

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

# **Enhancing Deposit Protection under the Deposit Protection Scheme**

**Raymond Li**

**Chief Executive Officer**

**Hong Kong Deposit Protection Board**

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## Objective and mandate (1)

- Objective : to improve protection to depositors under the Deposit Protection Scheme (DPS)
- The Board decided to conduct a review in June 2008, and commenced the review in Q4 2008, review completed in Q1 2009 as scheduled
- Factors considered in the review
  - experience gained from operating the DPS since its inception in 2006
  - international developments on reforming deposit insurance regime
  - consultancy report on the HKMA's work on banking stability published in July 2008
  - introduction of the full deposit guarantee by the Government in October 2008
  - recent public concern about the coverage of the DPS



## Objective and mandate (2)

- The review concluded that the existing design features of the DPS are already in substantial compliance with international best practices. Nevertheless, areas for improvement have been identified
- Assumptions and limitations of the review
  - the review will not touch on the operation and functions of other safety net players in Hong Kong
  - nothing in the review will bind the Government's decisions in relation to the full deposit guarantee
  - the review will not seek to change the basic function of the DPS as a “pay-box” as defined by the DPS Ordinance



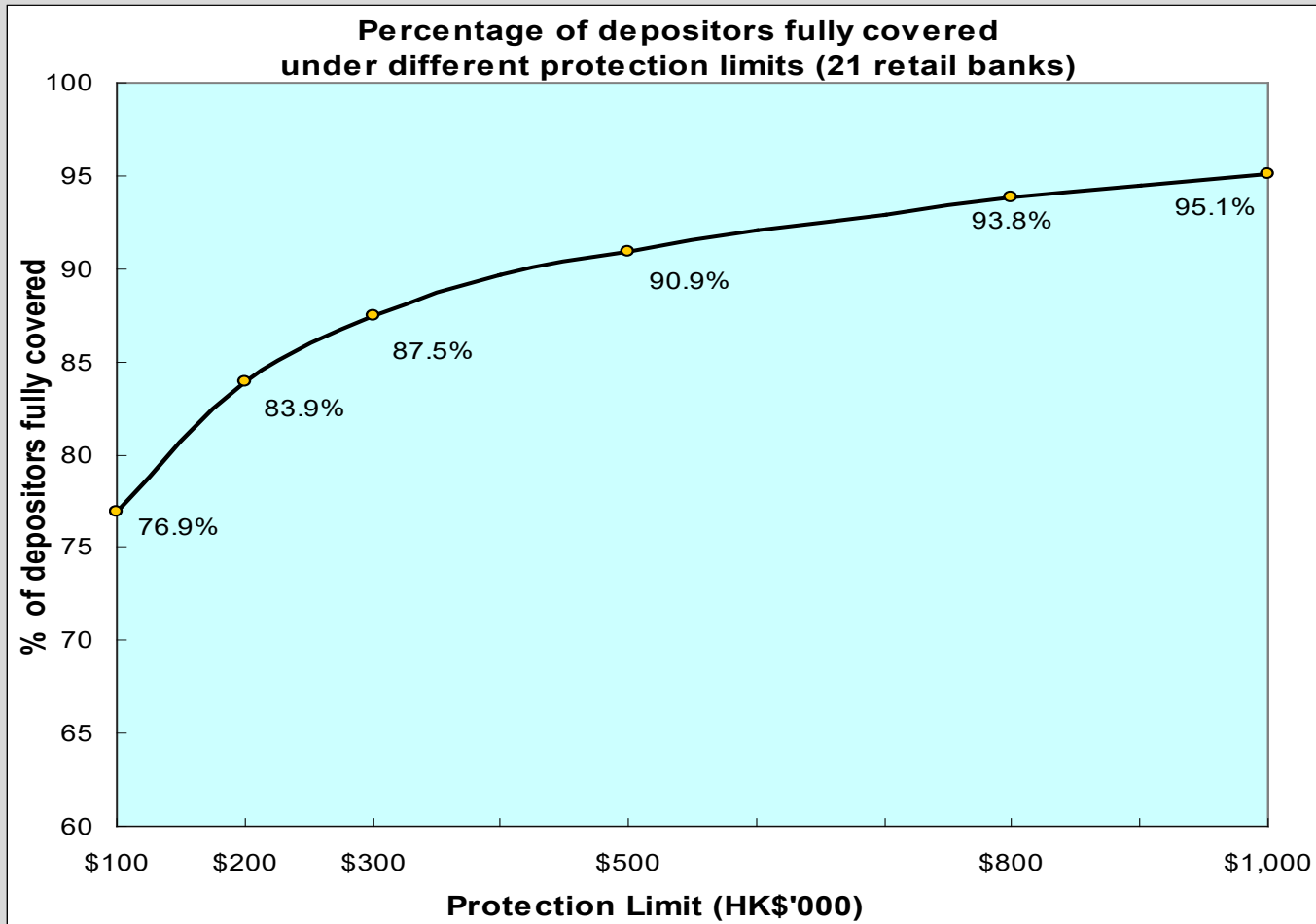
## Scope of the review

- 1<sup>st</sup> batch of enhancements
  - Protection limit
  - Compensation calculation basis
  - Product coverage
  - Types of institution covered
  - Funding arrangements
- 2<sup>nd</sup> batch of enhancements
  - Technical amendments (for improving payout efficiency, enforcement of DPS rules and guidelines, etc.)
- Intend to make enhancements under both batches effective as soon as possible



## Protection limit (1)

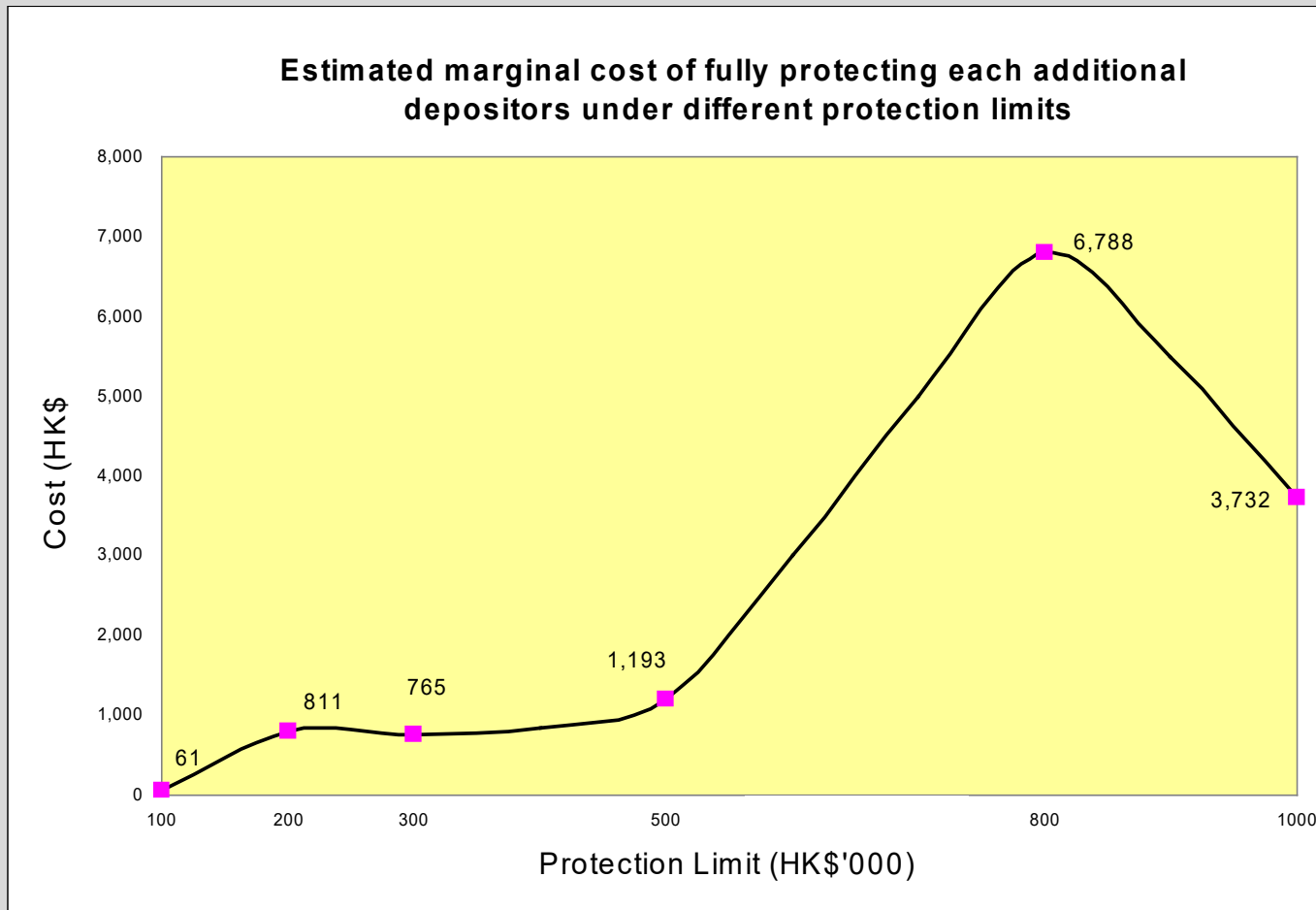
- Impact on effectiveness from raising the protection limit





## Protection limit (2)

- Impact on cost from raising the protection limit





## Protection limit (3)

- Possible options identified: HK\$200,000 as suggested in the HKMA consultancy report, or HK\$500,000
- Recommend HK\$500,000 for better protection to depositors
  - only about 84% depositors would be fully protected under HK\$200,000
  - international standard is 80-90%, prefer to move it close to the higher end
  - if it is too close to 80%, may require another review in the near term
  - higher limit better able to meet the now higher public expectations
  - raising the level above HK\$500,000 would add little to effectiveness at disproportionately high cost and generate a higher level of moral hazard



## Protection limit (4)

- HK\$500,000 is comparable to the level of protection in major countries

	US	UK	EU minimum	Singapore	Hong Kong
Limit in home currency ('000)	250 <sup>1</sup>	50	50	20	500 (Proposed)
Limit in HK\$ equivalent ('000)	2,000	550	500	104	
Ratio of limit to per capita GDP	5.5 <sup>2</sup>	2.2	2	0.4	2.1

Note 1: Effective from October 2008 to December 2009, US\$100,000 before October 2008

Note 2: If calculated at US\$100,000, the ratio would be 2.2



## Compensation calculation basis

- The HKMA consultancy report recommends the DPS to study the UK proposal of switching to payment on a gross deposit basis
- Concluded no strong grounds for change
  - the objective of the UK proposal is to speed up payout, expectedly from 6 months to 7 days. The DPS already can pay reasonably fast (in 2 weeks)
  - payment on gross deposit basis can be unfair (UK is in fact unique in proposing a gross approach)
  - as the DPS relies on the priority claims of depositors under the insolvency regime to recover the payments it made. A fundamental change to the regime is required for making the change in DPS netting approach cost viable (the UK met with the same controversy and the way forward is unclear)



## Product coverage

- Except a few types of deposit, the DPS protects all deposits meeting the definition of deposit in the Banking Ordinance (BO). The coverage of the DPS is in fact very comprehensive
- Source of recent confusions observed
  - in the BO, a deposit referable to the provision of a good or service is carved out from the definition of deposit, including secured deposits
  - some depositors find it difficult to tell whether their deposits are subject to any encumbrances
- Confusions undermine DPS effectiveness. To eliminate the potential for confusion, suggest to bring secured deposits related to banking and financial services under protection by changing the definition of deposit under the DPS
- Also reviewed the protection status of structured deposits, no strong grounds for protecting them as they are more akin to investment and not popular among small depositors



## Types of institution covered

- Restricted licence banks (RLBs) and deposit-taking companies (DTCs) are covered by the full deposit guarantee but not by the DPS
- Concluded no strong grounds for the DPS to protect them
  - they have very few small depositors as they cannot take deposits below HK\$100,000, protecting them will not help prevent rumour-driven runs on them
  - they account for about 0.5% of total deposits in the banking industry
  - most of them are not accessible by retail depositors



## Cost mitigating measures to avoid cost transfer

- The amount of protected deposits will slightly more than double if the limit is raised to HK\$500,000, contributions by banks will increase by the same magnitude if charged at the current premium rates
- Suggest to cut the premium charging rates by half (from an average of 0.08% to 0.04%) to keep the absolute amount of annual contributions largely unchanged
  - no additional financial burden on banks
  - average cost of protecting each dollar of deposit will be lower, hence, little grounds for cost transfer to depositors
  - however, will prolong the time for achieving the target fund size
- Bring the basis for reporting protected deposits for contribution assessment in line with that for compensation determination, i.e. allow banks to choose to report on a net deposit basis



## Consequential changes to the insolvency regime

- The DPS will subrogate into the priority claims of depositors in bank liquidations to recover the compensation it paid to depositors
- Corresponding changes to the limit and product coverage (secured deposits) of the priority claims have to be made to match the changes to the DPS
- If the changes cannot be made to the priority claims, the costs of the DPS would be prohibitively high (due to shortfalls in recovering the compensation paid)



## Consultation arrangements

- Consultation paper published today (27 April 2009)
- Consultation period will run from 27 April to 26 June 2009
- Public comments can be made to the Board by mail, e-mail, fax and at the Board's website
- The Board will actively solicit comments from interested parties, e.g. consumer interest group, banking industry, insolvency practitioners
- Extensive publicity activities to encourage the public to give comments