

**Subcommittee to Study Issues Arising from  
Lehman Brothers-related Minibonds and  
Structured Financial Products**

**The Administration's Response to the letter from  
Hon Regina Ip dated 12 December 2008**

**Background**

In her letter of 12 December 2008 to the Chairman of the Subcommittee, the Hon Regina Ip requested the Administration to consider adopting a more proactive approach in protecting the interest of the investing public with reference to how the U.S. authorities resolved the Auction Rate Securities (ARS) incident. The Administration has taken note of Hon Ip's suggestions and our response is set out in the ensuing paragraphs.

**Response**

2. The Administration and our regulators have all along attached great importance to investor protection. In view of the exceptional circumstances and the large number of retail investors involved in the Lehman Brothers incident, the Administration had proposed to banks to buy back the Minibonds arranged by Lehman Brothers (Minibonds) at their estimated market value. This could reduce the need for the investors to go through a long and uncertain liquidation process. However, the timetable of the buy-back is inevitably being delayed because of the legal challenge that has been raised recently by the U.S. lawyers that act for the liquidator of Lehman Brothers.

3. The investors can seek compensation from the distributing banks and brokerages of Minibonds if a case of mis-selling is established through lawsuit or complaints to the Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC). The situation is similar to the ARS incident in the U.S. where the 12 financial institutions involved in the selling of ARS were willing to settle with the investors on ARS because they were under investigation by the New York State Attorney General about the misrepresentation of the nature of the ARS and the failure to disclose the liquidity and credit risks involved.

4. We understand that certain investors have taken or threatened legal proceedings in the courts to seek compensation from the distributing banks and brokerages concerned, with a number of settlements being reached. Furthermore, a process is already in place for the HKMA and the SFC to investigate into the complaints filed against the distributing banks and brokerages. Up to 12 December 2008, the HKMA has referred 213 cases to the SFC for follow-up. Should the SFC identify any misconduct that amounts to a breach of the Code of Conduct for Persons Licensed or Registered with the Securities and Futures Commission, the SFC is expected to take appropriate enforcement actions. The Administration is monitoring the actions of the regulators in this regard.

5. We are aware that banks are settling with the investors concerned. According to the figures collected by the HKMA, 616 voluntary settlements have been reached by the distributing banks with their customers as of 10 December 2008. Discussions on settlements are underway in about 1 000 cases.

6. Separately, the Consumer Council is processing the applications received for assistance under the Consumer Legal Action Fund. The Police are also investigating a number of cases which may be referred to the SFC or the Secretary for Justice for prosecution in line with the established practice.

7. The Administration will continue to keep itself informed of the position and facilitate the regulatory actions by the HKMA and the SFC in so far as possible and lawful.

**Financial Services Branch  
Financial Services and the Treasury Bureau  
December 2008**