

SCHEME OPERATIONS



SCHEME MEMBERS' PROFILE AND RELEVANT DEPOSITS

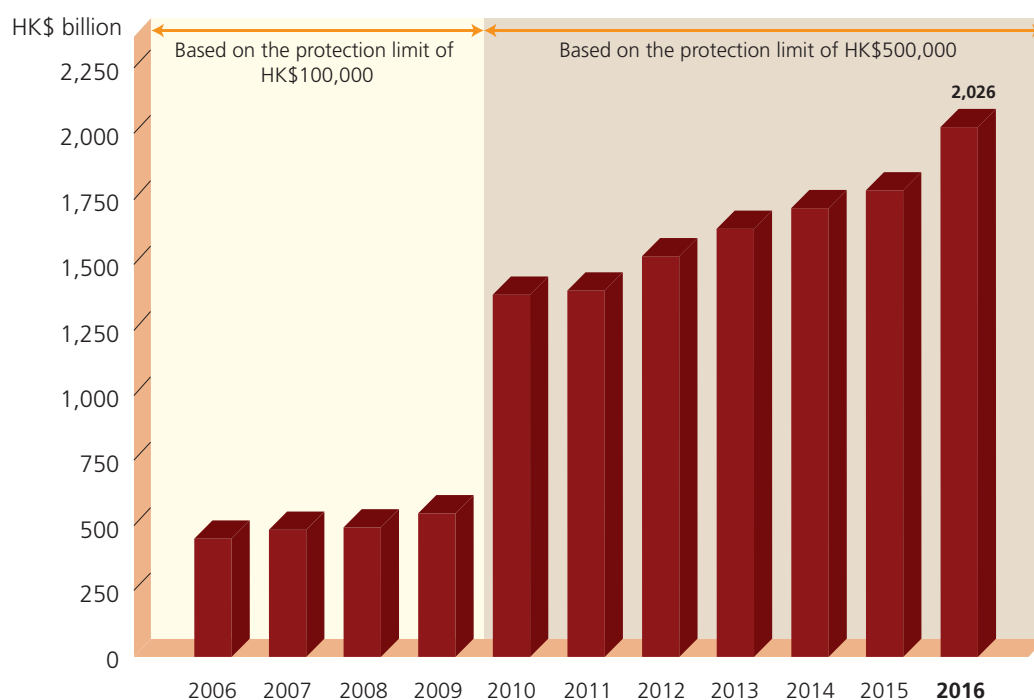
The Scheme had 153 members at the end of March 2017, two less than a year ago. Two newly licensed banks joined the Scheme, while three memberships were revoked and one bank was exempted from being a member. Twenty-two of the Scheme members were locally incorporated banks and 131 were banks incorporated outside Hong Kong. This is largely in line with the number of retail and wholesale banks in Hong Kong.

Based on returns submitted by Scheme members, the aggregate amount of their relevant deposits grew by 14% to HK\$2,026 billion during 2016, compared with HK\$1,784 billion in 2015. This

was attributed to an increase in total deposits held with Scheme members and the change in return reporting from net to gross basis (i.e., without deducting a depositor's liabilities from his or her protected deposits held with the same bank) to tally with the implementation of the gross payout approach in March 2016. The distribution of relevant deposits among Scheme members remained similar to that of the previous year. The top 20 Scheme members, most of which were retail banks, held 97% of the industry's aggregate relevant deposits.

The Board's objective is for most depositors to be fully protected by the DPS protection limit. According to statistics provided by Scheme members, about 90% of depositors are fully protected by the Scheme.

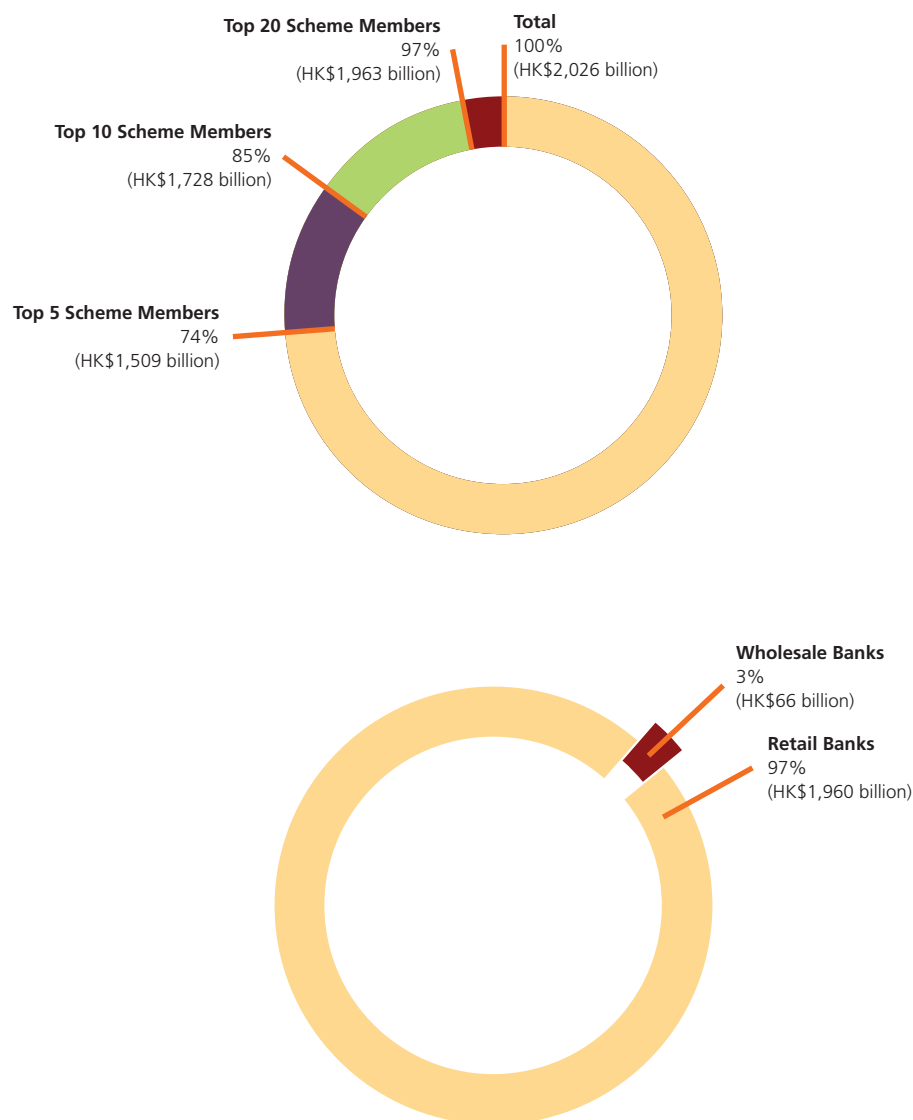
Relevant Deposits Held with Scheme Members (2006 - 2016)



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Distribution of Relevant Deposits in 2016





Is e-money or stored value facility a protected deposit under the DPS?

E-money or stored value facility (SVF) is generally referred to payment products that can store value on a card, mobile phone or internet-based account for the payment of goods and services, or for the transfer of funds between different parties. Thanks to this ever-expanding technology, consumers can conveniently “check out” at shops (physically or online), book tickets or split dinner bills in seconds. While SVF is as convenient as paying with cash, or even more so, consumers are required to deposit or top-up money into their SVF accounts before the facility can be used for payments.

As the stored value feature of an SVF seems similar to a bank deposit account, people may wonder whether the money in such an account is the same as a bank deposit and therefore protected by Hong Kong’s Deposit Protection Scheme. Under the Payment Systems and Stored Value Facilities Ordinance (PSSVFO), the “float” as it’s called, which is the total sum paid by a consumer to an SVF operator for storage on an SVF account, is specifically defined as not a “deposit”. In addition, the float is subject to a different set of regulatory protection under the PSSVFO, such as a number of licensing criteria, proper float separation from the issuer’s own fund and adequate float protection measures. In summary, the interests of consumers holding SVF are adequately protected by the SVF licensing and supervisory regime implemented by the Hong Kong Monetary Authority. As a result, an SVF is not a bank savings account and hence outside the scope of the Deposit Protection Scheme in Hong Kong.



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PAYOUT READINESS

Implementation of the Gross Payout Approach

The necessary operational transition was completed within three months following the adoption of the gross payout approach. The operational plan, procedures and payout system were enhanced and, more importantly, the payout agents were trained to ensure their preparedness to reimburse depositors within seven days of a bank failure. Information requirements for Scheme members were streamlined to enable a more straightforward compliance with the new requirements.

We will also continue to explore the costs and benefits of using various electronic channels to supplement paper cheques as this may help speed up the process of disbursing compensation payment to depositors.

Modernisation of the Payout System

The existing IT infrastructure for the payout operations has been in use for over 10 years. The system hardware is becoming obsolete and the hardware vendor has already informed the Board of discontinuing the ongoing support and maintenance service in the near future. Against this background, a project plan has been formulated to replace the existing payout system, with the aim of completing implementation of the new system by the end of 2018.

Objectives of the Modernisation of the Payout System

Infrastructure Renewal



- Refresh technology to improve computing resource utilisation, system reliability and security
- Strengthen system resilience by shortening recovery time when a disastrous event occurs
- Improve system processing power by 30%
- Enhance personal data protection

Application Redevelopment



- Streamline system workflow for the gross payout approach
- Enhance process efficiency
- Support electronic payment methods
- Reduce cost of maintenance

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Contingency Planning and Rehearsal

The Board has entered into a formal co-operative agreement with the HKMA to allow the Board to receive an early warning signal to prepare for a payout in the event of a possible bank failure.

A full payout rehearsal has been planned for 2017-2018, the first to test the newly implemented gross payout arrangement. The full rehearsal will involve the Board members and all payout agents in a “close-to-real-life” situation to verify if the seven-day payout target can be met. The scope of the rehearsal will cover all relevant deposits of the selected bank, and the command, control and communication framework of the Board, crisis media and co-ordination among payout agents.



A walk-through training of payout procedures for payout agents

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Pre-payout and Payout Processes and Benefits to Depositors under the Gross Payout Approach

Early Preparation

Early warning received from the HKMA to allow preparatory work for a potential payout

This will facilitate the essential preparatory work for achieving a fast payout to depositors



Information Collection

Deposit records are submitted by the failed Scheme member following the DPS trigger while submission of liabilities records is no longer required

Liabilities of depositors owing to the failed Scheme member will not be deducted for compensation payment under the gross payout approach and only deposit records are required for calculation



Data Processing

The data received from the failed Scheme member will be uploaded to the Payout System for processing

Compensation determination is based directly on deposit balances maintained by the failed Scheme member



Compensation Determination

Compensation amount of each depositor is determined by a highly automated process

The calculation under the gross payout approach is relatively simple and the compensation amount can be quickly determined



Disbursement of Compensation

Cheques will be posted to the correspondence addresses of the depositors maintained by the failed Scheme member

Cheques and payout notices will be sent to the depositors within seven days under most circumstances

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Information System Requirements and Compliance

The Information System Guideline (IS Guideline) issued by the Board sets out the requirements for the Scheme members to prepare information submission for the compensation calculation.

Information Requirements for Scheme Members to Achieve a Fast Payout

Deposit Information for Compensation Calculation

- Account number
- Deposit type
- Deposit balance
- Interest information
- Special status: deposit subject to encumbrance, deposit held by a trust or in a client account

Depositor Information for Paying Compensation

- Personal particulars: name, Hong Kong Identity Card number, date of birth
- Company identification: business registration number, name of sole proprietorship
- Contact details: correspondence address, telephone and mobile number, e-mail address
- Special status: depositor with undeliverable address, deceased depositor

Deposit Product Information for Determining DPS Protection

- DPS protection status
- Interest calculation methodology
- Product terms and conditions

Information for Facilitating Payout Process

- Scheme members' IT system and accounting information
- Related companies and special officers
- Contacts of key personnel

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Scheme members' ongoing compliance status is monitored by various measures under the Compliance Review Programme. These measures include self-certification, assessment conducted by independent auditors and reviews done by the Board. The overall compliance level of the industry

during the year was satisfactory. To further enhance the overall effectiveness of the independent assessment, a series of information sessions will be arranged for IT auditors and IT practitioners to deepen their understanding of the assessment requirements.

Monitoring of Scheme Members' Compliance

Compliance Areas to be Examined



- Availability of complete and accurate information
- Format in which the information is made available
- Timeliness in making the required information available
- Readiness of information submission for a payout

Monitoring Tools



Annual Self-certification Endorsed by the Senior Management of Scheme Members

- Annual declaration of compliance with the IS Guideline by Scheme members based on regular internal reviews
- Periodic drill test to ensure effectiveness of Scheme members' procedures related to the IS Guideline

Triennial Assessment by Independent Auditors

- Assessment of Scheme members' systems and controls related to the compliance with the IS Guideline
- Assurance of ongoing compliance with the IS Guideline by Scheme members

Review of Selected Scheme Members by the Board

- Comprehensive review of controls and correctness of bank records submitted by selected Scheme members
- Verification of data compatibility with the payout system using the bank records

How the Board Enhances Scheme Members' Compliance Level



- Provides technical advice on IS Guideline requirements
- Closely monitors Scheme members' remedial actions
- Issues guidance on independent assessment
- Conducts briefing sessions for Scheme members and independent auditors

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DEPOSIT PROTECTION SCHEME FUND

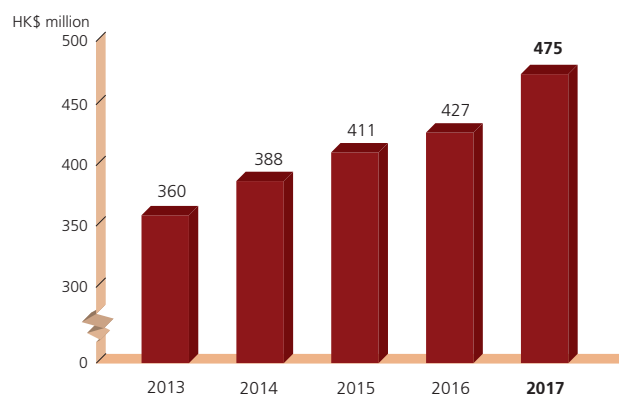
Composition of the Fund

The build up of the DPS Fund is mainly from two sources, namely annual contributions paid to the Board by Scheme members, and the returns generated by the Fund's investments. The amount of relevant deposits reported by Scheme members, together with the supervisory rating provided by the HKMA, serves as the basis for determining their contributions for the coming year.

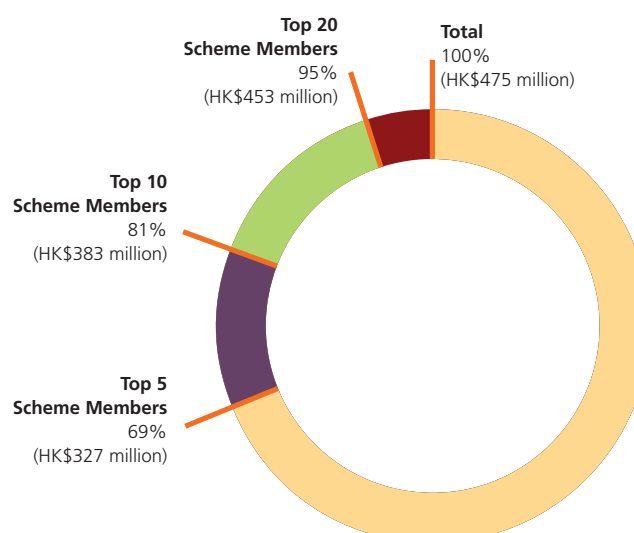
Assessment and Collection of Contributions

The contributions collected from Scheme members during the year amounted to HK\$475 million, an increase of 11% from the previous year. Similar to the distribution of relevant deposits, the amount of contributions collected from the top 20 Scheme members accounted for more than 95% of the total. To ensure the reporting accuracy of Scheme members, the Board, since 2007, has requested Scheme members to conduct regular audit reviews of their returns of relevant deposits in accordance with the policy for reviewing returns. The Board selected 21 Scheme members to submit an audit report on the accuracy of their returns in 2017. The audit results were generally satisfactory, and no reporting error leading to a material impact on the amount of contributions collected by the Board was noted.

Contributions Paid by Scheme Members



Contributions by Relevant Deposits Held with Scheme Members



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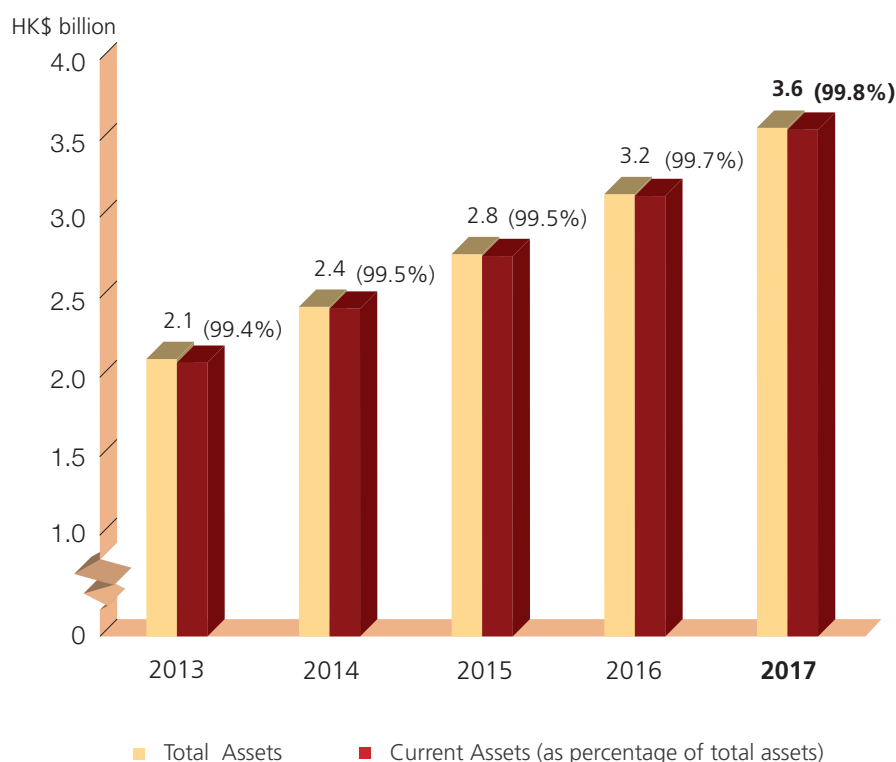


DPS Fund Investments

In view of the continuing uncertainties surrounding the global financial markets, the Board maintained a cautious approach by adopting a capital preservation and conservative strategy for the investment of the DPS Fund. Investments were made in strict compliance with the DPSO and the investment control policies of the DPS Fund, which set out clear

guidelines on risk assessment and control measures, and the segregation of duties required for investment activities. The DPS Fund's assets were maintained with highly liquid assets and were predominantly held in the form of Hong Kong dollar deposits at the end of March 2017. The DPS Fund achieved an investment return of 0.34% for the year despite the uncertain investment environment.

DPS Fund's Assets



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REINFORCING PUBLIC AWARENESS AND UNDERSTANDING OF THE SCHEME

The Board's publicity and community education programmes aim to reinforce public awareness and understanding of the Scheme. During the year, the publicity campaign focused on sharing stories and anecdotes developed on the basis of selected winning entries of the earlier Deposit Story Competition which attracted over 2,000 entries from people across generations and backgrounds. The Competition was designed to encourage appreciation of the underlying meaning of deposits and a greater understanding of deposit protection. The publicity initiatives utilised both conventional and new media to reach a wider audience, and were complemented by an array of community education and engagement activities tailored for specific demographic groups in Hong Kong.



Promotional videos share deposit stories and experiences across different generations

Multi-media Deposit Story Campaign

Riding on the momentum of the Deposit Story Competition among the public, the story sharing initiative was further expanded during the year to include:

- promotional videos posted on the Board's Facebook page, "Save with Confidence", and its YouTube channel, as well as out-of-home and digital publicity channels, such as cinemas, public transport and related advertisements on websites and mobile applications;
- an infotainment series, "Protecting your Deposits", containing five 1-minute deposit story episodes highlighting key features of the DPS for broadcast on a major TV channel and its online platform, supplemented by a magazine advertorial;
- social media engagement encouraging the viewing and sharing of the videos and infotainment through games on the DPS Facebook Page; and
- newspaper advertorial featuring the award presentation ceremony of the Deposit Story Competition, with highlights of the winning stories and sharing by the winners.



TV infotainment series carries the important theme "Protecting your Deposits"

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Community Education and Neighbourhood Outreach Activities

The Board enhanced its efforts to communicate with people from all walks of life, including:

- reaching out to ethnic communities through community activities, supplemented by TV, radio and online advertisements as well as advertorials in relevant free newspapers;
- promoting the DPS board game, “Around the World in \$80”, to the younger generation to further disseminate basic knowledge of the DPS to students and parents through inter-school competition, workshops at schools and youth centres, as well as exhibition booths at the Book Fair, and Learning and Teaching Expo;
- conducting money management cum DPS workshops for financial literacy ambassadors of The Family Planning Association of Hong Kong’s Women’s Club and training them as DPS board game instructors to further spread DPS messages to their families and friends; and
- connecting electronically with the elderly through the launch of a monthly “DPS Tips” column on the Cyber Engagement Platform of the Senior Citizen Home Safety Association.



Enhancing promotion of the DPS to all members of the public



Students consider their next move at the Inter-School Board Game Competition



Female financial literacy ambassadors help spread the word about the DPS

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An Overview of the Community Education and Neighbourhood Outreach Activities in the Past Five Years

147 Talks and Seminars

19 Training Workshops



Elderly



Students



Homemakers



Elderly

28 Consumer Shows and Engagement Activities

70 Board Game Activities



General Public



Families



Students



Youth and Kids

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Understanding the DPS

According to an independent public opinion survey conducted in 2016, the level of awareness and understanding of the DPS among the general public was maintained at a healthy 78%. Of those aware of the Scheme, about 80% knew about the HK\$500,000 protection limit, and understood the legal backing behind the protection. In order to better understand target audiences, the Board also conducted a qualitative focus group study in early 2017 and leveraged on the opportunity to test new creative concepts. The study confirmed the appreciation of the public on the protection offered by the DPS and highlighted the relative importance of the key features of the DPS in the

minds of the participants. The Board will continue to make reference to the findings to fine-tune its communication strategies.

In addition to gauging public opinion, the Board operates the DPS Public Enquiry Service, which is a convenient and effective channel through which members of the public can enquire about different aspects of the Scheme and the functions of the Board. Nearly half the enquiries received in 2016-2017 were related to the scope of protection of the DPS, including types of financial products protected by the DPS, and the handling of deposits in joint accounts and company accounts.

Nature of Enquiries Received by the DPS in 2016-2017



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COMPLIANCE WITH THE REPRESENTATION RULES

The Deposit Protection Scheme (Representation on Scheme Membership and Protection of Financial Products under Scheme) Rules (Representation Rules) govern representations made by Scheme members about their DPS membership and the protection status of the financial products offered by them. To monitor their compliance with the representation requirements, Scheme members were asked to conduct a self-assessment review covering the period from 1 July 2015 to 30 June 2016. In addition, on-site examinations continued to be undertaken to ascertain in greater detail the level of Scheme members' compliance with the Representation Rules. The Board reviewed the self-assessment reports and findings of the on-site examinations conducted by the HKMA to decide the necessity of follow-up actions. The results indicated that the overall compliance level was satisfactory generally, and no non-compliance cases with a systemic impact were identified.

RELATIONSHIPS WITH OTHER SAFETY NET PLAYERS

Co-operation with the HKMA

The Board and the HKMA both have the common objective of promoting the stability of the banking system. To accomplish this, the two parties have signed a Memorandum of Understanding (MoU) that sets out how they co-operate in the performance of their respective functions. Since the Board is required by the DPSO to perform functions through the HKMA, the Board and the HKMA have agreed on the extent of the support provided by the HKMA to the Board on a day-to-day basis. The Board also has in place a standby facility from the Exchange Fund to provide the liquidity required to pay compensation in the event of a bank failure. In addition, there is a co-operative agreement between the Board and the HKMA on an early warning system of a potential bank failure to enable a fast DPS payout.

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

In the event of a bank failure, the funds of a depositor or a portion of those funds may, in certain circumstances, be covered by both the DPS and the Investor Compensation Fund (ICF) established under the Securities and Futures Ordinance to compensate 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 them. These have been documented in an MoU between the Board, the SFC and the Investor Compensation Company, the company established by the SFC to administer the ICF. The MoU recognises that the DPS will normally pay the depositors first in the event of a bank failure, and that the parties involved will avoid double compensation by exchanging relevant information.

International Co-operation

As a member of the International Association of Deposit Insurers (IADI), the Board actively participates in its conferences and seminars and other events organised by member deposit insurers and international organisations, and exchanges knowledge and views on issues relevant to deposit protection in international forums. This is particularly important for keeping up to date with international developments, and for sharing experience about the effectiveness of overseas reform measures that may provide insights and impetus for changes to ensure the robustness of Hong Kong's DPS. In 2016-2017, the Board's personnel took part in a number of international meetings, including:

- The 15th IADI Annual General Meeting and 2016 Annual Conference in Seoul, Korea;
- The Deposit Insurance Corporation of Japan-IADI International Conference "The Changing Environment and Deposit Insurers" in Tokyo, Japan;
- The IADI Asia-Pacific Regional Committee Technical Assistance Seminar in Tokyo, Japan;
- The Financial Stability Institute-IADI Joint Conference on Bank Resolution, Crisis Management and Deposit Insurance Issues in Basel, Switzerland; and
- The International Training Seminar on Payout Operations, Mechanisms and Case Studies organised by the Central Deposit Insurance Corporation, Taiwan in Taipei.