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LEGISLATIVE COUNCIL BRIEF

Deposit Protection Scheme Ordinance
(Cap.581)

DEPOSIT PROTECTION SCHEME (ASSET MAINTENANCE) RULES

INTRODUCTION

The Monetary Authority (MA) has published in the Gazette the Deposit Protection Scheme (Asset Maintenance) Rules (hereinafter referred to as “Asset Maintenance Rules” or “the Rules”), at Annex, under section 53 of the Deposit Protection Scheme Ordinance (Cap.581).

BACKGROUND

2. Established under Cap.581, the Hong Kong Deposit Protection Board (HKDPB) is charged with the responsibility for establishing and maintaining the Deposit Protection Scheme (DPS) in Hong Kong. All licensed banks, unless exempted by the HKDPB, are required to join the DPS as members (referred to as “Scheme members”). The DPS was formally launched and started providing deposit protection in Hong Kong on 25 September 2006. In order to minimize possible losses that the HKDPB may suffer in the liquidation of a failed Scheme member, section 53 of the DPS Ordinance empowers the MA, after consultation with the Hong Kong Association of Banks (HKAB), to make rules for the purpose of requiring a Scheme member to maintain sufficient assets in Hong Kong.

JUSTIFICATIONS

3. Where the HKDPB makes a compensation payment to a depositor, it will be subrogated to all the rights and remedies of the depositor in relation to his deposits with the failed Scheme member. Such rights and remedies will include the depositor’s entitlement to priority claims under section 265 of the Companies Ordinance¹. If the

¹ Section 265(1)(db) of the Companies Ordinance provides that, each depositor is entitled to receive priority in the repayment of his aggregate deposits, up to a maximum of HK\$100,000, in the liquidation of a bank.

failed Scheme member has maintained sufficient assets in Hong Kong to cover the priority claims of depositors², the shortfall loss³ of the HKDPB in the liquidation of the failed Scheme member will be lower. In addition, the HKDPB will be able to recover its payments from the liquidator more quickly (because the assets are located in Hong Kong), and thus will incur a lesser amount of financing cost in the payout.

4. In view of the above, the Asset Maintenance Rules are made under section 53 of the DPS Ordinance to empower the MA to require, under certain circumstances, a Scheme member to maintain assets in Hong Kong of a specified amount. Under the Rules, the MA may impose an asset maintenance requirement on a Scheme member where –

- (a) the MA is of the opinion that a Scheme member is likely to fail;
- (b) the MA is of the opinion that the Scheme member is carrying on its business in a manner detrimental to the interests of its depositors; or
- (c) the MA has triggered payment under the DPS.

These circumstances are similar to those in section 52 of the Banking Ordinance, which provides the MA with the necessary powers to deal with a troubled institution.

5. The Asset Maintenance Rules also specify what assets qualify as “assets in Hong Kong”. The overriding principle is that the asset can be disposed of in Hong Kong readily and the proceeds thus obtained can be distributed to priority creditors, including depositors, under the Companies Ordinance. In addition, the asset should not be subject to any encumbrance, charge (other than floating charge) or outstanding incidental payment. The Schedule to the Rules sets out the types of assets that qualify as assets in Hong Kong and the extent to which the value of such assets should be taken into account in determining whether an asset maintenance requirement has been complied with.

6. Under the Asset Maintenance Rules, the amount of assets to be maintained by the Scheme member will be determined by the MA on a case-by-case basis. Nevertheless, the maximum amount of assets that the MA may require a Scheme member to maintain is capped at 200% of the relevant deposits held by the Scheme member. This aims to provide flexibility for the MA to deal with extreme cases, e.g. where the

² Since the priority claims limit is the same as the coverage limit of the DPS, deposits given priority under the Companies Ordinance, subject to a few exceptions, are also protected by the DPS.

³ Shortfall loss refers to the loss suffered by the HKDPB because the assets available in the liquidation is insufficient to meet its claims.

amount of other priority claims (e.g. wages and statutory debts) against a Scheme member is unusually high.

7. The Asset Maintenance Rules also provide that the MA's decision to impose an asset maintenance requirement is subject to review by the Deposit Protection Appeals Tribunal.

THE RULES

8. The key provisions of the Asset Maintenance Rules are as follows –

- (a) Section 3 sets out what assets are considered as assets maintained in Hong Kong for the purpose of these Rules;
- (b) Section 4 sets out how the amount of assets maintained in Hong Kong should be calculated;
- (c) Section 5 provides for the circumstances under which the MA may require a Scheme member to maintain assets in Hong Kong of a specified amount, the limit of the specified amount and the requirement on the MA to afford a Scheme member an opportunity to make written representations on the MA's intention to issue an asset maintenance requirement;
- (d) Section 6 provides for the withdrawal of an asset maintenance requirement;
- (e) Section 7 specifies the time limit for an application to the Deposit Protection Appeals Tribunal for a review of the MA's decision to issue an asset maintenance requirement or refusal to withdraw the asset maintenance requirement; and
- (f) the Schedule to the Rules lists out the types of assets that qualify as assets in Hong Kong and the extent to which the value of such assets should be taken into account in determining whether an asset maintenance requirement has been complied with.

LEGISLATIVE TIMETABLE

9. The Rules were published in the Gazette on 10 November 2006 and will be tabled at the Legislative Council on 15 November 2006 for negative vetting. Subject to the completion of the negative vetting process, the Rules shall come into effect on 15 January 2007.

IMPLICATIONS OF THE RULES

10. The Rules are in conformity with the Basic Law, including the provisions concerning human rights. They have no financial, civil service, productivity, environmental or sustainability implications. The Rules will bring about economic benefits in terms of minimizing any possible shortfall loss that the HKDPB may suffer, which in turn can reduce the overall cost of the DPS to the banking system. The cost involved in enforcing the Rules will be absorbed by the MA. The Rules will not affect the current binding effect of the existing provisions of the DPS Ordinance.

PUBLIC CONSULTATION

11. In accordance with section 53 of the DPS Ordinance, the MA has consulted the HKAB on the Asset Maintenance Rules. The comments of the HKAB have been taken on board as appropriate.

PUBLICITY

12. The Hong Kong Monetary Authority (HKMA) will issue a letter to all Scheme members informing them of the issuance of the Rules.

ENQUIRIES

13. Inquiries on this brief may be directed to Mr. Raymond Chan, Division Head (Banking Development), HKMA (telephone number: 2878 1846).

Hong Kong Monetary Authority
Financial Services and the Treasury Bureau
10 November 2006

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MAINTENANCE) RULES****CONTENTS**

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DEPOSIT PROTECTION SCHEME (ASSET MAINTENANCE) RULES

(Made by the Monetary Authority under section 53 of the Deposit Protection Scheme Ordinance (Cap. 581) after consultation with The Hong Kong Association of Banks)

1. Commencement

These Rules shall come into operation on 15 January 2007.

2. Interpretation

(1) In these Rules, unless the context otherwise requires—

“book value” (帳面價值), in relation to an asset at a particular time, means the book value of the asset at that time after deducting the amount of any specific provision made at that time in the books against a reduction in its value;

“debt securities” (債務證券) means any securities other than shares, stocks, import or export trade bills;

“Hong Kong office” (香港辦事處), in relation to a Scheme member or an authorized institution, means—

(a) the local office or the local branch, within the meaning of section 2(1) of the Banking Ordinance (Cap. 155), of the Scheme member or the authorized institution, as the case may be;

(b) the Scheme member's or the authorized institution's, as the case may be, principal place of business in Hong Kong; or

(c) any other place in Hong Kong at which the Scheme member or the authorized institution, as the case may be, carries on business;

“marketable debt securities” (有市債務證券) means any debt securities which can be sold readily;

“relevant asset” (有關資產) means an asset described in column 2 of the Schedule;

“residential mortgage loan” (住宅按揭貸款) means a loan—

(a) that is granted by an authorized institution to an individual on the security of a first legal charge on an immovable property—

(i) located in Hong Kong; and

(ii) used as a residence by the individual or his tenant; and

- (b) the amount of which does not exceed 90% of the purchase price of the immovable property or the market value of the immovable property as at the time when the loan was approved by the authorized institution concerned, whichever is the lower.

(2) For the purposes of these Rules, a loan or residential mortgage loan granted to a person is a fully performing loan or residential mortgage loan if—

- (a) the condition set out in subsection (3)(a) or (b) is satisfied;
 - (b) the condition set out in subsection (4)(a) or (b) is satisfied; and
 - (c) the condition set out in subsection (5)(a) or (b) is satisfied.
- (3) The condition for the purposes of subsection (2)(a) is—
- (a) the loan or residential mortgage loan is not raised to repay another loan or residential mortgage loan granted by the lender to the person; or
 - (b) in the case where the loan or residential mortgage loan is raised to repay another loan or residential mortgage loan granted by the lender to the person—
 - (i) the raising of that loan or residential mortgage loan is not caused by a deterioration in the financial position of the person or by the person's inability to repay on the original repayment date; and
 - (ii) the terms of repayment of that loan or residential mortgage loan are not less favourable to the lender than those of other loans of similar nature granted by the lender to other customers and negotiated at arm's length at the time when that loan or residential mortgage loan is granted.
- (4) The condition for the purposes of subsection (2)(b) is—
- (a) the repayment date of the loan or residential mortgage loan has not been postponed; or
 - (b) in the case where the repayment date of the loan or residential mortgage loan has been postponed—
 - (i) the postponement is not caused by a deterioration in the financial position of the person or by the person's inability to repay on the original repayment date; and
 - (ii) the terms of repayment of that loan or residential mortgage loan are not less favourable to the lender than those of other loans of similar nature granted by the lender to other customers and negotiated at arm's length at the time when that loan or residential mortgage loan is granted.
- (5) The condition for the purposes of subsection (2)(c) is—
- (a) there are no arrears of principal or interest payment in respect of the loan or residential mortgage loan; or

- (b) in the case where the loan or residential mortgage loan is repayable by periodic instalments at intervals of not more than one month, there is no instalment that is in arrears for more than one month.

3. Assets in Hong Kong

(1) For the purposes of these Rules, an asset is maintained in Hong Kong by a Scheme member if, subject to subsections (4), (5) and (6)—

- (a) the asset is a relevant asset;
- (b) the asset is recorded as an asset in the accounts of the Scheme member for all its Hong Kong offices;
- (c) the asset is not subject to any encumbrance, charge (other than floating charge) or outstanding incidental payment; and
- (d) the asset is not a claim on, or a share of, a related company of the Scheme member.

(2) For the purposes of subsection (1)(d), a company is a related company of a Scheme member if, subject to subsection (3)—

- (a) the company is a subsidiary, or the holding company, of the Scheme member; or
- (b) the company is a subsidiary of that holding company.

(3) On the written application by a Scheme member, the Monetary Authority may designate that a company is not a related company of the Scheme member for the purposes of subsection (1)(d).

(4) If the asset is a relevant asset described in item 3, 4, 5 or 6 of the Schedule and comprising claims or securities that are in bearer form and transferable by delivery, the asset is not maintained in Hong Kong by a Scheme member by virtue of subsection (1) unless the documents of title of the claims or securities are also kept in Hong Kong.

(5) If the asset is a relevant asset described in item 3, 4, 5 or 9 of the Schedule and comprising securities that are in registered form, the asset is not maintained in Hong Kong by a Scheme member by virtue of subsection (1) unless one of the following conditions is also satisfied—

- (a) the securities are transferable and registrable only at a register in Hong Kong; or
- (b) the securities are transferred and registered at a register in Hong Kong in the ordinary course of business and the certificates of the securities (if any) are kept in Hong Kong.

(6) If the asset is a relevant asset described in item 3, 4, 5 or 9 of the Schedule and comprising securities held by an intermediary—

- (a) with whom a Scheme member maintains a securities account; and

(b) on whose records the Scheme member's rights or interests in the securities are recorded,
the asset is not maintained in Hong Kong by the Scheme member by virtue of subsection (1) unless the conditions set out in subsection (7) are also satisfied.

(7) The conditions for the purposes of subsection (6) are—

- (a) the intermediary is located in Hong Kong;
- (b) the intermediary's records of the Scheme member's rights or interests in the securities are kept in Hong Kong; and
- (c) the agreement for the securities account between the intermediary and the Scheme member is enforceable by legal proceedings in a court in Hong Kong.

4. Amount of relevant assets in Hong Kong

(1) For the purposes of these Rules, the amount of a relevant asset maintained in Hong Kong by a Scheme member at a particular time is calculated by deducting from the relevant value of the asset at that time an amount equal to the relevant percentage of that relevant value.

(2) For the purposes of this section—

- (a) the relevant value of a relevant asset at a particular time is, subject to paragraphs (b) and (c), the market value, or the book value, of the asset, as set out in column 3 of the Schedule opposite the description of the asset, at that time;
- (b) the relevant value of a relevant asset described in item 3 of the Schedule at a particular time is calculated by using the following formula—

$$A + B - C$$

where—

- A represents the aggregate of the value, at that time, of each of the claims of the Scheme member on the Exchange Fund that are marketable debt securities;
 - B represents the book value, at that time, of the claims of the Scheme member on the Exchange Fund that are not marketable debt securities;
 - C represents the book value, at that time, of the liabilities (other than contingent liabilities), whether incurred in or outside Hong Kong, owed by the Scheme member to the Exchange Fund;
- (c) the relevant value of a relevant asset described in item 4 of the Schedule at a particular time is calculated by using the following formula—

$D + E - F$

where—

D represents the aggregate of the value, at that time, of each of the claims of the Scheme member on the authorized institution that are marketable debt securities;

E represents the book value, at that time, of the claims of the Scheme member on the authorized institution that are not marketable debt securities;

F represents the book value, at that time, of the liabilities (other than contingent liabilities), whether incurred in or outside Hong Kong, owed by the Scheme member to the authorized institution.

(3) In this section, “relevant percentage” (有關百分率), in relation to the relevant value of a relevant asset, means the percentage set out in column 4 of the Schedule opposite the description of the asset.

(4) In this section, a reference to the value of a claim of the Scheme member on the Exchange Fund, or an authorized institution, that is marketable debt securities is a reference to the market value or book value of the claim, whichever is the lower.

5. Issuance of asset maintenance requirement

(1) Subject to subsection (4), if the Monetary Authority—

(a) is of the opinion that a Scheme member—

(i) is likely to become unable to meet its obligations;

(ii) is likely to suspend payment to its depositors;

(iii) is likely to become insolvent or cease to pay its debts in the ordinary course of business; or

(iv) cannot pay its debts as they become due;

(b) is of the opinion that a Scheme member is carrying on its business in a manner detrimental or likely to be detrimental to the interest of its depositors or potential depositors; or

(c) has served on the Board a notice of the Monetary Authority’s decision in respect of a Scheme member under section 22(2) of the Ordinance,

the Monetary Authority may, by notice in writing served on the Scheme member, require the Scheme member to maintain, during the period specified in the requirement, assets in Hong Kong of the amount specified in the requirement.

(2) The period so specified may begin on a date specified in the requirement and continues to run whilst the requirement is in effect.

(3) The amount of asset so specified is not to exceed 200% of the amount of relevant deposits maintained by the Scheme member as at a date specified in the requirement.

(4) Before issuing a requirement under subsection (1), the Monetary Authority shall—

- (a) serve on the Scheme member a preliminary notice in writing—
 - (i) stating that he intends to issue to the Scheme member such a requirement;
 - (ii) stating what he intends to specify in the requirement; and
 - (iii) stating the reasons for his intention;
- (b) afford the Scheme member an opportunity to submit to the Monetary Authority representations in writing on the preliminary notice within 7 days after the notice is served on the Scheme member; and
- (c) consider any representation so submitted by the Scheme member.

(5) In this section, “amount of relevant deposits” (有關存款款額) has the meaning assigned to it by section 1 of Schedule 4 to the Ordinance.

6. Withdrawal of asset maintenance requirement

(1) After a requirement has been issued under section 5(1) to a Scheme member, the Monetary Authority may withdraw the requirement on his own initiative or on an application by the Scheme member.

(2) An application by a Scheme member for withdrawal of a requirement issued under section 5(1) is—

- (a) to be made in writing;
- (b) to state the grounds for the application; and
- (c) to be accompanied by such information and documents as the Monetary Authority may reasonably require for the purpose of deciding whether the requirement should be withdrawn.

(3) The Monetary Authority shall not withdraw a requirement under subsection (1) unless—

- (a) he is satisfied that the reasons for issuing the requirement no longer exist; or
- (b) if the Monetary Authority has, before or after the issuance of the requirement, served on the Board a notice of his decision in respect of the Scheme member under section 22(2) of the Ordinance, the decision has been revoked under section 23(4) of the Ordinance or has been set aside by a court.

(4) The Monetary Authority shall also withdraw a requirement issued under section 5(1) to a Scheme member if he issues another requirement under that section to the Scheme member to replace that requirement.

(5) As soon as practicable after having withdrawn a requirement issued under section 5(1) to a Scheme member, the Monetary Authority shall serve on the Scheme member a notice in writing of the withdrawal.

(6) As soon as practicable after having refused an application by a Scheme member for withdrawal of a requirement issued under section 5(1), the Monetary Authority shall serve on the Scheme member a notice in writing informing the Scheme member of the refusal and the reasons for the refusal.

7. Application for review: specification for the purposes of section 41 of the Ordinance

(1) For the purposes of section 41(3) of the Ordinance, the Monetary Authority's decision to issue a requirement under section 5(1), or to refuse an application by a Scheme member under section 6(2) for withdrawal of such a requirement, is a decision to which section 41 of the Ordinance applies.

(2) For the purposes of section 41(5)(a) of the Ordinance—

- (a) if a person applies for a review of the Monetary Authority's decision to issue a requirement under section 5(1), the application for review is to be made within 30 days after the date of service of the notice by which the requirement is issued; and
- (b) if a person applies for a review of the Monetary Authority's decision to refuse an application by a Scheme member under section 6(2) for withdrawal of such a requirement, the application for review is to be made within 30 days after the date of service of the notice of the decision.

8. Offences

If a Scheme member fails to comply with a requirement that is issued to it under section 5(1), every director and every chief executive of the Scheme member commits an offence and is liable—

- (a) on summary conviction to a fine at level 6 and to imprisonment for 6 months and, in the case of a continuing offence, to a further fine of \$10,000 for each day during which the offence continues; or
- (b) on conviction on indictment to a fine of \$400,000 and to imprisonment for 2 years and, in the case of a continuing offence, to a further fine of \$20,000 for each day during which the offence continues.

9. Defences

In any proceedings for an offence under section 8, it is a defence for the person charged to prove that he took reasonable precautions and exercised due diligence to avoid the commission of the offence by himself or any person under his control.

10. Service of notices

In the absence of evidence to the contrary, a notice which is required to be, or may be, served on a Scheme member under section 5 or 6 is deemed to be so served if—

- (a) in the case of a Scheme member that is a company within the meaning of section 2 of the Companies Ordinance (Cap. 32)—
 - (i) it is left at the Scheme member's principal place of business in Hong Kong or registered office;
 - (ii) it is sent by post to the Scheme member at its principal place of business in Hong Kong or registered office; or
 - (iii) it is sent by telex, facsimile transmission or other similar method to the Scheme member at its principal place of business in Hong Kong or registered office;
- (b) in the case of any other Scheme member—
 - (i) it is left at the Scheme member's principal place of business in Hong Kong;
 - (ii) it is sent by post to the Scheme member at its principal place of business in Hong Kong; or
 - (iii) it is sent by telex, facsimile transmission or other similar method to the Scheme member at its principal place of business in Hong Kong.

SCHEDULE

[ss. 2, 3 & 4]

ASSETS IN HONG KONG

Item	Description of assets	Relevant value	Relevant percentage
1.	A currency note or coin held in Hong Kong	Book value of the asset	0%

Item	Description of assets	Relevant value	Relevant percentage
2.	A piece of gold held in Hong Kong	Market value or book value of the asset, whichever is the lower	0%
3.	A net claim of the Scheme member (other than a contingent claim) on the Exchange Fund ^{Note 1}	—	10%
4.	A net claim of the Scheme member (other than a contingent claim) on an authorized institution that ^{Note 2} — (a) is payable in Hong Kong by a Hong Kong office of the authorized institution; and (b) is enforceable by legal proceedings in a court in Hong Kong	—	20%
5.	Marketable debt securities (other than those described in items 3 and 4)	Market value or book value of the asset, whichever is the lower	20%
6.	A negotiable bill of exchange, within the meaning of the Bills of Exchange Ordinance (Cap. 19), that is payable by a company (other than an authorized institution)	Book value of the asset	50%

^{Note 1} For the relevant value of this item, please see section 4(2)(b) of these Rules.

^{Note 2} For the relevant value of this item, please see section 4(2)(c) of these Rules.

Item	Description of assets	Relevant value	Relevant percentage
7.	A fully performing loan granted to a person (other than an authorized institution) that is repayable in Hong Kong and enforceable by legal proceedings in a court in Hong Kong (other than that described in item 8)	Book value of the asset	50%
8.	A fully performing residential mortgage loan that is repayable in Hong Kong and enforceable by legal proceedings in a court in Hong Kong	Book value of the asset	30%
9.	A share issued by a company that is a constituent stock of Hang Seng Index	Market value of the asset	20%
10.	An immovable property located in Hong Kong	Market value or book value of the asset, whichever is the lower	30%

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Explanatory Note

The object of these Rules is to empower the Monetary Authority to require, under certain circumstances, a member of the Deposit Protection Scheme ("Scheme member") to maintain assets in Hong Kong of a specified amount.

2. Section 2 defines various terms used in the Rules.
3. Section 3 (when read with the items set out in the Schedule) sets out what assets are maintained in Hong Kong for the purposes of the Rules.
4. Section 4 (when read with the relevant value and percentage set out in the Schedule) sets out how to calculate the amount of assets maintained in Hong Kong for the purposes of the Rules.
5. Section 5 provides for—
 - (a) the circumstances under which the Monetary Authority may require a Scheme member to maintain assets in Hong Kong of a specified amount (“asset maintenance requirement”);
 - (b) the limit of the specified amount;
 - (c) the requirement on the Monetary Authority to afford a Scheme member an opportunity to make written representations on the Monetary Authority’s intention to issue an asset maintenance requirement.
6. Section 6 provides for the withdrawal of an asset maintenance requirement.
7. Section 7 specifies the time limit for an application to the Deposit Protection Appeals Tribunal for a review of the Monetary Authority’s decision to issue an asset maintenance requirement and refusal to withdraw the asset maintenance requirement.
8. Sections 8 and 9 provide for offences and defences.