



HONG KONG MONETARY AUTHORITY
香港金融管理局

Joseph C. K. Yam GBS, JP
Chief Executive

任志剛 GBS, JP
總裁

Our Ref: G14/64C

Your Ref: CB1/HS/1/08

15 June 2009

Miss Polly YEUNG
Clerk to Subcommittee to Study Issues Arising from
Lehman Brothers-related Minibonds and Structured Financial Products
Legislative Council Building
8 Jackson Road
Central
Hong Kong

Dear Miss YEUNG,

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

I refer to your letter dated 10 June 2009 requesting responses to questions regarding targets for handling Lehman Brothers-related complaints. Our responses are set out below.

General Remarks

The enforcement process for Lehman Brothers-related complaints against banks undertaking securities-related business, known as Registered Institutions (RIs), or their staff is shown schematically at Annex 1. The objective of the process is to deal with complaints as quickly as possible, consistent with the need to observe due process. It should be emphasised that the process may lead to disciplinary action in cases where evidence of wrongdoing by RIs or their staff is discovered and that this may have serious consequences for the institutions or staff involved. It is therefore essential that investigations are carried out thoroughly and objectively to ensure fairness both to complainants and those complained against. In particular, it is necessary to gather all relevant information and allow those complained against to respond to allegations against them. This process involves the collection of documentary evidence and extensive interviews with complainants and staff of RIs.

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On 11 June 2009 the HKMA had received 21,226 complaints regarding Lehman-related investment products sold through RIs. The progress on dealing with these complaints is summarised in Annex 2.

To speed up the processing of complaints, the HKMA agreed with the Securities and Futures Commission (SFC) shortly after the failure of Lehman Brothers in September 2008 that the HKMA would assist the SFC in its investigation into the RIs concerned by undertaking expedited preliminary assessments and preliminary investigations of complaints to identify cases where there was prima facie evidence to support a referral to the SFC for consideration of whether there has been a failure at the RI level. More than 20,000 such preliminary assessments have been carried out and, up to 12 June 2009, 482 cases have been referred to the SFC.

It is important to note that the HKMA's enforcement process is intended to impose appropriate sanctions on relevant individuals or executive officers of RIs if misconduct is found. The HKMA does not have the power to order payment of compensation. Although the finding of the HKMA may be of evidential value to complainants who wish to make a claim against the RIs concerned, the most efficient process through which complainants may seek redress is by voluntary settlement with the RIs concerned. Up to 10 June 5,416 cases had been settled by RIs following their own investigations in response to complaints they had received from customers. We understand that a further 1,657 cases are likely to be settled shortly. The HKMA encourages RIs to reach such voluntary settlements wherever possible. However, the fact that a settlement has been reached will not in itself affect the HKMA's investigation into the case or any disciplinary action that may result.

The SFC's current top-down investigations on RIs with the assistance of cases referred by the HKMA may or may not result in some form of settlement involving compensation to investors. We understand that these investigations are underway. The HKMA will continue to co-operate fully with the SFC.

Responses to Specific Questions

Our responses to the specific questions under paragraph 2 of your letter are:

- (a) The target of concluding the HKMA's enforcement work on 70% of the complaints by the end of March 2010 is based on the need to complete the task as quickly as possible consistent with the need to ensure due process; the time required to gather and review all relevant information and to allow RIs to

respond; the practicalities involved in recruiting and training personnel; and the need to ensure value for money. Based on experience with handling the complaints so far it is assumed that each complaint will require on average 11 man-days including information gathering, interviews with relevant parties, analysing evidence and preparation of reports. It must be emphasised that these are average figures: the actual time required may vary considerably depending on the complexity of individual cases. Taking these factors into account, we believe the target to be realistic, although we will, of course, make every effort to complete the task earlier if possible.

On 11 June 2009 the HKMA has deployed 243 personnel, including permanent staff, specially employed contract and support staff, and secondees from audit firms, to handle the Lehman-related complaints. We have experienced some difficulty in recruiting personnel with the skills required for this work despite advertising several times since December 2008. Nevertheless, to achieve the target of concluding the HKMA's investigatory enforcement work on 70% of the complaints by the end of March 2010, we are increasing the resources devoted to this task over the summer to over 300 permanent HKMA, contract and support staff, supplemented as necessary by additional secondees from audit firms. The operating costs of the project up to the end of March 2010 are estimated at \$190 million, about 81% of which is personnel costs.

- (b) The resources required to handle all of the complaints received by the end of 2009 are difficult to estimate accurately: in particular it must be recognised that there are likely to be some especially complex cases that will be impossible to complete within the next half year. Based on the assumptions in (a) about the time required for each case, we estimate that a total of 1,274 personnel would be needed to handle all complaints by the end of 2009. Because of the difficulty of recruiting personnel in such large numbers for such short periods, it is likely that a higher proportion would have to be seconded from audit firms, although there is no guarantee they would be available in sufficient numbers. Such secondees are likely to cost substantially more than directly employed staff. Given this uncertainty over the source of personnel, we estimate the operating costs of completing our enforcement work by the end of 2009 at between \$708 million and \$894 million, including premises and other costs.
- (c) The main difficulties with a target to conclude the HKMA's investigatory enforcement work on all the Lehman-related cases by the end of 2009 relate to personnel. The skills required for this work include a familiarity with structured investment products and the process by which such products

are distributed through RIs, familiarity with the regulatory requirements and, ideally, investigative experience. The pool of people with such skills is not large and is also in demand from banks and other financial institutions. In most cases, we have not been able to recruit personnel with all the necessary skills but have recruited candidates who meet some of the requirements and have then arranged on-the-job training, requiring an average of two months for personnel to become fully productive. Even if the 1,274 personnel needed to complete all cases by the end of 2009 could be found, this period of training would still be required. The lead-time for recruitment and training would effectively increase because of the larger numbers, but the productive time of those personnel would be reduced. There is also some turnover of recruited personnel as they find other jobs.

There would also be difficulties in identifying and preparing sufficient office space and in leasing space for the short time required and the shorter leases would probably increase rental costs.

Adopting an unrealistic deadline for completion of our enforcement work, particularly in the face of such practical difficulties, would risk compromising the due process required and increasing the possibility of successful legal challenges to the authorities' disciplinary findings. This would not be in the public interest. In view of these factors, we do not believe that it would be prudent or realistic to adopt a target of completing the cases by the end of 2009.

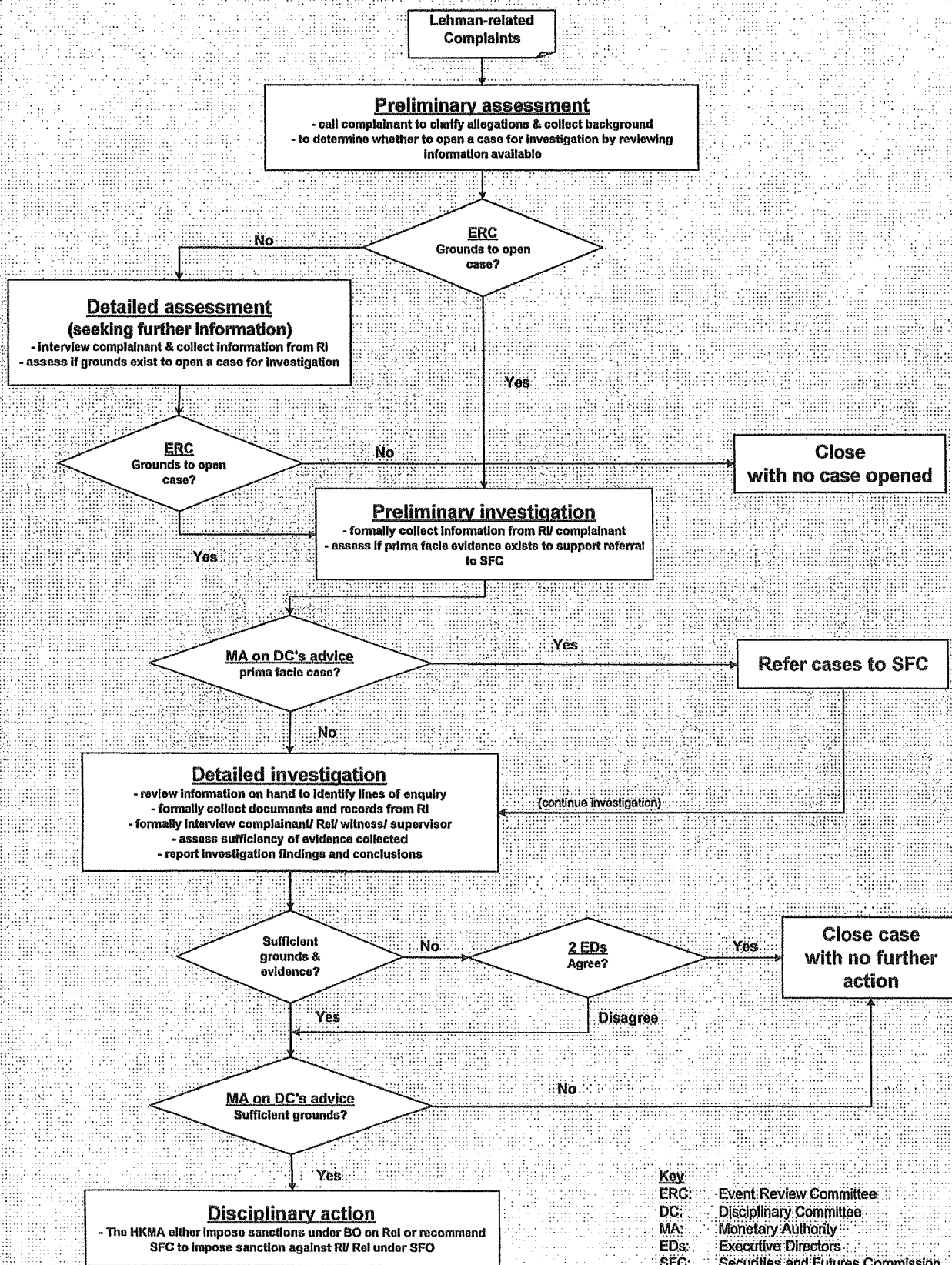
Yours sincerely,

A handwritten signature in black ink, consisting of a large, sweeping initial letter followed by a series of horizontal and vertical strokes.

p.p. Monetary Authority

Encls.

Enforcement Process for Lehman-related Complaints



- Key**
- ERC: Event Review Committee
 - DC: Disciplinary Committee
 - MA: Monetary Authority
 - EDs: Executive Directors
 - SFC: Securities and Futures Commission
 - BO: Banking Ordinance
 - SFO: Securities and Futures Ordinance
 - Rel: Relevant Individual
 - RI: Registered Institution

Complaints statistics concerning Lehman-related investment products (Up to 11 Jun 2009)

	No. of complaints received	Stage 1 & 2 Registration and establishment of allegations completed ¹	Stage 3 Preliminary assessment completed ²	Stage 4 Actions following preliminary assessment						Stage 5 Actions following detailed investigation		
				Insufficient prima facie evidence	Seeking further information ³	Preliminary investigation in progress ⁴	Preliminary investigation completed	Detailed investigation in progress ⁶	Cases with no further action ⁷	Cases under disciplinary consideration	Disciplinary action taken	
												Of which referred to SFC ⁵
Products arranged / issued by Lehman Brothers		16,833	16,759	727	10,541	1,528	3,963	458	3,360	182	421	
- Minibonds		14,113	14,046	591	8,909	1,440	3,106	367	2,940	147	19	
- Others		2,720	2,713	136	1,632	88	857	91	420	35	402	
Products referenced to Lehman Brothers		4,082	4,067	216	2,660	195	996	24	934	51	11	
Product type to be confirmed		195	193	36	157	-	-	-	-	-	-	
Total:	21,226	21,110	21,019	979	13,358	1,723	4,959	482	4,294	233	432	
			(a)=	(b)	(c)	(d)	(e)=	(f)	(g)	(h)	(i)	
			(b)+(c)+(d)+(e)				(f)+(g)+(h)+(i)					

(For details on the various stages under the enforcement process, please refer to the flowchart at http://www.info.gov.hk/hkma/eng/new/lehman/enforcement_process.pdf)

Note

- ¹ The Hong Kong Monetary Authority (HKMA) formally registers each complaint and writes to each complainant to confirm receipt of his/her complaint, assigns a complaint number to facilitate subsequent communication and makes follow-up contact with each complainant (mainly by phone) to obtain or clarify details of allegations.
- ² The HKMA reviews and decides for each case (a) whether there is a lack of prima facie evidence for investigation, (b) whether further information should be sought or (c) whether there is prima facie evidence to open a case for investigation.
- ³ These are cases where additional information is being obtained from the complainant and the registered institution to facilitate the HKMA's consideration of whether to open a case for investigation. There are 3,571 cases in which it has, so far, proved impossible to obtain one or more types of necessary information from the complainants.
- ⁴ These are cases considered to have sufficient grounds for opening cases for investigation. The relevant registered institution will be required to provide, where necessary, additional information to facilitate investigation.
- ⁵ These are cases where the HKMA has decided, after a preliminary investigation, that there is prima facie evidence to support a referral to the Securities and Futures Commission for consideration of whether there has been a failure at the bank level. The HKMA will continue its investigation into these cases to establish if there has been a failure by the relevant individuals concerned.
- ⁶ These are cases which have gone through preliminary investigation but further information from the complainant and the registered institution is considered necessary to enable the HKMA to take the matter further.
- ⁷ These are closed cases where the HKMA's investigation has not found sufficient evidence or grounds to proceed with the relevant individuals concerned. However, investigations at the bank level, if any, will continue. These also include cases where investigations are unable to proceed further because the complainants have declined to provide further information to the HKMA. Investigation into these cases may be re-opened if more information is received.