

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

Annual Report 2008-2009

The Hong Kong Deposit Protection Board is a statutory body established under the Deposit Protection Scheme Ordinance to oversee the operation of the Deposit Protection Scheme. The Scheme is designed to protect depositors and to help maintain the stability of Hong Kong's banking system.

The Board's mission is to maintain an effective and efficient deposit protection scheme in accordance with the Ordinance and in line with international practices.

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Deposit
Protection Board**

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MAIN FEATURES OF THE DEPOSIT PROTECTION SCHEME

- All licensed banks, unless otherwise exempted by the Board, are required to participate in the Deposit Protection Scheme (DPS) as a Scheme member. They are required to display a membership sign prominently at their places of business.



[計劃成員名稱]是存款保障計劃的成員。本銀行接受的合資格存款受存款保障計劃保障，最高保障額為每名存款人HK\$100,000。

[Name of the Scheme member] is a member of the Deposit Protection Scheme. Eligible deposits taken by this Bank are protected by the Scheme up to a limit of HK\$100,000 per depositor.

- The compensation limit of the DPS is set at HK\$100,000 per depositor per Scheme member.

- Depositors are not required to apply for protection or compensation, eligible deposits held with Scheme members are automatically protected by the DPS.

- Both Hong Kong dollar and foreign currency deposits are protected.

- The DPS protects eligible deposits held with Scheme members. It does not protect term deposits with a maturity longer than five years, structured deposits, secured deposits, bearer instruments, off-shore deposits and non-deposit products, such as bonds, stocks, warrants, mutual funds, unit trusts and insurance policies.

- A depositor's entitlement to compensation will be calculated on a net basis, that is, the liability of the depositor will be deducted from the amount of protected deposits in determining compensation.

- A Deposit Protection Scheme Fund (DPS Fund) with a target fund size of 0.3% of the total amount of relevant deposits held with all Scheme members (translating into a fund size of approximately HK\$1.5 billion) will be built up through collecting contributions from members.

- Differential contributions will be assessed based on the supervisory ratings of individual Scheme members for building up the DPS Fund.

ADMINISTRATION OF THE DPS

- The Board collected on schedule HK\$340 million in contributions from Scheme members for the DPS Fund in 2009.
- The assets of the DPS Fund totalled HK\$963 million at the end of March 2009.
- The DPS Fund achieved a positive investment return of 0.8% in 2008-09 despite the volatile market environment.

ADEQUACY OF THE DPS COVERAGE

- The Board commenced a review of the DPS. The first phase of the review, which mainly covered the level and scope of protection of the DPS, was completed, as scheduled, in the first quarter of 2009.

READINESS OF THE DPS PAYOUT PROCEDURES

- The Board implemented a compliance review programme for monitoring the readiness of Scheme members' systems and data to payout. A total of six compliance reviews were conducted under the programme – three of them in conjunction with a simulation test.
- A rehearsal was held to test the adequacy of the Board's payout procedures, including the readiness of its payout agents.

PUBLIC AWARENESS AND UNDERSTANDING OF THE DPS

- Apart from ongoing publicity activities to promote awareness and understanding of the DPS, the Board undertook focused publicity activities in response to the financial crisis. These were designed to reinforce public confidence in the deposit protection arrangements in Hong Kong and to clarify the coverage of the DPS.
- A Hong Kong-wide opinion survey in December 2008 revealed public awareness of the DPS had topped 75%.



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

**Professor
Andrew Chan Chi-fai**, SBS, JP
Chairman

“The financial crisis has brought about new challenges as well as opportunities for the Deposit Protection Scheme in Hong Kong.”

The DPS entered its second full year of operation in 2008. As readers can reasonably expect, the Board was heavily engaged in streamlining the operation of the relatively young scheme during the year. The deepening global financial crisis, however, has opened up a new dimension to the work of the Board: coping with the challenge and opportunity of redefining deposit protection arrangements in Hong Kong.

The turbulence experienced by global financial markets last year was rarely seen in the financial history. The US sub-prime crisis deepened and eventually precipitated into a global financial crisis. Extraordinary measures, such as capital injections to banks and blanket deposit guarantees, were introduced by many countries to combat the crisis and keep their financial institutions afloat. As one of the key international financial centres, Hong Kong was not immune from the contagion of the crisis. A small-scale bank run occurred in September 2008 due to unfounded rumours. Pre-emptive measures were introduced by the authorities to reinforce confidence amid the crisis. While the crisis has taken a heavy toll of financial institutions overseas, the local banking system has been able to withstand the storm relatively well, because of the robustness of Hong Kong's financial system, and the timely and decisive measures taken by the authorities.

However, the crisis revealed a host of supervisory and regulatory issues warranting close attention by financial regulators and central banks worldwide. It has also fuelled a rapid growth of attention to and demand for enhancing protection for financial market participants. Proposals for stepping up market surveillance and reforming financial regulatory regimes have been put forward by local and overseas authorities. The Board has been paying close attention to these market developments. Although the crisis has not led to the triggering of the DPS, it has brought about new challenges, some of which can only be addressed by making adjustments to the DPS framework. The Board has also seen credible opportunities for fortifying the deposit protection arrangements in Hong Kong. Despite the added pressure of the crisis on the day-to-day operations of the DPS, the Board embarked on a review of the DPS framework.



Chairman of the Board makes an opening speech at the press conference on the public consultation on enhancing the DPS

The first phase of the review was completed on schedule in early 2009. While concluding that the existing design features of the DPS substantially complied with international best practices, a number of improvements were identified based on past operating experience and lessons learnt from the latest international developments. For example, our recommendations on raising the protection limit and expanding the coverage to include secured deposits are expected to add significantly to the effectiveness, adequacy and clarity of the DPS coverage. The Board has also commenced work on improving the operating efficiency of the DPS under the second phase of the review. We believe these enhancements will bring the DPS in Hong Kong to the forefront among its peers in being able to provide protection with a clear and comprehensive coverage, as well as having an efficient mechanism for compensating depositors.

I am greatly impressed with the diligence and persistence demonstrated by the Management Team in taking on these new challenges posed by the rapidly changing environment, notwithstanding the enormous pressures the financial crisis has already put on the DPS operations. Taking this opportunity, I would also like to pay tribute to my fellow Board members for their invaluable advice and contributions over the past year.

No doubt, the financial crisis has brought about challenges and hardships; it has also opened up new horizons for perfecting our system. We are glad to note the recommendations concluded from our review have received broad public support. Nevertheless, a lot of work still has to be accomplished to turn the recommendations into operative legislation, and a continued support of the public remains inevitable. We therefore look forward to working hand in hand with the public in making the DPS better able to meet their expectations and more effective in contributing to banking stability in Hong Kong.

A handwritten signature in black ink that reads "cF Chan". The "c" is lowercase and the "F" is uppercase, both in a cursive style. "Chan" is written in a similar cursive script.

Andrew Chan Chi-fai

Chairman



Mr Raymond Li, JP
Chief Executive Officer

“The completion of the project of reviewing and enhancing the Deposit Protection Scheme has become the prime business objective of the Board.”

The deepening global financial crisis last year put considerable pressure on the operation of the DPS. Nevertheless, under the Board's guidance, the Management Team was able to meet fully the operational objectives set for the year. During the year, the Board embarked on a project of reviewing and enhancing the DPS, the completion of which has become the Board's prime business objective. Highlights of our achievements in 2008-2009 include:

ADMINISTRATION OF THE DPS

The collection of contributions from Scheme members was completed on schedule. The Board collected a total of HK\$340 million in contributions for 2009, which brought the total assets of the DPS Fund to HK\$963 million by the end of March 2009. The deepening global financial crisis triggered steep and rapid rate cuts by monetary authorities around the world and brought global interest rates down to nominal levels. Despite the highly volatile market conditions during the year, the DPS Fund was able to achieve a positive investment return of 0.8%.

The Board continued to monitor the accuracy of the returns filed by Scheme members for contribution assessment purposes by reviewing auditor's reports submitted by the members. The results were satisfactory and no reporting error with a significant impact on total contributions was noted.

ENSURING ADEQUACY OF THE COVERAGE OF THE DPS

In view of the experience gained from operating the DPS and overseas reforms of deposit insurance regime after the outbreak of the US sub-prime crisis, the Board decided in mid-2008 to conduct a review of the DPS. In accordance with its project plan formulated for the review, the Board commenced the review in the fourth quarter of 2008.

The first phase was completed as scheduled in the first quarter of 2009 and a consultation paper was published in April 2009. The recommendations concluded from the review mainly cover enhancements to the level and scope of the protection provided by the DPS.

MAINTAINING AND IMPROVING THE READINESS OF THE DPS TO PAYOUT

The Board implemented a compliance review programme for monitoring Scheme members' compliance with the requirements in a statutory guideline on how they should maintain customer information and provide such information to the Board in a payout. In accordance with the programme, six compliance reviews were conducted, three of which were held in conjunction with a simulation test. Based on the experience gained from the compliance reviews and simulation tests, and after consulting the industry, the Board refined the guideline to streamline its operation.

In the fourth quarter of 2008, the Board conducted its second payout rehearsal to test its payout procedures and systems, and the readiness of the network of service providers for assisting it in a payout. Based on the experience gained from the simulation tests and payout rehearsals, the Board identified and initiated refinements to its systems and processes to further improve payout readiness.

ENHANCING PUBLIC AWARENESS, UNDERSTANDING AND CONFIDENCE IN THE DPS

The Board continued to undertake on-going educational and promotional activities to maintain and enhance public awareness and understanding of the DPS. In the fourth quarter of 2008, the authorities introduced a number of pre-emptive measures to strengthen confidence in Hong Kong's banking system, including a blanket deposit guarantee, amid the rapidly worsening market sentiment following the failure of the US investment bank Lehman Brothers. In collaboration with the Hong Kong Monetary Authority (HKMA), the Board stepped up its publicity effort to help lift confidence in the deposit protection arrangements in place. A focused publicity campaign was launched in the first quarter of 2009 to clarify the coverage of the DPS.

The Board continued to review self-assessment reports submitted by Scheme members on their compliance with the requirements in a set of statutory rules on how they should disclose their membership status and the protection status of their financial products to customers. The reports indicated the compliance status of Scheme members was satisfactory.

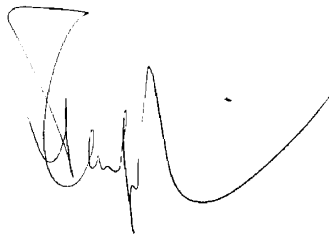
PLANS FOR 2009-10

In the coming year, the key objective of the Management Team is to assist the Board in completing the review of the DPS and to start the legislative process for effecting the enhancements concluded from the review. It is the intention of the Board to introduce the enhancements as soon as possible, preferably before the end of 2010, so the public will benefit from an enhanced DPS when the blanket deposit guarantee expires. We will also continue to assist the Board in ensuring a smooth and effective operation of the DPS under the existing framework.

The Board will work hand in hand with the HKMA to align the operation of the DPS with that of the blanket deposit guarantee to derive the greatest possible synergistic effect from the co-existence of the two deposit protection arrangements.

Though there have been signs of the global financial market stabilising, it remains uncertain whether the crisis will soon come to an end. Any signs of deterioration can trigger fresh public concerns about the security of their bank deposits and put new pressure on the operation of the DPS. The Management Team remains vigilant to the rapidly changing environment and stands ready to meet any new challenges.

Finally, I would like to take this opportunity to thank members of the Board for their support and advice over the past year, as well as my colleagues in the Board for their outstanding performance in assisting the Board in discharging its duties.

A handwritten signature in black ink, appearing to read 'Raymond Li', with a stylized flourish at the end.

Raymond Li
Chief Executive Officer

INTRODUCTION

Launched in September 2006, the DPS is a key building block in Hong Kong's financial safety net. Through the provision of a measure of protection to depositors, the DPS contributes to the stability of the banking system. The Board is a statutory body established under section 3 of the DPS Ordinance to oversee the operation of the DPS.

FUNCTIONS OF THE BOARD

Under section 5 of the DPS Ordinance, the Board's functions include 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 made to depositors from the assets of the failed Scheme member.

PERFORMANCE OF FUNCTIONS THROUGH THE MONETARY AUTHORITY

Pursuant to section 6 of the DPS Ordinance, the Board shall perform its functions through the Monetary Authority (MA) unless indicated otherwise by the Financial Secretary (FS). This means the MA will act as an executive arm of the Board in administering the DPS.

The 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 of the Board. The HKMA also supports the Board on aspects such as accounting, administration, human resources and information technology. Detailed arrangements regarding the extent of support provided by the HKMA are set out in a Memorandum of Understanding between the two organisations.

COMPOSITION OF THE BOARD

Members of the Board are appointed by the FS, with power delegated from the Chief Executive. They come from different professions such as accounting, banking, consumer protection, insolvency law, investment, information technology and public administration. The Board currently comprises eight members including two ex-officio members representing the MA and the Secretary for Financial Services and the Treasury. Except for the two ex-officio members, all existing members were appointed or re-appointed for a two-year term on 1 July 2008.

MEMBERS OF THE BOARD

Chairman



Professor Andrew CHAN Chi-fai, SBS, JP

Professor Chan has been Chairman of the Board since 1 July 2004. He is Professor in Marketing and Director of the Executive MBA Programme, The Chinese University of Hong Kong.

Members



Mr Ian CHAPMAN

Mr Chapman is a Senior Consultant of Mayer Brown JSM specialising in restructuring and insolvency law.



Professor David CHEUNG Wai-lok

Professor Cheung is Head of the Department of Computer Science, The University of Hong Kong.



Mr Nicholas Peter ETCHES

Mr Etches is a former partner of KPMG with experience in accounting and insolvency practice.

ABOUT THE HONG KONG DEPOSIT PROTECTION BOARD

Ms Eleanor WAN Yuen-yung

Ms Wan is the former Chief Executive Officer of Allianz Global Investors Hong Kong Limited and the former Vice Chairman of the Hong Kong Investment Funds Association.



Professor YEUNG Yuet-bor

Professor Yeung is the former Head of Information Technology of HSBC and is currently Professor of Information Systems, City University of Hong Kong.



Mr Y K CHOI, JP

Mr Choi is Deputy Chief Executive of the Hong Kong Monetary Authority. He is an ex officio member of the Board representing the Monetary Authority.



Miss Au King-chi, JP

(from 5 January 2009)

Miss Au is the Permanent Secretary for Financial Services and the Treasury (Financial Services). She is an ex officio member of the Board representing the Secretary for Financial Services and the Treasury.



Mr Kevin HO Chi-ming, JP

(until 4 January 2009)

Mr Ho was the Permanent Secretary for Financial Services and the Treasury (Financial Services). He was an ex officio member of the Board representing the Secretary for Financial Services and the Treasury.



INVESTMENT COMMITTEE OF THE BOARD

The Investment Committee is established in accordance with section 7 of Schedule 2 to the DPS Ordinance. It consists of the following members:

Chairperson

Ms Eleanor WAN Yuen-yung

Former Chief Executive Officer of Allianz Global Investors Hong Kong Limited and former Vice Chairman of the Hong Kong Investment Funds Association

Members

Mr Francis CHU Siu-chuen

Executive Director (Reserves Management), Hong Kong Monetary Authority

Mr Nicholas Peter ETCHES

Former partner of KPMG

Professor YEUNG Yuet-bor

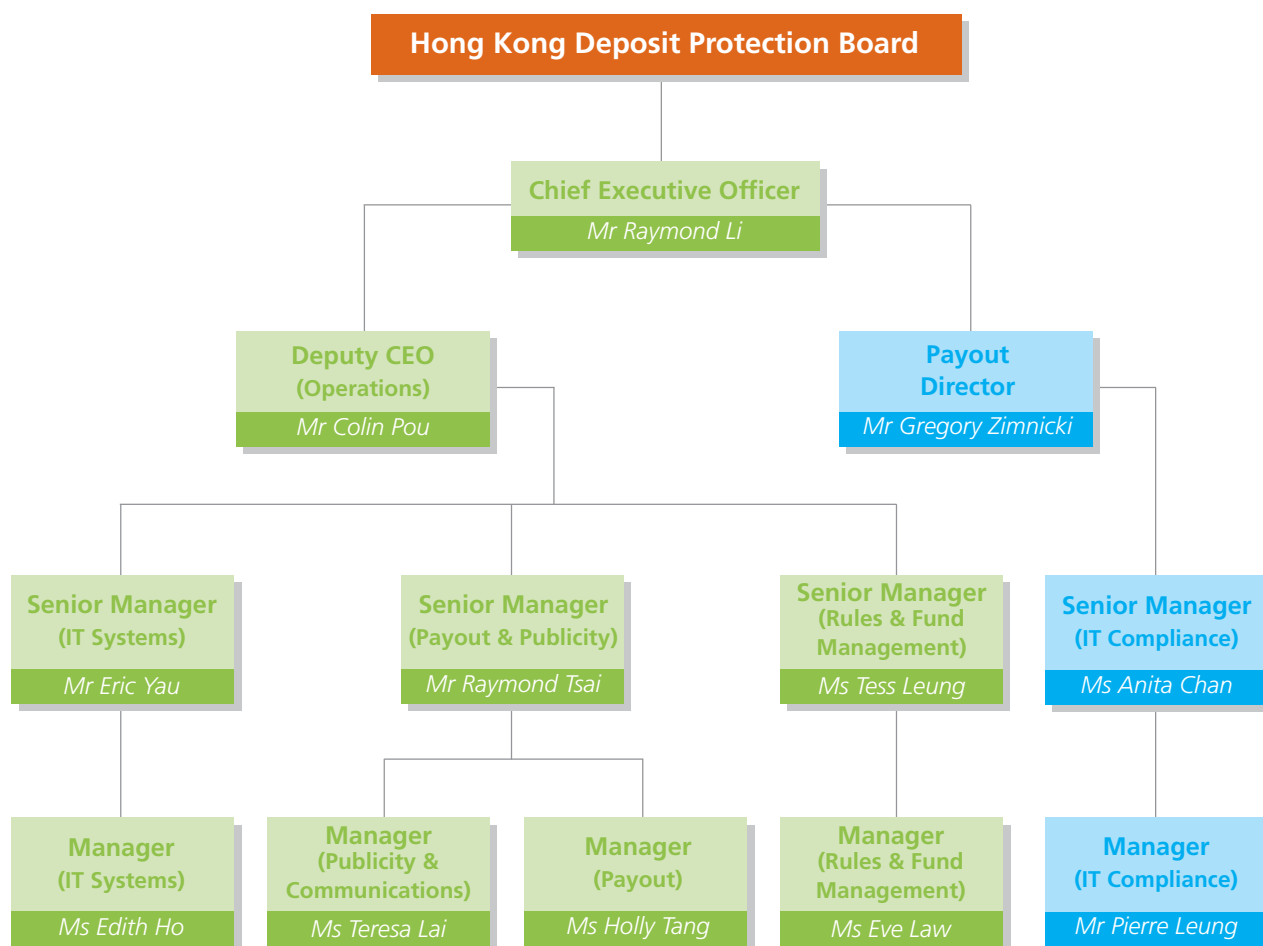
Professor, Department of Information Systems, City University of Hong Kong

The terms of reference of the Investment Committee are:

- to make recommendations on the investment policy and strategy in respect of the DPS Fund;
- to monitor the investment performance of the DPS Fund and to establish proper risk management controls for the investment activities of the Board; and
- to work on any other matters as determined from time to time by the Board.

ABOUT THE HONG KONG DEPOSIT PROTECTION BOARD

ORGANISATIONAL STRUCTURE OF THE BOARD (1 JULY 2009)



HKMA staff seconded to assist the Board. The emoluments of these staff members are reimbursed by the Board to the Exchange Fund.

The term of appointment of the staff of the Board was changed from contract basis to permanent basis in the second quarter of 2009.

CONSULTATIVE COMMITTEE ON DEPOSIT PROTECTION SCHEME

To keep the industry informed of the development of the DPS, the Board has established a Consultative 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. Members of the Committee are:

Mr CHOW Chak-chee, Bank of China (Hong Kong) Limited

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

Mr Ron LEUNG, 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 Joseph CHO, Hang Seng Bank Limited

Mr Steve CHOI, The Hong Kong and Shanghai Banking Corporation Limited

Mr David CHENG, Industrial and Commercial Bank of China (Asia) Limited

Mr Dennis CHAN, JPMorgan Chase Bank, Hong Kong Branch

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

Mr Peter HUI, Nanyang Commercial Bank Limited

Mrs Pauline LAI, Standard Chartered Bank (Hong Kong) Limited

The Committee's terms of reference are:

- to advise the Board on the formulation of the approach and strategy to engage the banking industry in the project of establishing the DPS;
- to consider and give comments on specific policy and operational initiatives proposed by the Board that may have an impact on the banking industry; and
- to assist the Board in maintaining effective communication with the banking industry.

DEPOSIT PROTECTION APPEALS TRIBUNAL

Under the DPS Ordinance, certain decisions of the Board and the MA can be the subject of an appeal to the Deposit Protection Appeals Tribunal. These include the Board's decisions on 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 FS from a panel of six people. The panel members are:

Chairman

Mr Simon Herbert MAYO, GBS

Members

Professor Charles David BOOTH

Professor Simon HO Shun-man

Miss Winnie LUN Pong-hing

Mrs Mabel LUI FUNG Mei-yee

Mr Rupert James PURSER

Mr James WARDELL

The current appointment of the Chairman and panel of members is for a period of three years from 14 January 2008 to 13 January 2011. Sittings of the Tribunal are convened when required.

Whether the DPS can be effective in promoting banking stability depends to a large extent on the confidence of the public in the DPS to honour its commitments when a bank failure occurs. Apart from putting in place an efficient payout infrastructure and engendering a high level of public awareness and understanding of the DPS, public perception of the integrity of the Board is also critical to building up confidence in the DPS. The Board is therefore fully aware that it must subscribe to sound corporate governance practices in administering the DPS. Given the nature of the Board and the functions of the DPS, the corporate governance structure of the Board shares the characteristics of both a public organisation and a deposit insurer.

COMPOSITION AND PROCEEDINGS OF THE BOARD

The Board is an independent statutory body formed under the DPS Ordinance. It is, however, subject to the oversight of the FS who is responsible for approving the Board's annual budget and tabling the Board's annual report to the Legislative Council.

The functions and composition of the Board are defined by the DPS Ordinance and, as such, the Board shall comprise between six to nine members, all of whom are non-executive members. Except for the two ex-officio members, all other members are appointed for a fixed, but renewable term. These members are appointed mainly because they possess professional or occupational experience relevant to the operation of the DPS.

The proceedings of the Board are governed by the relevant provisions in the DPS Ordinance. The Board meets three to four times every year to deliberate policy issues crucial to the operation and development of the DPS. In 2008-09, the Board met four times. On average, over 85% of members were present at each meeting.

Under the DPS Ordinance, the Board may appoint committees to assist in performing its functions. An Investment Committee comprising members with experience and expertise in banking and investment matters has been formed to advise the Board on the investment of the DPS Fund. The Chairman and a majority of the members of the Committee are also members of the Board.

EXECUTIVE MANAGEMENT

Pursuant to section 6 of the DPS Ordinance, the Board shall perform its functions through the MA unless otherwise directed by the FS. This means the MA, acting as the executive arm of the Board, is responsible for managing the day-to-day operation of the DPS and assisting the Board in developing and implementing corporate policies and strategies.

The powers that can be exercised by the Board in administering the DPS are detailed in the DPS Ordinance. The Board has established clear guidelines on the division of responsibilities between the Board, the Management Team and other supporting divisions of the HKMA, and between the posts of the Chairman and the Chief Executive Officer, which have been separated in line with good corporate governance practice. In general, strategic decisions relating to the operation and development of the DPS and those decisions requiring an exercising of the Board's powers under the DPS Ordinance have to be taken by the Board. The Management Team, on the other hand, is responsible for maintaining the day-to-day operation of the DPS according to the policies and principles endorsed by the Board.

INTERNAL CONTROLS AND AUDITS

Assisted by the Internal Audit Division (IAD) of the HKMA, which is a division independent of the department in the HKMA supporting the Board, the Management Team performs an annual assessment of the risks inherent in different operational areas of the Board, and evaluates whether appropriate controls are in place to safeguard the Board against the potential risks identified. The findings of the risk assessment will form the basis for the IAD to formulate its annual plan for auditing the operation of the DPS.

The IAD performs an annual audit of the DPS to ensure that the various internal control procedures of the Board have been properly adhered to, especially on activities posing a relatively high level of risk to the Board. The IAD will report its findings and recommendations directly to a meeting of the Board. The IAD reported satisfactory results on the audit conducted in 2008.

The appointment of the external auditor of the DPS Fund requires the approval of the FS. The external auditor is responsible for auditing the annual statement of accounts of the DPS Fund prepared by the Board. The external auditor will report its findings directly to the Board. The external auditor for the year under review was PricewaterhouseCoopers (PwC). Apart from auditing the statement of accounts for 2008-09, PwC did not offer any non-audit service to the Board.

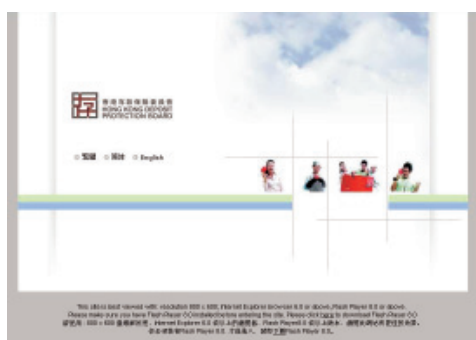
CONFLICTS OF INTEREST AND CODE OF CONDUCT

In line with the good corporate governance standards applicable to deposit insurers, government representatives, including those of the HKMA, account for only a minority of the members of the Board. This allows the government and the banking supervisor to contribute to the operation of the DPS from the public administration and financial regulatory perspectives, but prevents the Board from overtly exposing itself to the influence of the government and other financial safety-net players. The Management Team assigned by the HKMA to assist the Board is not responsible for banking supervisory matters. The operation of the Board is insulated from the influence of the banking industry as no employees or directors of banks and banks' related companies can be appointed as a Board member.

The Board has established clear guidelines and procedures for disclosing interests and avoiding conflicts of interest. The relevant guidelines and procedures are set out in the DPS Ordinance and the Codes of Conduct for members and staff of the Board. Board members are required to register in writing their personal interests when they first join the Board or its committees, and annually thereafter, to the secretary of the Board. The register of Members' interests is kept by the secretary and is available for public inspection. Senior staff members of the Board are required to make a declaration to the Chairman of the Board annually. Specific procedures are available on how members and staff of the Board should report their interests and be excused from a decision making process.

COMMUNICATION AND TRANSPARENCY

The Board is committed to open communication with the public and other stakeholders. It has set up an enquiry hotline to answer questions from the public, and maintains a website to facilitate access to information on different aspects of the DPS operations. In 2008-09, the website registered over 160,000 visits. The Board also publishes an annual report.



APPEAL MECHANISM

Certain decisions made by the Board and the MA under the DPS Ordinance can be the subject of an appeal to the Deposit Protection Appeals Tribunal. The Tribunal is chaired by a High Court judge appointed by the Chief Executive. Members of the Tribunal are appointed by the FS from a panel of six people appointed by the Chief Executive.

REGULAR REVIEW OF THE CORPORATE GOVERNANCE STRUCTURE

The Board has set a policy of reviewing its corporate governance structure regularly to ensure that it continues to adhere to sound corporate governance standards, despite any expansion or change in the scope of the Board's operation driven by the development of the DPS. Refinements will be made between individual reviews as and when necessary as the Board gains experience with operating the DPS. The next review is scheduled to be conducted in 2011.

OUR OPERATING ENVIRONMENT

The financial turmoil triggered by the US sub-prime mortgage crisis eventually precipitated into a systemic crisis on a global scale in 2008. The collapse of the US investment bank Lehman Brothers and the failure of a number of large financial institutions in major markets resulted in a severe global credit crunch in the fourth quarter of 2008, triggering widespread concern over a possible meltdown of the global financial system. The crisis also spilled over to the real sectors and dragged major economies into recession. Unprecedented measures were taken by many countries to restore confidence in their financial systems and to stimulate their economies. These included steep and rapid rate cuts, injections of liquidity, tremendous packages to rescue troubled financial institutions and stimulate economies, and measures to protect depositors. While there have been signs these measures are beginning to restore stability and confidence, it remains unclear whether the crisis will end soon.

Being a highly open economy, Hong Kong is not immune from the contagion of the financial and economic downturn of its major trading partners. A brief and small-scale run occurred on a local bank in late September 2008 on unfounded rumours amid the deteriorating market sentiment after the collapse of Lehman Brothers. The tightness of liquidity in the global market also spread to the local market. In response, the authorities introduced a series of pre-emptive measures to reinforce confidence and promote stability. In addition to measures for easing market liquidity, a blanket deposit guarantee was introduced in mid-October 2008 covering all deposits in Hong Kong. The guarantee protects fully the deposits held with all authorized institutions in Hong Kong, in excess of the portion covered by the DPS, until the end of 2010.



Mr John Tsang (centre), Financial Secretary, together with Mr Joseph Yam (left), Chief Executive of the HKMA, and Mr Raymond Li (right), CEO of the Board at the press conference in mid-October 2008 announcing the blanket deposit guarantee by the Government

As a result of these measures, the operation of the local banking system gradually returned to normal towards the end of the year. Indeed, banks in Hong Kong generally remained liquid and well capitalised despite the sector's profitability being noticeably affected by the crisis and the conspicuous slow-down in domestic economic growth, from 6.4% in 2007 to 2.4% in 2008.

Statistics released by the HKMA show the aggregate pre-tax operating profits of retail banks' Hong Kong offices fell by 35.7% in 2008 compared with 2007. The post-tax return on average assets declined to 0.85% in 2008 from 1.48% a year earlier. The deterioration in profitability mainly resulted from narrower interest margins and a sharp decline in non-interest income. An increase in provisions for asset devaluation and impairments also eroded operating income. The asset quality of retail banks, however, remained good by historical standards, but a few indicators showed signs of deterioration. The classified loan ratio increased to 1.24% in 2008 from 0.85% in 2007 and sub-standard debt securities represented about 0.06% of retail banks' total assets in 2008, compared with 0.04% in 2007. Retail banks generally remained liquid with the quarterly average liquidity ratio standing at 45% in the final quarter of 2008, compared with the statutory minimum of 25%. Despite the difficult operating environment, the consolidated capital adequacy ratio of all locally incorporated authorized institutions rose to 14.8% at the end of 2008 from 13.4% a year earlier. Tier-1 capital ratio also increased to 11.2% at the end of 2008 from 10.4% in 2007. Overall, Hong Kong's banking sector has managed to withstand the external shocks reasonably well.

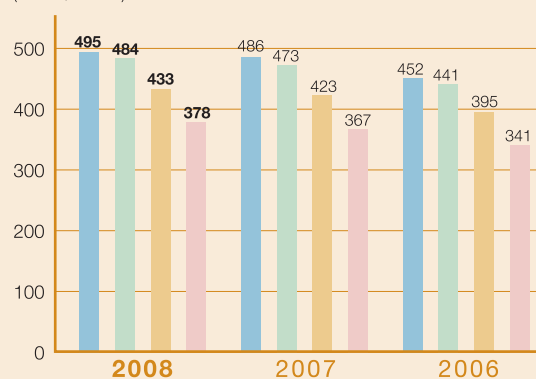
Profile of Scheme members

At the end of March 2009, there were 140 Scheme members, compared with 141 a year earlier. During the year, three new members joined, two of which were upgraded from restricted licence banks to licensed banks; four ceased to be members because of mergers and acquisitions, and downsizing. Of the 140 Scheme members, 23 are locally incorporated banks and 117 are foreign bank branches. This is roughly in line with the number of retail banks and wholesale banks in Hong Kong respectively.

Based on the returns of relevant deposits submitted by Scheme members in 2008, the total amount of relevant deposits in the industry continued to grow, albeit at a slower pace. They expanded by about 2% to HK\$495 billion from HK\$486 billion a year earlier. The growth was more benign than the 7% recorded in 2007, possibly due to the economic slow-down during the year. As in previous years, the top 20 members by size of relevant deposits are all retail banks, accounting for more than 95% of total relevant deposits in the industry.

Relevant deposits held with Scheme members

(in HK\$ billion)



% of total	2008	2007	2006
Top 5	76%	76%	75%
Top 10	87%	87%	87%
Top 20	98%	98%	98%
Total	100%	100%	100%

Statistics on the growth of relevant deposits recorded by small to medium-sized retail banks and large retail banks show that the rates are largely comparable, at 1% and 2% respectively. As a result, the split of relevant deposits among the retail banks remained stable over the year: large retail banks accounted for 87% of the total relevant deposits of the industry, and small to medium-sized retail banks held 11%.

Relevant deposits held with large retail banks and small to medium-sized retail banks

(in HK\$ billion)	2008	2007	±%
Large retail banks	430.6	420.5	2%
Small to medium-sized retail banks	55.4	54.8	1%

ADMINISTRATION OF THE DPS

The Board completed the key tasks in different operational areas of the DPS smoothly in accordance with the applicable requirements, based on past experience and under the guidance of well established policies and procedures.

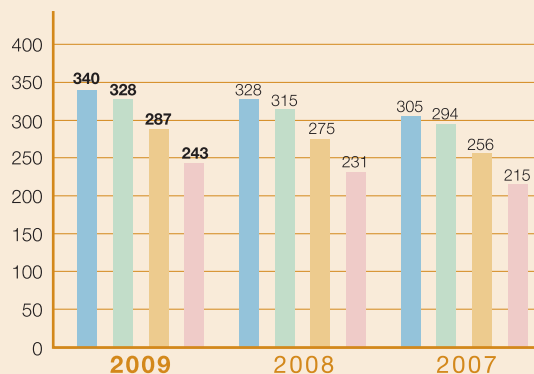
Assessment and collection of contributions

All Scheme members are required to make an annual contribution to the DPS Fund in the manner specified in a set of statutory rules (Contribution Rules). Under Schedule 4 of the DPS Ordinance, the Board assessed and collected HK\$340 million in contributions from Scheme members for 2009 – a 4% increase on the HK\$328 million collected in 2008. Similar to the distribution of relevant deposits, over 95% of the total contributions were paid by the top 20 Scheme members. This distribution pattern has been much the same since the commencement of the DPS. All contributions were paid by Scheme members on time in January 2009 in the manner prescribed in the Contribution Rules.

The contribution payable by a Scheme member each year is assessed by the Board based on an annual return submitted by the member. To ensure the accuracy of the amount of relevant deposits reported by Scheme members in the returns, the Board introduced a policy in 2007 to require Scheme members to submit an auditor's report to certify the correctness of their returns. A second review under the policy was conducted in early 2009. In the review, 27 Scheme members were required to submit an auditor's report. The results were satisfactory and no reporting error with a significant impact on the total contributions was noted. After the completion of the second review, 60 Scheme members, accounting for more than 90% of the relevant deposits, have had the accuracy of their returns verified by an auditor. This has provided a reasonable assurance over the correctness of the total amount of contributions payable by the industry.

Contribution paid by Scheme members by relevant deposits held

(in HK\$ million)



% of total	2009	2008	2007
Top 5	72%	70%	71%
Top 10	84%	84%	84%
Top 20	97%	96%	96%
Total	100%	100%	100%

Investment of the DPS Fund

During the year, the Board continued to invest the DPS Fund in accordance with the DPS Ordinance and the Board's investment policy, which set out strict guidelines on the risk assessment and control measures, and the segregation of duties required for the investment activities.

As US dollar interest rates generally stayed above their Hong Kong dollar counterparts during the year, the Board switched most of the DPS Fund assets into US Treasury papers to fully capture the yield advantage offered by the US dollar assets. At the end of March 2009, cash and investment securities accounted for about 18% and 82% of the investment assets of the DPS Fund respectively, compared with 52% and 48%

a year ago. In terms of currency mix, the proportion of US dollar assets increased from 48% to 82% during the same period. However, the investment return of the DPS Fund fell along with the rapidly easing global interest rates. Nevertheless, the DPS Fund was able to achieve a positive return of 0.8% for the year (3.8% in 2007-08) despite the highly volatile market environment.

Mix of cash and investment of the DPS Fund (as at 31 March 2009)

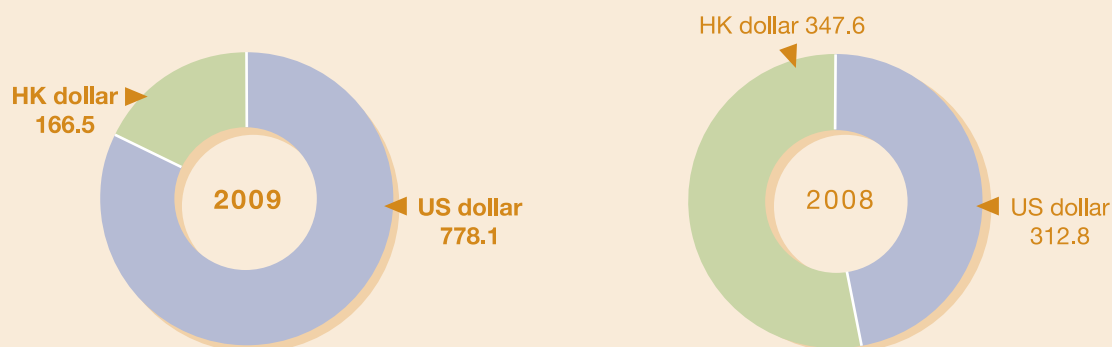
(in HK\$ million)	2009	2008
Cash and deposit balance*	168.9	347.6
Investment securities	775.7	312.8
Total	944.6	660.4

* Net of securities commitment payable

To improve the return on the DPS Fund, the Board sought the FS's approval to lengthen the investment horizon of the DPS Fund to include Exchange Fund Notes and US Treasury Notes of a tenor up to two years. Expansion of the investment scope was approved by the FS in December 2008. However, as the yield advantage of 2-year papers over the shorter term papers diminished with the easing in global interest rates during the year, no switching was made to the longer term papers. The Board also reviewed its investment policies and control procedures to accommodate the expansion in the investment scope of the DPS Fund.

Currency mix of cash and investments of the DPS Fund (as at 31 March 2009)

(in HK\$ million)



ENSURING ADEQUACY OF THE DPS COVERAGE

In response to changes and emerging trends in the operating environment, the Board initiated a review of the DPS to maintain and improve its effectiveness in protecting depositors and promoting banking stability. The first phase of the review, which focused on enhancing the coverage of the DPS, identified a number of improvements.

Enhancing deposit protection under the DPS

Since the onset of the US sub-prime mortgage crisis in August 2007, a number of countries have proposed reforms to their financial regulatory and deposit insurance regimes. In March 2008, the US Treasury released a blueprint for modernising its financial regulatory structure. In the UK, following a run on the Northern Rock bank in September 2007, the authorities commenced consultation on measures to reform the UK financial regulatory and deposit insurance arrangements in January 2008. The Financial Stability Forum, a prominent international forum of national financial regulators, central banks and international financial institutions, issued recommendations in April 2008 to enhance financial market and institutional resilience. This led to the development and consultation of a set of recommended core principles for effective deposit insurance systems by the Basel Committee on Banking Supervision of the Bank for International Settlements in March 2009. The European Parliament adopted a series of amendments to its directive governing deposit insurance schemes in the European Union in December 2008. Extraordinary measures, such as capital injections to banks and blanket deposit guarantees, were introduced by many countries in the second half of 2008 to combat the deepening crisis in global financial markets.

In Hong Kong, the HKMA published a consultancy report on its work on banking stability in July 2008. The report carries a number of recommendations in respect of the DPS. Towards the end of 2008, public attention to the security of their deposits at banks heightened amid the deepening global financial crisis. The unlimited protection offered by the blanket deposit guarantee introduced by the authorities and misunderstandings about the circumstances under which a deposit would fall outside the scope of the DPS protection triggered concerns in early 2009 about the coverage of the DPS.

Against this backdrop, the Board decided in mid-2008 to review the DPS. The first phase of the review commenced in the fourth quarter of 2008 and was completed in the first quarter of 2009 as scheduled. With reference to the reform experience in other countries and emerging international principles for deposit insurance, the review concluded that the existing design features of Hong Kong's DPS already complied substantially with international best practices. Nevertheless, in the light of the latest developments in overseas and local markets, the review made a number of recommendations to enhance coverage of the DPS.

As part of the review, the Board conducted a survey of major retail banks on the percentage of their depositors fully covered by the DPS under different protection limits. The survey revealed that the percentage of depositors in the industry fully covered by the DPS under the current limit might have dropped below 80%, the threshold set by the Board for reviewing the protection limit. The review therefore recommended lifting the limit from HK\$100,000 to HK\$500,000, bringing the percentage of depositors fully covered to above 90%. This will also bring the level of protection for depositors in Hong Kong close to the higher end of international benchmarks and in line with the level in major countries.

The review also observed that the public concern about the coverage of the DPS in early 2009 was mainly caused by misunderstandings over the circumstances under which a deposit becomes pledged and falls outside the protection of the DPS. To eliminate any potential for misunderstanding, which can erode the effectiveness of the DPS, the review recommended extending the scope of the DPS to cover secured deposits.

The recommendations on raising the DPS protection limit and expanding its scope to cover secured deposits will increase the amount of deposits protected by the DPS, and hence, the contributions payable by Scheme members. However, the Board is mindful of the cost impact on Scheme members because of the recommendations, which, if substantial, can increase the likelihood of being passed on to depositors. The review, therefore, recommended introducing cost mitigating measures to neutralise any cost implications resulting from the enhancements to the Scheme. The measures include halving the premium rates and allowing Scheme members to report protected deposits on a net deposit basis for the purpose of assessing contributions.

The recommendations from the first phase of the review were published for public consultation in late April 2009 with the consultation period ending in late June. The Board has since commenced the second phase of the review and intends to introduce the enhancements identified in both phases simultaneously, preferably before the end of 2010, so the public can benefit from an enhanced DPS when the blanket deposit guarantee expires.

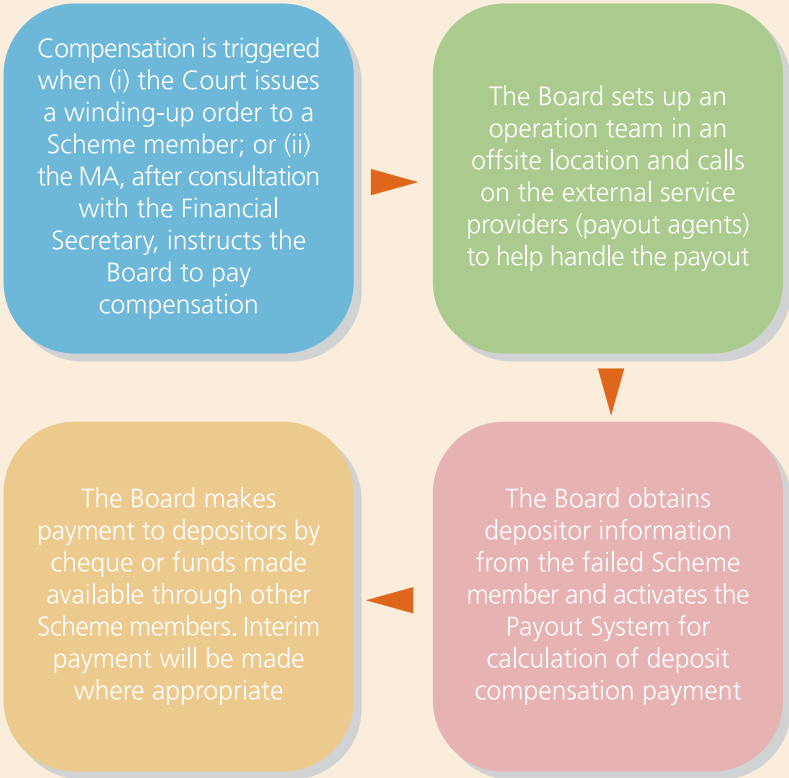
IMPROVING READINESS OF THE DPS TO PAYOUT

The Board continued to build on activities to enhance its payout readiness, concentrating its work on areas designed to allow the Board to better respond to the risks it may face if called upon to make compensation payments. These are described in more detail below.

Payout readiness

“Payout readiness” refers to the Board’s ability to deliver on its mandate of making compensation payments to affected depositors in the event of a bank failure (a process that is commonly referred to as a payout). This generally relates to having the appropriate people, processes and systems in place to be brought into action on short notice if payment of compensation from the DPS Fund is triggered. As illustrated by the Payout process diagram below, a number of elements need to be already in place for the Board to promptly begin, and expeditiously complete, a payout.

Payout process



As the Board uses a virtual organisation of external service providers (collectively referred to as payout agents) to assist with the calculation and payment of compensation to depositors in the event of a payout, this readiness extends to ensuring these payout agents are able to work in a co-ordinated and efficient manner and that they are familiar with the Board’s payout processes and systems.

The Management Team and payout agents (the Payout Team) rely on a comprehensive set of procedures, documented in the Board's Payout Procedure Manual as well as other reference materials, to guide them in performing the activities required to complete a payout. The procedures relate not only to manual processes performed during a payout, but also to the operation of the Board's computer system (the Payout System) that was developed to handle the volume of data and complex processing necessary to arrive at determinations of depositors' balances on which compensation payments are based.

Integral to payout readiness is the Guideline on Information Required for Determining and Paying Compensation (ISG) issued by the Board in 2006, which provides direction to Scheme members on how data from their information systems should be made available or retrievable by the Board in the event of a payout. This ISG is necessary to ensure the Board can quickly use data from a failed Scheme member in its payout processing, as the Board will rely on those records in making its determinations of entitlement to compensation payments.

Improving payout policies, procedures and processes

With the knowledge gained through conducting simulations and payout rehearsals, as well as analysing international developments in deposit protection spurred by the global financial crisis, the Board continued its programme of updating payout procedures and enhancing its Payout System. During the year, the Board completed and tested enhancements to the Payout System that allow the Board to better anticipate the outcomes of different payout strategies, and improve the efficiency of the payout process in terms of data transformation, payment generation and interest calculation. More information on the calculation and payment status has been made available in the Payout System for responding to depositors' enquiries.

Second payout rehearsal

Building on the results from its first payout rehearsal and previous simulations, the Board conducted a second payout rehearsal in November and December 2008. The rehearsal tested the capabilities of the Board's payout agents to efficiently perform payout processes as a cohesive team. The format and scope of work was similar to



Members of the Payout Team started the rehearsal activities at the payout operation centre



Operators at the call centre responding to simulated enquiries

the previous rehearsal, since the Board engaged its second accounting firm to act as the Project Manager for the exercise. In preparing for the rehearsal, the payout agents were provided with training on payout processes and the use of the Payout System. This was followed by a complete payout (from beginning to end) involving providers of accounting, information technology, business recovery, security printing and call centre services. Additional procedures were performed to test the capabilities of the Payout System to handle payment generation under the blanket deposit guarantee offered by the government to prepare the Board for providing assistance in making compensation payments under the guarantee.

The payout agents completed the rehearsal within the expected time frame, performed their work within the pre-specified service standards, and met the objectives of the rehearsal. The Payout System also satisfactorily performed the necessary payment processes for the blanket deposit guarantee. Recommendations from the payout agents have been incorporated in the Board's plans for future changes to payout processes and documentation, and for Payout System enhancements.

Compliance with the ISG

With Scheme members having self-reported compliance with the ISG by the end of 2007, the Board commenced a compliance review programme in 2008 to verify members' levels of compliance. As indicated to Scheme members in the programme, the Board conducted six compliance reviews during the year using a risk-based approach to select Scheme members. The scope of each review covered verification of the correctness of the format, and the completeness and the accuracy in which the Scheme member made the required data available to the Board. Based on the reviews conducted so far, the compliance level has been generally satisfactory. For the non-conformity issues identified, Scheme members were requested to take remedial action and the Board would monitor the progress until the measures were completed.

The Board also took the opportunity during the compliance reviews to conduct simulation tests in which data, from three of the Scheme members under review, were processed on the Payout System. Payout processes and procedures were applied to test for specific simulated scenarios, such as incomplete depositor details and the determination of compensation related to different capacities of trust and client accounts. The simulations also served as part of a knowledge management process to maintain the readiness of Board personnel and payout agents to perform payouts.

As reported last year, the Board observed a number of interpretation issues of the ISG during previous simulation tests, compliance reviews and results from a survey on the information systems of Scheme members. Following consultations with the Consultative Committee on the Deposit Protection Scheme and the Hong Kong Association of Banks, the Board issued an amendment to the ISG and an Explanatory Note in March 2009. The amendment refines some of the requirements in the ISG to enhance payout efficiency, and the Note provides supplementary guidance to improve Scheme members' understanding of the ISG to promote compliance. The Board will monitor Scheme members' progress in achieving compliance with the amended requirements in accordance with the specified time frames.

MAINTAINING AND ENHANCING PUBLIC AWARENESS AND UNDERSTANDING

Promotion and public education

With advice from a professional public relations consultant and an advertising agency, the Board continued to conduct a wide variety of promotional and educational activities to maintain and enhance public awareness and understanding of the DPS. After successfully building up a satisfactory level of general awareness through the work in the past two years, the Board has shifted the focus of its publicity effort to enhancing public understanding of the Scheme's key features. In addition to utilising publicity material issued through traditional communications channels, the Board has explored new approaches to more effectively explain the relevant concepts of the DPS, for example, through seminars and drama performances.



Keeping the public awareness of the DPS on public transport



Table-mat advertising campaign promoting the DPS



The DPS message is spread through cyberspace



Community outreach programmes: seminars by the Board's personnel, drama performances and roving exhibitions to promote the DPS

In response to the deepening global financial crisis, the Board adjusted its publicity plan and stepped up its publicity effort since the third quarter of 2008 to address the growing concern of members of the public about the security of their bank deposits and to help reinforce confidence in the banking system.

Local sentiment in the financial market deteriorated notably after the collapse of US investment bank Lehman Brothers and a small-scale run on a local bank in September 2008. In mid-October, the authorities introduced a blanket deposit guarantee to help reinforce confidence and maintain banking stability. The guarantee fully protects deposits held with all authorized institutions in Hong Kong in excess of the portion covered by the DPS, until the end of 2010. Shortly afterwards, the Board launched a modified TV Announcement in the Public Interest (API) and an updated information leaflet to assist in enhancing the effectiveness of the measure and to explain the co-existence of the government guarantee and the DPS.



A new API is released on full deposit protection



Updated campaign message for educational purposes

In early 2009, a spate of concerns over the coverage of the DPS was observed. The concerns were probably triggered by the introduction of the guarantee, which offered unlimited protection in line with DPS principles, and worries about the security of bank deposits. In collaboration with the HKMA, the Board launched a focused publicity campaign highlighting and explaining the coverage of the DPS. The campaign included a new TV API, printed advertisements, media releases and a feature article by the CEO in newspapers. Arrangements were also made to distribute about eight million copies of an updated information leaflet to bank customers as an insert with their statements starting from March 2009.



Scenes from the new TV API



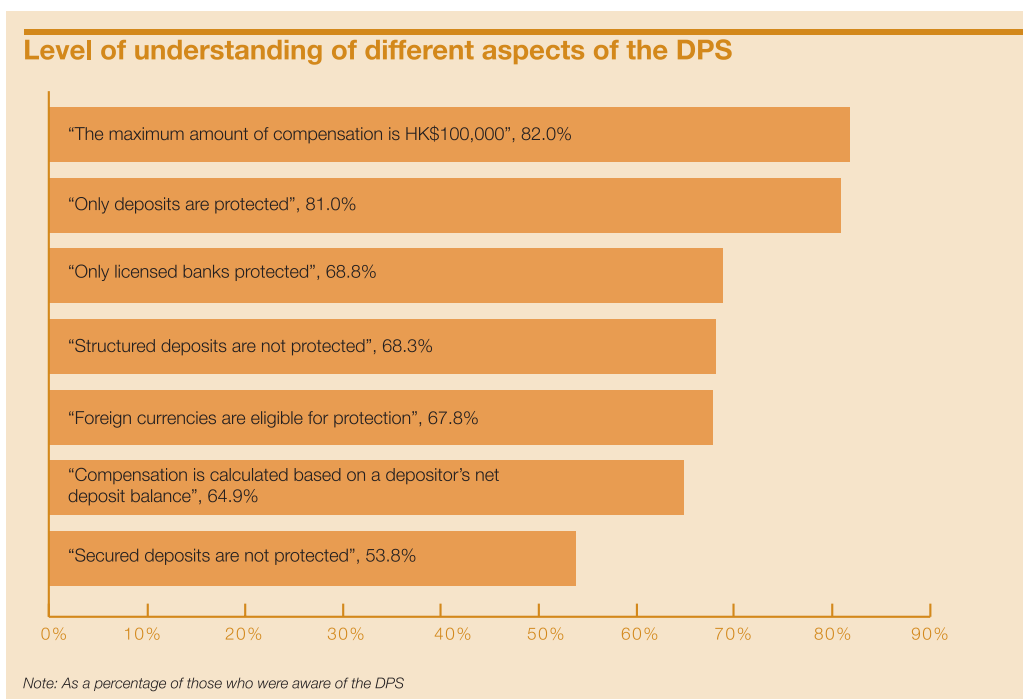
A full page newspaper advertisement explains coverage of the DPS

A list of major promotion and public education activities is in Annex 2.

Effectiveness of the publicity campaign

To monitor whether the Board's communications objectives had been met and to identify improvements for the publicity plan, an independent research agency was engaged to conduct two Hong Kong-wide opinion surveys on the DPS in June and December 2008.

Based on the surveys' findings, the general level of public awareness of the DPS improved to over 75% in December 2008 from about 70% a year earlier. There were notable improvements in the level of public understanding of the DPS' key features, for example, the percentage of respondents knowing foreign currency deposits are protected jumped to 67.8% from 30.4% a year ago. This improvement might be partly explained by the heightened public interest in the DPS following the introduction of the blanket deposit guarantee and partly by the more focused publicity effort by the Board.



DPS membership and product representations

Since the DPS commenced operation in 2006, Scheme members must observe the requirements in a set of statutory rules (Representation Rules) on how they should disclose their DPS membership and the protection status of their financial products. In 2007, the Board introduced a self-assessment framework to assess the level of compliance of Scheme members with the Representation Rules. The second self-assessment review, covering the period from 1 October 2007 to 30 September 2008, was completed in early 2009. According to the self-assessment reports received by the Board, the overall compliance level of all Scheme members was satisfactory.

Following the introduction of the blanket deposit guarantee by the authorities, the Board shared its experience in developing and implementing the Representation Rules with the HKMA to facilitate the HKMA in formulating and promulgating a statutory guideline on the representation requirements for the guarantee. Under the statutory guideline issued by the HKMA, all authorized institutions are required to practise disclosures in respect of the guarantee similar to those applicable to the DPS. The application of these uniform disclosure standards has been helpful in enhancing clarity and confidence in the two deposit protection arrangements.

香港特別行政區政府外匯基金對存放在[認可機構名稱]超過存款保障計劃保障額的合資格存款提供償還擔保，直至2010年底。

The repayment of eligible deposits in excess of the amount protected under the Deposit Protection Scheme taken by [name of authorized institution] is guaranteed by the Hong Kong SAR Government's Exchange Fund, until the end of 2010.

The deposit guarantee sign displayed by Scheme members next to the DPS Membership sign

RELATIONSHIP WITH OTHER SAFETY NET PLAYERS

Co-operation with the Hong Kong Monetary Authority

Both the Board and the HKMA are financial safety net players in Hong Kong and share a common aim of promoting the stability of the banking system. To ensure this is accomplished, the Board and the HKMA have agreed on how the two organisations should co-operate with each other in the performance of their respective functions. In addition, as the Board is required by the DPS Ordinance to perform functions through the MA, the Board and the HKMA have agreed on the extent of support provided by the HKMA. The Board has also secured a standby facility from the Exchange Fund to provide the necessary liquidity required for payment of compensation in the event of a bank failure. The detailed arrangements on how the two organisations should co-operate have been set out in a Memorandum of Understanding (MoU). In the past year, the Board and the HKMA closely co-operated with each other under the terms of the MoU, especially in areas common to the operation of the DPS and the blanket deposit guarantee introduced by the authorities.

Relationship with the Securities and Futures Commission and the Investor Compensation Company

Under certain circumstances in the event of a bank failure, the funds of a depositor or a portion of those funds is simultaneously covered by the DPS and the Investor Compensation Fund (ICF) established under the Securities and Futures Ordinance for compensating securities or futures investors. To ensure that no person receives double compensation, the Board and the Securities and Futures Commission (SFC) have agreed on a set of arrangements on co-ordination and exchange of information between the parties. The detailed arrangements have been documented in an MoU between the Board, the SFC and the Investor Compensation Company (ICC), the company recognised by the SFC for administering the ICF. Specifically, the MoU recognises that the DPS will normally pay the depositors first in the event of a bank failure and, to avoid double compensation, the parties should inform each other when compensation is paid to a depositor that has lodged a claim with the ICF.

INTERNATIONAL CO-OPERATION

As a member of the International Association of Deposit Insurers (IADI), the Board continued to participate in forums organised by both IADI, its member deposit insurers and other international organisations to exchange knowledge and ideas on issues relevant to deposit protection in an international context. In 2008-09, Board personnel took part in a number of international meetings including:

- the 2008 Financial Stability Institute and the Executives' Meeting of East Asia-Pacific Central Banks Seminar in Seoul, South Korea;
- the IADI 7th Annual Conference and Annual General Meeting in Washington, USA;



- the Deposit Insurance Corporation of Japan 4th Round Table in Tokyo, Japan;



Manager Eve Law (fifth from left, second row) at the Deposit Insurance Corporation of Japan 4th Round Table in Tokyo

- an audit and control workshop organised by the Malaysia Deposit Insurance Corporation in Kuala Lumpur, Malaysia;
- the 7th Asia Regional Committee Annual Meeting of IADI and International Conference in Almaty, Kazakhstan; and



Manager Teresa Lai (seventh from left, second row) at the 7th Asia Regional Committee Annual Meeting and International Conference of IADI in Almaty

- a course organised by the South East Asian Central Banks Research and Training Centre and the Malaysia Deposit Insurance Corporation in Kuala Lumpur, Malaysia



Payout Director Gregory Zimnicki (middle) is a guest speaker at the event

To share the Board's experience in conducting payout simulations and to promote international co-operation and knowledge sharing among deposit insurers, the Board received delegates from the Jamaica Deposit Insurance Corporation in March 2009.



Payout Director Gregory Zimnicki (middle) with representatives from the Jamaica Deposit Insurance Corporation

THE OUTLOOK

Widespread pessimism persisted in global financial markets at the beginning of 2009 amid fears of a new wave of turbulence. However, since the start of the second quarter there have been sporadic signs of improvement. The tremendous rescue packages implemented by the overseas authorities appeared to have taken some effects in giving a lift to financial institutions reported to be deeply in trouble at the height of the crisis. Major stock markets have registered noticeable gains from the troughs seen during the crisis. Despite the emergence of some positive signs, there remain significant risks to the economic outlook for 2009. While global financial markets are still vulnerable to fresh waves of turbulence, the full impact of the financial crisis on the real sector has yet to be seen. Therefore, considerable uncertainties remain over the length and severity of the recession in major economies. Whilst the economy of its major trading partner remains frail, a recovery in the domestic economy can be slow and protracted.

The operating environment for banks in Hong Kong is expected to continue to be difficult in 2009. The contagion of the global financial crisis and the slowing domestic economy may put further pressure on the profitability of banks. Nevertheless, in light of the robustness and resilience demonstrated by the banking system in withstanding the crisis so far, it should be well positioned to cope with any new challenges.

On the operation of the DPS, the Board will remain vigilant to the changing market conditions and be ready to collaborate with other financial safety net players in maintaining the stability of the banking system. On work priorities, the Board's prime focus will be on completing the review of the DPS and starting the legislative process for the recommendations concluded from the review. At the same time, the Board will continue to work closely with the HKMA to align the operation of the DPS with that of the blanket deposit guarantee to maximise their effectiveness in maintaining banking stability. Continued effort will also be applied to enhancing the effectiveness and efficiency of the DPS in other operational areas.

ADMINISTRATION OF THE DPS

The Board will assess and collect the contributions from Scheme members payable for 2010 in January, based on the returns of relevant deposits to be submitted by Scheme members in relation to their positions on 20 October 2009 and the supervisory ratings to be supplied by the HKMA. A third batch of Scheme members will be required to submit an auditor's report certifying the correctness of their returns of relevant deposits. The DPS Fund will continue to be invested in accordance with the DPS Ordinance and the investment policy of the Board.

ENSURING ADEQUACY OF THE DPS COVERAGE

The Board will endeavour to complete the review of the DPS and effect the enhancements concluded from the review as soon as possible. After completing the first phase of the review in the first quarter of 2009 as scheduled, the Board published a consultation paper on the review in late April. During the consultation period, the Board launched an extensive publicity campaign to invite public participation, and approached key stakeholders to solicit their views. The comments received during the two-month consultation period indicated broad public support for the recommendations. The stakeholders consulted were also generally supportive of the recommendations.



The Board's Chairman (left) and CEO (right) launching the public consultation at a press conference

In parallel with the consultation on the review's first phase, the Board commenced the second phase of the review, which covers mainly technical amendments for improving the effectiveness and efficiency of the DPS. The recommendations from phase two are expected to be made available for public consultation in the third quarter of 2009. Subject to the progress of consultation and law drafting, the Board intends to introduce an amendment bill to the Legislative Council in the first quarter of 2010 covering enhancements concluded from both phases of the review.

IMPROVING READINESS OF THE DPS TO PAYOUT

Applying the lessons and experience gathered from previous rehearsals and simulations, the Board will continue to improve its payout policies, processes, procedures and tools. For 2009-10, activities will focus on:

- enhancing reporting functionality of the Payout System in order to better support management decision-making;
- fine-tuning certain Payout System processes to continually improve the system's efficiency in giving greater certainty to delivering compensation payments on a timely basis;
- revamping the Payout Procedure Manual to strengthen procedures and workflows on making payments within a short period of time while balancing the Board's exposure to overpayment risks; and
- developing protocols with the HKMA for making payments under the blanket deposit guarantee.

As some of the contracts with payout agents will expire in the coming year, the Board will review its requirements and conduct tenders to ensure it maintains its network of payout agents with appropriate levels of resources and expertise.

The Board will expand the scope of compliance reviews in 2009-10 to perform simulation tests concurrently with all the reviews, as previous simulations, compliance reviews and the IT survey have indicated that an assortment of data issues may be encountered in a payout. This will provide the Board with greater confidence that data available from Scheme members can be utilised promptly by the Payout System for compensation determinations. In addition, commencing in the second half of 2009, the Board will monitor Scheme members' progress in complying with the amended ISG through the use of surveys in which Scheme members self-report their levels of compliance.

The third payout rehearsal, to be conducted in the fourth quarter of 2009, will focus on delivering an interim compensation payment within a specified operational target time while the payout agents operate in a "real-time" mode that approximates, as closely as possible, an actual payout. The Board will also review its strategy for conducting future payout rehearsals to determine how best to use its resources and funds while maintaining an appropriate level of operational readiness.

MAINTAINING AND ENHANCING PUBLIC AWARENESS AND UNDERSTANDING

Promotion and public education

In addition to sustaining public awareness of the DPS and enhancing understanding of its key features, another focus of the Board's publicity plan for the year is to assist with the consultation on the DPS review. As part of this, the Board launched an extensive publicity campaign to promote public participation in the consultation on the recommendations from the review's first phase. The extensive media coverage and the keen response from members of the public indicate the publicity effort was effective in stimulating widespread interest in, and discussion of, the subject.



TV APIs are shown on public transport



Full page newspaper advertisements encourage public participation

The implementation of the enhancements to the DPS concluded from the review is expected to have a significant impact on the Board's publicity strategy in the years ahead. The Board will work closely with its public relations consultant and advertising agent to develop an appropriate publicity plan to facilitate a smooth transition to the new regime when the enhancements take effect.

The Board will continue to use diversified and creative channels to deliver DPS messages to the public to promote awareness and understanding. The effectiveness of these will be monitored through regular opinion surveys.

DPS membership and product representations

To ensure compliance with the Representation Rules by Scheme members, the Board will continue to monitor the standard of compliance through the self-assessment review exercise. In addition, the Board will work with the HKMA to develop and implement a compliance review programme for HKMA bank examiners to conduct on-site examinations on authorized institutions to verify their compliance with the representation requirements under DPS Representation Rules and the statutory guideline issued by the HKMA for the blanket deposit guarantee.

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 Deposit Protection Scheme Ordinance (the "Ordinance") set out on pages 47 to 67, which comprises the balance sheet as at 31 March 2009, and the income and expenditure account, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

THE BOARD'S RESPONSIBILITIES FOR THE STATEMENT OF ACCOUNTS

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. The Board is responsible for the preparation and the true and fair presentation of the statement of accounts in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants.

This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of statement of accounts that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on the statement of accounts based on our audit and to report our opinion solely to you, as a body, in accordance with section 19 of the Ordinance and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the statement of accounts is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the statement of accounts. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the statement of accounts, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the statement of accounts in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board, as well as evaluating the overall presentation of the statement of accounts.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the statement of accounts gives a true and fair view of the state of affairs of the Fund as at 31 March 2009 and of the surplus and cash flows of the Fund for the year then ended in accordance with Hong Kong Financial Reporting Standards and has been properly prepared in accordance with the Ordinance.

PricewaterhouseCoopers

Certified Public Accountants

Hong Kong, 29 July 2009

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND INCOME AND EXPENDITURE ACCOUNT

for the year ended 31 March 2009

(Expressed in Hong Kong dollars)

	Note	2009	2008
Income			
Contributions		\$ 330,756,596	\$ 310,950,193
Interest income from cash and balances with bank and the Exchange Fund		1,777,490	5,852,386
Interest income from available-for-sale securities		6,090,884	8,683,701
Exchange (losses)/gains		(1,870,743)	282,198
Other income		30,907	60,000
		\$ 336,785,134	\$ 325,828,478
Expenditure			
Staff costs	6	\$ 5,216,167	\$ 5,473,024
Premises costs		2,343,627	2,336,172
Depreciation and amortisation		4,075,685	2,962,048
Office supplies		19,622	96,076
Overseas travel		91,592	32,054
Transport and travelling		5,093	4,003
Hire of services		24,704,824	22,495,039
Communications		65,375	65,961
Printing and publicity		19,955,869	15,485,853
Other expenses		1,903,682	1,024,661
		\$ 58,381,536	\$ 49,974,891
Surplus for the year		\$ 278,403,598	\$ 275,853,587

The notes on page 51 to 67 form part of this statement of accounts.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND BALANCE SHEET

as at 31 March 2009

(Expressed in Hong Kong dollars)

	Note	2009	2008
Non-current assets			
Fixed assets	7	\$ 6,211,528	\$ 3,663,231
Intangible assets	8	10,899,398	10,450,302
		\$ 17,110,926	\$ 14,113,533
Current assets			
Other receivables	9	\$ 875,963	\$ 820,025
Available-for-sale securities	10	775,730,067	312,805,015
Cash and balances with bank and the Exchange Fund	12	631,524,035	347,581,496
		\$ 1,408,130,065	\$ 661,206,536
Current liabilities			
Contributions received in advance		\$ 254,765,057	\$ 245,729,293
Other payables	11	480,224,298	17,541,419
		\$ 734,989,355	\$ 263,270,712
Net current assets		\$ 673,140,710	\$ 397,935,824
Net assets		\$ 690,251,636	\$ 412,049,357
Represented by			
Accumulated surplus		\$ 690,172,681	\$ 411,769,083
Investment revaluation reserve		78,955	280,274
		\$ 690,251,636	\$ 412,049,357

Approved and authorised for issue by the Hong Kong Deposit Protection Board on 29 July 2009.

Professor Andrew Chan Chi-fai, SBS, JP

Chairman

The notes on page 51 to 67 form part of this statement of accounts.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

STATEMENT OF CHANGES IN NET ASSETS

for the year ended 31 March 2009

(Expressed in Hong Kong dollars)

	2009	2008
Fund balance as at 1 April	\$ 412,049,357	\$ 135,915,684
Surplus for the year	278,403,598	275,853,587
Change in fair value of available-for-sale securities	(201,319)	280,086
Fund balance as at 31 March	\$ 690,251,636	\$ 412,049,357

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

CASH FLOW STATEMENT

for the year ended 31 March 2009

(Expressed in Hong Kong dollars)

	2009	2008
Operating activities		
Surplus for the year	\$ 278,403,598	\$ 275,853,587
Interest income	(7,868,374)	(14,536,087)
Exchange losses/(gains)	1,870,743	(282,198)
Depreciation and amortisation	4,075,685	2,962,048
Cash inflow from operating surplus before changes in operating assets and liabilities	\$ 276,481,652	\$ 263,997,350
Changes in operating assets and liabilities		
Increase in other receivables	(55,938)	(516,969)
Increase in contributions received in advance	9,035,764	17,027,778
Increase in other payables	462,682,879	7,827,211
Net cash inflow from operating activities	\$ 748,144,357	\$ 288,335,370
Investing activities		
Purchase of intangible assets	\$ (3,023,569)	\$ (2,798,487)
Purchase of fixed assets	(4,049,509)	(892,252)
Interest received	1,777,490	5,852,386
Purchase of available-for-sale securities	(1,318,383,312)	(412,554,233)
Redemption of available-for-sale securities	859,477,082	139,970,838
Net cash outflow from investing activities	\$ (464,201,818)	\$ (270,421,748)
Net increase in cash and cash equivalents	\$ 283,942,539	\$ 17,913,622
Cash and cash equivalents at 1 April	347,581,496	329,667,874
Cash and cash equivalents at 31 March	\$ 631,524,035	\$ 347,581,496
Analysis of balance of cash and cash equivalents		
Cash and balances with bank and the Exchange Fund	\$ 631,524,035	\$ 347,581,496

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

NOTES TO THE STATEMENT OF ACCOUNTS

for the year ended 31 March 2009

(Expressed in Hong Kong dollars)

1 PURPOSE AND ACTIVITIES

The Deposit Protection Scheme Fund (the "Fund") is established under the Deposit Protection Scheme Ordinance (the "Ordinance") for the purpose of providing compensation to depositors under certain circumstances in respect of deposits maintained with banks that 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 Fund mainly consists of contributions collected from Scheme members and returns on investments of the Fund. Expenditure incurred in the establishment and maintenance of the Scheme, as well as the management and administration of the Fund are paid from the Fund.

The Hong Kong SAR Government announced in October 2008 the use of the Exchange Fund to guarantee repayment of all customer deposits held in all authorized institutions in Hong Kong, following the principles of the Deposit Protection Scheme, until the end of 2010.

2 SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of preparation

The statement of accounts of the Fund has been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs" is a collective term which includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKASs") and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), and accounting principles generally accepted in Hong Kong. The statement of accounts has been prepared under the historical cost convention, as modified by the revaluation of available-for-sale securities.

The preparation of statement of accounts in conformity with HKFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Fund's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the statement of accounts are disclosed in Note 4.

- (i) Standards, amendments and interpretations effective in 2008

HKAS 39 (Amendment) "Financial instruments: Recognition and measurement" and HKFRS 7 (Amendment) "Financial instruments: Disclosures" – "Reclassification of financial assets"

These amendments do not have any impact on the Fund's statement of accounts as the Fund has not reclassified any financial assets.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(a) Basis of preparation *(continued)*

- (ii) Standards, amendments and interpretations effective in 2008 but not relevant to the Fund's operations

The following standards, amendments and interpretations are mandatory for accounting periods beginning on or after 1 April 2008, but are not relevant to the Fund's operations:

HK(IFRIC) – Int 12 "Service concession arrangements"; and
HK(IFRIC) – Int 14 "HKAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction"

- (iii) Standards, amendments and interpretations that are not yet effective and have not been early adopted by the Fund

The Fund has chosen not to early adopt the following new and revised HKFRSs which have been issued but are not yet effective. Adoption of these new and revised HKFRSs is not expected to have any significant effect on the Fund's results of operations or financial position.

HKAS 1 (Revised) "Presentation of financial statements";
HKAS 16 (Amendment) "'Property, plant and equipment" (and consequential amendment to HKAS 7, 'Statement of cash flows')
HKAS 19 (Amendment) "Employee benefits";
HKAS 37 "Provisions, contingent liabilities and contingent assets";
HKAS 36 (Amendment) "Impairment of assets";
HKAS 38 (Amendment) 'Intangible assets";
HKAS 23 (Revised) "Borrowing costs";
HKAS 23 (Amendment) "Borrowing costs";
HKAS 27 (Revised) "Consolidated and separate financial statements";
HKAS 32 (Amendment) "Financial instruments: Presentation" and HKAS 1 (Amendment) "Presentation of financial statements" – "Puttable financial instruments and obligations arising on liquidation";
HKAS 39 (Amendment) "Financial instruments: Recognition and measurement" – "Eligible hedged items";
HKFRS 1 (Revised) "First time adoption of Hong Kong Financial Reporting Standards";
HKFRS 2 (Amendment) "Share-based payment" – "Vesting conditions and cancellations";
HKFRS 3 (Revised) "Business combinations";

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(a) Basis of preparation *(continued)*

- (iii) Standards, amendments and interpretations that are not yet effective and have not been early adopted by the Fund *(continued)*

HKFRS 7 (Amendment) "Financial instruments: Disclosures" – "Improving disclosures about financial instrument";

HKFRS 8 "Operating segments";

HK(IFRIC) – Int 9 (Amendment) "Reassessment of embedded derivatives" and HKAS 39 "Financial instruments: Recognition and measurement" – "Embedded derivatives";

HK(IFRIC) – Int 13 "Customer loyalty programmes";

HK(IFRIC) – Int 15 "Agreements for the construction of real estate";

HK(IFRIC) – Int 16 "Hedges of a net investment in a foreign operation";

HK(IFRIC) – Int 17 "Distributions of non-cash assets to owners"; and

HK(IFRIC) – Int 18 "Transfer of assets from customers".

(b) 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.

Contributions and exemption fees are collected from Scheme members as specified in Schedule 4 to the Ordinance. They are accounted for on an accrual basis.

Contributions are calculated based on the amount of relevant deposits and the respective supervisory rating of each non-exempted bank applicable at a specified date. Contributions are collected annually in advance for each calendar year.

Interest income is recognised in the income and expenditure account using the effective interest method.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Revenue recognition (continued)

The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Fund estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

(c) Expenses

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

(d) Fixed assets

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 costs:	
• Servers	5
• Others, e.g. personal computers, printers and accessories	3
Office furniture, equipment and fixtures	5

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.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(e) Financial assets

The Fund classifies its investments in debt securities as available-for-sale securities. Available-for-sale securities are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or market prices.

Purchases and disposal of available-for-sale securities are recognised on the trade-date – the date on which the Fund commits to purchase or dispose of the securities. They are initially recognised at fair value plus transaction costs and subsequently held at fair value.

Unrealised gains and losses arising from changes in the fair value are recognised directly in reserve, until the available-for-sale securities are derecognised or impaired at which time the cumulative gain or loss previously recognised in the reserve should be recognised in the income and expenditure account. However, interest calculated using the effective interest method is recognised in the income and expenditure account.

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale are analysed between translation differences resulting from changes in amortised cost of the securities and other changes in the carrying amount of the securities. The translation differences on monetary securities are recognised in the income and expenditure account. Other changes in the carrying amount are recognized in reserve.

When the available-for-sale securities are disposed, the difference between the net sale proceeds and the carrying value, and the accumulated fair value adjustments in the reserve are treated as gains or losses on disposal.

(f) Fair value measurement principles

The fair value of quoted investments in active markets is based on current bid prices. If the market for a financial asset is not active, the Fund establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and other valuation techniques commonly used by market participants.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(g) Intangible assets

Costs that are directly associated with the development of identifiable and unique systems controlled and used by the Fund, and that will probably generate economic benefit exceeding costs beyond one year, are recognised as intangible assets. Expenditure on development of the Payout System is capitalised if the systems are technically and commercially feasible. The expenditure capitalised includes the direct labour and costs of materials. Intangible assets are stated at cost less accumulated amortisation and any impairment losses.

Amortisation of intangible assets with definite life is charged to the income and expenditure account on a straight-line basis over the assets' estimated useful life of 5 years.

(h) Impairment of financial assets

The Fund assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. If any such evidence exists for available-for-sale securities, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in income and expenditure account – is removed from reserve and recognised in the income and expenditure account. If, in a subsequent period, the fair value of a debt securities classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income and expenditure account, the impairment loss is reversed through the income and expenditure account.

(i) Impairment of other assets

Assets that have an indefinite useful life or are not yet available for use are not subject to amortisation, but are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. Assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(j) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of transaction including: cash at bank and on hand, demand deposits with banks, other financial institutions and the Monetary Authority ("MA") for the account of the Exchange Fund, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

(k) Other payables

Other payables are initially recognised at fair value and thereafter stated at amortised cost.

(l) Translation of foreign currencies

(i) Functional and presentation currency

Items included in the statement of accounts are measured using the currency of the primary economic environment in which the Fund operates ("the functional currency"). The statement of accounts is presented in Hong Kong dollars, which is the Fund's functional and presentation currency.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income and expenditure account.

(m) Operating leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income and expenditure account on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(n) Provisions and contingent liabilities

Provisions are recognised when the Fund has a present legal or constructive obligation as a result of past events where it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated.

Provisions are measured at the present value of the expenditure expected to be required to settle the obligation that reflects current market assessments of the time value of money and the risks specific to 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.

(o) Employee benefits

(i) Employee leave entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. An accrual is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave and maternity leave are recognised when the absence occurs.

(ii) Pension obligations

The Fund offers a mandatory provident fund scheme, the assets of which are generally held in separate trustee – administered funds. These pension plans are generally funded by payments from employees and by the Fund. The Fund's contributions to the mandatory provident fund scheme are expensed as incurred.

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(p) Related parties

Related parties are those parties which have the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or entities.

3 RISK MANAGEMENT

(a) Governance

The Fund is established under 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 Scheme. Under Part 4 of the Ordinance, the Fund is to consist of:

- contributions and late payment fees collected from Scheme members;
- money recovered by the Board from, or out of the assets of, failed Scheme members;
- returns on investments;
- money borrowed by the Board for the purpose of performing its functions; and
- any other money lawfully paid into the Fund.

The Board established an Investment Committee and delegated its power to the Committee to place, or invest, money of the Fund that is not immediately required by the Board for the performance of its functions. In particular, the Investment Committee:

- makes recommendations on the investment policy and strategy in respect of the Fund;
- monitors the investment performance of the Fund and establishes proper risk management controls for the investment activities of the Board; and
- works on any other matters as determined from time to time by the Board.

Operating within the requirements under the Ordinance and policies endorsed by the Investment Committee, the Board's staff conduct the day-to-day investment management and risk management of the Fund.

3 RISK MANAGEMEN *(continued)*

(b) Investment management and control

Under section 21 of the Ordinance, the Fund or any part of it may be invested in the following investment instruments:

- deposits with the MA for the account of the Exchange Fund;
- Exchange Fund Bills;
- US Treasury Bills; and
- any other investment approved by the Financial Secretary.

In December 2008, the Financial Secretary approved an expansion of the investment scope of the Fund to cover Exchange Fund Notes and US Treasury Notes with remaining term to maturity of not more than 2 years, and Hong Kong dollar and US dollar deposits of up to 3 months in tenor with financial institutions.

Investment activities of the Fund are conducted in accordance with the requirements set out in the Ordinance and the policies endorsed by the Investment Committee to ensure the investment objectives of capital preservation and maintaining sufficient liquidity are met.

The Board's Management Team is responsible for the day-to-day investment management of the Fund. Investment reports showing the latest market values, rate of return, maturity profile, types of financial instruments held and limit exposures are regularly submitted to the Investment Committee for control purpose.

(c) Financial risk management

Market risk

Market risk is the risk that changes in market variables such as interest rates, equity prices and exchange rates which may affect the fair value or cash flows of a financial instrument. Market risk to the Fund mainly comprises interest rate risk and currency risk.

3 RISK MANAGEMENT *(continued)*

(c) Financial risk management *(continued)*

(i) Interest rate risk

Interest rate risk refers to the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Since the tenor of the Exchange Fund Bills and Notes and US Treasury Bills and Notes held by the Fund do not exceed 2 years, any impacts of interest rate fluctuations on the Fund are considered minimal.

(ii) Currency risk

Currency risk is the risk of loss arising from changes in foreign exchange rates. The investments held by the Fund are denominated either in Hong Kong dollars or US dollars. Because of the linked exchange rate with the US dollar, the exchange risk to the Fund is considered minimal.

As at 31 March 2009, if interest rates increased by 25 basis points with all other variables remaining stable, the increase in net assets of the Fund for the year would amount to approximately HK\$461,311 (2008: HK\$839,354), arising substantially from the increase in interest receivable from cash balances with bank and the Exchange Fund. Conversely, if interest rates decreased by 25 basis points, the effect would be a decrease in net assets of the Fund of the same amount.

Liquidity risk

Liquidity risk refers to the risk that the Fund may not have sufficient funds available to meet its liabilities as they fall due. In addition, the Fund may not be able to liquidate its financial assets at a price close to the fair value within a short period of time.

Given that the Fund can only make deposits with the MA for the account of the Exchange Fund or with financial institutions approved by the Investment Committee or invest in the highly liquid Exchange Fund Bills and Notes and US Treasury Bills and Notes, the liquidity of the Fund is maintained at a high level at all times.

3 RISK MANAGEMENT *(continued)*

(c) Financial risk management *(continued)*

Credit risk

The Fund is exposed to credit risk as a borrower or a counterparty may not be able or willing to perform its contractual obligations in full when due. The credit risk of the Fund can be broken into (i) counterparty risk from placement activities; (ii) counterparty risk from investment transactions; (iii) issuer risk arising from debt securities holdings; and (iv) country risk.

Counterparty credit exposures arise mainly from the Fund's deposit placements with the MA for the account of the Exchange Fund and financial institutions approved by the Investment Committee and securities transactions with financial institutions. In this respect, the Fund will only conduct securities transactions with counterparties approved by the Investment Committee. Issuer risk arises from investments in debt securities. The types of investment securities of the Fund are limited to Exchange Fund Bills and Notes and US Treasury Bills and Notes, both with minimal default risk. In addition to the counterparty and issuer risks, the Fund is exposed to country risk, which is confined to the sovereign risk of Hong Kong and the US and the country risk of financial institutions approved by the Investment Committee given the Fund's limited types of investments. The Fund's credit exposures are reported regularly to the Investment Committee based on its delegated authority from the Board.

Fair value of financial assets and financial liabilities

The fair value of the financial instruments traded in active markets is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Fund is the current bid price. In the absence of such quoted market prices, fair values are estimated using present value or other valuation techniques, with inputs based on market conditions existing at the balance sheet date.

3 RISK MANAGEMENT *(continued)*

(c) Financial risk management *(continued)*

Fair value of financial assets and financial liabilities (continued)

The fair values of financial assets and liabilities not presented on the Fund's balance sheet at their fair value are estimated as follows:

- (i) Bank balances and balances with the Exchange Fund

The fair values of bank balances and balances with the Exchange Fund are their carrying amounts.

- (ii) Other receivables

The estimated fair value of other receivables, which are non-interest bearing balances, is their carrying value.

- (iii) Other payables

The estimated fair value of other payables, which are non-interest bearing balances, is their carrying value.

4 CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

The Fund makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The estimates and assumptions made in the preparation of these accounts do not have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

5 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.

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

NOTES TO THE STATEMENT OF ACCOUNTS

6 STAFF COSTS

	2009	2008
Salaries	\$ 4,594,406	\$ 4,823,854
Gratuity	412,056	414,055
Other employee benefits	209,705	235,115
	<u>\$ 5,216,167</u>	<u>\$ 5,473,024</u>

7 FIXED ASSETS

	Office equipment, furniture and fixtures	Computer hardware/ software	Total
Cost			
As at 1 April 2008	\$ 1,007,974	\$ 3,772,597	\$ 4,780,571
Additions	24,320	4,025,189	4,049,509
As at 31 March 2009	<u>\$ 1,032,294</u>	<u>\$ 7,797,786</u>	<u>\$ 8,830,080</u>
Accumulated depreciation			
As at 1 April 2008	\$ 268,143	\$ 849,197	\$ 1,117,340
Charge for the year	202,000	1,299,212	1,501,212
As at 31 March 2009	<u>\$ 470,143</u>	<u>\$ 2,148,409</u>	<u>\$ 2,618,552</u>
Net book value			
As at 31 March 2009	<u>\$ 562,151</u>	<u>\$ 5,649,377</u>	<u>\$ 6,211,528</u>
As at 31 March 2008	<u>\$ 739,831</u>	<u>\$ 2,923,400</u>	<u>\$ 3,663,231</u>

for the year ended 31 March 2009

(Expressed in Hong Kong dollars)

8 INTANGIBLE ASSETS

	Development costs of Payout System
Cost	
As at 1 April 2008	\$ 12,899,487
Additions	3,023,569
<hr/>	
As at 31 March 2009	<u>\$ 15,923,056</u>
Accumulated amortisation	
As at 1 April 2008	\$ 2,449,185
Charge for the year	2,574,473
<hr/>	
As at 31 March 2009	<u>\$ 5,023,658</u>
Net book value	
As at 31 March 2009	<u>\$ 10,899,398</u>
<hr/>	
As at 31 March 2008	<u>\$ 10,450,302</u>

9 OTHER RECEIVABLES

	2009	2008
Prepayment	\$ 858,790	\$ 779,133
Interest receivables	673	4,043
Contribution receivables	—	20,349
Others	16,500	16,500
<hr/>		
	<u>\$ 875,963</u>	<u>\$ 820,025</u>

STATEMENT OF ACCOUNTS OF THE DEPOSIT PROTECTION SCHEME FUND

NOTES TO THE STATEMENT OF ACCOUNTS

10 AVAILABLE-FOR-SALE SECURITIES

	2009	2008
Debt securities:		
– Unlisted US Treasury Bills	\$ 775,730,067	\$ 312,805,015

11 OTHER PAYABLES

	2009	2008
Hire of services	\$ 15,827,948	\$ 14,896,238
Staff expenses	456,397	534,487
Unsettled securities trades (a)	462,645,033	—
Others	1,294,920	2,110,694
	\$ 480,224,298	\$ 17,541,419

(a) This amount represents unsettled securities trades. These were subsequently settled on 1 April 2009.

12 MATERIAL RELATED PARTY TRANSACTIONS

Pursuant to section 6 of the Ordinance, the Board shall perform its functions through the MA unless indicated otherwise by the Financial Secretary. 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 of the Board. The HKMA also supports the Board on aspects such as accounting, administration, human resources, and information technology.

The related party transactions with the HKMA are as follows:

	Note	2009	2008
Aggregate amounts outstanding at the year end			
Balances with the Exchange Fund	(a)	\$ 163,992,879	\$ 343,215,625
Interest income from balances with the Exchange Fund	(a)	1,776,240	5,785,908
Operating expenses reimbursed to the HKMA	(b)	\$ 14,701,143	\$ 12,589,792

(a) During the year, the Fund placed deposits with the Exchange Fund amounting to HK\$163,992,879 (2008: HK\$343,215,625) and earned interest amounting to HK\$1,776,240 (2008: HK\$5,785,908) at a rate which makes reference to the market interest rates.

(b) Certain operating expenses are reimbursed to the HKMA on a cost recovery basis in accordance with the provision set out in the Ordinance.

(c) During the year, the HKMA provided the Board a standby facility from the Exchange Fund for meeting the necessary liquidity required for payment of compensation in the event of a bank failure. The maximum amount which may be drawn under the facility is HK\$40,000,000,000 (2008: HK\$40,000,000,000) of which nil (2008: nil) was drawn during the year.

13 APPROVAL OF STATEMENT OF ACCOUNTS

The statement of accounts was approved by the Board on 29 July 2009.

ANNEX 1: LIST OF SCHEME MEMBERS AS OF 31 MARCH 2009

ABN AMRO BANK N.V.
AGRICULTURAL BANK OF CHINA LIMITED
AIG PRIVATE BANK LIMITED
ALLAHABAD BANK
AUSTRALIA AND NEW ZEALAND BANKING GROUP LIMITED
AXIS BANK LIMITED
BANCA MONTE DEI PASCHI DI SIENA S.P.A.
BANCO BILBAO VIZCAYA ARGENTARIA S.A.
BANCO DE ORO UNIBANK, INC.
BANCO SANTANDER, S.A.
BANGKOK BANK PUBLIC COMPANY LIMITED
BANK OF AMERICA, NATIONAL ASSOCIATION
BANK OF BARODA
BANK OF CHINA (HONG KONG) LIMITED
BANK OF CHINA LIMITED
BANK OF COMMUNICATIONS CO., LTD.
BANK OF EAST ASIA, LIMITED (THE)
BANK OF INDIA
BANK OF MONTREAL
BANK OF NEW YORK MELLON (THE)
BANK OF NOVA SCOTIA (THE)
BANK OF SCOTLAND PLC
BANK OF TAIWAN
BANK OF TOKYO-MITSUBISHI, UFJ LTD.(THE)
BANK SINOPAC
BARCLAYS BANK PLC
BAYERISCHE HYPO-UND VEREINSBANK AKTIENGESELLSCHAFT
BAYERISCHE LANDESBANK
BNP PARIBAS
BNP PARIBAS WEALTH MANAGEMENT
CALYON
CANADIAN IMPERIAL BANK OF COMMERCE
CANARA BANK
CATHAY BANK
CATHAY UNITED BANK COMPANY, LIMITED
CHANG HWA COMMERCIAL BANK, LTD.
CHIBA BANK, LTD (THE)
CHINA CONSTRUCTION BANK (ASIA) CORPORATION LIMITED
CHINA CONSTRUCTION BANK CORPORATION
CHINA MERCHANTS BANK CO., LTD.
CHINATRUST COMMERCIAL BANK, LIMITED
CHIYU BANKING CORPORATION LIMITED
CHONG HING BANK LIMITED
CHUGOKU BANK, LTD (THE)
CITIBANK (HONG KONG) LIMITED
CITIBANK, N.A.
CITIC KA WAH BANK LIMITED
COMMONWEALTH BANK OF AUSTRALIA
COOPERATIEVE CENTRALE RAIFFEISEN-BOERENLEENBANK B.A.
CREDIT SUISSE
DAH SING BANK, LIMITED
DBS BANK (HONG KONG) LIMITED
DBS BANK LTD.
DEPFA BANK PLC
DZ BANK AG DEUTSCHE ZENTRAL-GENOSSENSCHAFTSBANK,
FRANKFURT AM MAIN
E.SUN COMMERCIAL BANK, LTD.
EAST WEST BANK
EFG BANK
ERSTE GROUP BANK AG
FAR EASTERN INTERNATIONAL BANK
FIRST COMMERCIAL BANK, LTD.
FORTIS BANK
FUBON BANK (HONG KONG) LIMITED
HACHIJUNI BANK, LTD (THE)
HANA BANK
HANG SENG BANK, LIMITED
HONG LEONG BANK BERHAD
HONGKONG AND SHANGHAI BANKING
CORPORATION LIMITED (THE)
HSBC BANK INTERNATIONAL LIMITED
HSBC BANK PLC

HSBC BANK USA, NATIONAL ASSOCIATION
 HSBC PRIVATE BANK (SUISSE) SA
 HUA NAN COMMERCIAL BANK, LTD.
 ICICI BANK LIMITED
 INDIAN OVERSEAS BANK
 INDUSTRIAL BANK OF TAIWAN CO., LTD.
 INDUSTRIAL AND COMMERCIAL BANK
 OF CHINA (ASIA) LIMITED
 INDUSTRIAL AND COMMERCIAL BANK
 OF CHINA LIMITED (THE)
 INDUSTRIAL BANK OF KOREA
 ING ASIA PRIVATE BANK LTD
 ING BANK N.V.
 INTESA SANPAOLO S.P.A.
 IYO BANK, LTD. (THE)
 JPMORGAN CHASE BANK, NATIONAL ASSOCIATION
 KBC BANK N.V.
 KOREA EXCHANGE BANK
 LAND BANK OF TAIWAN CO., LTD.
 MALAYAN BANKING BERHAD
 MEGA INTERNATIONAL COMMERCIAL BANK CO., LTD.
 MELLI BANK PLC
 MEVAS BANK LIMITED
 MITSUBISHI UFJ TRUST AND BANKING CORPORATION
 MIZUHO CORPORATE BANK, LTD
 NANYANG COMMERCIAL BANK, LIMITED
 NATIONAL AUSTRALIA BANK, LIMITED
 NATIONAL BANK OF PAKISTAN
 NATIXIS
 NEWEDGE GROUP
 OVERSEA-CHINESE BANKING CORPORATION LTD.
 PHILIPPINE NATIONAL BANK
 PT. BANK NEGARA INDONESIA (PERSERO) TBK.
 PUBLIC BANK (HONG KONG) LIMITED
 PUBLIC BANK BERHAD
 PUNJAB NATIONAL BANK
 RBS COUTTS BANK AG
 ROYAL BANK OF CANADA
 ROYAL BANK OF SCOTLAND PUBLIC LIMITED COMPANY (THE)
 SHANGHAI COMMERCIAL & SAVINGS BANK, LTD. (THE)
 SHANGHAI COMMERCIAL BANK LIMITED
 SHIGA BANK LIMITED (THE)
 SHINHAN BANK
 SHIZUOKA BANK, LTD. (THE)
 SOCIETE GENERALE
 SOCIETE GENERALE BANK & TRUST
 STANDARD BANK ASIA LIMITED
 STANDARD CHARTERED BANK
 STANDARD CHARTERED BANK (HONG KONG) LIMITED
 STATE BANK OF INDIA
 STATE STREET BANK AND TRUST COMPANY
 SUMITOMO MITSUI BANKING CORPORATION
 SVENSKA HANDELSBANKEN AB (PUBL)
 TAI SANG BANK LTD.
 TAI YAU BANK LTD.
 TAIPEI FUBON COMMERCIAL BANK CO., LTD.
 TAISHIN INTERNATIONAL BANK CO., LTD
 TAIWAN BUSINESS BANK
 TAIWAN COOPERATIVE BANK, LTD.
 TORONTO-DOMINION BANK
 UBS AG
 UCO BANK
 UNICREDIT, SOCIETA' PER AZION
 UNION BANK OF INDIA
 UNITED COMMERCIAL BANK
 UNITED OVERSEAS BANK LTD.
 WELLS FARGO BANK, NATIONAL ASSOCIATION
 WESTLB AG
 WESTPAC BANKING CORPORATION
 WING HANG BANK, LIMITED
 WING LUNG BANK LIMITED
 WOORI BANK

ANNEX 2: LIST OF MAJOR PUBLIC EDUCATION AND PUBLICITY ACTIVITIES FOR YEAR 2008-2009

Commencement Date	Activities
5 April 2008	Launched the DPS roving exhibition programme for 2008-09. In all, 36 weekly exhibitions with the theme "Know Your DPS Day" were held during the year at public housing estates and shopping malls operated by the Housing Authority and The Link Management Limited.
15 May 2008	The first MTR advertising campaign, lasting for 5 weeks, was launched. DPS advertisements in the form of educational comics were placed inside MTR cart apartments.
17 May 2008	A 32-week table-mat advertising campaign was launched in selected restaurant chains. DPS educational comics were inserted in table-mats for diners in the selected restaurants.
19 May 2008	A 4-week TV advertising campaign got under way on major channels with "Announcements in the Public Interest" (APIs) on deposit protection under the DPS.
26 May 2008	A 5-week Internet advertising campaign was launched with on-line advertisements posted on mass-appeal portals and through e-news letters.
2 June 2008	A 4-week print advertising campaign in newspapers was launched with DPS educational comics being inserted in selected newspapers, including free dailies.
5 June 2008	Commenced a series of 7 community talks through collaboration with members of District Council and non-government organisations (NGOs) for public education in the DPS.
18 Jun 2008	The second MTR network advertising campaign, lasting for 4 weeks, was launched, this time on the East and West Rail Lines. Advertisements of the DPS in form of educational comics were placed inside MTR cart apartments.
20 June 2008	A 4-week bus advertising campaign began with advertisements of the DPS covering double-decker bus bodies.

Commencement Date	Activities
3 July 2008	The third MTR advertising campaign, lasting for 4 weeks, began with the broadcast of DPS advertisements on in-station plasma TVs at MTR stations.
15 September 2008	The second TV advertising campaign, lasting for 4 weeks, for the year was launched on major TV channels. TV APIs of the DPS were broadcast on major TV channels.
25 September 2008	Issued a press release on Annual Report to highlight the key accomplishments of the year.
6 October 2008	The second print advertising campaign, lasting for 4 weeks, in newspapers for the year began. DPS educational comics were inserted in selected newspapers, including free dailies.
17 October 2008	An 11-week TV advertising campaign, the third during the year, was launched, with a modified TV API on the deposit protection provided by the DPS and the blanket deposit guarantee introduced by the government.
Mid – end of October 2008	Conducted a series of media interviews on the deposit protection arrangements in Hong Kong.
6 November 2008	The fourth MTR advertising campaign, lasting for 4 weeks, got under way with educational comics being made available inside MTR cart apartments.
23 January 2009	<p>A 4-week print advertising campaign in newspapers, the third for the year, focused on explaining products protected and not protected by the DPS was launched. The advertisements appeared in selected newspapers and free dailies.</p> <p>The fourth TV advertising campaign began, also featuring a new TV API explaining the products protected and not protected by the DPS.</p>
5 February 2009	A press release was issued reiterating and explaining the coverage of the DPS.
9 February 2009	The fifth TV advertising campaign for the year, lasting for 7 weeks, was launched to highlight the deposit protection provided by the DPS and the blanket deposit guarantee introduced by the government.

ANNEX 2: LIST OF MAJOR PUBLIC EDUCATION AND PUBLICITY ACTIVITIES FOR YEAR 2008-2009

Commencement Date	Activities
13 February 2009	Major newspapers published a feature article by the Chief Executive Officer of the Board on the coverage of the DPS.
24 February 2009	Commenced a series of 9 drama performances at NGOs and schools to promote awareness of the DPS.
4 March 2009	A fifth MTR advertising campaign, lasting for 4 weeks, began, on the MTR's East and West Rail Lines.