

# HONG KONG DEPOSIT PROTECTION BOARD

## Information Note on Reviewing Compliance with the Guideline on Information Required for Determining and Paying Compensation

### PURPOSE

This information note sets out the arrangements adopted by the Hong Kong Deposit Protection Board (the Board) starting from May 2016 for reviewing Scheme members' compliance with the Guideline on Information Required for Determining and Paying Compensation (the IS Guideline) and the requirements of self-monitoring for improving Scheme members' information readiness.

### BACKGROUND

2. According to the Deposit Protection Scheme Ordinance (**the DPS Ordinance**), when compensation under the Deposit Protection Scheme (**the DPS**) is triggered in respect of a Scheme member, the Board should determine the compensation entitlements of the depositors of the Scheme member and pay compensation to them as soon as practicable. To ensure that the Board can discharge its functions in this respect efficiently and effectively, the Board issued the IS Guideline to specify the manner in which Scheme members should maintain information that is relevant to the determination of compensation in a payout and how they should submit it to the Board. Compliance reviews and self-monitoring are conducted periodically to ascertain that Scheme members maintain adequate records and procedures to permit complete, timely and accurate information submission in accordance with the IS Guideline.

### COMPLIANCE REVIEW CONDUCTED BY THE BOARD

3. According to section 48(1) of the DPS Ordinance, the Board may require a Scheme member to submit such information as it may require for the performance of its functions, and such information shall be submitted within such period and in such manner as the Board may specify. The Board is empowered to

require a Scheme member to submit information to the Board for conducting a compliance review under this section of the DPS Ordinance.

4. The requirements in the IS Guideline generally cover three areas:
  - (i) availability of the required information, including the completeness and accuracy of the information;
  - (ii) timeliness in making the required information available; and
  - (iii) format in which the required information to be submitted to the Board.

5. The Board recognizes that a Scheme member's compliance with some of the requirements in the IS Guideline cannot be verified directly. For example, unlike in a payout, it will not be possible to call a halt to the normal operation of a Scheme member at any time to test whether it can mobilize all its resources to make the required information available to the Board within the specified timeframes. Compliance with such requirements can only be verified indirectly, for example, by verifying whether a system is in place to meet the relevant requirements if the DPS is triggered; and by testing the timeliness of certain data submission, on a sample basis, on the Board's request during the review. In conducting a compliance review, the Board will mainly rely on information supplied by a Scheme member and will not access the information systems of the Scheme member to retrieve the required information.

6. In order to verify the consistency and completeness of the information extracted from the different systems of a Scheme member, the Scheme member under review should perform reconciliation between the position records submitted in accordance with the IS Guideline against the accounting books. A reconciliation report with a supplementary note attached should be submitted, explaining the reasons and amounts of gaps as identified, such as the float cheque.

7. The scope of work to be performed by the Board in each compliance area is set out in the following table:

<b>Compliance areas</b>	<b>Scope of work for compliance checking</b>
Availability of the required information	<ul style="list-style-type: none"> <li>• obtain data of a random position date and terms and conditions of all deposit products (or a subset of them containing major deposit products of which the Board deems sufficient)<sup>1</sup>, to ascertain whether the required information is available and can be retrieved in Hong Kong</li> <li>• review the reconciliation report submitted which compares the balances in the position data with accounting reports to ascertain the completeness of the information</li> <li>• examine the terms and conditions of major deposit products to ascertain their protection status</li> <li>• verify the accuracy of the information in the position data by obtaining and reviewing source documents of a set of randomly selected positions</li> </ul>
Timeliness in making the information available	<ul style="list-style-type: none"> <li>• substantiate whether a system and/or a set of processes is in place to make the required information available to the Board within the specified timeframes</li> <li>• request data submission on a sample basis during the compliance review to ascertain whether the data can be made available within the time periods as specified in the IS Guideline</li> </ul>
Format in which the information is made available	<ul style="list-style-type: none"> <li>• examine the electronic files obtained to establish whether the position and position-holder information can be obtained in the specified formats</li> </ul>

In addition to the scope of work set out in the table above, the Board will also examine in each review whether a Scheme member has put in place a mechanism to ensure that due regard will be given to meeting the requirements in the IS Guideline when new systems or new products are introduced by the Scheme member over time. Scheme members should have established management oversight and internal control processes to maintain continuous conformance with the IS Guideline.

8. The Board conducts around six compliance reviews every year. A risk-based approach is adopted by the Board to identify Scheme members to be subject to a compliance review. Selection of Scheme members is made with

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<sup>1</sup> It is important to select a random position date (not limited to month-end or quarter-end) in compliance review to evaluate the readiness and timeliness of Scheme members on making the required information available at any date. However, to minimize the potential impact to normal daily operations, the Board will consider setting the position date to be at weekend. Where the Board deems sufficient after due consideration, a subset, as opposed to full set, of data containing major deposit products will be requested for the review.

reference to various factors such as the size and complexity of their information systems, in terms of data volume, variety and level of sophistication. Except where a significant change in those factors or a major system change is noted for a Scheme member, a Scheme member subject to a compliance review is not expected to be involved in another review until the Board has completed a cycle of checking on Scheme members of a comparable risk profile. Scheme members chosen for a review will be notified of this at the beginning of the year, followed by a reminder provided at about 1 to 2 months prior to the review but the exact date of the commencement of the review will not be notified. A subsequent information request will be issued at a time nearer to commencement of the review giving the Scheme member 10 business days to prepare, comprising 5 business days prior to the designated position date of information required and another 5 business days for the Scheme member's data extraction and submission.

9. It is expected that, depending on a number of factors specific to the Scheme member involved, it will take 4 to 10 weeks to complete a compliance review. The Scheme member chosen will be requested to nominate representatives from their information systems, compliance, accounting and banking services departments to liaise with the Board on matters relating to the review. However, it is not expected that such personnel will be required to devote significant amount of time throughout the compliance review.

## **SIMULATION TESTS**

10. Simulation tests may be conducted in conjunction with the compliance review of the Board. In a simulation test, the position data obtained from a Scheme member will be uploaded to the information system developed by the Board for calculating compensation entitlements of depositors in a payout (the Payout System) to simulate calculation. It is not anticipated that Scheme member personnel will be required to devote significantly more time to a compliance review that is conducted in conjunction with a simulation test if the position data provided to the Board is in compliance with the IS Guideline. According to the Board's experience in the simulation tests conducted so far, Scheme members may be consulted occasionally in relation to the format and contents of the position data to facilitate the uploading of the data to the Board's Payout System.

## **SELF DECLARATION AND INDEPENDENT ASSESSMENT OF COMPLIANCE**

11. In order to facilitate the Board to monitor whether the requirements set out in the IS Guideline have been met and provide the Board a reasonable assurance that Scheme members maintain systems and processes for compliance with the IS Guideline, Scheme members are required to perform self declaration and to commission a qualified independent party such as internal or external auditors to undertake a comprehensive review (independent assessment) on a regular basis and submit an auditors' report on its assessment.

12. The self declaration is due to be submitted to the Board by the end of March every year. The Chief Executive of the Scheme member should co-sign the declaration. The Board also requires Scheme members to conduct an independent assessment every three years. The process of self declaration, the scope of the independent assessment and the reporting requirements are set out in the Program Guide of the Independent Assessment Program (the Program Guide) and Self-Declaration.

13. To facilitate the Board's planning of compliance reviews and to maintain payout readiness, Scheme members are required to complete a questionnaire in relation to depositor profile, banking products and system information. The questionnaire should be returned at time together with the annual declaration of that year.

## **NON-COMPLIANCE AND REMEDIAL ACTIONS**

### *Compliance review conducted by the Board*

14. After the completion of a compliance review, the Board will issue a letter to the Scheme member to advise on the findings of the review. Where non-compliance issues are identified in the review, the Scheme member will be required to establish an action plan to resolve such issues, and report to the Board upon completion of the plan. The Scheme member should provide relevant information and supporting documents to substantiate the satisfactory implementation of the relevant remedial actions.

### *Self declaration and independent assessment*

15. Where an instance of non-compliance is identified, the Scheme member concerned should put in place a plan to rectify it. The Board, when deemed necessary, may also require the Scheme member to provide relevant information to substantiate the completion of the remedial actions. The Program Guide sets out the standards of a plan to rectify any non-compliance issues identified by Scheme member during the review.

### **HANDLING OF SEVERE NON-COMPLIANCE ISSUES**

16. Where severe non-compliance issues are identified from a compliance review conducted by the Board or self declaration or an independent assessment of the Scheme member, or when the Scheme member has failed to rectify the situation reasonably, the Board may require the Scheme member to undergo further review. These issues, for illustrative purpose, may relate to a concern about whether the Scheme member has sufficient systems and processes that would allow it to comply with the IS Guideline requirements; or if the Scheme member has adequate systems of control to rectify the identified non-compliance issues. Under section 48(4) of the DPS Ordinance, the Board may require a Scheme member to submit a report prepared by an auditor appointed by the Scheme member and approved by the Board as to whether or not, in the opinion of the auditor, the Scheme member has put in place systems of control that are adequate to enable the Board to perform its functions. The scope of the auditors' report may call for a review to be conducted to ensure non-compliance issues already identified are fully rectified in accordance with a proper remediation plan.

17. For any weaknesses identified by the auditor, the Board will request the Scheme member to establish an action plan and to inform the Board of its course of actions under section 48(1) of the DPS Ordinance.