

Dated 29 April 2010

**WRITTEN STATEMENT OF  
MR HUNG PI-CHENG, BENJAMIN, EXECUTIVE DIRECTOR AND CHIEF EXECUTIVE OFFICER,  
STANDARD CHARTERED BANK (HONG KONG) LIMITED (SCBHK)**

To the Subcommittee to Study Issues Arising from  
Lehman Brothers-related Minibonds and  
Structured Financial Products of the Legislative Council

**GLOSSARY OF TERMS USED IN THE WRITTEN STATEMENT OF MR HUNG PI-CHENG, BENJAMIN**

**"AUM"** means Assets Under Management.

**"Bank"** means the retail business of the Consumer Banking arm of SCBHK.

**"Banking Ordinance"** means the Banking Ordinance, Cap.155.

**"Code of Conduct"** means the "Securities and Futures Commission Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission".

**"Companies Ordinance"** means the Companies Ordinance, Cap. 32.

**"CPT"** means Continuous Processional Training.

**"DSSPP"** means the Debt Securities Services Product Program.

**"DTPM"** means the Debt Securities / Structured Notes Deal Taking Procedural Manual.

**"ELNs"** means equity-linked notes.

**"FAQ"** means the Questions and Answers on Suitability Obligations of Investment Advisers published by the SFC.

**"Group"** means Standard Chartered Bank Group.

**"GWM"** means the Group Wealth Management.

**"GWMPM"** means the Group Wealth Management Process Manual.

**"HK\$"** means Hong Kong Dollars.

**"HKMA"** means the Hong Kong Monetary Authority.

**"HKWM"** means Wealth Management of the Bank.

**"ICs"** means Investment Counsellors.

**"IPSP"** means the Investment Product Sales Process.

**"LB"** is used as a generic description of a Lehman Brothers entity.

**"LB ELN"** means the LB-related structured financial products distributed by the Bank during the Relevant Period.

**"LB-related structured financial products"** mean structured products issued and/or guaranteed by a Lehman Brothers entity.

**"OL"** means Organization Learning.

**"Relevant Individual"** means "Relevant Individual" as defined in section 20(10) of the Banking Ordinance and registered with the HKMA.

**"Relevant Period"** means the period from August 2006 to June 2008.

**"RFI"** means Request for Information.

**"SCBHK"** means Standard Chartered Bank (Hong Kong) Limited.

**"Securities and Futures Ordinance"** means the Securities and Futures Ordinance, Cap. 571.

**"SFC"** means the Securities and Futures Commission.

**"US\$"** means United States Dollars.

Written statement of  
Mr HUNG Pi-cheng, Benjamin, Executive Director and Chief Executive Officer,  
Standard Chartered Bank (Hong Kong) Limited (SCBHK)

**ROLE OF SCBHK**

**1. Please advise:**

**(a) Apart from being a seller/distributor of the Lehman Brothers (LB)-related structured financial products, did your bank act as the Arranger of any or all of such products sold by your bank? If yes, was your bank the sole Arranger or one of the joint Arrangers? Please explain the roles and responsibilities of your bank as the Arranger of such products and its relationship with the issuer(s);**

1.1 The Bank was only a distributor of Lehman Brothers ("LB") related structured financial products ("LB ELN") and did not act as Arranger.

**(b) did your bank acquired the LB-related structured financial products from the issuer(s) before further selling them to clients? If yes, please provide the details; and**

1.2 No. The Bank did not acquire the LB ELN from LB before distributing them to its customers. In other words, the Bank did not hold any inventory of LB ELN before selling to its customers.

**(c) did your bank have any involvement in the design of the LB-related structured financial products sold by your bank through private placement?**

1.3 No. The Bank was not involved in the design of the LB ELN. The structures of these products were designed by LB.

**LEHMAN BROTHERS-RELATED STRUCTURED FINANCIAL PRODUCTS SOLD BY SCBHK**

**2. Please advise:**

**(a) the number and value (HK\$) of LB-related structured financial products sold by your bank for each year from April 2003 to 15 September 2008;**

2.1 The Bank distributed LB ELN from August 2006 to June 2008 (the "Relevant Period"). During the Relevant Period, the total value of LB ELN distributed by the Bank was about HK\$5.23 billion.

Year	Number / Value of LB structured notes distributed (HK\$)
2003	Nil
2004	Nil
2005	Nil
2006	1,010 transactions / HK\$931 million
2007	1,807 transactions / HK\$1,869 million
2008	2,836 transactions / HK\$2,432 million

(b) whether the products in (a) comprised equity-linked notes (ELNs) only;

2.2 The products in (a) comprised primarily (about 99%) equity-linked notes.

(c) the first and the last LB-related structured financial products sold by your bank (together with a copy of the offer documentation (such as the prospectus, programme memorandum, product booklet, term sheet, etc.) and marketing material for each of the aforesaid first and the last products); and

	Description	Subscription close
First note	LB 1-Year Notes HKD/USD (2628+857)	11 Aug 2006
Last note	LB 1-Year Notes HKD/USD (388+941+2628)	5 Jun 2008

2.3 Copies of the relevant offer documentation are enclosed as item 1.

(d) whether there were any major differences in design and structure between the first and the last LB-related structured financial products sold by your bank. If yes, please provide a comparison.

2.4 There were no major differences in the fundamental design and structure of these products. However, there were variations in the product features – mainly in relation to the underlying stock, coupon payments and redemption arrangements.

3. Based on the information provided by your bank to the Subcommittee on 16 January 2009, it is noted that the following series of ELNs recorded the highest values of sales and the highest numbers of investors and complaints:

(i) Lehman Brothers 1-Year HKD All Weather Coupon Daily Callable ELN – Series 17 (390+1800);

(ii) Lehman Brothers 1-Year USD All Weather Coupon Daily Callable ELN – Series 17 (390+1800); and

(iii) Lehman Brothers 1-Year HKD All Weather Coupon Daily Callable ELN – Series 18 (390+1800+2800).

(a) Please complete Tables 1 and 2 and provide a copy of the offer documentation and marketing materials for each of the products; and

3.1 Please refer to the attached Tables 1 and 2. Copies of the relevant offer documentation are enclosed as item 2.

(b) Whether there were any major differences between the following product series in terms of the product structure and design:

• Series 1 and Series 17 of the ELN in (i); and

• Series 1 and Series 18 of the ELN in (iii).

3.2 There were no major differences. However, there were variations in the product features – mainly in relation to the underlying stock and coupon payments.

INTERNAL PROCESS FOR APPROVAL OF OFFER

4. **Please advise:**

(a) **how and when the first LB-related structured financial product (mentioned in Question 2(c)) was introduced to your bank; and**

4.1 The product team of LB approached the Bank's Wealth Management ("HKWM") and Group Wealth Management ("GWM") teams in 2005 to present product ideas. This was followed by an evaluation of LB as a third party product provider by GWM pursuant to the Group Wealth Management Process Manual ("GWMPM") towards the end of 2005. The evaluation of LB's products was subsequently conducted by GWM and HKWM and in 2006 an agreement for the distribution of LB ELN was entered into between Standard Chartered Bank and LB.

4.2 Following the relevant product due diligence process (please refer to the response to Question 8 below for details), the first LB ELN was launched on 7 August 2006.

(b) **who introduced the first LB-related structured financial product to your bank and whether all other LB-related structured financial products sold by your bank were also introduced by the same source; if no, please provide the details.**

4.3 The first and all other LB ELN were introduced to the Bank by the same source, i.e. the product team of LB.

5. **Before the collapse of LB, many banks in Hong Kong were the distributors of LB-related structured financial products and sold considerable quantities of such products to their retail clients. Your bank did not seem to have taken part in such retail sales. Please explain the reasons for not selling these products on a retail basis.**

5.1 In late 2006, the Bank was approached by Sun Hung Kai Financial with whom the Bank had no global distribution agreement for the distribution of LB Minibonds. Since Sun Hung Kai Financial was not on the Bank's global list of providers, the Bank did not enter into any arrangement with Sun Hung Kai Financial in relation to the sale of Minibonds.

6. **What were the considerations that prompted your bank to act as a distributor/seller of LB-related structured financial products? To what extent was the need to increase non-interest income a factor?**

6.1 LB, as a product provider, was rated A+ by Standard & Poor's, had sound financial position and was one of the key suppliers in structured financial products in the region. To provide more product choices to customers and to cater for investors' diversified investment objectives, the Bank began offering structured financial products to its customers in 2004. LB became one of the Bank's approved product providers of structured notes in 2006.

6.2 The potential to increase non-interest income was only one of many other factors that the Bank considered when offering the LB ELN for sale. For reference, LB ELN accounted for less than 1% of the Bank's revenue during the Relevant Period.

7. **Under the existing regulatory regime, banks may offer financial products to clients through "private placement". Please advise:**

**(a) whether your bank had offered all the LB-related structured financial products to your clients through private placement; and**

7.1 During the Relevant Period, the Bank distributed two types of LB ELN: one using the authorisation procedure under the Securities and Futures Ordinance, Cap.571 (the "SFO") and the other using the Companies Ordinance, Cap.32 "Minimum Investment Offer Exemption" which is referred to as private placement in this case.

**(b) if yes, the reasons for your banks' decision for selling such products through private placement rather than by way of retail sales as other banks had been doing. For example, whether your bank would receive a higher rate of commission or there was a demand for such products from bank customers.**

7.2 The Bank did not have any particular preference as to authorisation procedures. As investors' interest and demand for these products grew, more products became available in the market, and the use of the relevant authorisation procedure was essentially driven by market demand. With respect to the rate of commission from the two types of products sold by the Bank, the difference was immaterial.

8. **Please advise:**

**(a) whether all of the LB-related structured financial products sold by your bank had gone through the same approval process, and whether they were approved by the same officers. If no, please provide the reasons and describe how different products/types of products were approved;**

8.1 All of the LB ELN sold by the Bank had gone through the same internal approval process required for structured products. Please refer to the following paragraphs for a detailed description of the approval process adopted by the Bank as stipulated in the GWMPM.

**(b) if yes, please describe the approval process in the form of a flow chart, together with the name(s) and position(s) of the officers(s) responsible for the approval;**

8.2 Please see item 3 enclosed. The approval of all new investment products is governed by the GWMPM. It was issued by GWM to align the business across a diverse range of products and geographies through standard policies and processes. The approval process involved both GWM and HKWM, and consists of 3 major phases:

- (i) Product Provider Evaluation and Distribution Agreement
- (ii) Product Programme
- (iii) Product Evaluation

8.3 GWM was responsible for driving the evaluation and approval of new product providers with input from HKWM. The evaluation entailed due diligence work on the provider at the Group as well as the country level. GWM was responsible for ensuring the provider had sound financial position, sound management and performance and optimised value to the Bank. HKWM was responsible for ensuring that the same product provider based locally in Hong Kong also had sound management in terms of product capability, management capability and strong service delivery to support Hong Kong. Due diligence work included Request for Information ("RFI") completed by the provider and reviewed by GWM, and interviews by GWM with the provider. Upon satisfactory result of the due

- diligence, GWM entered into a global agreement with LB for the distribution of structured products (including ELNs) in consultation with Group Legal & Compliance. Specifically for LB, GWM was further assured by the fact that it was already a customer of the Wholesale Banking business and would have been subject to due diligence as a borrowing customer of SCBHK.
- 8.4 In-country, HKWM was also responsible for compiling the "Product Programme" for an investment product, in accordance with GWMPM. The purpose of the Product Programme was to detail the product specifications, risk analysis and local adaptations required. The Product Programme was formally approved by key stakeholders including GWM, HKWM and in-country functions independent of day-to-day business, including Legal & Compliance, Operational Risk, Market Risk, Credit, Finance, Systems and Operations and Global Markets.
- 8.5 With the approval of the product provider, the global distribution agreement and the Product Programme in place, GWM was responsible for approving specific product launches at the request of HKWM. Prior to selecting a particular product for distribution, HKWM will first conduct its own due diligence on the product features and terms. Upon satisfactory result of the due diligence, HKWM will submit the completed product evaluation form together with the relevant term sheet to GWM for approval. GWM will check that the product to be offered complied with the parameters of the relevant Product Programme and GWM's guidelines. GWM will then formally approve, assign the risk classification and make the product available to HKWM to sell.
- (c) if the approval was made by a committee or department within your bank, please provide the details of the committee or department, including its membership, scope of responsibilities and internal guidelines or code of practice that it should follow;**
- 8.6 For details of the approval departments, please refer to the response to Question 8(b) above.
- (d) if the approval was made by the Board of Directors, please provide the date(s) of its meeting(s) at which such approval was made; and**
- 8.7 The approval for a particular investment product is performed by the Bank and specialist functions as explained in the response to Question 8(b) above and is not a direct function of the Board of Directors of SCBHK.
- (e) please provide the record of deliberations on why the following products had been approved for sale:**
- (i) the first LB-related structured financial products mentioned in Question 2(c); and**
- (ii) the three LB-related structured financial products mentioned in Question 3.**
- 8.8 These products were approved in accordance with the prescribed product approval process described in the response to Question 8(b) above and documented in the Product Evaluation Form enclosed as item 4.
9. **Regarding the LB-related structured financial products that were launched in the market in a number of series, was your bank's decision in approving the sale of**



*such products made once and for all types, or individually per series? Please explain.*

- 9.1 Each individual series of LB ELN was separately reviewed and approved.
10. *Did your bank sell any LB-related structured financial products between June and mid-September 2008 when the financial difficulties of LB were reportedly worsening? If yes, please explain why your bank had decided to continue to sell the LB-related structured financial products amidst such reports. When and why did your bank decide to stop selling any LB-related structured financial products?*
- 10.1 The Bank did not sell any LB ELN after 5 June 2008.
- 10.2 On 2 June 2008, LB was downgraded by Standard & Poor's from a credit rating of A+ to A. On 3 June 2008, the Bank requested LB to provide official feedback which was received by the Bank on 4 June 2008. In view of the downgrade and market uncertainty prevailing at the time, the Bank decided to put the sale of all LB ELN on hold on 5 June 2008 pending further development in relation to LB.
11. *Had your bank been approached to engage in the sale of LB Minibonds? Had there been any deliberations on whether your bank should take part in the sale of Minibonds? If yes, please provide the details (including the level at which the deliberations were made, the organ(s) and officer(s) making the decision, and the records, if any, of such deliberations).*
- 11.1 In around late 2006, the Bank was approached by Sun Hung Kai Financial with whom the Bank had no existing relationship concerning the distribution of LB Minibonds. Since Sun Hung Kai Financial was the sole distributor of Minibonds and was not on the Bank's global list of providers, the Bank did not enter into any arrangement with Sun Hung Kai Financial in relation to the sale of Minibonds.

#### PRODUCT DUE DILIGENCE

12. *Did your bank have any written policy/internal guidelines on how product due diligence should be conducted? If yes, please provide the relevant documentation; if no, the reasons.*
- 12.1 The relevant internal guidelines regarding the approval process included the following:
- (a) GWMPM – item 5
  - (b) Debt Securities Services Product Programme ("DSSPP") - item 6
13. *Please name the person(s)/department(s) responsible for preparing the written policy/internal guidelines on how product due diligence should be conducted. Was reference made to the requirements of the regulators (e.g. the Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC)) in preparing the relevant written policy/internal guidelines? Was a copy of the written policy/internal guidelines provided to the regulators for record?*
- 13.1 The relevant internal guidelines stated in paragraph 12.1 were designed to incorporate and operationalise the relevant requirements of the Securities and Futures Ordinance ("SFO") and the Hong Kong Monetary Authority ("HKMA")'s regulatory requirements.

- 13.2 GWMPM, issued by GWM, sets the standards and policies by which Standard Chartered Bank Group (the "**Group**") governs its Wealth Management business. It aims to align how the Group does business across a wide and diverse range of products and geographies. GWMPM was submitted to the HKMA during their onsite examinations in the Relevant Period.
- 13.3 DSSPP is a programme that allows all relevant functions to review and approve debt securities related products. Its purpose is to define and approve, in a standard format, the business parameters within which the product is distributed in a specific locality, with reference to the local legal, business, and operational risks environment. DSSPP was prepared by HKWM and was signed off by relevant in-country specialist functions including Legal & Compliance, Operational Risk, Market Risk, Credit, Finance, Systems and Operations and Global Markets. DSSPP was submitted to the HKMA during their onsite examinations in the Relevant Period.
- 14. *Had any product due diligence been conducted on a LB-related structured financial product before your bank made the policy decision to sell the product to your clients? If no, please provide the reasons; if yes, please provide information on how such due diligence had been conducted and the conclusions of the exercise.***
- 14.1 Yes. For details of the product evaluation and approval process, please refer to the response to Question 8 above.
- 15. *Was product due diligence conducted in respect of each series of a LB-related structured financial product (e.g. ELNs) sold by your bank? If yes, please provide information on how your bank conducted the exercise, including the dedicated team, if any, for such work; if no, the reasons.***
- 15.1 Yes. Product due diligence was conducted in respect of each series of LB ELN sold by the Bank. For details of the product evaluation and approval process, please refer to the response to Question 8 above. In particular, given each series contained different underlying stocks, there were additional checks to ensure these stocks chosen met with the Bank's criteria.
- 16. *Did your bank make any enquiries or obtain any information from the issuer(s) and/or other independent sources about the nature, structure and risks of each LB-related structured financial product to be sold by your bank? If no, please provide the reasons; if yes, please explain using the following products as examples: (i) the first and the last LB-related structured financial products mentioned in Question 2(c); and (ii) the three LB-related structured financial products mentioned in Question 3.***
- 16.1 The Bank conducted due diligence on the product provider at the Group level (with input from country) to ensure it had sound financial position, sound management and performance through the RFI process. Please refer to the response to Question 8 above for details. In addition the Bank had ongoing dialogues with the LB product team regarding their product structures and offering and independently verified the latest credit rating of LB from Standard & Poor's and Moody's. For the respective product series, the Bank also obtained information about the underlying stocks of respective product series from Bloomberg, including market capitalisation, issuer credit rating, buy/hold rating etc. The Bank validated those underlying stocks were constituent of indices and not subject to impact as a result of both positive and negative corporate events/actions.

**17. Did your bank have any written policy or guidelines on product risk assessment? If yes, please provide the relevant documentation; if no, the reasons.**

17.1 Yes. GWMPM governed processes, related but not limited to, product evaluation and risk assessment. GWMPM explicitly provided that every type of product that GWM approves for distribution will be given an asset code; and each asset code will be given a product risk rating.

**18. Did your bank assess the risks of each product sold by your bank? If yes, please give in tabular form the risk ratings of each product assessed by your bank and explain how your bank arrived at each of the risk ratings (including all factors and criteria taken into consideration in arriving at the ratings); if no, the reasons.**

18.1 Yes. The Bank assesses the risk of each product sold. The product risk rating exercise was performed by specialists in GWM.

18.2 The risk category classification of an investment product is primarily assessed by reference to the chance of investment capital loss and volatility. Investment products are classified into 7 risk categories from "A" to "F", with "F" being the highest risk category, and "P" being used for products that have capital or principal protection at maturity. All series of LB ELN were risk rated as "F", unless they were principal protected in which case they were given a "P" risk rating.

**19. Please provide an explanation on the scale of risks assessment adopted by your bank in respect of the LB-related structured financial products sold by your bank.**

19.1 For all the series of LB ELN, the highest risk rating of "F" was assigned where the product was non-principal protected; and a risk rating of "P" was assigned where the product was principal protected at maturity. The basis for assigning "F" to all non-principal protected series was because the performance of such ELNs was linked to underlying stocks which, by their nature, were volatile.

**20. Did your bank conduct any after-sale risk assessment in respect of each of the LB-related structured financial products sold by your bank? If yes, please provide the details including whether the clients were informed of the latest assessment results?**

20.1 According to GWMPM, it was not necessary to undertake periodic product evaluation review for close-ended products or products that have fixed tenors, like ELNs.

**21. It is noted that between June and July 2008, credit-rating agencies (such as Standard & Poor's, Fitch Ratings and Mood's) lowered the credit ratings of LB, and the shares of LB also dropped substantially. Did your bank conduct any assessment on the possible impact of the financial difficulties of LB on the outstanding LB-related structured financial products sold by your bank? If yes, please provide the details; if no, the reasons.**

21.1 On 2 June 2008, LB's credit rating was downgraded by Standard & Poor's from A+ to A. On 3 June 2008, the Bank requested LB to provide official feedback which was received by the Bank on 4 June 2008. In view of the downgrade and market uncertainty prevailing at the time, the Bank decided to put the sale of all LB ELN on hold on 5 June 2008 pending further development in relation to LB. Please also see the response to Question 20 above.

OFFER DOCUMENTATION AND MARKETING MATERIALS

22. ***Did your bank have any involvement in the preparation of the offer documentation and marketing materials of the LB-related structured financial products sold by your bank (such as the products mentioned in Questions 2(c) and 3)? If yes, please provide the details.***
- 22.1 As the Bank did not have any above-the-line and direct marketing activities for selling LB ELN, the Bank did not prepare any promotional materials.
- 22.2 Pre-September 2007, the Bank was involved in preparing supplementary information essentially involving product description and scenario analysis of the products, primarily based on information supplied by the product provider. The scenario analysis together with the term sheets issued by the product provider were used as the Information Package for LB ELN. Since September 2007, the Bank had requested the product provider to incorporate all the information into the Information Package. In both cases, the Bank produced a supplementary cover sheet which sets out, among other things, warning statements.
23. ***Since the offer documentation and marketing materials for LB-related structured financial products for sale by way of private placement did not require SFC's authorization, did your bank have any mechanism to vet/review the contents and presentation of such documentation and materials? If yes, please provide the details and whether your bank ever raised any queries/comments to the issuer(s). If no, how did your bank ensure that there was full disclosure of product information (such as risks) in such documentation?***
- 23.1 At all times, the Bank had a review process to ensure that the documentation sufficiently set out the product features in a transparent and fair manner and that key risk elements were adequately disclosed. A number of business and risk functions were involved in the review process including GWM, HKWM, Legal & Compliance and Operational Risk. See also the response to Question 22 above.

TRAINING AND GUIDANCE TO FRONTLINE SALES STAFF

24. ***Please describe the training arrangements for staff engaged in the sale of LB-related structured financial products, including the following particulars:***
- (a) ***whether the training was general or product specific or both;***
  - (b) ***if only general, please give the details of the training programme(s);***
  - (c) ***if product specific, please give details of the training programme(s) for the following products:***
    - (i) ***the first and the last LB-related structured financial products mentioned in Question 2(c); and***
    - (ii) ***the three LB-related structured financial products mentioned in Question 3.***
  - (d) ***if the training was both general and product specific, please give all details specified in (b) and (c); and***
  - (e) ***if there had been changes to the training arrangements, please describe.***

- 24.1 The Bank recognises the importance of training and, over the years, has devised extensive training programmes for its staff delivered via multi-dimensional platforms, ranging from structured classroom training to on-the-job training by internal or external subject experts.
- 24.2 The Bank's approach to training is a holistic one. Sales staff received training in the areas of risk management and control, code of conduct, sales investment process, product concepts and specific product features, which are detailed below.
- 24.3 The Bank's training framework for sales staff in respect of the sales of investment products included structured training and on-the-job training as follows:
- (a) Structured training included Wealth Management training programs, Continuous Professional Training ("**CPT**") programs, E-Learning programs, as well as Sales Governance Briefings.
  - (b) Practical on-the-job training is conducted by Branch Managers and a team of experienced product specialists (Investment Counsellors ("**ICs**")), through regular clinics, weekly briefings, role playing in small interactive groups.
- 24.4 There are several types of structured training courses conducted for sales staff:
- (a) Wealth Management training programs organised by the Bank's training department "Organization Learning" ("**OL**")

As stipulated in the Bank's Investment Product Sales Process ("**IPSP**"), sales staff are required to attend the Wealth Management Core Training (total 5 days). In addition they were also required to attend the Wealth Management Boot-Camp Training. These courses were designed and conducted for newly joined sales staff. After attending the courses, all participants must pass the assessments of both courses before they were permitted to conduct sales of investment products. Sales staff were trained on a variety of topics in the courses including, among other things, the IPSP, structured products, equities, debt securities and investment funds selling.
  - (b) CPT

CPT programs comprised training courses arranged by the Bank's Legal & Compliance department, and external professional training courses taken by staff (e.g. Hong Kong Securities Institute) subject to assessment by Legal & Compliance on CPT eligibility and accreditation. CPT programs mainly cover legal and compliance issues, including the Securities and Futures Commission ("**SFC**")'s "*Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission*" (the "**Code of Conduct**"), "*Suitability and Mis-selling*" and "*Market Misconduct*". CPT programs arranged by Legal & Compliance comprised seminars and training courses scheduled and run throughout the year, which were mainly given by professional law firms, regulatory and law enforcement authorities. All of the Bank's Relevant Individuals ("**RI**") staff must undertake a regulatory minimum of 5 CPT hours per calendar year.

(c) E-Learning

All staff were required to complete a variety of E-Learning training modules on regulatory, compliance and risk management topics online through the Bank's intranet. The relevant programmes include: Group Code of Conduct, Anti Money Laundering & Terrorist Financing, Basic Operational Risk Management & Assurance Framework, Reputational Risk, Treating Customers Fairly (mandatory from January 2007) and Leading the Way in Compliance (mandatory from September 2007). Most of these programmes require regular refresher training.

(d) Sales Governance Briefings

Sales governance briefings were conducted by Risk and Productivity Management team. These briefings had been run on a quarterly basis with a view to reinforcing staff's awareness of regulatory requirements and key concepts within the selling process.

24.5 Thus, the training in respect of the sale of investment products, including LB ELN, such as training on suitability, mis-selling and compliance with the Code of Conduct was embedded in a variety of structured training set out above.

24.6 In addition to the structured training described above, the Bank's training to its sales staff on the above areas also included on-the-job training.

- (a) Ongoing coaching for frontline staff on the sale of specific investment products is conducted through a team of ICs.
- (b) ICs are experienced product specialists assigned to the role of briefing, updating and coaching the sales staff. Sales staff are briefed by ICs at weekly branch meetings on the new investment products to be launched for a particular week.
- (c) ICs use the Information Package as the key training material for coaching frontline staff in respect of the LB ELN, supplemented by market information and update of the underlying stocks. The Information Package set out information on product features, associated risks and fees and charges.
- (d) Copies of the Information Package in respect of the first LB ELN and the last LB ELN mentioned in Question 2(c); and the three LB ELN mentioned in Question 3 are enclosed as item 1 and item 2.
- (e) For new sales staff who have completed the Wealth Management Boot-Camp Training and Wealth Management Core Training programs, ICs will also conduct interactive small group sessions to offer continuous coaching on product knowledge through various means e.g. role play.
- (f) More informal training or coaching exists at the branch level in the form of staff weekly meetings for experience sharing. There were also opportunities for staff to shadow more senior staff in sales meeting.

25. ***Did the issuer(s) or your bank or any other party conduct any product briefings and/or provide training materials to the frontline sales staff of your bank for each of the LB-related structured financial products sold by your bank? If yes, please provide the details; if no, the reasons.***

- 25.1 Before a new structure was launched, the Bank's product managers and representatives of the structured product provider will brief the ICs during the weekly IC meetings. The Bank adopted a 'train the trainer' approach. In line with this approach, ICs, who had good knowledge of the abilities of the small number of sales staff in branches designated to them, will then conduct face to face training to frontline staff through the weekly branch meetings or small interactive group sessions.
- 25.2 For existing structures, ICs will also receive updates on new series at the weekly IC meetings for briefing frontline sales staff at the weekly branch meetings. Training generally covered key product features and risks.
26. ***Did your bank provide any further training to your frontline sales staff for each of the LB-related structured financial products distributed by your bank prior to the launch of the private placement of each of such products? If yes, please provide the details; if no, the reasons.***
- 26.1 Yes. Please refer to the response to Question 25.
27. ***Was it mandatory for the frontline sales staff of your bank to attend the product briefing and/or training before they could sell a LB-related structured financial product to clients? If no, please provide the reasons.***
- 27.1 Yes. As set out in the response to Question 24 and as stipulated in the IPSP, sales staff were required to attend the Wealth Management Boot-Camp Training and Wealth Management Core Training. Newly joined staff could only conduct sales of investment products after completing these courses and passing the assessment.
- 27.2 Existing frontline sales staff must also attain a regulatory minimum of 5 CPT hours per calendar year, which included: SFC's "Code of Conduct", "Suitability and Mis-selling" and "Market Misconduct".
- 27.3 Frontline sales staff were required to attend weekly branch meetings. If they were unable to attend a certain briefing, they will be asked to attend a similar session of other branches or a make-up briefing session.
28. ***Did your bank have any procedures to assess the frontline sales staff's knowledge on a LB-related structured financial product before they were allowed to sell the product to clients? If yes, please provide the details; if no, the reasons.***
- 28.1 Yes, as set out in the response to Question 24 above, there was a requirement for frontline sales staff to pass the assessment for the Wealth Management Boot-Camp Training and Wealth Management Core Training before they were allowed to sell investment products.
- 28.2 ICs worked closely with frontline sales staff to brief, update and provide continuous coaching, through their small group role play sessions where they will reinforce the product knowledge of frontline sales staff, as needed.
29. ***Did your bank receive any feedback from your sales staff on the training provided to them in relation to the sale of LB-related structured financial products? If yes, please provide the details.***
- 29.1 All of the Bank's structured training programmes will be accompanied by feedback form for staff to give feedback on training. A sample standard feedback form used for Wealth

Management Boot-Camp Training and Wealth Management Core Training is enclosed as item 7.

29.2 The weekly branch meetings provided an occasion for interactive feedback. Staff were encouraged to ask questions in a small group setting. Any comments will have been addressed on the spot or dealt with accordingly.

**30. Did your bank provide any sales scripts to your frontline sales staff on the solicitation process relating to the sale of LB-related structured financial products? If yes, please provide a copy of the script.**

30.1 There were no specific sales scripts in relation to the sale of LB ELN. All staff were required to abide by the guidelines set out in detail in the IPSP and the Debt Securities/Structured Notes Deal Taking Procedure Manual ("DTPM").

**31. Please provide a copy of the operational guidelines, manual, internal memoranda, instructions or any other documents prepared by your bank to the staff engaged in the sale of LB-related structured financial products to assist them in complying with the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the Code of Conduct). If such guidelines, manual, memoranda, instructions and documents were product specific, please supply them in respect of each of the following products:**

**(a) the first and the last LB-related structured financial products mentioned in Question 2(c); and**

**(b) the three LB-related structured financial products mentioned in Question 3.**

31.1 The Bank's internal guidelines/manuals in regulating the sale of ELNs seek to operationalise the requirements of the regulations, rules, codes and guidelines of the HKMA and SFC and Group policies, namely the Group Code of Conduct, GWMPM and Group Policy on Mis-selling, Suitability, Advertising & Marketing. The requirements laid down in the policies above have been embedded in the Bank's policy and manuals applicable to the sale of all investment products, including LB ELN products:

(a) IPSP - governing the sales process for 5 key stages: 1) understanding and uncovering customer needs/upon customer's request of ELN, 2) conducting the Suitability Assessment, 3) fulfilling customer's needs with suitable products, 4) explanation of product features, risks, fees & charges and 5) order taking (item 8); and

(b) DTPM (item 9).

31.2 In addition to the above policies, set out below are key internal guidelines and operational practices of the business and risk functions that reinforce the policies:

(i) IC briefing and training on investment product features

(ii) CPT hours

(iii) Security Awareness For Everyone E-Learning

(iv) Group Code of Conduct E-Learning

(v) Reputation Risk E-Learning



- (vi) Quarterly Sales Governance meeting
- (vii) Daily branch meetings
- (viii) Automated Suitability Assessment module
- (ix) Automated Financial profiling modules
- (x) Sales kit, product summary, fact sheets etc. to explain product features and associated risks
- (xi) Branch Operations Circulars
- (xii) Key Control Standards checking & monitoring
- (xiii) Internal Audits
- (xiv) Compliance & Assurance Reviews
- (xv) CPT monitoring
- (xvi) RI registration monitoring

31.3 As set out in the response to Question 24 above, the Bank adopted a holistic approach to training.

**32. *Did your bank have any policy/procedures to ensure that your sales staff would meet the Fit and Proper Guidelines, the Guidelines on Competence and the Guidelines on Continuous Professional Training issued by SFC? If yes, please provide the details of such policy/procedures; if no, the reasons.***

32.1 Apart from the IPSP and DTPM referred to in the response to Question 31 above, the Bank has the following relevant guidelines and processes to raise staff awareness to the importance of complying with the requirements set out in the Fit and Proper Guidelines, the Guidelines on Competence and the Guidelines on Continuous Professional Training issued by SFC in conducting sales of LB ELN:

- (a) "*Process Document for Registration Process for Executive Officers and Relevant Individuals*" sets out the regulatory requirements of the registration process, including the Fit & Proper and Competence requirements under the relevant SFC Guidelines, as well as the roles and responsibilities of Business units, Human Resources, and Compliance in the registration process to ensure sales staff meet the Fit & Proper and Competence requirements upon registration as well as on an on-going basis (item 10)
- (b) "*Guidelines on Continuous Professional Training*" stipulates the requirements and process for CPT. Sales staff must attain a regulatory minimum of 5 CPT hours per calendar years including a bank wide annual refresher course on the SFC Code of Conduct (item 11)
- (c) "*Customer Complaint Handling Guidelines*" (item 12)
- (d) Hong Kong Compliance Manual which sets out the SCBHK's philosophy in relation to compliance and contains general compliance principles applicable to all SCBHK's staff

- (e) Various Compliance Alert broadcasts between 2005 and 2008 (item 13)
- (f) Group Employee Discipline Policy and Group Employee Discipline Procedures (item 14)
- (g) Local Key Control Standards and Local Key Control Self Assessment
- (h) Sample of training materials described in the response to Question 24 above (item 15)

**33. Did your bank involve the legal/compliance team in vetting the relevant training materials so as to ensure that all relevant legal and regulatory requirements had been met? If yes, was any false/inaccurate/misleading information in the materials identified? If no, please provide the reasons.**

33.1 Training materials derived from or related to the IPSP or product materials were reviewed by relevant risk functions, including Legal & Compliance.

33.2 No false, inaccurate or misleading information was identified in the materials.

#### **Know your clients**

**34. Did your bank have any policy/procedures to ensure that your frontline sales staff did conduct risk profiling exercise with the customers to assess their risk appetite? If yes, please provide the details; if no, the reasons.**

34.1 The IPSP, which is designed to incorporate and operationalise the relevant requirements of the SFO and the HKMA's regulatory requirements, details the key policy and procedures to ensure frontline sales staff properly conduct risk profiling with the customers. It is mandatory for all sales staff to comply with these procedures. The sales process pertaining to risk profiling comprises 3 key steps, which are detailed below:

1. Understand & uncover customer needs
2. Conduct Suitability Assessment ("SA") to establish suitability of products (item 16)
3. Explain product features, associated risk and charges

34.2 1. Understand and uncover customer needs – Frontline sales staff seeks general information through discussions with the customer on his financial background, personal circumstances and their needs. For customers who have expressed an explicit interest in investment products regulated by the SFC (such as structured notes), only RI who have met all the regulatory requirements are authorised to deal with them.

34.3 2. Conduct Suitability Assessment (SA) – Prior to making an investment, customers need to undergo a risk profiling exercise, conducted through the Bank's Suitability Assessment tool, to ensure that the customers are provided with investment solutions that are suitable and meet their needs.

- (a) The RI will use the questionnaire in the SA tool to seek key information including customers' financial situation, investment knowledge and experience, investment horizon and risk tolerance. Based on this information, the SA tool generates a list of possible investment solutions at the asset class level (e.g. "structured investments – equities") with their associated risk category ranging from "A" to "F" or "P", with "F" being the highest risk category and "P" being the principal

protected category. Structured notes had a risk category of "F" except those with a principal protection feature which were classified as "P". For those asset classes in which customers expressed interest, the RI will then introduce the available products.

- (b) Upon completion of the suitability assessment, the SA tool generates a report consisting of 3 sections for the customer to confirm and sign to acknowledge their understanding of their risk profiling and acceptance of the information printed - Section 1 includes the 9 investment profiling questions; Section 2 is a list of possible investment asset classes that are suitable for the customer; Section 3 is a customer declaration section showing the suitability of customer's selected product type.
- 34.4 3. Explain product features, associated risk & charges - Based on the result of the SA and the product chosen by the customer, the RI will explain its product features, associated risks, underlying stocks, fees and charges. After the customer confirms his understanding of the product features and risks, and wishes to place an order, the RI will complete the order forms for the customer to sign for execution. A full set of the documents including copies of the order form, newly signed SA (if applicable) and the Information Package will be provided to the customer. The final term sheet and the deal confirmation form will be mailed to the customer by the Bank after the trade date.
- 34.5 Specifically for customers aged 65 and above, additional control measures were implemented by way of additional safeguards:
- (a) Customers will be encouraged to seek independent advice or bring a companion to take part in the sales process; and
- (b) An officer independent of the sales transaction will be required to meet with the customer to confirm his understanding of the product, re-emphasise key information including product features, associated risks, fees and charges and remind the customer to avoid making hasty investment decisions.
- 34.6 To ensure that sales staff were complying with the sales process, there were established additional control measures as follows:
- (a) Daily checking in branches by the Branch Service Manager, covering 100% of investment documentation to ensure compliance with the relevant sales process and procedures.
- (b) Sample checking by Risk and Compliance Officer of investment transactions concluded in branches to ensure compliance with supervision and monitoring requirements.
- (c) Sample checking by Risk and Compliance Manager on staff's knowledge on mis-selling through interviews with frontline sales staff.
- (d) Monitoring of complaint trends by Branch Managers and Branch Service Managers to identify opportunities in training or supervision/monitoring requirements.
- 34.7 The Bank's extensive training programme for its entire staff as set out in the responses to Questions 24 to 33 and 38 also ensured that its sales staff were properly trained and updated with the latest regulatory requirements and internal guidelines.

35. ***Did your bank require the risk profiling exercise be conducted in relation to the customers only once when they opened an investment account, or continuously at regular intervals? If continuously, how did your bank ensure compliance by each staff member?***

35.1 Risk profiling or SA is conducted prior to account opening and is valid for 12 months. All customers must have a new or valid SA prior to placing an order.

35.2 Customer's signature is required upon first time completion of the SA. In addition, where there are changes in a customer's risk profile or his existing SA was conducted more than 12 months ago and hence invalid, customer's signature is also required. However for a SA which is within 12 month of validity period and where the customer has not indicated any changes in his risk profiling, the previous version of the SA will continue to apply and in such case customer's signature is not required. Customer is also required to sign the SA if the product selected by him is unsuitable. Please refer to the response to Question 24 on training and Question 33 on internal control measures established for the response on how the Bank ensures compliance by staff member.

36. ***Did your bank have any internal mechanism to conduct periodic review of the risk profiling questionnaire and scoring system? If yes, please provide the details; if no, the reasons.***

36.1 Yes. Pursuant to the GWMPM, the SA tool is updated periodically to include new types of products and to reflect changing market conditions. Changes to the SA tool whether initiated by country or Group requires endorsement at both levels to ensure adherence to Group standards and local regulatory requirements.

37. ***Did your bank require your sales staff to assess the customers' specific needs and personal circumstances in addition to the risk profiling questionnaire? If no, please provide the reasons.***

37.1 Yes, please refer to the response to Question 34.

#### SUITABILITY OF RECOMMENDATION AND SOLICITATION

38. ***Were the Questions and Answers on Suitability Obligations of Investment Advisers (FAQ) published by SFC in May 2007 brought to the attention of the sales staff of your bank? Were they briefed on FAQ?***

38.1 Yes. The suitability obligations, whether contained in the Code of Conduct, the FAQ or elsewhere, where appropriate, were brought to the attention of the Bank's sales staff. As with all other regulatory requirements, instead of simply copying codes or circulars and asking its sales staff to read the same, the Bank's approach has always been to involve process and compliance professionals who would collaborate to convert the regulatory requirements into practical and executable steps and then embed the requirements into its operational guidelines and manuals.

38.2 The FAQ has been integrated and embedded in the IPSP and DTPM and turned into practical and executable steps.

38.3 The 9 questions in the SA tool also covered the general principles contained in the FAQ in their totality.

- 38.4 As set out in the response to Question 24 above, sales staff receive regular training and briefings on the Bank's selling process and IPSP, reinforced by regular CPT training on suitability, mis-selling and compliance with the Code of Conduct.
39. ***Did your bank have any internal controls to ensure suitability of the recommendations and solicitations for investment in LB-related structured financial products? If yes, please provide the details; if no, the reasons.***
- 39.1 Yes, the Bank had robust internal controls in place to ensure suitability of investment products. For the end-to-end controls embedded in the investment sales process, please refer to the response to Questions 34 and 42.
40. ***Did your bank have any system to require the sales staff to document the reasons for the recommendation given to the clients? If yes, please provide the details; if no, the reasons.***
- 40.1 The Bank provided a list of suitable asset classes after conducting the SA and this information was contained in the SA report retained by the Bank and provided to the customer.
41. ***Did your bank have any measures to ascertain whether the clients were fully aware of the nature and risks of the LB-related structured financial products recommended by your sales staff? If yes, please provide the details; if no, the reasons.***
- 41.1 Yes. The Bank's selling process required RIs to explain the product features and associated risks to the customer. For details, please refer to the response to Question 34.
- 41.2 Only upon confirmation by the customer of his understanding on the product features and risks, and supported by the customer's signature on the order form, will the RI place the order for execution.
- 41.3 Specifically for customers aged 65 and above, additional control measures were in place to provide additional safeguards:
- (a) Such customers will be encouraged to seek independent advice or bring a companion before proceeding with the investment order;
  - (b) An officer independent of the sales transaction will be required to meet with the customer to confirm their understanding of the product and to re-emphasize key information including product features, associated risks, fees and charges and remind the customer to avoid making hasty investment decisions.
42. ***Did your bank have any internal controls to identify transactions in which there was a mismatch between the product risk rating and the customer's risk profile? If yes, please provide the details; if no, the reasons.***
- 42.1 Yes. The Bank's investment sales process required sales staff to introduce possible investment solutions or asset classes, generated through the SA process and considered suitable to the customer's risk profile. Mismatches between the product risk rating and the customers' risk profile will generally arise where the customer explicitly requested a product outside of his risk profile. In this event, the RI was required to inform the customer that the product chosen was unsuitable based on the SA result and invited the customer to consider a product within the suitable asset classes listed in the SA.

- 42.2 If the customer desired to subscribe the unsuitable product, the customer was required to sign on the Customer Declaration in the SA to acknowledge that he was advised that the product chosen was unsuitable for him and accepted the associated risk of the said product(s)/service(s). The Branch Manager's exceptional approval was required for sales of unsuitable product for customers aged 65 or over.
- 42.3 Daily checking in branches by the Branch Service Manager, covering 100% of investment documentation to ensure compliance with the relevant sales process and procedures.
- 42.4 In addition, as set out in the response to Question 35, the SAs were required to be updated when there was a change to the customer's risk profile or upon renewal to ensure it properly reflected the customer's risk appetite.

#### **SALE OF PRODUCTS**

**43. *Did all your frontline staff engaged in the sale of LB-related structured financial products sit and pass the relevant examinations for representatives to be licensed by SFC? If no, did your bank set any qualifications (e.g. seniority, rank, experience, education, and training courses attended) when selecting frontline staff to engage in the sale of the aforesaid products?***

43.1 Pursuant to the IPSP, only RIs were allowed to conduct sales of LB ELN.

**44. *Was all the sale of LB-related structured financial products conducted by staff members who were Relevant Individuals registered with HKMA?***

44.1 Yes, all sales of LB ELN were conducted by RIs.

**45. *Please describe how your bank had conducted the private placement of LB-related financial products, including the following particulars:***

**(a) *how your bank had identified the target clients (using the first and the last LB-related structured financial product mentioned in Question 2(c) and the three LB-related structured financial products mentioned in Question 3 as illustration, describe the target clients (in terms of age, education level, net worth and relationship with your bank) in the sale of each of the products);***

45.1 For the purpose of Question 45, we assume that references to "private placement" in the question refer to the Bank's distribution of LB ELN through the Minimum Investment Offer Exemption as set out in the response to Question 7 above.

45.2 The Bank did not have customer call lists for its distribution of ELNs, including LB ELN. Frontline sales staff were not specifically instructed to target certain customer segments. The Bank used the SA tool to ascertain the list of eligible asset classes for customers' consideration. Typically these eligible customers tended to have a medium to high Assets Under Management ("AUM") and higher risk tolerance and to look for greater yield enhancement.

**(b) *the criteria adopted to designate certain clients as professional investors, and whether the clients were aware that they were so classified;***

45.3 The Bank did not designate any of its customers as professional investors.

**(c) *how your bank had approached the target clients (e.g. making telephone calls, by invitation in writing or personal visits);***

45.4 As set out in the response to Question 45(a), there were no target customers or customer call lists for LB ELN. Customers will be shown the list of eligible asset classes post completion of the SA, which were typically conducted in branches.

**(d) the preparatory works undertaken before private placement could take place, e.g. what promotional materials were prepared and how the staff were trained;**

45.5 In relation to marketing materials, please refer to the response to Question 22 above.

45.6 Before a new structure was launched, the Bank's product managers and representatives of the structured product providers will brief the ICs during the weekly IC meetings on key product features and risks using the marketing materials above. By adopting a 'train-the-trainer' approach, ICs will then conduct face-to-face training with the small group of sales staff under their responsibility, through the weekly branch meetings or small interactive group sessions.

45.7 The LB ELN Information Package provided by LB will be uploaded onto the Bank's information hub system, a central repository containing current Bank products to be available for sale to eligible customers, to make it readily accessible to all frontline sales staff.

**(e) the features of the LB-related structured financial products emphasized in the relevant marketing or promotional materials used by your bank;**

45.8 All product features are captured within the Information Package which can be categorised into 3 areas:

(i) Product terms and features: including Issuer, Guarantor, whether the product is principal protected, tenor, issue date, trade date, underlying shares, minimum deal size, mechanism including strike price, maturity date, coupon payment, redemption terms

(ii) Investment risk factors: including entire loss of their investment, market risk, event risk, liquidity risk and credit risk

(iii) Different scenarios on investment outcome: including early redemption and scenario where the customer could receive physical delivery of worst performing share at maturity

**(f) the typical process of a successful sale (from approaching a target client for the first time to the settlement of all relevant transactions);**

45.9 There were no target customers or customer call lists for LB ELN. The Bank used the SA tool to ascertain the list of eligible asset classes for customers' consideration. Typically these eligible customers tended to have a medium to high AUM and higher risk tolerance and to look for greater yield enhancement. Please refer to the response to Question 45(a) for details.

45.10 The investment sales process involved understanding and uncovering customer needs, suitability assessment, disclosure of risks, fees and charges and order placing upon customers confirmation. For details of the investment sales process, please refer to the response to Question 34.

- (g) How such private placements were organized (e.g. by bank branches, by sales teams or by designated officers);**
- 45.11 After passing the product due diligence process (please refer to the response to Question 8), the product related information will be placed in the information hub system. As and when the minimum threshold set by the product provider is met, HKWM would launch the series. The Bank did not organise such placements by the branch or by the sales team.
- (h) How such private placements were monitored (e.g. at different levels, by a team leader or branch manager or department head or designated officer);**
- 45.12 At the deal level, as set out in the response to Question 7, ELNs were offered pursuant to the Minimum Investment Offer Exemption with a minimum purchase denomination of HK\$ 500K or US\$ 65,000. Every transaction must be input into the system before it can be processed. At day end, the Branch Service Manager is required to perform order reconciliation to ensure that each transaction complies with the operational requirements. The Risk and Compliance Officer would conduct sample checking of the order transacted in the branches to ensure compliance with the supervision and monitoring process. The work conducted by the Risk and Compliance Officer is reviewed by the Risk and Compliance Manager.
- (i) the officer(s) (name(s) and position(s)) in charge of the overall strategy of staff deployment for the sale of LB-related structured financial products;**
- 45.13 The Head of Branch Banking was in charge of the overall strategy of staff deployment for the sale of LB ELN. This position reported to the General Manager of Branch and Direct Banking. At the material time, Catherina Chan was the Head of Branch Banking and Ann Kung was the General Manager of Branch and Direct Banking.
- (j) The officer(s) (name(s) and position(s)) in charge of the overall supervision of the marketing or promotion of LB-related structured financial products;**
- 45.14 The Bank was not involved in the preparation of promotion materials of LB ELN.
- (k) the officer(s) (name(s) and position(s)) responsible for ensuring the achievement of sales targets;**
- 45.15 During the Relevant Period, the overall responsibility for Consumer Banking business performance including sales targets, was with the Head of Consumer Banking, General Manager, Branch and Direct Banking and General Manager, Wealth Management. At the material time, Benjamin Hung was the Head of Consumer Banking and Mary Huen was the General Manager of Wealth Management.
- (l) How your bank ensured that the applicable law and regulations were complied with in the entire sale process;**
- 45.16 Please refer to the responses to Question 32 (for compliance with Fit & Proper and Competence requirements) and Question 38 above (for overall mechanism in addressing new / changed regulatory requirements and ensuring such requirements be met by the Bank's internal process and selling procedures).
- (m) what records were made after each successful and unsuccessful transaction;**



- 45.17 Records will be kept in support of successful transactions.
- 45.18 Order forms together with the underlying SA and the computer generated contract note will also be kept pursuant to the Bank's document retention policy.
- 45.19 The transactions if successful will also be reflected in the monthly statement of the customer's account.
- (n) ***the quantitative sales targets, if any, set for specific time period for each branch of your bank and for each staff member at different levels involved in such sales;***
- 45.20 The Bank did not have individual sales targets specific to LB ELN for sales staff.
- (o) ***Details of the incentive scheme(s) for:***
- (i) ***staff on the basis of the amount of sales of LB-related structured financial products achieved; and***
- (ii) ***investors on the basis of the amount of LB-related structured financial products they purchased;***
- (p) ***if such incentive scheme(s) changed over time, please give details of each stage of the scheme(s) in chronological order; and***
- (q) ***was there a different incentive scheme if the LB-related structured financial products were sold to professional investors or where the subscription amount in a single transaction was HK\$500,000 or more.***
- 45.21 The Bank had in place a holistic staff performance framework, primarily driven by a Balanced Scorecard, to promote customer need based selling, customer service excellence and compliance and control. Specifically, the performance of frontline sales staff were measured based on balanced-portfolio revenue achievements, customer service and compliance with control procedures. Product level incentives were also available for products including Unit Trust, Insurance, Deposits, Structured Notes etc.
- 45.22 There was no customer incentive scheme specifically designed for LB ELN. There were from time to time schemes designed to reward customers by reference to their total amount of investments.
46. ***Using the first and the last LB-related structured financial products mentioned in Question 2(c) and the three LB-related structured financial products mentioned in Question 3 as examples, please describe your bank's sales strategies of LB-related structured financial products.***
- 46.1 The Bank had no sales strategies specific to LB ELN.
47. ***Please set out in the form of a chart the organizational structure of the staff (including all sales teams or units and the number of staff) engaged in the sale of LB-related structured financial products. If the organizational structure varied over time, please provide a chart for each of the following stage:***
- (a) ***the sale of the first and the last LB-related structured financial products mentioned in Question 2(c); and***

**(b) the sale of the three LB-related structured financial products mentioned in Question 3.**

47.1 Please refer to the organisation chart in item 17.

**48. Besides the offer documentation and marketing material, did your bank provide any other materials, such as posters, promotional letters and leaflets, to customers for the sale of LB-related structured financial products? If yes, please provide the details and a copy of the relevant materials.**

48.1 The Bank did not issue any promotion materials in respect of LB ELN. Please also see the response to Question 22.

**49. Did your bank detect any false/inaccurate/misleading information contained in the advertising materials for a particular LB-related structured financial product which had not been consistent with the information in the offer document for the product?**

49.1 No, the Bank did not detect any false/inaccurate/misleading information.

**50. Did your bank have any supervision or management measures to ensure that the frontline sales staff would follow the proper procedures stipulated in the Code of Conduct, as well as relevant manuals/guidelines, if any, during the selling process? If yes, please provide the details; if no, the reasons.**

50.1 As set out in the response to Question 38, the regulatory obligations, whether contained in the Code of Conduct or elsewhere will be brought to the attention of the Bank's sales staff by converting the regulatory requirements into practical and executable steps and then embed the requirements into its guidelines and manuals.

50.2 This was supplemented by an extensive training programme for its entire staff including staff selling structured products ranging from structured classroom training to on the job training by internal or external subject experts, for details please refer to the responses to Questions 24 to 33.

50.3 The Bank also had management supervision and controls to oversee that its staff followed the Bank's guidelines and manuals during the selling process including:

- (a) Routine checking within branches by the Branch Service Manager covering 100% of investment documentation on a daily basis to ensure compliance with the relevant sales process and procedures.
- (b) The business Risk and Compliance Officer will carry out sample checking of the sales, deal or order concluded by all the branches to ensure that the above-mentioned supervision and monitoring process is actually carried out. The Risk and Compliance Manager will review the work carried out by the Risk and Compliance Officer. The Risk and Compliance Manager also conducted regular sample checking on staff's knowledge on mis-selling by interviewing frontline staff and asking them related questions on the same.
- (c) The relevant business department will also study and monitor complaint trends with Branch Managers and Branch Service Manager to consider whether any enhancement in training and supervision and monitoring was required.

- (d) The Bank's Group Internal Audit also conducted internal audits each year, during which various aspects of the selling process will be covered following which reports will be issued to senior management.
- (e) The Bank's Compliance & Assurance teams also conducted risk-based compliance reviews on a regular basis, which included mystery shopping exercise.

**51. Under the existing regulatory regime, regardless of how financial products are offered (such as through private placement or retail sale), the conduct of sale by intermediaries has to comply with the Code of Conduct. How did your bank ensure that your sales staff were aware of their obligations and complied with the requirements under the Code of Conduct, including FAQ, when selling LB-related structured financial products?**

51.1 The overall framework by which the Bank ensured that the staff were aware and complied with the relevant regulatory requirements comprised (a) professional accreditation, (b) training and ongoing reinforcement, (c) documented policies and procedures and (d) monitoring and assurance. For more details, please see the responses to Questions 24 to 33, 38 and 50. In summary:

- (a) Professional accreditation - All staff members who sold LB ELN were RIs. This ensured that each sales staff had good understanding of the relevant laws and regulations and ethical standards required under the Code of Conduct.
- (b) Training & ongoing reinforcement - the Bank also had extensive training programmes for all staff, including sales staff, ranging from structured classroom to on-the-job training. Sales governance briefings were also conducted by Risk and Productivity Management team. These briefings had been run on a quarterly basis with a view to reinforcing staff's awareness of regulatory requirements and key concepts within the selling process.
- (c) Policies & Procedures – the requirements under the Code of Conduct were also integrated and embedded into the IPSP and the relevant internal guidelines and manuals.
- (d) Monitoring & Assurance – there were various checking and monitoring activities conducted by business risk and compliance, audit and compliance and assurance functions.

#### HANDLING OF COMPLAINTS

**52. Before the collapse of LB in mid-September 2008, did your bank receive any complaints in relation to alleged mis-selling of LB-related structured financial products? If yes, please provide the details, including the number of cases and particular series involved.**

52.1 From the time the Bank started selling LB ELN up to the collapse of LB in mid September 2008, out of a total of 5,653 transactions sold through the Bank, the Bank received 1 complaint of alleged mis-selling in respect of Lehman Brothers 1-year HKD All Weather Coupon daily Callable ELN - Series 18 (390+1800+2800).

**53. Please provide the following information:**

- (a) *the number of customers who purchased LB-related structured financial products from your bank and were affected by the collapse of LB;*
- (b) *the number of complaints your bank received after the collapse of LB concerning the sale of LB-related structured financial products;*
- (c) *the latest number of complaints in relation to LB-related structured financial products that your bank has settled, together with information on the settlement arrangements (e.g. repurchase of the products);*
- (d) *the latest number of unresolved complaints;*
- (e) *the expected time-frame to settle the unresolved complaints;*
- (f) *Whether a broad-based settlement similar to the repurchase of Minibonds by the 16 distributing banks would be reached. If yes, please provide the details; if no, the reasons; and*
- (g) *Whether a broad-based settlement in relation to a particular type of LB-related structured financial products or a particular series of such a product sold by your bank has been/would be reached. If yes, please provide the details; if no, the reasons.*

53.1 The number of customers who purchased LB ELN from the Bank and were affected by the collapse of LB is 2,234 customers.

53.2 As at 7 April 2010, the Bank received 1,231 complaints in relation to LB ELN transactions. The Bank had approved settlement for 152 cases (at up to 100% of principal amount invested). The Bank will continue to deal with the outstanding complaints expeditiously and in a fair and equitable manner, adhering to the time line stipulated in the HKMA's Supervisory Policy Manual Module IC4 on Complaint Handling Procedure.

53.3 The Bank's current stance is to assess complaints on a case-by-case basis in accordance with its complaint handling process described in the response to Question 54 below and does not believe that there is a basis on which a broad-based settlement should be achieved. In any event, the Bank is bound by the secrecy provisions contained in s.378 of the SFO.

54. *Please advise:*

- (a) *has your bank put in place any written policy/procedures on handling and investigating complaints lodged by clients who have purchased investment products from your bank?*
- (b) *if yes, please provide a copy of such policy/procedures and a flow chart on your bank's complaint handling and investigative process in relation to LB-related structured financial products sold by your bank;*
- (c) *are such policy/procedures required to be endorsed by the regulators (such as HKMA)? If no, is a copy of such policy/procedures provided to the regulator(s) for record?*
- (d) *Has your bank put in place "enhanced" complaint handling procedures to resolve complaints in relation to the sale of LB-related structured financial*

*products, similar to the 16 banks which entered into the Minibonds repurchase agreement with HKMA and SFC? If yes, please provide the details.*

- 54.1 All customers' complaints involving LB ELN were rigorously investigated under an enhanced complaints handling process by a specialised complaint handling taskforce involving senior management (independent from front line staff) and the Bank's external lawyers.
- 54.2 Please refer to item 18 for the flow chart.
- 54.3 Under the enhanced complaints handling process, complaints received must be investigated by staff who were not directly involved in the case. A review panel was established consisting of representatives from Group Internal Audit, the Bank's external lawyers, Legal & Compliance, Operational Risk and/or Operational Risk Assurance. The review panel will consider whether the allegations were founded and, as appropriate, escalate cases to an approval panel for its further review and consideration. The approval panel consisting of senior bank executives will take an overall view of the cases escalated and, where appropriate, approve settlement.
- 54.4 The enhanced complaints handling process had been reviewed by Ernst and Young under section 59(2) of the Banking Ordinance. The terms of reference (which were prescribed by the HKMA) required consideration of specific matters in the following four areas relating to the enhanced complaints handling process: (1) policies and procedures, (2) organisation structure and establishment, (3) senior management oversight and (4) complaint investigation procedures. The terms of reference also required checking of a sample of LB ELN complaints. This report was submitted by the Bank to the HKMA on or around 30 April 2009.
- 55. *Did your bank detect any substantiated non-compliance cases in relation to the sale of LB-related structured financial products during its internal investigations into the complaints filed by investors of such products? If yes, please provide the number and key particulars of such cases.***
- 55.1 As per the response to Question 53 the Bank approved settlement for 154 cases based on consideration of a number of factors including hardship and material inconsistency with internal standards which impacted the customer's investment decision. Roughly two-thirds were cases in the latter category.

#### REGULATORY OVERSIGHT AND COMPLIANCE

- 56. *It is noted that since 2000, HKMA has adopted the practice of holding prudential meetings with the boards of directors of local banks once a year to the extent possible. From 2003 to September 2008, how many prudential meetings, if any, did HKMA hold with the boards of directors of your bank? At these prudential meetings, did HKMA express concerns or raise suggestions about boosting the bank's non-interest income? Please explain.***
- 56.1 SCBHK became a locally incorporated bank in March 2004.
- 56.2 The HKMA met the Audit Committee on 29 May 2006. At that meeting, the HKMA did not express concerns or raise suggestions about the Bank's non-interest income. The HKMA commented that they could choose to meet with the Bank's audit or other specialised committees as an alternative to meeting with the Board of Directors if there were no substantial supervisory concerns that needed to be brought up to the board level.

56.3 During the period from 2006 to 2008, prudential meetings were held between the HKMA and senior management of the Bank. Similarly, the HKMA did not express concerns or raise suggestions about the bank's non-interest income in any of these meetings.

57. ***Prior to the collapse of LB in September 2008, did HKMA, in the course of its on-site and off-site examinations, relay to your bank any concerns in the following areas in relation to the sale of structured financial products (such as LB-related products) sold by your bank:***

- (a) product due diligence;***
- (b) training and guidance to staff;***
- (c) handling customers;***
- (d) information about customers;***
- (e) suitability of recommendation and solicitation; and***
- (f) supervision of sales process.***

***If yes, please explain.***

57.1 During the Relevant Period, the HKMA conducted on site examinations of the Bank's regulated activities. The key observations related to items (a) to (f) above and actions taken by the Bank are described below. All observations were noted, action plans devised and duly implemented.

- (i) The HKMA commented that the "Second Checker mechanism" for vulnerable customers should be strengthened. In response, the Bank revised the IPSP to reinforce the "Second Checker" procedures (effective from May 2006) and enhanced its training programme to include on-going coaching to frontline staff.
- (ii) The HKMA also provided various recommendations to extend the use of the then version of the client profiling procedures to more products. In response, the Bank enhanced the relevant procedures to include other investment products such as premium deposit and securities products.
- (iii) The HKMA commented on the desirability of automation of the customer's profiling procedures in order to minimise paper-based manual errors. This was duly automated in 2007.
- (iv) The HKMA noted that the Bank should consider updating its audio technology system in branches. In response, the Bank upgraded the system in all its branches in 2008 to minimise the risk of manual errors.
- (v) The HKMA recommended enhancements to the process flow and pre-employment checks for new joiners. These procedures were subsequently reinforced.

57.2 During the Relevant Period, the HKMA had commented that they considered that the control environment and risk management systems of the areas examined were generally adequate, whilst noting the above recommendations for improvement.

58. ***It is noted that HKMA issues from time to time advice and circular letters to all Registered Institutions (for example, the circular letter dated 1 March 2005 on "The Securities and Futures Commission's Report (the Report) on Selling Practices of Licensed Investment Advisers" and the circular letter dated 3 March 2006 on "Retail Wealth Management (RWM) Business"). Does your bank have had any***

*arrangements in place to take heed of and/or follow up the regulatory concerns raised by HKMA? If yes, please provide the details; if no, the reasons.*

- 58.1 Please refer to the response to Question 38 above in relation to the dissemination of new regulatory requirements to the relevant Business and/or Support Function Units including frontline staff.
- 58.2 Apart from cascading to staff, the Bank's Compliance & Assurance function will request the relevant Business and/or Support unit to review the new requirements, ascertain necessary enhancements and agree on action plans to embed the new or amended regulatory requirements.
- 58.3 Compliance & Assurance will also update the Bank's Local Regulatory Key Control Standard based on its assessment of the associated regulatory risk and, in conjunction with the business, other criteria such as product complexity, frequency of operation, degree of automation and staff experience. These would also be cascaded to the relevant business and/or support units.