

12th November 2010

小組委員會文件編號 SC(1)-F(DSB)3

~~Private and Confidential~~

Your Ref: CB1/HS/1/08

BY HAND

Clerk to Subcommittee
Legislative Council Secretariat
3rd Floor, Citibank Tower
3 Garden Road, Central
Hong Kong

Attn: Miss Polly Yeung

Dear Sirs,

**Re: Subcommittee to Study Issues Arising from Lehman Brothers-related
Minibonds and Structured Financial Products (the "Subcommittee")**

I refer to your letter dated 5 November 2010 referring to the order made by the Chairman of the Subcommittee at the Subcommittee's hearing on 5 November 2010 (the "Hearing") that I provide written answers to certain questions as set out in the Appendix to your letter.

I set out below my response to those questions. Unless otherwise stated, I shall adopt the same defined terms as I have used in my witness statement dated 15 October 2010 (the "Witness Statement").

1. According to Appendix 2(a) of W44(C), Dah Sing Bank, Limited (DSB) offered principal protected notes LMP0017 to LMP0023 and LMP0025 in 2008. Please advise on the exact dates on which each of these eight LMP series was offered for sale by the bank.

- 1.1 Please see enclosed as Appendix 1.1.

2. According to the Indicative Terms and Conditions for Lehman Brothers (LB) 2-Year HKD Index Bonus Fixed Coupon Principal Protected Note (PPN) distributed by DSB, the customer should assume the credit risk that "the Issuer might not be able to honour its obligation to pay the principal or the interest on the Notes" (page 6 of Appendix 3(a)(ii) of W44(C)). Please provide documented records, if any, to indicate that the frontline sales staff of DSB, during the sale process of the product in question, had clearly advised customers that "principal protection" of the Notes was subject to the credit risk of the Issuer or the Guarantor, rather than being provided by DSB.

- 2.1 As mentioned in paragraph 8.2 of my letter to the Subcommittee dated 8 November 2010 (the "8 November Letter"), BMD had organised specific training to sales staff

on product features of Private Placement Notes which had a principal protection feature and the procedures with respect to the selling of those products. A copy of the relevant training materials was enclosed as Appendix 8.3 of my 8 November Letter.

- 2.2 In particular, during those trainings, the trainers had explained to sales staff that even though a product had a principal protection feature, customers would only be able to receive 100% of the principal amount at maturity if customers held the product until the maturity date and that the customer was subject to the credit risk of the issuer and guarantor.
- 2.3 Per indicative term sheet, credit risk had already been included under the heading of "Some Risk Factors" (please see Appendix 3(a)(ii) of W44(C) at Page 6). Under the Bank's policies and procedures, in particular the Branch Operations Guidelines for Bonds / Notes Services, sales staff were required to provide customers with the relevant offering documentation and explain the product features and risks to the customers during the selling process.
- 2.4 Whilst at the time, it was not the Bank's practice to require audio recording of the entire selling process, the Bank had in place an internal control and supervision framework to monitor the conduct of sales staff in selling investment products to customers as explained in paragraphs 58.1 and 58.2 of my Witness Statement.
3. **It is noted from paragraph 30.1 of W44(C) that DSB did not provide any sales scripts to sales staff for the sale of Minibonds and/or other LB-related structured financial products. Please advise whether any other aids had been provided by the bank to facilitate self-checking by the sales staff that they had adequately disclosed essential product information (e.g. product risks) to customers, and if yes, the details of these aids.**
 - 3.1 The Bank had in place policies and procedures which required sales staff to explain product features and risks to customers during the selling process. Even though the Bank did not provide any sales scripts to sales staff, sales staff would make use of the relevant offer documentation and marketing materials as reference when they explained product features and risks to customers. Sales staff were also required to provide a copy of such offering documentation to customers.
 - 3.2 Moreover, sales staff had been given training on investment products, the policies and procedures governing the selling process and selling techniques.
 - 3.3 Finally, the Bank mandated the selling process to be documented by completing a set of the relevant documents. Sales staff were required to explain and complete these documents with the customers. By signing on these documents, customers acknowledged, amongst other things, that they had received a copy of the relevant offering documentation and were fully aware of the nature of the product subscribed and the risks associated with the product. The Bank had procedures in place to review the documentation of investment product transactions to track that

sales staff had followed the relevant policies and procedures for the Bank when selling investment products.

4. It is noted from paragraph 45.1 of W44(C) that DSB customers were required to sign an Investment Product Risk Declaration Form in circumstances where the risk level of the investment product did not match the customer's risk tolerance level. A "suitability checking mismatch report" (under Appendix 31(iii) of W44(C)) would be compiled by the branch concerned. As stated by Mr Derek WONG at the hearing, the aforesaid report would be further checked by the Branch Management Department of DSB.
 - (a) Please advise when DSB implemented the mechanism of additional checking in respect of risk mismatch cases.
 - 4.1 The Bank had implemented a mechanism for each branch to compile a suitability checking mismatch report and to submit such report to BMD for review on a monthly basis since around October 2007.
 - (b) Please provide a breakdown on the number of customers with different tiers of risk-mismatch who had purchased (i) Minibonds and (ii) LB-related non-Minibonds structured financial products during the period from April 2003 to September 2008.
 - 4.2 Please find enclosed as Appendix 4.2
5. Under the Minibonds Repurchase agreement, "experienced investors", i.e. investors who in the three years preceding their first purchase of Minibonds, executed five or more transactions in leveraged products, structured products or a combination of these products, are not eligible for the repurchase offer. Please advise on:
 - (a) the number of Minibonds investors of DSB who have been excluded from the Minibonds Repurchase Scheme for being "experienced investors"; and
 - 5.1 Please find enclosed as Appendix 5.1.
 - (b) the number of Minibonds investors of DSB who have lodged complaints against the bank about their being categorized as "experienced investors" under the Minibonds Repurchase Scheme, and the up-to-date status of these complaint cases.
 - 5.2 Please find enclosed as Appendix 5.2.
6. According to paragraph 34.3 of W44(C), DSB conducted customer risk profiling by way of completing a Risk Assessment Questionnaire (the Questionnaire (Appendix 36 of W44(C))).

- (a) If there had been different versions of the Questionnaire during the period from 2003 to 2008, please provide a specimen copy of each version, and specify their respective effective dates.
- 6.1 Please find enclosed as Appendix 6.1.
- (b) Please advise whether DSB was aware of the changes, if any, made by the consultant to the design of the Questionnaire during the period from 2003 to 2008; if yes and practicable, please advise on the changes introduced, and the reasons for introducing such changes.
- 6.2 Enclosed at Appendix 6.1 are sample copies of the Guided Assessment Questionnaire and the Self Assessment Questionnaire (together, the "Risk Assessments") designed by Watson Wyatt and adopted by the Bank in relation to customers' risk profiling during the Relevant Period.
- 6.3 By way of background, when Risk Assessments were first introduced in or around June 2006, two questionnaires, namely the Guided Assessment Questionnaire and the Self Assessment Questionnaire were deployed by the Bank. Both the Guided Assessment Questionnaire and the Self Assessment Questionnaire would categorise customers into 4 different sample risk profiles provided by Watson Wyatt: 1 – Stable Growth / Conservative, 2 – Balanced, 3 – Growth and 4 – Aggressive. Whilst sales staff were encouraged to invite customers to the use of the Guided Assessment Questionnaire (whereby sales staff would ask customers to answer a set of questions devised by Watson Wyatt and an assessment would automatically be made by the system to categorise customers into one of the 4 sample portfolios), customers were also permitted to opt for the use of a Self Assessment Questionnaire (whereby customers would select 1 of the 4 sample risk profile descriptive statements according to their own perception of risk tolerance level and investment objectives). It was only when a customer indicated to the sales staff that he/she did not want to complete the Guided Assessment Questionnaire (for example, he or she may not want to disclose certain private information) that the customer would perform the Self Assessment Questionnaire. The Bank had discontinued the use of the Self Assessment Questionnaire in or around August 2007.
- 6.4 There had not been any other changes made by Watson Wyatt to the design of the Risk Assessments save that in or around October 2007, the number of questions in the Guided Assessment Questionnaire had increased from 10 to 15 as part of our overall process enhancement.
- (c) Please advise whether different versions of the Questionnaire used over the aforesaid period would give different assessment results for the same answers given by the customer in the Questionnaire.
- 6.5 No, the assessment results of the Guided Assessment Questionnaire would be the same. The changes made in or around October 2007 aforesaid would not affect the assessment results.

7. It is noted from paragraph 22.1 of W44(C) that the Wealth Management Team (WMT) of DSB would study the relevant offer documentation and marketing materials and follow up with the issuer/arrangers for clarification of product features, if necessary. As stated by Mr Derek WONG at the hearing, WMT would make such enquiries by telephone or email. Please provide the documented records of these enquiries.
- 7.1 Whilst WMT would communicate with the issuers / arrangers / coordinating distributors by telephone and by email, in so far as clarification of product features is concerned, such discussion would generally be conducted over the telephone which were not documented in writing. Having said that, we are able to locate certain sample emails which documented some of such enquires made during the Relevant Period enclosed as Appendix 7.2.

Should you have any queries to the above, please do not hesitate to contact our Mr. Derek Chan or Mr. Richard Li.

Yours faithfully,



Wong Hon Hing, Derek
Managing Director and Chief Executive
Dah Sing Bank, Limited

Encl.