other payables

The estimated fair value of other payables, which are non-interest bearing balances, is their carrying value.

4 TAXATION

No provision for Hong Kong Profits Tax has been made as the Board is exempt from Hong Kong Profits Tax pursuant to section 10 of the Ordinance.

5 STAFF COSTS

	2012 HK\$	2011 HK\$
Salaries	3,289,636	4,968,960
Gratuity	–	71,612
Other employee benefits	395,119	345,377
	3,684,755	5,385,949

6 FIXED ASSETS

	Office equipment, furniture and fixtures HK\$	Computer hardware/ software HK\$	Total HK\$
Cost			
As at 1 April 2011	1,062,094	8,463,417	9,525,511
Additions	–	1,073,299	1,073,299
As at 31 March 2012	1,062,094	9,536,716	10,598,810
Accumulated depreciation			
As at 1 April 2011	879,164	5,388,830	6,267,994
Charge for the year	138,011	1,554,791	1,692,802
As at 31 March 2012	1,017,175	6,943,621	7,960,796
Net book value			
As at 31 March 2012	44,919	2,593,095	2,638,014
As at 31 March 2011	182,930	3,074,587	3,257,517

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

NOTES TO THE STATEMENT OF ACCOUNTS

for the year ended 31 March 2012
(Expressed in Hong Kong dollars)

7 INTANGIBLE ASSETS

	Development costs of Payout System HK\$
Cost	
As at 1 April 2011	19,959,376
Additions	980,650
As at 31 March 2012	20,940,026
Accumulated amortization	
As at 1 April 2011	12,069,655
Charge for the year	3,632,163
As at 31 March 2012	15,701,818
Net book value	
As at 31 March 2012	5,238,208
As at 31 March 2011	7,889,721

8 OTHER RECEIVABLES

	2012 HK\$	2011 HK\$
Prepayment	1,076,474	1,056,497
Interest receivables	50,334	10,049
Others	16,500	64,730
	1,143,308	1,131,276

9 MATERIAL RELATED PARTY TRANSACTIONS

Pursuant to section 6 of the Ordinance, the Board shall perform its functions through the MA unless indicated otherwise by the Financial Secretary. The Hong Kong Monetary Authority ("HKMA") has assigned a team of staff to assist the Board in discharging its functions. The team is headed by an Executive Director of the HKMA, who is designated as the Chief Executive Officer of the Board. The HKMA also supports the Board on aspects such as accounting, administration, human resources, and information technology.

The related party transactions with the HKMA are as follows:

	Note	2012 HK\$	2011 HK\$
Aggregate amounts outstanding at the year end			
Balances with the Exchange Fund	(a)	1,414,924,210	1,528,322,621
Transactions during the year			
Interest income from balances with the Exchange Fund	(a)	2,085,488	558,493
Operating expenses reimbursed to the HKMA	(b)	22,055,559	16,044,004

- (a) During the year, the Fund placed deposits with the Exchange Fund amounting to HK\$1,414,924,210 (2011: HK\$1,528,322,621) and earned interest amounting to HK\$2,085,488 (2011: HK\$558,493) at a rate which is referenced to the market interest rates.
- (b) Certain operating expenses are reimbursed to the HKMA on a cost recovery basis in accordance with the provisions set out in the Ordinance.
- (c) During the year, the HKMA provided the Board a standby facility from the Exchange Fund for meeting the necessary liquidity required for payment of compensation in the event of a bank failure. The maximum amount which may be drawn under the facility is HK\$120 billion (2011: HK\$120 billion) of which nil (2011: nil) was drawn during the year.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

NOTES TO THE STATEMENT OF ACCOUNTS

for the year ended 31 March 2012
(Expressed in Hong Kong dollars)

10 OTHER PAYABLES

	Note	2012 HK\$	2011 HK\$
Hire of services	(a)	23,412,856	18,847,606
Staff expenses		190,618	133,962
Others		2,008,527	1,504,795
		25,612,001	20,486,363

- (a) This amount includes operating expenses reimbursed to the HKMA HK\$22,055,559 (2011: HK\$16,044,004), services fee for payout rehearsal HK\$185,000 (2011: HK\$1,863,840) and fees for other hire of services HK\$1,172,297 (2011: HK\$939,762).

11 APPROVAL OF STATEMENT OF ACCOUNTS

The statement of accounts was approved by the Board on 22 June 2012.

ANNEX 1 NAMES OF SCHEME MEMBERS AS OF 31 MARCH 2012

ABN AMRO BANK N.V.	BARCLAYS BANK PLC
AGRICULTURAL BANK OF CHINA LIMITED	BNP PARIBAS
ALLAHABAD BANK	BNP PARIBAS SECURITIES SERVICES
AUSTRALIA AND NEW ZEALAND BANKING GROUP LIMITED	BNP PARIBAS WEALTH MANAGEMENT
AXIS BANK LIMITED	BSI LTD
BANCA MONTE DEI PASCHI DI SIENA S.P.A.	CANADIAN IMPERIAL BANK OF COMMERCE
BANCO BILBAO VIZCAYA ARGENTARIA S.A.	CANARA BANK
BANCO DE ORO UNIBANK, INC.	CATHAY BANK
BANCO SANTANDER, S.A.	CATHAY UNITED BANK COMPANY, LIMITED
BANGKOK BANK PUBLIC COMPANY LIMITED	CHANG HWA COMMERCIAL BANK, LTD.
BANK JULIUS BAER & CO. LTD.	CHIBA BANK, LTD (THE)
BANK OF AMERICA, NATIONAL ASSOCIATION	CHINA CONSTRUCTION BANK (ASIA) CORPORATION LIMITED
BANK OF BARODA	CHINA CONSTRUCTION BANK CORPORATION
BANK OF CHINA (HONG KONG) LIMITED	CHINA DEVELOPMENT BANK CORPORATION
BANK OF CHINA LIMITED	CHINA MERCHANTS BANK CO., LTD.
BANK OF COMMUNICATIONS CO., LTD.	CHINA MINSHENG BANKING CORP., LTD.
BANK OF EAST ASIA, LIMITED (THE)	CHINATRUST COMMERCIAL BANK, LIMITED
BANK OF INDIA	CHIYU BANKING CORPORATION LIMITED
BANK OF MONTREAL	CHONG HING BANK LIMITED
BANK OF NEW YORK MELLON (THE)	CHUGOKU BANK, LTD (THE)
BANK OF NOVA SCOTIA (THE)	CITIBANK (HONG KONG) LIMITED
BANK OF SINGAPORE LIMITED	CITIBANK, N.A.
BANK OF TAIWAN	CITIC BANK INTERNATIONAL LIMITED
BANK OF TOKYO-MITSUBISHI UFJ, LTD. (THE)	COMMONWEALTH BANK OF AUSTRALIA
BANK SARASIN & CIE AG	COOPERATIEVE CENTRALE RAIFFEISEN-BOERENLEENBANK B.A.
BANK SINOPAC	COUTTS & CO AG
BANQUE PRIVEE EDMOND DE ROTHSCHILD SA	

ANNEX 1 NAMES OF SCHEME MEMBERS AS OF 31 MARCH 2012

CREDIT AGRICOLE CORPORATE AND
INVESTMENT BANK

CREDIT AGRICOLE (SUISSE) SA

CREDIT SUISSE AG

DAH SING BANK, LIMITED

DBS BANK (HONG KONG) LIMITED

DBS BANK LTD.

DZ BANK AG DEUTSCHE ZENTRAL-
GENOSSENSCHAFTSBANK,
FRANKFURT AM MAIN

E.SUN COMMERCIAL BANK, LTD.

EAST WEST BANK

EFG BANK LTD

ERSTE GROUP BANK AG

FALCON PRIVATE BANK LTD.

FAR EASTERN INTERNATIONAL BANK

FIRST COMMERCIAL BANK, LTD.

FUBON BANK (HONG KONG) LIMITED

HACHIJUNI BANK, LTD. (THE)

HANA BANK

HANG SENG BANK, LIMITED

HDFC BANK LIMITED

HONG LEONG BANK BERHAD

HONGKONG AND SHANGHAI BANKING
CORPORATION LIMITED
(THE)

HSBC BANK INTERNATIONAL LIMITED

HSBC BANK PLC

HSBC BANK USA, NATIONAL ASSOCIATION

HSBC PRIVATE BANK (SUISSE) SA

HUA NAN COMMERCIAL BANK, LTD.

ICICI BANK LIMITED

INDIAN OVERSEAS BANK

INDUSTRIAL AND COMMERCIAL BANK OF
CHINA (ASIA) LIMITED

INDUSTRIAL AND COMMERCIAL BANK OF
CHINA LIMITED (THE)

INDUSTRIAL BANK OF KOREA

INDUSTRIAL BANK OF TAIWAN CO., LTD.

ING BANK N.V.

INTESA SANPAOLO SPA

IYO BANK, LTD. (THE)

JPMORGAN CHASE BANK, NATIONAL
ASSOCIATION

KBC BANK N.V.

KOREA EXCHANGE BANK

LAND BANK OF TAIWAN CO., LTD.

LGT BANK IN LIECHTENSTEIN AG

LLOYDS TSB BANK PLC

MACQUARIE BANK LIMITED

MALAYAN BANKING BERHAD

MEGA INTERNATIONAL COMMERCIAL BANK
CO., LTD.

MELLI BANK PLC

MEVAS BANK LIMITED

MITSUBISHI UFJ TRUST AND BANKING
CORPORATION

MIZUHO CORPORATE BANK, LTD

NANYANG COMMERCIAL BANK, LIMITED

NATIONAL AUSTRALIA BANK, LIMITED

NATIONAL BANK OF ABU DHABI

NATIONAL BANK OF PAKISTAN

NATIXIS

NEWEDGE GROUP

OVERSEA-CHINESE BANKING CORPORATION
LTD.

PHILIPPINE NATIONAL BANK

PT. BANK NEGARA INDONESIA (PERSERO) TBK.

PUBLIC BANK (HONG KONG) LIMITED

PUNJAB NATIONAL BANK

ROYAL BANK OF CANADA

ROYAL BANK OF SCOTLAND N.V. (THE)

ROYAL BANK OF SCOTLAND PUBLIC LIMITED
COMPANY (THE)

SHANGHAI COMMERCIAL & SAVINGS BANK,
LTD. (THE)

SHANGHAI COMMERCIAL BANK LIMITED

SHANGHAI PUDONG DEVELOPMENT BANK
CO., LTD.

SHIGA BANK LIMITED (THE)

SHINHAN BANK

SHIZUOKA BANK, LTD. (THE)

SKANDINAVISKA ENSKILDA BANKEN AB

SOCIETE GENERALE

SOCIETE GENERALE BANK & TRUST

STANDARD BANK ASIA LIMITED

STANDARD BANK PLC

STANDARD CHARTERED BANK

STANDARD CHARTERED BANK (HONG KONG)
LIMITED

STATE BANK OF INDIA

STATE STREET BANK AND TRUST COMPANY

SUMITOMO MITSUI BANKING CORPORATION

SVENSKA HANDELSBANKEN AB (PUBL)

TAI SANG BANK LTD.

TAI YAU BANK, LIMITED

TAIPEI FUBON COMMERCIAL BANK CO., LTD.

TAISHIN INTERNATIONAL BANK CO., LTD

TAIWAN BUSINESS BANK

TAIWAN COOPERATIVE BANK, LTD.

TAIWAN SHIN KONG COMMERCIAL BANK
CO., LTD

TORONTO-DOMINION BANK

UBS AG

UCO BANK

UNICREDIT BANK AG

UNION BANK OF INDIA

UNITED OVERSEAS BANK LTD.

WELLS FARGO BANK, NATIONAL ASSOCIATION

WESTLB AG

WESTPAC BANKING CORPORATION

WING HANG BANK, LIMITED

WING LUNG BANK LIMITED

WOORI BANK

ANNEX 2 LIST OF MAJOR PUBLIC EDUCATION AND PUBLICITY ACTIVITIES FOR YEAR 2011-2012

Month	Activities
May 2011 - March 2012	Co-operated with different NGOs to organise talks in community centres located in various districts to promote the DPS. Eight talks were held during the year.
June - July 2011	<p>The first TV advertising campaign, lasting six weeks, was launched on major paid and free TV channels to promote the DPS.</p> <p>The first print advertising campaign, lasting four weeks, was launched in different newspapers, including free dailies, to reinforce public understanding of the key features of the DPS. Two different formats were adopted – top banners for the display of key messages, and advertorials to provide detailed explanation of key messages.</p> <p>The first radio advertising campaign and the first internet advertising campaign were launched, both lasting three weeks. Radio APIs (Announcements in the Public Interest) were also broadcast on major radio stations.</p>
June 2011 - March 2012	A short drama performance in secondary schools and events organised by the offices of district councillors were launched. Twenty shows were held to spread the DPS message. Reference materials were also provided to teachers of participating schools for use as teaching aids in Liberal Studies.
July - September 2011	Published print advertisements in the form of advertorials in different NGO publications to reach niche groups (including blue collar workers, teachers, and civil servants).
July 2011	Press release issued on the publication of the Annual Report for 2010-2011 on 13 July 2011.
July - August 2011	<p>A bus shelter advertising campaign, lasting six weeks, was launched to reinforce public awareness of the DPS. In addition to placing traditional format posters at different bus stations, a special creative design was adopted in two high traffic bus stations located in Causeway Bay and Tsim Sha Tsui to drive home the DPS messages.</p> <p>The first MTR network advertising campaign, lasting three weeks, was launched to promote the DPS, especially its key features, and included in-train stickers in rail compartments running on various MTR lines.</p>

Month	Activities
September - December 2011	A three-month-long taxi network advertising campaign highlighting the main aspects of the DPS, was launched featuring 3D taxi tops to attract public attention to the campaign's theme stickers on the taxis.
September 2011	A media luncheon was hosted on 20 September to mark the fifth anniversary of the launch of the DPS.
October - December 2011	Sponsored a radio quiz programme on the DPS on the RTHK Radio 2.
November - December 2011	<p>The second TV advertising campaign, spanning four weeks, was launched to remind the public about the major features of the DPS. APIs were also broadcast to expand the reach of the messages from December 2011 to January 2012.</p> <p>The second print advertising campaign, running for three weeks, was launched in a range of print titles, including the free dailies.</p>
December 2011	<p>The second radio advertising campaign was broadcast over a period of three weeks.</p> <p>The second MTR network advertising campaign, also spread over three weeks, covered high-traffic MTR lines.</p>
December 2011 - January 2012	The second internet advertising campaign, lasting three weeks, was launched on mass-appeal portals.
February - April 2012	Sponsored a radio quiz programme on RTHK's Putonghua channel to promote greater understanding of the DPS' key features.