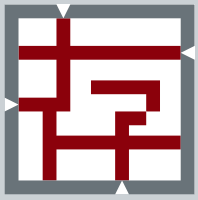


香港存款保障委員會
HONG KONG DEPOSIT PROTECTION BOARD

Annual Report 2005-2006

Mission Statement

To maintain an effective and efficient deposit protection scheme in accordance with the Deposit Protection Scheme Ordinance and in line with international practices.

Contents

	Page
Chairman's Statement	2
Members of the Board	3
About the Hong Kong Deposit Protection Scheme	4
Report on Activities	9
Report of the Auditors	17
Statement of Accounts of the Deposit Protection Scheme Fund	18

Chairman's Statement

Professor
Andrew Chan Chi-fai, JP
Chairman

I am pleased to report that, after two years of intensive preparation, the Hong Kong Deposit Protection Board ("the Board") is ready to launch the deposit protection scheme ("DPS" or "the Scheme"). The Scheme will start to provide deposit protection and collect contributions from Scheme members in the second half of 2006 as planned.

The Board made impressive progress in the past year. In May, we introduced an Amendment Notice to clarify the protection status of structured products and streamline certain areas of operation of the DPS Ordinance. At the same time, the Board promulgated two sets of rules, namely the Representation Rules and Contribution Rules. The former governs how Scheme members should make representations about their DPS membership and the protection status of their financial products. The latter lays down the manner in which Scheme members should pay contributions to the Board. The Amendment Notice and the Rules were tabled for negative vetting before the Legislative Council on 24 May 2006, and the vetting process ended smoothly in July. On the payout infrastructure, we completed the development of the Payout System and subjected it to rigorous user acceptance tests. We have also identified a network of service providers to assist the Board in assessing and disbursing compensation to depositors in the event that a payout is deemed necessary. Based on the current work schedule, we are confident that the DPS can commence full operation shortly, and have selected 25 September 2006 as the target launch date of the DPS.

The DPS will not be effective if members of the public are not aware of it and the protection it provides. With that in mind, we will soon embark on an extensive publicity campaign to promote public understanding of the Scheme.

Taking this opportunity, I would like to express my gratitude to my fellow members for their continued contribution and guidance to the Board since its inception. I would also like to extend my warmest welcome to Ms Elisabeth Scott and Mr Yeung Yuet-bor, who joined the Board in July. Last but not least, I would like to congratulate all staff of the Board for their dedication to seeing the Scheme to fruition.

Going forward, we will constantly review our systems and processes with the aim of ensuring efficient handling of payout. As stated in our mission statement, we will strive to maintain an effective and efficient deposit protection scheme in accordance with the DPS Ordinance and in line with international practices.

Professor Andrew Chan Chi-fai, JP
Chairman, Hong Kong Deposit Protection Board

Members of the Board

Mr Ian Chapman
Member

Prof David Cheung Wai-lok
Member

Mr Nicholas Peter Etches
Member

Mr Nam Lee-yick
Member

Ms Elisabeth Charlotte Scott
Member

Mr Yeung Yuet-bor
Member

Mr William Ryback, JP
Ex officio Member
Representative of the Monetary Authority

Mr Kevin Ho Chi-Ming, JP
Ex officio Member
Representative of the Secretary for Financial Services and the Treasury

About the Hong Kong Deposit Protection Scheme

INTRODUCTION

Enacted in May 2004, the Deposit Protection Scheme Ordinance ("the Ordinance") provides for the establishment of a deposit protection scheme ("DPS") in Hong Kong. To oversee the establishment of the DPS, the Hong Kong Deposit Protection Board ("the Board") was formed in July 2004.

COMPOSITION OF THE BOARD

The Board is a body corporate established under section 3 of the Ordinance. Members of the Board are appointed by the Financial Secretary with powers delegated to him by the Chief Executive. As of 1 July 2006, the Board has nine members including two ex officio members, namely the Deputy Chief Executive (Banking) of the Hong Kong Monetary Authority (being the Monetary Authority ("MA")'s representative) and the Permanent Secretary for Financial Services and the Treasury (Financial Services) (being the representative of the Secretary for Financial Services and the Treasury).

FUNCTIONS OF THE BOARD

Under section 5 of the Ordinance, the Board's functions are confined to 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 from the assets of the failed Scheme member.

INVESTMENT COMMITTEE

In accordance with section 7 of Schedule 2 to the Ordinance, the Board established an investment committee on 1 July 2006 to recommend investment policy and strategy for the DPS Fund, monitor the investment performance of the DPS Fund, and establish proper risk management controls for the investment activities of the Board. The members of the Committee are:

Mr Nam Lee-yick, Chairman
Ms Elisabeth Charlotte Scott, Member
Mr Yeung Yuet-bor, Member
Mr Francis Chu Siu-chuen, Member

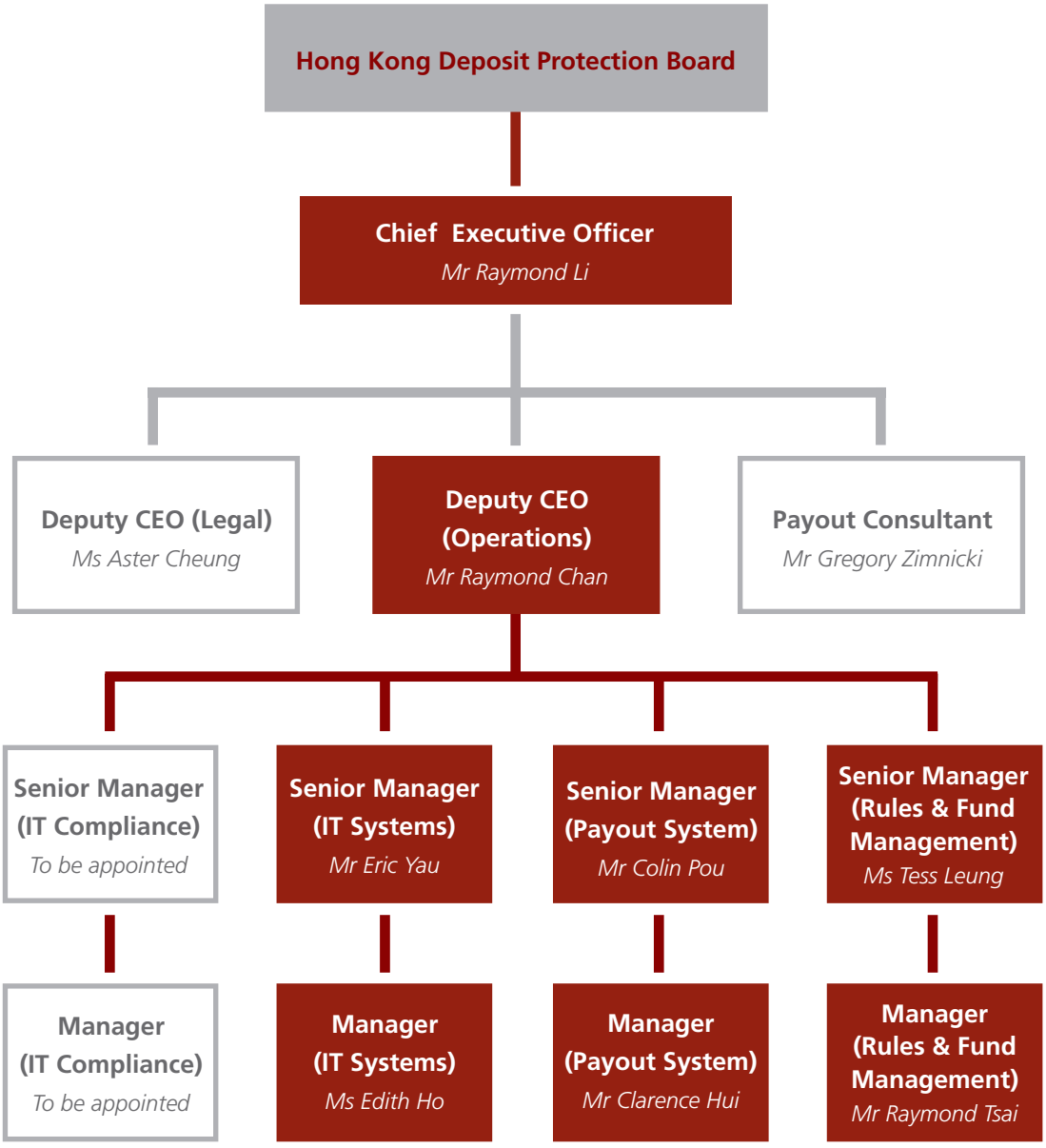
PERFORMANCE OF FUNCTIONS

Pursuant to section 6 of the Ordinance, the Board shall perform its functions through the MA unless indicated otherwise by the Financial Secretary. This means that the MA will act as an executive arm of the Board in administering the DPS and will, in this respect, be subject to the oversight of the Board.

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 ("CEO") of the Board. The CEO is assisted by two Deputy CEOs in charge of operational matters and legal services respectively, and a Payout Consultant responsible for developing payout procedures and systems. The HKMA also supports the Board on aspects such as accounting, administration, human resources, and information technology.

About the Hong Kong Deposit Protection Scheme

Organisation Structure of the Board



HKMA staff seconded to assist the Board. The emoluments of these staff are borne by the HKMA until the DPS starts to collect contributions from Scheme members.

About the Hong Kong Deposit Protection Scheme

Front row, from left to right:
Mr Gregory Zimnicki, Ms Aster Cheung, Mr Raymond Li, Mr Raymond Chan

Back row, from left to right:
Mr Clarence Hui, Mr Eric Yau, Mr Colin Pou, Mr Raymond Tsai, Ms Tess Leung, Ms Edith Ho

MAIN FEATURES OF THE DEPOSIT PROTECTION SCHEME

The DPS in Hong Kong has the following key features:

(a) all licensed banks, unless otherwise exempted by the Board, are required to participate in the DPS as Scheme members;

(b) the compensation limit is set at HK$100,000 per depositor per Scheme member;

(c) both Hong Kong dollar and foreign currency deposits are protected;

(d) a DPS Fund with a target fund size of 0.3% of the total amount of relevant deposits (translating into a fund size of approximately HK$1.3 billion) will be built up through collecting contributions from Scheme members; and

(e) differential contributions will be assessed based on the supervisory ratings of individual Scheme members.

About the Hong Kong Deposit Protection Scheme

CONSULTATIVE COMMITTEE ON DEPOSIT PROTECTION SCHEME

To keep the industry informed of the development of the DPS, the Board established a Consultative Committee on DPS ("the Committee") comprising 13 representatives of 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. The members of the Committee are:

Mr Fung Tin-yiu, Bank of China (Hong Kong) Limited

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

Mr Gilbert Lee, BNP Paribas, Hong Kong Branch

Mr C Y Ling, CITIC Ka Wah Bank Limited

Ms Francesca So, Dah Sing Bank Limited

Ms Sinna Ho, DBS Bank (Hong Kong) Limited

Mr S C Lau, Hang Seng Bank Limited

Ms Diana Cesar, The Hong Kong and Shanghai Banking Corporation Limited

Mr George Kwan, Industrial and Commercial Bank of China (Asia) Limited

Mr Andrew Lau, JPMorgan Chase Bank, Hong Kong Branch

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

Ms Tai Kwai Heung, Nanyang Commercial Bank Limited

Ms Ann Kung, Standard Chartered Bank (Hong Kong) Limited

About the Hong Kong Deposit Protection Scheme

DEPOSIT PROTECTION APPEALS TRIBUNAL

Under the Ordinance, certain decisions of the Board and the MA can be the subject of an appeal to the Deposit Protection Appeals Tribunal ("the Tribunal"). These include the Board's decisions regarding whether a foreign bank branch can be exempted from participation in the DPS, the amount of contribution payable by a Scheme member, and the amount of compensation payable to a depositor, as well as the MA's decision to impose an asset maintenance requirement on a Scheme member.

The Tribunal was established in January 2005. Mr Simon Herbert Mayo, a former Vice-President of the Court of Appeal of the High Court, was appointed by the Chief Executive as Chairman of the Tribunal. Members of the Tribunal are appointed by the Financial Secretary from a panel of six persons. The panel members are listed below. Sittings of the Tribunal will be convened on an as needed basis.

Mr Charles David Booth

Professor Simon Ho Shun-man

Miss Winnie Lun Pong-hing

Ms Melissa Kaye Pang

Mr Rupert James Purser

Mr James Wardell

Report on Activities

The Board had a busy but fruitful year in 2005-2006. It completed all necessary preparation for the launch of the deposit protection scheme ("DPS"). The key tasks accomplished by the Board and their details are described below.

(a) Legislative amendments to DPS Ordinance

Treatment of structured products under the DPS

In the course of preparing for the launch of the DPS, the Board has observed that many Scheme members are unclear about the protection status of structured products such as equity-linked deposits, currency-linked deposits, credit-linked deposits, index-linked deposits, inverse floaters and range accruals. The Board notes that whether a financial product constitutes a deposit within the meaning of section 2 of the DPS Ordinance and is thus protected by the DPS needs to be determined on a case by case basis and with regard to the terms and conditions of the product. The ambiguity regarding the protection status of structured products is undesirable. Scheme members will need to incur additional costs in determining the nature of their structured products case by case. Despite the additional costs and efforts, some Scheme members may still not be able to correctly advise their customers whether a structured product is protected by the DPS. As a result, consumers may make wrong decisions in their choice of suitable structured products.

To remove the ambiguity, the Board introduced amendments to Schedule 1 to the DPS Ordinance to clarify that structured products are not protected by the DPS. There are three main reasons for this amendment. Firstly, many structured products offered in the market are not deposits, thus outside the scope of protection by the DPS. Secondly, the DPS in Hong Kong is aimed at protecting small, unsophisticated depositors, and structured products attract mostly large and sophisticated depositors. Excluding structured products from deposit protection is therefore consistent with the original policy objective of establishing a DPS in Hong Kong to protect mainly small depositors. Thirdly, the aggregate amount of structured products, which are likely to be deposits and thus protected by the DPS, is very small. Therefore, the exclusion of structured products from DPS protection is not seen as likely to undermine the ability of the DPS to contribute to banking stability.

Going forward, the Board will keep this issue under review. It has established a set of quantitative benchmarks for triggering a review of this matter. In the unlikely event that the exclusion of structured products materially affects the effectiveness of the DPS, the Board will consider introducing appropriate amendments to the DPS Ordinance to reverse the exclusion.

Report on Activities

Other amendments to DPS Ordinance

In the course of establishing the DPS, the Board also saw the relevance of introducing the following miscellaneous amendments to improve the operation of Schedules 1 and 4 to the Ordinance:

- Amending the definition of "excluded person" in section 3 of Schedule 1 to the DPS Ordinance so that Scheme members need not exclude the deposits held by officers of Scheme members and their related companies for the purpose of calculating the amount of contribution to be paid into the DPS Fund. This amendment alleviated the reporting burden of Scheme members who consider that the resources required to identify the amount of such deposits outweigh any savings in their contribution to the DPS Fund;

- Amending Schedule 4 to provide that if 20 October (the date for Scheme members to report the amount of relevant deposits each year) of any year is a public holiday, Scheme members should report the amount of relevant deposits based on the position on the immediate preceding day which is not a public holiday; and

- Amending section 3 of Schedule 4 to allow the calculation of the build-up levy for the first year of operation of the DPS to be made on a pro rata basis.

The relevant legislative amendments were tabled before the Legislative Council for negative vetting on 24 May 2006 and the vetting process was completed in July.

(b) Rules and guidelines governing operation of the DPS

The Board is empowered under the DPS Ordinance to make rules governing the operation of the DPS. After consultation with the Financial Secretary and the Hong Kong Association of Banks ("HKAB"), the Board issued two sets of rules in the form of subsidiary legislation in May 2006. The negative vetting process of the rules was completed in July.

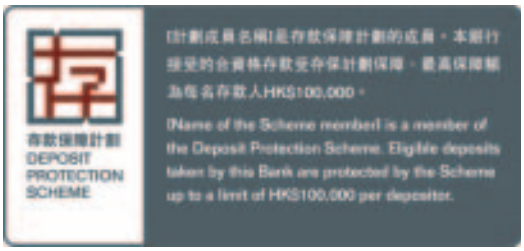
DPS (Representation on Scheme Membership and Protection of Financial Products under Scheme) Rules ("Representation Rules")

The Representation Rules govern the representations Scheme members are to make regarding their membership and the protection status of their financial products. The objective of this set of Rules is to assist members of the public to distinguish between DPS protected and non-DPS protected financial products, so that they can make informed decisions in selecting suitable financial products. In formulating the requirements in the Representation Rules, the Board had referred to the practices of leading deposit insurers in Canada, the UK and the US. It had also taken into account comments from HKAB and the Consumer Council.

Report on Activities

The major requirements contained in the Representation Rules are:

(i) A Scheme member is required to make known to the public that it is a member of the DPS by displaying a DPS membership sign at its relevant places of business;



DPS Membership Sign

(ii) Where a Scheme member shares its website with another person, and the website contains information about the Scheme member's DPS membership or the protection status of its financial products, the Scheme member should display the DPS membership sign on the website in such a manner that any person accessing the website would reasonably be aware that the Scheme member, and not any other person, is a member of the Scheme;

(iii) If a Scheme member refers to its DPS membership or its protected deposits in an advertisement, a standard statement should be included in the advertisement;

(iv) Where a financial product offered by a Scheme member is not protected by the DPS but is described as a deposit in any advertisement, promotional material or document, the Scheme member should notify the customer that the product is not protected by the DPS and request the customer to acknowledge receipt of the notification; and

(v) Where a protected deposit is no longer protected by the DPS because of a variation to the terms and conditions of the deposit or the provision to the customer of a credit facility secured on the deposit or the provision of a service, the Scheme member should notify the customer that the product is not protected by the DPS and request the customer to acknowledge receipt of the notification.

DPS (Payment of Contributions, Late Payment Fees and Rebates) Rules ("Contribution Rules")

The Contribution Rules prescribe the manner in which Scheme members should pay contributions or late payment fees to the Board, as well as the manner in which the Board should pay rebates of contribution to Scheme members. The amount of contribution payable by a Scheme member is determined with reference to its supervisory rating assigned by the Monetary Authority ("MA"). It is a piece of sensitive information, which should not be disclosed to any third party without the consent of the MA. In view of this, the Board has appointed the MA as its collection and payment agent. This arrangement ensures that contributions and rebates of contribution are paid through the inter-bank settlement system instead of the books of a commercial bank.

Report on Activities

The Contribution Rules provide that:

(i) A Scheme member shall pay contribution or any late payment fee through its settlement account opened and maintained with the MA as required under section 3A(1) of the Exchange Fund Ordinance, or where the Scheme member does not maintain such an account, through a settlement account designated by the Scheme member;

(ii) Any contribution payable by a Scheme member should be paid within 21 days after the date of the payment notice given by the Board to the Scheme member; and

(iii) The Board shall pay rebate to a Scheme member through the latter's settlement account maintained with the MA, or where the Scheme member does not maintain such an account, through a settlement account designated by the Scheme member.

Guideline on Information Required for Determining and Paying Compensation

When compensation under the DPS is triggered in respect of a Scheme member, the Board shall determine whether a depositor is entitled to compensation under the DPS, and if yes, the amount of his entitlement. To do so, the Board will rely on the records obtained from the failed Scheme member. To enable the Board to make compensation payments quickly, the Board issued a statutory guideline under section 8(1) of the DPS Ordinance setting out the requirements on information systems and customer records to be followed by Scheme members. In general, Scheme members are required to achieve compliance with the guideline by the end of August 2006. Noting that large Scheme members will need to develop a considerably larger number of data extraction programmes to comply with the guideline, Scheme members having a total number of deposit accounts of more than 500,000 or for a Scheme member belonging to the same group of companies of such a Scheme member are given the flexibility to achieve full compliance by the end of 2007.

The Board organised two rounds of briefings to Scheme members in April and May 2006 to explain to them the above rules and guidelines. These briefings were very well received by the participants who found the information useful in assisting them in achieving compliance with the requirements.

The rules and the guidelines governing the operation of the DPS are accessible on the Board's website: http://www.dps.org.hk

Mr Colin Pou, Senior Manager (Payout System), hosting a briefing on information system requirements to banks

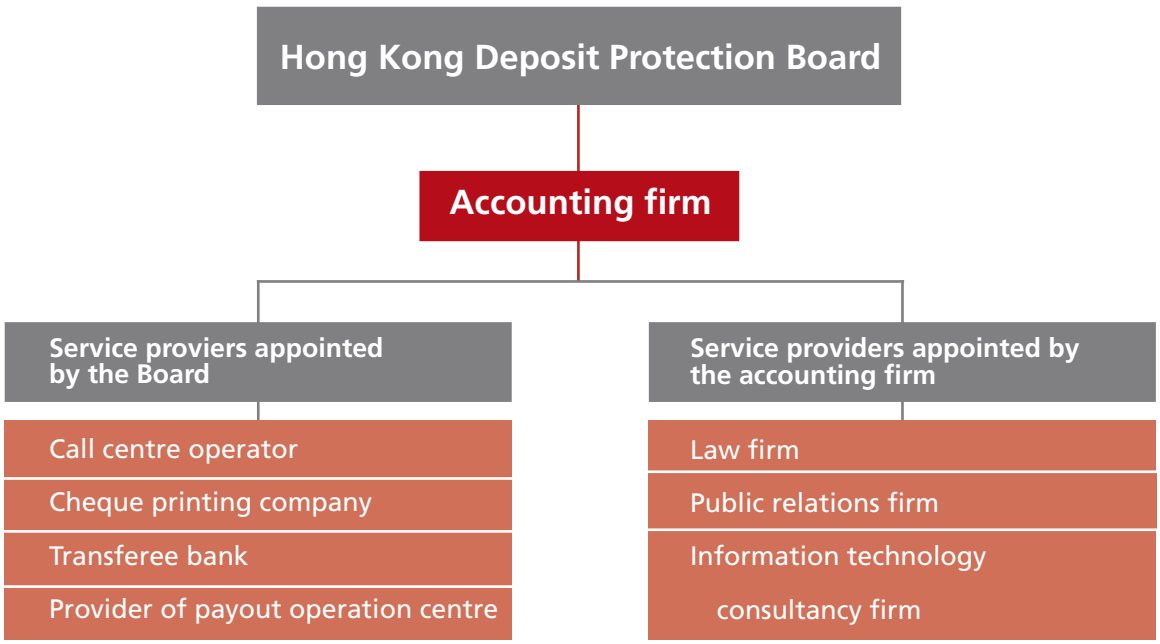
Report on Activities

(c) Payout infrastructure

Payout System and procedures

The development of the Payout System for facilitating payment of compensation to depositors was completed in December 2005 as scheduled. An independent information technology consultancy firm was subsequently engaged to conduct a User Acceptance Test ("UAT") of the Payout System. Three rounds of UAT took place in the first half of 2006 with no major problems identified. Following the completion of the UAT, the Board is planning to conduct a series of simulation tests using data obtained from Scheme members.

Considering that the incidence of bank failures in Hong Kong is low, the Board has adopted a virtual organisation structure. It will retain a core team of staff to administer the DPS during normal times, and has the flexibility to call upon a network of external service providers to assist with calculation and payment of compensation to depositors should payout be required. In this connection, the Board conducted a series of tenders in the second half of 2005 and identified suitable payout agents, including accounting firms, an information technology consultancy firm, a cheque printing company, a call centre operator and a business recovery service provider. The Board also identified a number of Scheme members that can help it disburse compensation payments to depositors in a payout. When a bank failure occurs, the Board will mobilise the network of payout agents to handle the payout. Regular payout rehearsals involving the payout agents will be conducted to familiarise them with the Board's payout procedures.



Report on Activities

Standby facility

When payment under the DPS is triggered, the Board is obliged to make compensation to the depositors of the failed Scheme member as soon as practicable. Since the DPS Fund is only intended to cover the shortfall loss[1] and the financing cost associated with the payout, the Board has secured a standby facility from the Exchange Fund to provide the necessary liquidity required for payment of compensation.

(d) Memorandum of Understanding (MoU) with the Monetary Authority

The Board and the MA are two important players in the financial safety net in Hong Kong. They share a common objective, which is to promote the stability of the banking system in Hong Kong. In order to ensure that this important objective is accomplished, the Board and the MA agree to set out in the form of an MoU how the two organisations are to cooperate both during normal times and when there is a banking crisis, and the support the MA will provide to the Board for it to perform its functions. The Board and the MA have agreed on the key principles to be set out in the MoU, which will be finalised soon.

(e) System for assessment of contributions

Every Scheme member is required to make an annual contribution to the DPS Fund in the manner prescribed by the Contribution Rules issued by the Board. The amount of contribution payable by a Scheme member will be assessed by the Board with reference to the amount of relevant deposits held with that Scheme member and its supervisory rating assigned by the MA. In this regard, Scheme members have submitted their first annual return on their amount of relevant deposits and the HKMA has also provided the Board with the supervisory ratings of individual Scheme members. The Board is thus ready to collect contributions from Scheme members upon the launch of the DPS.

According to the returns submitted by Scheme members, the total amount of relevant deposits was HK$440 billion in October 2005. The Board expects to collect HK$90 million in 2006, representing the contribution from Scheme members for the period from the launch of the DPS to 31 December 2006. The target DPS Fund size, at 0.3% of relevant deposits held by Scheme members (around HK$1.3 billion), is expected to be reached in about four years, i.e. by 2010.

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[1] Shortfall loss refers to the loss suffered by the Board as a result of the payout amount to a depositor exceeding the amount recovered from the liquidation of the failed Scheme member.

Report on Activities

(f) Promotion of the DPS

Maintaining a high level of public awareness about the DPS is critical to ensuring its effectiveness. To promote public understanding of the DPS, the Board has developed a publicity campaign to support the launch of the DPS. The series of publicity measures to be rolled out near the launch date will include an information leaflet about the DPS to be distributed through the branch networks of Scheme members, TV and radio commercials, exhibitions at shopping malls and railway stations, etc. The Board has also engaged a public relations consultancy firm to advise it on the development of a long-term strategy for promoting the DPS.

LAUNCH OF THE DPS

As most of the preparatory tasks for launching the DPS have been completed, the Secretary for Financial Services and the Treasury has selected 25 September 2006 as the effective date for those provisions of the DPS Ordinance that have not come into operation. The Board will make a formal announcement regarding when the DPS will start providing deposit protection nearer the date.

PLAN FOR 2006-2007

After the launch of the DPS, the Board will monitor the effectiveness of the DPS taking into account latest market developments, including the popularity of structured products among depositors. In relation to the payout infrastructure, the Board will conduct a series of simulation tests with Scheme members using data obtained from Scheme members and assess their compliance with the *Guideline on Information Required for Determining and Paying Compensation*. The Board will also carry out a payout rehearsal involving the payout agents to familiarise them with the Board's payout procedures. The Board will learn from the simulation and rehearsal exercises and continue to improve the efficiency of the payout process.

Report on Activities

PARTICIPATION IN INTERNATIONAL FORUMS

The Board has taken active participation in international forums to benefit from the experiences of its international counterparts as well as to keep abreast of development in deposit protection worldwide. In the past year, the Board's representatives had participated in a number of forums and conferences organised by the International Association of Deposit Insurers ("IADI") and other deposit insurers.

Mr Raymond Li (1st from left), Chief Executive Officer, moderating in the Deposit Insurance International Forum at Dalian, China

Mr Gregory Zimnicki (5th from left in the back row), Payout Consultant, attending the 4th Annual Conference of the IADI in Taipei

Ms Aster Cheung (6th from right in the second row), Deputy Chief Executive Officer (Legal), attending a meeting of the IADI in Manila, The Philippines

Auditors' 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 Hong Kong Deposit Protection Scheme Ordinance ("the Ordinance") set out on pages 18 to 28 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

RESPECTIVE RESPONSIBILITIES OF THE BOARD AND AUDITORS

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 and cause to be prepared a statement of accounts in respect of each financial year. The Board does so on the basis that this statement of accounts gives a true and fair view. In preparing the statement of accounts which gives a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on the statement of accounts prepared by the Board and to report our opinion to the Board, as a body, in accordance with section 19 of the Ordinance. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

BASIS OF OPINION

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the statement of accounts. It also includes an assessment of the significant estimates and judgements made by the Board in the preparation of the statement of accounts and of whether the accounting policies are appropriate to the Fund's circumstances, have been consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the statement of accounts is free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the statement of accounts. We believe that our audit provides a reasonable basis for our opinion.

OPINION

In our opinion the statement of accounts gives a true and fair view of the state of affairs of the Fund at 31 March 2006 and of the deficit and cash flows of the Fund for the year then ended, and has been properly prepared in accordance with the Ordinance.

KPMG
Certified Public Accountants
Hong Kong
17 July 2006

Income and Expenditure Account

for the year ended 31 March 2006

(Expressed in Hong Kong dollars)

	Year ended 31 March 2006	Period from 1 July 2004 to 31 March 2005
Income	**$ 13,921**	$ –
Total revenue	**$ 13,921**	$ –
Expenditure		
Staff costs	**$ 3,701,595**	$ 833,736
Financial information services	**6,000**	–
Office equipment and stationery	**641**	1,216
Overseas travel	**34,694**	–
Transport and travelling	**618**	1,296
Hire of services	**73,675**	102,880
Training expenses	**6,462**	–
Communication	**959**	11,000
Printing and publicity	**47,960**	53,200
Publications	**30,650**	14,242
Membership fee	**140,232**	–
Recruitment expenses	**5,699**	36,631
Other expenses	**4,050**	3,433
Depreciation	**30,868**	3,944
Total expenditure	**$ 4,084,103**	$ 1,061,578
Deficit for the year/period	**$ (4,070,182)**	$ (1,061,578)

The notes on pages 22 to 28 form part of this statement of accounts.

Balance Sheet

at 31 March 2006
(Expressed in Hong Kong dollars)

	Note	2006	2005
Non-current assets			
Fixed assets	3	**$ 193,678**	$ 67,046
Current assets			
Prepayments and deposit	4	**$ 5,322,379**	$ 2,309,718
Cash		**523,306**	532,939
		$ 5,845,685	$ 2,842,657
Current liabilities			
Accrued expenses	5	**$ 571,123**	$ 271,281
Loan	6	**10,600,000**	3,700,000
		$ 11,171,123	$ 3,971,281
Net current liabilities		**$ (5,325,438)**	$ (1,128,624)
NET LIABILITIES		**$ (5,131,760)**	$ (1,061,578)
Representing:			
FUND			
Accumulated deficit		**$ (5,131,760)**	$ (1,061,578)

Approved and authorised for issue by the Hong Kong Deposit Protection Board on 17 July 2006.

Professor Andrew Chan Chi-fai, JP
Chairman

The notes on pages 22 to 28 form part of this statement of accounts.

Statement of Changes in Net Assets

at 31 March 2006

(Expressed in Hong Kong dollars)

	2006	2005
Fund balance as at 1 April	**$ (1,061,578)**	$ –
Deficit for the year/period	**(4,070,182)**	(1,061,578)
Fund balance as at 31 March	**$ (5,131,760)**	$ (1,061,578)

Cash Flow Statement

for the year ended 31 March 2006
(Expressed in Hong Kong dollars)

	Year ended 31 March 2006	Period from 1 July 2004 to 31 March 2005
Operating activities		
Deficit for the year	**$ (4,070,182)**	$ (1,061,578)
Adjustments for:		
– Depreciation	**30,868**	3,944
– Interest income	**(13,921)**	–
Operating deficit before changes in working capital	**$ (4,053,235)**	$ (1,057,634)
Increase in prepayments and deposit	**(3,012,661)**	(2,309,718)
Increase in accrual expenses	**299,842**	271,281
Increase in loan	**6,900,000**	3,700,000
Net cash generated from operating activities	**$ 133,946**	$ 603,929
Investing activities		
Purchase of fixed assets	**$ (157,500)**	$ (70,990)
Interest received	**13,921**	–
Net cash used in investing activities	**$ (143,579)**	$ (70,990)
Net (decrease)/increase in cash and cash equivalents	**$ (9,633)**	$ 532,939
Opening cash and cash equivalents	**532,939**	–
Closing cash and cash equivalents	**$ 523,306**	$ 532,939

The notes on pages 22 to 28 form part of this statement of accounts.

Notes to the Statement of Accounts

(Expressed in Hong Kong dollars)

1 PURPOSE AND ACTIVITIES

The Deposit Protection Scheme Fund ("the Fund") is established under the Hong Kong Deposit Protection Scheme Ordinance ("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 Deposit Protection Scheme ("the Scheme"). The Hong Kong Deposit Protection Board ("the Board") manages the Fund in accordance with the provisions of the Ordinance.

The Scheme will be funded by contributions levied on member banks. During the year, the Board has continued the establishment of the Scheme. However as the Scheme was not fully operational during the year, no contributions were levied and the Fund was not required to provide deposit protection. The expenditure incurred during the year was financed by an interest free credit facility from the Hong Kong Monetary Authority ("HKMA") which will be repaid from contributions once the Scheme is fully operational.

2 SIGNIFICANT ACCOUNTING POLICIES

(a) Statement of compliance

This statement of accounts has been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (which includes all applicable Statements of Standard Accounting Practice and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and accounting principles generally accepted in Hong Kong. A summary of the significant accounting policies adopted by the Fund is set out below.

(b) Basis of preparation

The measurement basis used in the preparation of the statement of accounts is historical cost.

(c) Fixed assets and depreciation

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 and development costs:	
– System development costs	5
– Servers (hardware and software)	5
– Others, e.g. personal computers, printers and accessories	3
Office furniture, equipment and fittings	5

Notes to the Statement of Accounts

(Expressed in Hong Kong dollars)

(c) Fixed assets and depreciation (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.

(d) 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.

Interest income is recognised in the income and expenditure account, as it accrues using the effective interest rate method.

(e) Expenses

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

(f) Translation of foreign currencies

Foreign currency transactions during the year are translated into Hong Kong dollars at the exchange rates ruling at the transactions dates. Monetary assets and liabilities in foreign currencies are translated into Hong Kong dollars at the exchange rate ruling at the balance sheet date. Exchange gains and losses are dealt with in the income and expenditure account.

(g) Operating leases

Where the Fund has the use of assets under operating leases, payments made under the leases are charged to the income and expenditure account in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset.

Notes to the Statement of Accounts

(Expressed in Hong Kong dollars)

(h) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Fund has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditures expected to settle 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.

(i) Impairment of assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that fixed assets may be impaired or, except in the case of goodwill, an impairment loss previously recognised no longer exists or may have decreased.

If any such indication exists, the asset's recoverable amount is estimated. In addition, for goodwill, intangible assets that are not yet available for use and intangible assets that have indefinite useful lives, the recoverable amount is estimated annually whether or not there is any indication of impairment.

– Calculation of recoverable amount

  The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

– Recognition of impairment losses

  An impairment loss is recognised in the income and expenditure account whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount.

Notes to the Statement of Accounts

(Expressed in Hong Kong dollars)

– Reversals of impairment losses

An impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount.

A reversal of an impairment loss is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to the income and expenditure account in the year in which the reversals are recognised.

(j) Employee benefits

Obligations for contributions payable under the Hong Kong Mandatory Provident Fund Schemes Ordinance are recognised as an expense in the income and expenditure account as incurred.

(k) Related parties

(i) Definition of related parties (HKAS 24, *Related party disclosures*)

As a result of the adoption of HKAS 24, *Related party disclosures*, the definition of related parties as disclosed below has been expanded to clarify that related parties include entities that are under the significant influence of a related party that is an individual (i.e. key management personnel, significant shareholders and/or their close family members) and post-employment benefit plans which are for the benefit of employees of the Fund or of any entity that is a related party of the Fund. The clarification of the definition of related parties has not resulted in any material changes to the previously reported disclosures of related party transactions nor has it had any material effect on the disclosures made in the current period, as compared to those that would have been reported had SSAP 20, *Related party disclosures*, still been in effect.

(ii) For the purpose of this statement of accounts, we consider that the following are related parties of the Fund:

– parties that the Fund has the ability, directly or indirectly, to control or significantly influence in making financial and operating decisions;

– parties that have the ability, directly or indirectly, to control or significantly influence the Fund in making financial and operating decisions; and

– parties that are subject to common control or common significant influence.

Related parties may be individuals (being members of key management personnel and/or their close family members) or corporate entities and include entities which are under the significant influence of related parties of the Fund where those parties are individuals or of any entity that is a related party of the group.

Notes to the Statement of Accounts

(Expressed in Hong Kong dollars)

3 FIXED ASSETS

	Office equipment	Desktop computer	System development cost	Total
Cost:				
As at 1 April 2005	$ –	$ 70,990	$ –	$ 70,990
Additions	34,800	29,700	93,000	157,500
As at 31 March 2006	$ 34,800	$ 100,690	$ 93,000	$ 228,490
Accumulated depreciation:				
As at 1 April 2005	$ –	$ 3,944	$ –	$ 3,944
Charge for the year	6,380	24,488	–	30,868
As at 31 March 2006	$ 6,380	$ 28,432	$ –	$ 34,812
Net book value:				
As at 31 March 2006	$ 28,420	$ 72,258	$ 93,000	$ 193,678
As at 31 March 2005	$ –	$ 67,046	$ –	$ 67,046

4 PREPAYMENTS AND DEPOSIT

	2006	2005
Deposit – Payout system	**$ 5,291,200**	$ 2,295,000
Others	**31,179**	14,718
	$ 5,322,379	$ 2,309,718

Notes to the Statement of Accounts

(Expressed in Hong Kong dollars)

5 ACCRUALS

	2006	2005
Hire of services	**$ 30,000**	$ 102,500
Staff expenses	**470,858**	101,535
Others	**70,265**	67,246
	$ 571,123	$ 271,281

6 LOAN – RELATED PARTY

The Deputy Chief Executive (Banking) of the HKMA is an ex-officio member of the Board which manages the Fund. The HKMA has also seconded the Executive Director (Banking Development) and a Division Head to assist the Board to establish the Scheme including the administration of the Fund. They are designated as the Chief Executive Officer and Deputy Chief Executive Officer (Operations) of the Board respectively. During the year, the HKMA provided a committed, interest-free credit facility to the Board for the purpose of meeting the establishment and initial operating costs of the Board. The maximum amount which may be drawn down under the facility is $30,000,000, of which HK$6,900,000 (2005: HK$3,700,000) was drawn down during the year.

7 FINANCIAL INSTRUMENTS

During this initial period of its operations, the Fund's financial instruments consist primarily of cash at bank and the interest-free loan from the HKMA. Consequently the Fund is not exposed to significant credit or interest rate risk. Fund's financial instruments are carried at amounts not materially different from their fair values.

8 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.

Notes to the Statement of Accounts

(Expressed in Hong Kong dollars)

9 POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING YEAR ENDED 31 MARCH 2006

Up to the date of issue of these financial statements, the HKICPA has issued a number of amendments, new standards and interpretations which are applicable to the Fund but not yet effective for the accounting year ended 31 March 2006 and which have not been adopted in these financial statements.

The Board is in the process of making an assessment of what the impact of these amendments, and new standards and new interpretations are expected to be in the period of initial application. So far it has concluded that while the adoption of them may result in new or amended disclosures, it is unlikely to have a significant impact on the Fund's results of operations and financial position.