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Dated 6 October 2010

**WRITTEN RESPONSE OF
MR CHU REN-YEE, ALEXANDER, COUNTRY EXECUTIVE, HONG KONG,
THE ROYAL BANK OF SCOTLAND N.V. TO ISSUES ARISING FROM THE
SUBCOMMITTEE'S HEARING ON 21 SEPTEMBER 2010**

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

GENERAL REMARKS

I refer to the summons issued by the Subcommittee to me on 26 May 2010 under the Legislative Council (Powers and Privileges) Ordinance (Cap 382) (“**Summons**”) and to my written statement dated 17 June 2010 (“**Written Statement**”), given in response to the Summons. This statement supplements my Written Statement.

Unless otherwise defined, capitalised terms used in this submission have the meanings given to them in my Written Statement.

RESPONSE TO REQUESTS FOR ADDITIONAL INFORMATION

- As stated in paragraph 5.2 of F(RBS)6, the weighting assigned to the three sections of the Qualitative Performance Scorecard that involved a points-based assessment, i.e. “**KYC or Account Opening**”, “**Sales/Regulated Activities**” and “**Compliance/Operations/Service Standard**” varied during April 2005 to September 2008. Please advise on the weighting of the sections over the said period in tabular form as follows:

Relevant section on scorecard	Weighting for each section			
	2005 (see paragraph 1.4)	2006 (see paragraph 1.5)	2007	2008 (see paragraph 1.6)
KYC or Account Opening	<p>This criteria was assessed in 2005 under the heading “Violation of sales process”. Examples of a violation of this criteria included: incomplete account opening documents, non-compliance with risk profiling or anti-money laundering requirements and problems with order confirmations.</p> <p>This criteria was weighted equally with the other criteria.</p>	<p>The Bank introduced the Qualitative Performance Scorecard in 2006.</p> <p>This criteria was assessed in the Scorecard in 2006 under the heading “Operations” which included the account opening process.</p> <p>Staff were rated against the criteria as either “Satisfactory”, “Fair” or “Unsatisfactory”.</p> <p>This criteria was weighted equally with all other criteria.</p>	Same as 2006.	As for 2007, the Qualitative Performance Scorecard was revised to provide for an incentive discount of up to 20% if a staff member needed improvement in respect of any one of the headings set out in the Scorecard.
Sales/Regulated Activities	This criteria was assessed in 2005 under the heading	This criteria was assessed in the Scorecard in 2006	Same as 2006.	As above.

Relevant section on scorecard	Weighting for each section			
	2005 (see paragraph 1.4)	2006 (see paragraph 1.5)	2007	2008 (see paragraph 1.6)
	<p>“Violation of sales discipline”. Examples of a violation of this criteria included: sales figure manipulation and unauthorised account transactions.</p> <p>This criteria was weighted equally with all the other criteria.</p>	<p>under the heading “Compliance” (which included compliance with the Code of Conduct and other regulatory requirements).</p> <p>Staff were rated as above. This criteria was weighted equally with all other criteria.</p>		
Compliance/ Operations/ Service Standard	<p>This criteria was assessed in 2005 under the heading “Customer complaints”.</p> <p>Again, this criteria was weighted equally with all other criteria.</p>	<p>This criteria was assessed in the scorecard in 2006 under the heading “Service Quality” (which included complaints and product knowledge) and “Sales Discipline”.</p> <p>Staff were rated as above. This criteria was rated equally with all other criteria.</p> <p>An incentive discount of between 30 to 100% was introduced, depending on the severity of the failure to comply.</p>	Same as 2006.	<p>As above.</p> <p>An incentive discount of up to 100% would apply to any staff member who was rated as “overall unsatisfactory”.</p>

1.1 One of the Bank’s core values is that its members of staff maintain a high level of compliance and operational standards. The staff incentive scheme during the Relevant Period assessed whether staff met that core value. The means by which staff were assessed evolved throughout the Relevant Period. The Qualitative Performance Scorecard was developed during the Relevant Period

in response to changes to the Bank's policies and guidelines. The result of the developments during the Relevant Period was the sample score card attached as Item 1 to F(RBS)6.

- 1.2 The table above tracks how the elements of staff performance evolved during the Relevant Period.
- 1.3 At all times, the Bank's management supervised the assessment of staff performance. The Qualitative Performance Scorecard was used as an important guide to that assessment. The Bank's management retained discretion as to the consequences of each assessment of a staff member's performance.
- 1.4 In 2005, a high level filter for meeting operations and compliance standards was introduced to ensure sales integrity and full compliance of operation guidelines by staff members. The Bank's management applied an equal weighting to each of the criteria listed in the table.
- 1.5 The emphasis in 2006 was to maintain excellent sales discipline and compliance standards. Failing to comply with sales discipline or compliance standards resulted in an incentive discount of between 30 to 100% depending on the severity of the failure to comply. Disciplinary action and/or re-training may also have applied.
- 1.6 In 2008, an incentive discount of up to 100% would apply to any staff member who was rated as 'overall unsatisfactory'. The discount rate depended on the nature and level of responsibility.
- 2 **It is stated in paragraph 5.2 of W37(C) that the Lehman Brothers (LB)-related structured financial products accounted for only 4.82% of the nominal value of all structured products distributed by ABN/RBS between 2005 and 2008. Please advise on the amount of LB-related structured products sold by ABN/RBS during the said period, in terms of the percentage of the nominal value of all structured products distributed by the bank, to illustrate how the concentration risk in relation to LB as issuer had nearly reached 15% by May 2008 leading to the decision of the bank to stop selling LB-related products.**
 - 2.1 The following table shows the nominal value of Lehman Products distributed by the Bank, the nominal value of all structured products distributed by the Bank and Lehman Products distributed in terms of percentage of all structured products distributed for each year between 2005 and 2008.

Year	Total nominal value of Lehman Products distributed	Nominal value of all structured products distributed	Percentage
2005	HKD11,759,229	HKD2,720,315,000	0.432%
2006	HKD23,696,451	HKD6,681,664,000	0.354%
2007	HKD969,491,205	HKD15,151,481,000	6.400%
2008	HKD336,470,778	HKD3,884,233,000	8.662%

- 2.2 The aggregate amount of LB-related structured products sold by the Bank during the Relevant Period was HKD1,371,417,660, and the aggregate nominal value of all structured products distributed by the Bank was HKD28,437,693,000. LB-related structured products sold by the Bank was therefore 4.82% of all structured products distributed by the Bank.
- 2.3 The concentration limit was introduced to minimise concentration risk by ensuring that the exposure to any individual issuer with a credit rating of between A- to A+ (S&P) did not exceed 15% (with +/- 5% buffer) of the total assets under management ("AUM").
- 2.4 The sales of the Lehman Products represented only 4.82% of the total sales of structured products by the Bank during the four years which comprised the Relevant Period. The concentration level for each issuer was calculated as a percentage of the total AUM of all the issuers as at a certain date or for a certain period. The Bank's concentration limit in respect of Lehman Brothers was triggered following an increase in sales of various series of LB-related non-Minibonds financial products in late 2007 and in early 2008.
- 3 As stated in paragraph 51.1 of W37(C), the Relationship Managers (RMs) of ABN/RBS who distributed LB-related structured financial products were licensed for Type 1 regulated activities. RMs were not permitted to provide investment advisory services, except on incidental basis as permitted under the terms of their licence. Please give some examples of such advice given on incidental basis.**
- 3.1 An individual with Type 1 licence may carry out other regulated activities, such as advising on securities, if that activity is wholly incidental to the individual carrying on of that regulated activity. As stated under Part 2, Schedule 5 of the Securities and Futures Ordinance (Cap 571), advising on securities does not include "a person who is licensed for Type 1 regulated activity who gives such advice or issues such analyses or reports wholly incidental to the carrying on of that regulated activity".

- 3.2 An example is given in the Securities and Futures Commission's ("SFC") FAQs dated 22 June 2009 on 'Incidental Exemption', which states that where an account executive of a broking firm with Type 1 licence gives investment advice while taking orders from a client, neither the broking firm nor the account executive need apply to be licensed for Type 4 regulated activity as the giving of investment advice is incidental to the carrying on of the brokerage services. To the extent that the giving of investment advice is subordinate or ancillary to the carrying on of the brokerage services, there is no need for the firm to apply to be licensed for Type 4 regulated activity.
- 3.3 The SFC has previously issued other FAQs in which the SFC gave the following examples:
- 3.3.1 a stockbroker, who is licensed for Type 1 regulated activity may carry out Type 4, Type 6 and Type 9 regulated activities, if those latter activities are wholly incidental to the individual's dealing activities as a stockbroker; and
- 3.3.2 a Type 4 licence will not be required if a firm is licensed for Type 1 regulated activity and the advisory activities are wholly incidental to the firm's dealing activities.
- 3.4 According to SFC FAQs dated 22 June 2009, in general, the SFC would take into account some or all of the following factors in considering whether or not advice was given on incidental basis:
- 3.4.1 whether the giving of advice to the customer is subordinate to the carrying out of Type 1 regulated activity by the licensed corporation or the RM;
- 3.4.2 whether a discrete fee would be charged for the advice; and
- 3.4.3 whether the giving of advice constitutes a major part of the licensed corporation's business.
- 3.5 In light of the factors to be considered, an RM who gives advice without charging for that advice, and gives it in subordination to the carrying out of Type 1 regulated activity should be permitted to give such advice.