

Dated 10 May 2010

RESPONSE TO LEGCO SUBCOMMITTEE LETTER  
DATED 3 May 2010

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

Unless otherwise stated, capitalised terms in this response have the meanings ascribed in the Written Submissions of Ms Amy Yip, Chief Executive Officer of DBS Bank (Hong Kong) Ltd. dated 26 March 2010 (the "Submissions").

**1 Please inform the Subcommittee of the following:**

**(a) the number of staff involved in the sale of Lehman Brothers (LB)-related Constellation Notes (CLN Notes) who had resigned after the collapse of LB in September 2008;**

1.1 47. This represents an annualised staff attrition rate of about 20% which is in line with DBSHK's historical attrition rate.

**(b) out of the resigned staff in (a), the number of these former staff who were involved in complaint cases in relation to CLN Notes, and the number of such complaint cases; and**

1.2 40 staff members. 447 complaint cases.

**(c) out of the complaint cases in (b), the number of cases in which DBSHK was unable to contact the responsible staff members who had resigned.**

1.3 4.

**2 HKMA announced on 20 November 2009 that it took disciplinary action for the first time against a "relevant individual" in connection with a Lehman Brothers-related investment product, and imposed sanctions on Ms LEUNG Wai-yu, who was a former employee of DBSHK. Please inform the Subcommittee of the irregularities and non-compliance that had been identified in Ms LEUNG's case.**

2.1 DBSHK was not a party to the HKMA investigation in relation to Ms Leung Wai Yu. As a consequence, we assume, of statutory secrecy provisions, neither the HKMA nor Ms Leung has informed DBSHK of the "irregularities and non-compliance" identified in Ms Leung's case. DBSHK's knowledge of such "irregularities and non-compliance" is limited to the information available in the HKMA announcement of 20 November 2009.

2.2 DBSHK has compensated the 5 customers who invested in CLN Notes through Ms Leung. In each case, DBSHK offered compensation on an *ex gratia* basis and by reference to the same factors as are referred to in paragraph 12.4 below (e.g. personal circumstances (personal health, health of family, employment status, age), concentration risk).

**3 According to DBSHK, the overall revenue target each year is made up of revenue from different sources. Please provide the quarterly revenue target for the sale of investment products from 2005 to September 2008 (prior to the collapse of LB).**

3.1 In 2005, sales staff were given sales targets expressed in terms of the notional amount of the products sold. The quarterly target for a financial service manager was HK\$4.17M in notional value.

3.2 In the years 2006 – 2008, sales staff were not given revenue targets. Rather, they were given points targets where points could be earned by performing a number of tasks (for example, opening a new account, taking a new deposit, selling an investment product).

**4 Please provide a sample of the evaluation form for appraising staff performance.**

4.1 A copy of the evaluation form for the year 2006 is enclosed as item 1 of Appendix 1.

- 5 Referring to paragraph 46.1(c) of W26(C), please provide more information on HKMA's concerns about the provision of investment advice to customers by DBSHK.**
- 5.1** In the HKMA 2007A Report, the HKMA noted that DBSHK had imposed a general prohibition on its staff members forbidding them from providing investment advice. However, HKMA suggested that additional controls preventing the provision of investment advice should be established. In particular, the HKMA observed that certain staff members had provided "house views" (e.g. views based on research papers issued by DBS Vickers (Hong Kong) Limited) to customers. According to the HKMA, the way in which the "house views" were presented to customers did not include any explicit indication that the relevant staff members were providing views based on published information. The HKMA recommended that the Bank established controls to ensure that the sources of any "house views" were clearly communicated to customers by staff members.
- 5.2** In response, the Bank implemented a control as a consequence of which staff are required to quote the source of information when discussing possible investments with customers.
- 6 It is stated in a letter issued by HKMA to all the retail banks on 23 October 2008 that incentive schemes to staff should not be linked solely to sales volume. It is also noted that 20% of the remuneration of the sales staff of DBSHK is a variable pay linked to the revenues they generated. Please confirm:**
- (a) whether the 20% variable pay for sales staff is solely linked to their achievement of the revenue target, or whether other performance indicators are also taken into account; and**
- 6.1** No. The Bank also considers, amongst other matters, quality of customer service and level of compliance with internal procedures and regulations. Any significant breach of compliance requirements by staff may result in total forfeiture of variable income.
- (b) did the remuneration structure in (a) predate September 2008? Or has it been revised in response to HKMA's letter in October 2008?**
- 6.2** The remuneration structure stated in paragraph 6.1 pre-dates September 2008. In light of the information provided, you will note that the compensation structure did not need to be varied in light of the HKMA's letter; it was already compliant.
- 7 As stated in paragraph 9.6 of F(DBS)1, the Internal Audit Department noted that some customer complaints had not been reported to the Complaint Handling Officer within the stipulated timeframe. Please inform the Subcommittee of the following:**
- (a) the number of complaint cases that had not been reported within the stipulated timeframe; and**
- 7.1** 7 cases were not reported to the complaint handling officer within the required time frame (only one of these complaints related to CLN Notes).
- (b) the proportion of cases in (a) out of all complaint cases in the same audit exercise;**
- 7.2** The relevant review considered 16 complaint cases.

- 8 It is noted that the Compliance Department had identified certain documentation lapses in a sample checks on the sale of CLN Notes (paragraph 9.8 of F(DBS)1). Please explain the "documentation lapses".**
- 8.1 The Bank identified the following documentation lapses with respect to the sale of CLN Notes:**
- (i) Certain sales staff did not know whether a particular check box on the Chinese version of the GAA needed to be ticked. The particular check box was to be ticked to indicate that the client had read and understood the prospectus / offer documents in relation to a product. Due to a discrepancy in the Chinese translation of the form, certain staff formed the view that this box only needed to be ticked if the prospectus in question related to a unit trust. Consequently in 24 out of 32 sampled cases, this box had not been ticked. Nevertheless, the other boxes on the GAA forms had been appropriately ticked (e.g. those confirming that the product term sheet, terms and conditions and risk disclosure statement had been provided to and understood by the customer). This confusion was addressed by amendments made to the 2007 version of the GAA.
  - (ii) 3 GAA could not be located.
  - (iii) 6 GAA were incomplete. For example: the product risk level field had not been completed; the boxes in relation to the recommendation that the customer seek independent financial advice and in relation to tenor of the investment had not been ticked; and/or the maturity date (which needed to be handwritten on to the document) had not been properly initialled.
- 9 It is noted that 10 branches were checked and irregularities were found in 8 sampling cases in an internal audit conducted in December 2007 (paragraph 9.11 of F(DBS)1). Please advise;**
- (a) the number of staff and branches sampled in the internal audit conducted in December 2007;
- 9.1 10 staff across 10 branches (1 staff member per branch).**
- (b) the average number of staff and branches sampled in each internal audit exercise; and
- 9.2 A minimum of 5 branches would generally be selected for each internal audit exercise. On average, a sample of 1 or 2 staff members would be reviewed in each branch.**
- (c) the average number of staff and branches sampled each month in the course of an internal audit exercise.
- 9.3 On average, 22 branches are audited each year and a sample of 1 or 2 staff members are reviewed in each audited branch.**
- 10 Referring to paragraph 9.11(iv) of F(DBS)1, please inform the Subcommittee of the following:**
- (a) Whether the one instance related to the sale of LB-related CLN Notes; if yes, the details; and
- 10.1 No.**

- (b) What exactly had been said by the sales staff to the customer which was regarded as personal investment advice.
- 10.2 The sales staff made certain recommendations in relation to types of unit trust. No orders were executed as a result of the recommendation.
- 11 In respect of the various rounds of internal audit and compliance review as mentioned in paragraphs 9.6 and 9.8 - 9.11 of F(DBS)1, please provide:
- (a) a copy of the relevant reports containing the findings of the aforesaid internal audit and compliance review;
- 11.1 Relevant extracts of the reports and compliance review mentioned in paragraphs 9.6 and 9.8 - 9.11 of F(DBS)1 are enclosed as items 2 to 6 of Appendix 1.
- (b) action plans to address the issues identified in the reviews; and
- 11.2 Relevant extracts of the reports with action plans mentioned in paragraphs 9.6 and 9.8 - 9.11 of F(DBS)1 are enclosed as items 2 to 6 of Appendix 1.
- (c) document(s) on post-implementation reviews of the action plans in (b).
- 11.3 Each action item that results from an internal audit is tracked by means of a computer system and reviewed to ensure that the action item is addressed. In addition, action items are reviewed in immediately subsequent audits to ensure that they have been appropriately dealt with and completed.
- 11.4 Sales practices in respect of investment products were subject to an annual review in each of the years 2005 - 2007. Action items from prior years were expressly stated, in the relevant audit announcement memo, to form part of the audit scope in the subsequent years' audits. If, in the course of the subsequent year's audit, it is discovered that an action item has not been addressed, this discrepancy is highlighted as a "repeat issue" in the respective audit report. No repeat issues were identified in the years 2005 - 2007.
- 11.5 We enclose the relevant audit announcement memos as items 7 to 8 of Appendix 1.
- 12 It is noted that DBSHK had settled 636 customer complaints out of 2775 complaints received in respect of the sale of LB-related CLN Notes (paragraph 44.2 of W26(C)). Please advise:
- (a) the number of settled cases involving customers over 65 years of age, and as a percentage of the complaints received from customers over 65 years of age;
- 12.1 202 cases were settled which involved customers over 65 years of age. These 202 cases constitute 73 per cent. of complaints received from customers over 65 years of age. In fact, DBSHK made settlement proposals in respect of 226 cases involving customers over 65 years of age.
- (b) the reasons why the remaining complaint cases from customers over 65 years of age had not been settled;
- 12.2 DBSHK established a rigorous complaint-handling process (see paragraph 13 below) and assessed customer complaints on a case-by-case basis. In relation to the complaint cases that have not been settled, in some instances offers of settlement have been made but have been rejected. In other cases, DBSHK was of the view that the complainants had

sufficient investment experience and that their investment portfolios were sufficiently diversified.

- (c) the number of settled cases involving customers over 60 years of age, and as a percentage of the complaints received from customers over 60 years of age; and

12.3 279 cases were settled which involved customers over 60 years of age. These 279 cases constitute 54 per cent. of complaints received from customers over 60 years of age.

- (d) a breakdown and analysis of the reasons that led to the settlement of these 636 complaints.

12.4 The reasons for settling the 636 complaints (in each case, on an *ex gratia* basis) can be classified into two broad categories:

- (i) Category I: DBSHK considered that the complainant's case should be settled in light of his/her investment experience, amount of liquid assets (concentration risk), occupation, income level, literacy level and age.
- (ii) Category II: DBSHK considered that the complainant's case should be settled in light of a lapse in the proper completion of documentation and a deviation in the sales process.
- (iii) The table below sets out the percentage of settlements in the respective categories in relation to the 636 complaints:

Categories	Percentage
Category I	64%
Category II	10%
Category I & II	26%
Total	100%

13 As mentioned by Ms Linda WONG at the hearing held on 30 April 2010, DBSHK had set up a 120-person team to receive complaints in the first instance. The relevant information would be forwarded to a so-called "independent investigation team" to conduct investigation. Please advise;

- (a) the membership of the "independent investigation team" that conducted the investigation of complaint cases and the relationship, if any, of these members with DBSHK;

13.1 The table below sets out the members of the investigation team (comprising both DBSHK staff and external independent parties) that conducted the investigation with respect to the complaint cases. Please note that all members of the investigation team are independent of the business/sales units of DBSHK.

	October 2008 – mid-November 2008	From mid-November 2008
DBSHK staff	1. Vice President and Assistant Vice President from CB Control Assurance and CB Business Operation	Investigation is led by Compliance Services and Security (a team of 13 that comprises of Vice Presidents, Assistant Vice Presidents and Managers independent of the

	<ol style="list-style-type: none"><li>2. Vice President and Assistant Vice President from Internal Audit</li><li>3. Vice President and Assistant Vice President from Risk Management</li><li>4. Vice President and Assistant Vice President from Compliance</li></ol>	business/sales unit) and supported by: <ol style="list-style-type: none"><li>1. Vice President and Assistant Vice President from CB Control Assurance and CB Business Operation</li><li>2. Vice President and Assistant Vice President from Internal Audit</li><li>3. Vice President and Assistant Vice President from Risk Management</li><li>4. Vice President and Assistant Vice President from Compliance</li></ol>
External independent parties		<ol style="list-style-type: none"><li>1. Deloitte Touche Tohmatsu (average of 24 to a maximum of 38 Managers, Senior Associates and Associates for a period of 4 months)</li><li>2. 2 independent consultants (retired ICAC officers)</li></ol>

**(b) in the course of investigating into complaint cases, whether DBSHK had held meetings attended by all relevant parties, including the complainant, to review the complaints. If such multi-party reviews were not held in respect of all complaint cases, please advise on the percentage of cases for which such reviews had been held; and**

**13.2** After a complaint is received, the investor care centre of DBSHK conducts an interview with the complainant to collect information with respect to the complaint. The investigation team (as discussed in paragraph 13.1 above) would conduct interviews with the relevant staff members.

**(c) a copy of the relevant document(s) setting out DBSHK's complaint-handling procedures adopted in handling complaints on CLN Notes,**

**13.3** A copy of the complaint handling procedures with respect to CLN Notes is enclosed as item 9 of Appendix 1.