

**立法會**  
**Legislative Council**

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**Paper for the House Committee meeting on 17 October 2008**

**Appointment of a subcommittee to study issues arising from Lehman Brothers-related minibonds and structured financial products**

**Purpose**

This paper invites members to endorse a proposal for a subcommittee to be appointed under the House Committee to study issues arising from Lehman Brothers-related minibonds and structured financial products.

**Background**

2. On 15 September 2008, the Lehman Brothers Holdings Inc. filed for bankruptcy protection in the United States. One of the aftermaths is that the Lehman Brothers-related entities (Lehman Brothers) have defaulted in respect of their obligations under minibonds and other structured products. There are widespread public concerns about the impact of the incident and the existing regulatory framework governing the sale of minibonds and other structured products. In view of the widespread concerns, the House Committee held a special meeting on 13 October 2008 to receive a briefing by the Government, the Hong Kong Monetary Authority (HKMA), the Securities and Futures Commission (SFC), the Hong Kong Association of Banks and over 20 financial institutions. The purpose of the meeting was to acquire a better understanding of the situation, in particular the reasons for these high-risk investment products being marketed as low-risk products for the general public in retail banks, the actions taken by the authorities in investigating into the complaints of alleged mis-selling of investment products and the means undertaken by the authorities and the financial institutions to assist the aggrieved investors.

3. At the special meeting on 13 October 2008, House Committee Members noted that as at 12 October 2008, HKMA and SFC had received respectively about 9 280 and 1 970 complaints of alleged mis-selling of investment products related to Lehman Brothers. Although both HKMA and SFC undertook to deal with the complaints expeditiously with a view to taking appropriate actions against substantiated cases of mis-selling, Members found the slow response of the authorities to investigate into these complaints and the passive response of financial

institutions to assist the aggrieved investors unacceptable. Members raised questions on the efficacy of the existing regulatory framework governing the sale of minibonds and other structured products, the protection for investors, the investigation and disciplinary mechanism, and the extent of assistance available to affected investors. Members also found that the Lehman Brothers minibonds incident had a serious adverse effect on the public's confidence in the banking industry and also on Hong Kong's status as an international financial centre. Given the magnitude of the problem, Members considered it necessary to further study the issues involved in order to address the concerns of the community and those of affected investors.

4. In considering the way forward, Members have considered whether the subject matter should be followed up by the Panel on Financial Affairs. However, given the significant impact of and public concern about the incident, Members expressed support for a subcommittee to be set up under the House Committee in order that any Member, including those who are not members of the Panel on Financial Affairs, could take part in the study of the subject matter. The Legislative Council Secretariat was requested to draw up the terms of reference, workplan and time-frame for the subcommittee for endorsement by the House Committee.

### **Proposed Terms of Reference of the Subcommittee**

5. The proposed Terms of Reference is as follows:

"To study issues arising from Lehman Brothers-related minibonds and structured financial products and to make recommendations where necessary."

### **Proposed workplan**

6. The Subcommittee will focus its work on the following major areas:

- (a) the regulatory framework for structured financial products and dealings in securities;
- (b) the sale of minibonds by authorized institutions;
- (c) protection for investors in respect of structured financial products and the mechanism of investigating complaints of mis-selling, and imposing sanctions against breaches of code of conduct;
- (d) ways of providing assistance to holders of minibonds; and
- (e) restoring confidence in the banking system and maintaining Hong Kong's status as an international financial centre.

7. The specific issues that may be studied under each major area are set out in the **Appendix**.

**Proposed time frame**

8. The Subcommittee would aim to complete its work and report to the House Committee within three months, i.e. around late January/early February 2009.

**Advice sought**

9. Members are invited to endorse the appointment of the subcommittee with the proposed Terms of Reference, workplan and time frame as set out in paragraphs 5 to 8 above.

Council Business Division 1  
Legislative Council Secretariat  
16 October 2008

### Proposed major areas of study

#### 1. *Regulatory framework*

- Respective roles of the Government, Hong Kong Monetary Authority (HKMA) and Securities and Futures Commission (SFC) in the regulation of the sale of structured products to small investors
- HKMA's regulatory powers over authorized institutions (AIs) engaging in regulated activities as specified in the Securities and Futures Ordinance (Cap. 571)
- Application of SFC rules and codes/guidelines to AIs and their securities staff in conducting securities-related business
- Approval for the launch of financial products by AIs as Registered Institutions (RIs) and securities firms
- Responsibilities of HKMA and SFC in the day-to-day front-line supervision of RIs and securities firms engaging in regulated activities
- Disparity, if any, of regulatory standards and requirements for RIs and securities firms in providing securities/investment services

#### 2. *Sale of minibonds by authorized institutions*

- Types of minibonds sold to investors through retail banks and brokers and the extent of risks associated with these products, in particular derivatives such as synthetic collateralized debts obligations (CDOs) and credit default swaps (CDS) contracts guaranteed by Lehman Brothers
- Procedure and mechanism adopted by RIs/brokers for selling financial products to clients
- Relationship between Lehman Brothers and RIs/brokers in selling their investment products
- Procedure for assessing the estimated value of the underlying collaterals of the Lehman-Brother-related minibonds
- Authority for the issue of advertisements and documents
- Disclosure of risks and full information to investors

- Role of HKMA and SFC in overseeing the packaging of these products and the marketing methodologies
3. ***Protection for investors in respect of structured financial products and mechanism of investigating complaints and imposing sanctions***
- Policy on protection for investors in respect of structured financial products
  - Current mechanism for investigating complaints by mini-bonds investors of mis-selling
  - Progress made so far and time schedule
  - Sanctions against breaches of code of conduct
  - Whether prosecution will be instituted
4. ***Ways of providing assistance to holders of minibonds***
- Measures to assist investors and current position regarding the Government's proposal for AIs to repurchase minibonds and views of banks/brokers on the Government's proposal
  - Plans to devise mediation and settlement to compensate the complainants
5. ***Restoring confidence in Hong Kong's banking system and maintaining Hong Kong's status as an international financial centre***
- Impact of the Lehman Brothers' minibond incident on public confidence in Hong Kong's banking system
  - Measures to assist banks/brokers to address concerns of affected investors and regain confidence of their customers
  - Whether the Exchange Fund will be used to assist banks/brokers to restore confidence and whether the Fund will be used to finance the banks/brokers in repurchasing the minibonds, and whether it is appropriate to do so under the law
  - Any other measures or contingency plans