



**BY FAX AND BY POST**  
**(2878 1670)**

Our Ref.: C/IPC, M20943

31 July 2003

Mr. Raymond Li  
Executive Director (Banking Development),  
Hong Kong Monetary Authority,  
30<sup>th</sup> Floor, 3 Garden Road,  
Hong Kong.

Dear Mr. Li,

**Deposit Protection Scheme Bill**

Thank you for your letter of 6 June 2003 inviting the Society's views on the Deposit Protection Scheme Bill.

After reviewing the proposed legislation, we have some concerns and points requiring clarification, primarily of a technical nature, in respect of certain provisions of the Bill. These are explained further below.

Clause 30(1)(b)

Under what circumstances is it envisaged that documents will be required from a depositor in support of the depositor's or another person's entitlement to compensation? Where there is such a requirement, what documents, is it expected that a depositor would need to provide?

We note that clause 49 empowers the board to make rules specifying the information and documents that the Board may require to determine the entitlement of a person to compensation. If this is intended to cover the requirements that may be imposed under clause 30(1)(b), in addition to any other requirements, it would be clearer if an appropriate cross-reference were also to be made between this part of the Bill and the rule-making powers in clause 49. We would, in any case, be grateful for your confirmation that there will be an opportunity in due course to comment on any draft rules specifying the nature of documents required to be submitted under clause 30(1)(b).

Clause 36(1)(b)

This provision raises certain questions. If a depositor has no right to receive any amount in respect of his deposits out of the assets of a failed Scheme member until the Board has been reimbursed in full, it needs to be clarified who is entitled to prove in a liquidation and for how much? Even if the depositor is entitled to prove, is his claim to be regarded as contingent (on the Board being paid) and so excluded for the purpose of voting (see Rule 125 of the Companies (Winding up) Rules)? Should it be discounted back to when the Board gets paid (see Rule 89)? We have some doubt therefore as to the purpose of and need for such a provision, particularly given the uncertainty that it may create.

### Clause 37

We are not clear as the circumstances in which it is envisaged that a provisional liquidator might make payments to the Board out of the assets of a failed Scheme member, although it appears that clause 37 would not impose any specific obligation on the provisional liquidator to do so.

It could be that at the time a provisional liquidator is in office, the bank is not in liquidation and it might never be. This would mean that proofs of debt would not have been called, the full extent of preferential and ordinary unsecured liabilities and secured liabilities would not have been established, and the realisable value of the assets not determined. In fact, the provisional liquidator would need to rely on the books and records of the bank to be able to estimate the distribution to preferential unsecured depositors, even if the bank were to be put into liquidation. In other words, a provisional liquidator, during the time he is in office as such, is unlikely to have a complete picture as regards the assets and liabilities of the company. In addition, a provisional liquidator generally has limited powers to dispose of the assets of a company being wound up. In normal circumstances, these powers would extend primarily to perishable assets or sales in the ordinary course of business.

The implications of making any such payments would also need to be considered if the Scheme member did not go into liquidation, but was subject to a formal or informal scheme of arrangement.

Before paying any monies to the Board, therefore, the provisional liquidator would, as a minimum, require an effective indemnity from the Board, not principally because of concern over insufficient funds in the administration, but to cover the possibility of payments being made that should not have been made due, for example, to inaccuracies in the accounting information system of the Scheme member or other issues that would take time to be revealed.

In this regard, although we note that clause 7(c) empowers the Board to provide an indemnity to a liquidator or provisional liquidator for the purpose of obtaining an early reimbursement from the assets of a failed Scheme member, a question mark remains over the effectiveness of any such indemnity. The potential size of payments to the Board could be very substantial. In the case of BCCHK, for example, around HK\$300 million was paid out to "small depositors" (i.e. in relation to balances of HK\$100,000 or less). However, it does not appear as if the Board will, for example, enjoy any guarantee from the Government. Clause 3 of the Bill makes it clear that the board is independent of the Government - is not a servant or agent of the Government and does not enjoy any status, immunity or privilege of the Government.

### Other matters

The use of certain terms, in particular references to a "depositor", seems to somewhat loose and ambiguous in places. "Depositor" is defined in clause 2 as "a person entitled to repayment of a deposit, whether made by him or not". Clause 27 (Division 2 of the Bill - Entitlement to compensation) makes it clear that a depositor, if he holds the deposit as a bare trustee, agent, or in a client account, is not entitled to compensation from the Fund where a Scheme member fails. In such cases, the entitlement to compensation rests with the beneficiary, principal or client respectively. However, in Division 3 (e.g. clauses 33-37) the references to payment of compensation seem to be confined to payment to a "depositor" only, and whilst clause 5(d) includes among the functions of the Board - "to decide the entitlement of depositors and other persons to compensation under Division 2

of Part 5” - the Board’s subsequent function under clause 5(e) is described as - “to pay compensation to depositors in accordance with this Ordinance”. We would suggest, therefore, that the use of the relevant terms needs to be reviewed to improve consistency and remove potential uncertainty.

You may wish to note that the Society has recently received a letter from the Legislative Council Bills Committee on the Bill, inviting our comments by 20 August 2003. In order for us to determine whether or not there are issues that we need to reflect to the Bills Committee, we should be grateful for an early response to the matters raised above.

Yours sincerely,

A handwritten signature in dark ink, appearing to read "Peter Tisman". The signature is written in a cursive, slightly slanted style.

PETER TISMAN  
DEPUTY DIRECTOR  
(BUSINESS & PRACTICE)

PMT/ay



Your Ref.: C/IPC, M20943

Our Ref.: B9/62C

12 August 2003

By Fax (2865 6603) and By Post

Mr Peter Tisman  
Deputy Director (Business & Practice)  
Hong Kong Society of Accountants  
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Lippo Centre  
89 Queensway  
Hong Kong

Dear Mr Tisman,

**Deposit Protection Scheme Bill**

Thank you for your letter of 31 July 2003. Our responses to the Society's comments are set out in the attachment.

As mentioned in your letter, the LegCo Secretariat has invited the Society to provide its comments on the Deposit Protection Scheme Bill. I would be most grateful if you could let us have a copy of your submission in due course.

Yours sincerely,

Raymond Li

Executive Director (Banking Development)

Encl

c.c. SFST (Attn: Mr Edmond Lau)

**RESPONSES TO THE COMMENTS OF  
THE HONG KONG SOCIETY OF ACCOUNTANTS**

**Clause 30(1)(b)**

***HKSA's comment***

Under what circumstances is it envisaged that documents will be required from a depositor in support of the depositor's or another person's entitlement to compensation? Where there is such a requirement, what documents, is it expected that a depositor would need to provide?

We note that clause 49 empowers the Board to make rules specifying the information and documents that the Board may require to determine the entitlement of a person to compensation. If this is intended to cover the requirements that may be imposed under clause 30(1)(b), in addition to any other requirements, it would be clearer if an appropriate cross-reference were also to be made between this part of the Bill and the rule-making powers in clause 49.

We would, in any case, be grateful for your confirmation that there will be an opportunity in due course to comment on any draft rules specifying the nature of documents required to be submitted under clause 30(1)(b).

***HKMA's response***

Normally, the DPS Board would rely on the failed member's records to determine the entitlement of depositors to compensation (see clause 30(6)). For bare trust, agent and client accounts, however, it is envisaged that the Board would require the depositor (i.e. the bare trustee, agent or client accountholder) to provide additional information in order to determine the entitlement to compensation of the underlying beneficiaries, principals and clients. Such information would include the identities of the beneficiaries, principals and clients, as well as their respective share in the balance of the account.

The rules to be made under clause 49(1)(d) are intended to cover the requirements that may be imposed by the Board under clause 30(1)(b). We will consult the Law Draftsman on the desirability of introducing a cross-reference between clause 30(1)(b) and clause 49(1)(d).

We can confirm that the Society will be consulted on any rules to be issued under clause 49(1)(d).

**Clause 36(1)(b)**

***HKSA's comment***

This provision raises certain questions. If a depositor has no right to receive any amount in respect of his deposits out of the assets of a failed Scheme member until the

Board has been reimbursed in full, it needs to be clarified who is entitled to prove in a liquidation and for how much? Even if the depositor is entitled to prove, is his claim to be regarded as contingent (on the Board being paid) and so excluded for the purpose of voting (see Rule 125 of the Companies (Winding up) Rules)? Should it be discounted back to when the Board gets paid (see Rule 89)? We have some doubt therefore as to the purpose of and need for such a provision, particularly given the uncertainty that it may create.

*HKMA's response*

The purpose of clause 36(1)(b) is to make it clear that the rights and remedies of the DPS Board acquired from the depositor will rank in priority to any residual rights and remedies of the depositor in respect of his deposits. It is modelled on section 118(b) of the repealed Securities Ordinance.

According to the Department of Justice, the clause only imposes a restriction on the right of the depositor to receive payment from the liquidator until the Board has been reimbursed in full. The effect is that any amount payable to the depositor from the liquidator would now be paid to the DPS Board first until the Board has fully recovered the compensation. The clause will not affect the depositor's right to prove in a winding up. Neither will it convert the deposit into a contingent debt or make the deposit become not payable at the date of the winding-up order. Rules 89 and 125 of the Companies (Winding Up) Rules are therefore not directly relevant in this context.

**Clause 37**

*HKSA's comment*

We are not clear as the circumstances in which it is envisaged that a provisional liquidator (PL) might make payments to the Board out of the assets of a failed Scheme member, although it appears that clause 37 would not impose any specific obligation on the PL to do so.

A PL, during the time he is in office as such, is unlikely to have a complete picture as regards the assets and liabilities of the company. In addition, a PL generally has limited powers to dispose of the assets of a company being wound up. In normal circumstances, these powers would extend primarily to perishable assets or sales in the ordinary course of business. The implications of making any such payments would also need to be considered if the Scheme member did not go into liquidation, but was subject to a formal or informal scheme of arrangement.

Before paying any monies to the Board, therefore, the PL would, as a minimum, require an effective indemnity from the Board. A question mark remains over the effectiveness of any such indemnity. The potential size of payments to the Board could be very substantial. In the case of BCCHK, for example, around HK\$300 million was paid out to "small depositors" (i.e. in relation to balances of HK\$100,000 or less). However, it does not appear as if the Board will, for example, enjoy any guarantee from the Government.

### ***HKMA's response***

A key factor affecting DPS cost is how quickly the DPS would be able to recover from the assets of the failed Scheme member the amount of compensation paid to depositors. From the HKMA's discussions with the insolvency practitioners, it appears that after a winding-up petition is filed, it would normally take about 3-6 months before a winding-up order is made by the Court. This means that the DPS would only start to receive payments from the liquidator some months after it has made payment to the depositors. It is hoped that this timeframe could be shortened by giving the PL a discretionary power to make early payment to the DPS.

We appreciate that it is not a normal practice for the PL to make early payment to a creditor during the time he is in office. That is why clause 37 only enables, but not obliges, the PL to make payment to the DPS Board. In addition, any such payment will be subject to the sanction of the court. We believe that in determining whether the PL should be allowed to make payment to the Board, the court will take into account all relevant factors including the implications of such payment for the creditors and shareholders of the failed Scheme member.

To protect the interests of the PL, we also envisage that the DPS Board would provide an indemnity to the PL. As currently proposed, the DPS Board would have under its management a DPS Fund with a target fund size of approximately \$1.6 billion. More importantly, it would have access to liquidity support from the Exchange Fund. In cases where the DPS Fund drops below 70% of the target fund size (e.g. after a payout), the Board can call upon the Scheme members to provide additional contributions (i.e. surcharges) to the Fund. These arrangements will ensure that the DPS Board would have sufficient resources to discharge its functions under the DPS legislation. We are not therefore too concerned about the acceptability of the indemnity provided by the Board, despite the fact that the Board is not part of the Government.

### **Other matters**

#### ***HKSA's comment***

The use of certain terms, in particular references to a "depositor", seems to somewhat loose and ambiguous in places. "Depositor" is defined in clause 2 as "a person entitled to repayment of a deposit, whether made by him or not". Clause 27 (Division 2 of the Bill – Entitlement to compensation) makes it clear that a depositor, if he holds the deposit as a bare trustee, agent, or in a client account, is not entitled to compensation from the Fund where a Scheme member fails. In such cases, the entitlement to compensation rests with the beneficiary, principal or client respectively. However, in Division 3 (e.g. clauses 33 – 37) the references to payment of compensation seem to be confined to payment to a "depositor" only whilst clause 5(d) includes among the functions of the Board – "to decide the entitlement of depositors and other persons to compensation under Division 2 of Part 5" – the Board's subsequent function under clause 5(e) is described as – "to pay compensation to depositors in accordance with this Ordinance".

***HKMA's response***

As defined in clause 2, the term "depositor" means a person entitled to repayment of a deposit, whether made by him or not. This definition is the same as the one used in the Banking Ordinance and the Companies Ordinance.

According to the Department of Justice, this definition of depositor does not include beneficiaries under bare trust accounts, principals under agent accounts or clients under client accounts. In view of this, our intention is that any compensation under the DPS will be paid to the bare trustee, the agent, or the client accountholder, instead of directly to the underlying beneficiaries, principals or clients (who are the persons entitled to compensation). This arrangement is necessary to ensure that the Board is able to subrogate into the rights and remedies of the depositors (i.e. the bare trustee, the agent or the client accountholder), including their entitlements to priority payment under section 265(1)(db) of the Companies Ordinance. To reflect the above intention, the whole Bill treats entitlement to compensation and payment of compensation separately. While both depositors and non-depositors (i.e. beneficiaries, principals and clients) may be entitled to compensation, payment of compensation is confined to depositors only. Where the depositor is a bare trustee, agent or nominee, it will be the responsibility of that person to pass the compensation on to the underlying beneficiaries, principals or clients.