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24 November 2008

Clerk to Subcommittee
Legislative Council
Legislative Council Building
8 Jackson Road
Central, Hong Kong
(Attn: Mr. Thomas Wong)

Dear Mr Wong,

**The Administration's Response to
Hon Regina Ip's letter dated 6 November 2008**

Since the collapse of Lehman Brothers on 15 September 2008, which has resulted in the default of Minibonds and other investment products related to Lehman Brothers, Government has been playing a facilitator role and coordinating and mediating among the relevant parties to secure the best arrangements for the aggrieved investors.

The Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC) have received more than 20,000 complaints in relation to the mis-selling of Lehman Brothers-related investment products. HKMA and SFC have already deployed additional resources with a view to handling the complaints as quickly as possible. At present, HKMA has already completed its initial assessment of over 5,000 cases, and has reviewed and referred a total of 113 cases involving seven banks to SFC for follow up. The SFC is now investigating those cases referred to it by HKMA, as well as the cases involving the misconduct of the sale of Lehman Brothers-related investment products by the three SFC-licensed firms.

The SFC is adopting a systemic top-down approach to investigate the selling practices and policies of relevant distributing banks and brokerages to ensure that allegations of mis-selling of Minibonds are investigated efficiently, effectively and expediently. Since a single selling organisation is often the subject of multiple allegations, the SFC will examine whether the evidence exposes any systemic weakness in management controls. This is consistent with the SFC's normal approach and the approach adopted in other developed jurisdictions to allegations of widespread mis-selling. Its objective is to respond quickly to the maximum number of complaints in the shortest possible time, while at the same time obtaining a full and proper understanding of the position of each bank and firm, including its management controls, training and supervision of sale staff, as well as due diligence process, etc, without taking short cuts that will prejudice its assessment of obligations to act fairly.

Hon Ip mentioned in her letter that the auction failures of auction rate securities (ARS) in February 2008 in the United States has led to an investigation of the auction rate securities industry led by the New York State Attorney General (NYAG). We understand that the NYAG has law enforcement powers under the U.S. legislation to conduct public and private investigations of suspected fraud in the offer, sale or purchase of securities. Apart from the NYAG, the investigation of the ARS incident in the U.S. was also conducted by different regulators, including the Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority, and the North American Securities Administrators Association, etc. The SEC, in coordination with the NYAG, took the lead in structuring, proposing and negotiating with the relevant market participants the framework for a settlement that included liquidity solutions for the aggrieved American investors in the incident. It is noted that after six months of investigation and negotiation, SEC announced settlements-in-principle with some of the largest ARS market participants which agreed to offer to purchase the frozen ARS from retail customers, small businesses and charitable organizations. For further information, please see hyperlink to the press release <http://www.sec.gov/news/press/2008/2008-168.htm>.

As regards the question of whether the Secretary for Justice could lead the investigation into the Lehman Brothers incident, we have to bear in mind that the role of NYAG and that of the Department of Justice (DoJ) in Hong Kong are not the same. The NYAG is vested with powers to investigate and prosecute both criminally and civilly. He also has his own legislation to enforce. In Hong Kong, the DoJ is not an investigator but the principal legal adviser to the Chief Executive, to the Government and to individual Government bureaux, departments and agencies. It controls criminal prosecutions. The Secretary for Justice is the nominal defendant in all civil actions brought against the Government and represents both the Government and the public interest in the courts. Under the current structure of the DoJ, the Secretary for Justice does not have the power to investigate complaints in relation to the Lehman Brothers incident.

Although the number of complaints received is voluminous and cases are complex, the Lehman Brothers incident only took place two months ago. We are of the view that sufficient and reasonable time has to be given to HKMA and SFC to handle these complaints expeditiously and at the same time observing the due process.

Following the passage of the motion authorizing the Subcommittee under the House Committee to exercise the power conferred by the Legislative Council (Powers and Privileges) Ordinance for its investigation of the Lehman Brothers incident on 12 November, the Government will cooperate with the Subcommittee and continue to assist the aggrieved investors in the Lehman Brothers incident.

Yours sincerely,

(Desmond Wu)
for Secretary for Financial Services
and the Treasury

c.c. :

Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP

(Subcommittee Chairman)

Mr Joseph YAM, GBS, JP, Chief Executive, Hong Kong Monetary Authority

Mr Martin WHEATLEY, Chief Executive Officer, Securities and Futures
Commission