

Responses to items 3, 4(c) and 4(d)**Follow-up Issues Arising from the Hearing on 5 June 2009**

3. *The relevant written records (including emails, memos and other internal correspondence) of the Monetary Authority's instructions, if any, received by DCE/HKMA since August 2008 on matters relating to the regulation of RIs' sale of derivatives (including structured financial products) to investors.*
- 3.1 The Monetary Authority (MA) has very frequent communications with me through regular meetings and other internal discussions on matters that are related to the areas under my responsibilities, including day-to-day regulation and enforcement of regulated activities conducted by registered institutions (RIs). Face-to-face discussion is our usual means of communication which enables direct and efficient exchange of information and views. For instance, the MA chairs a daily morning meeting which is attended by senior management staff of the Hong Kong Monetary Authority (HKMA). Matters in relation to regulation of regulated activities conducted by RIs and the handling of related complaints have been one of the items for discussion at such meetings. In addition, I make oral reports to the MA on key issues from time to time. The MA's instructions to me are normally given orally during these meetings and internal discussions and there are normally no written records on such discussions and instructions.
- 3.2 According to my recollection, the major instructions that I have received from the MA since August 2008 on matters relating to the regulation of RIs' sale of derivatives (including structured financial products) mainly cover the areas set out below.
- 3.3 Before the collapse of Lehman Brothers (LB), the MA had expressed concerns about the complaints involving possible mis-selling of stock accumulators by a number of RIs. He had orally instructed me on various occasions to ensure that we should handle the complaint cases as quickly as possible, and that the HKMA

should co-operate with and provide the necessary assistance to the Securities and Futures Commission (SFC) in the latter's review of the definition of "professional investor".

3.4 Since the collapse of LB, the MA's instructions to me on matters relating to the regulation of RIs' sale of derivatives are summarised below:

(a) In respect of the handling of LB-related complaints, the MA has instructed me to ensure that sufficient resources should be deployed to handle the complaint cases as quickly as possible while ensuring that the process is fair and equitable. I have also received the MA's oral instructions on full co-operation with the SFC to facilitate the SFC's "top-down" investigatory approach. The MA has so far given written instructions for referring 482 LB-related cases to the SFC to facilitate its "top-down" investigation following the recommendations of the internal Disciplinary Committee chaired by me. Section 120 of the Banking Ordinance (Cap. 155) (BO) imposes restrictions on my ability to disclose information on individual cases or on the relevant staff and customers involved as such information was obtained in the course of the exercise of the MA's functions under the BO. I am not therefore in a position to disclose information or provide any document pertaining to these referrals to the Subcommittee.

(b) To provide an additional channel to help investors and RIs to reach settlement agreement, the MA, my colleagues and I had numerous discussions on the proposal of setting up an arbitration and mediation mechanism after the collapse of LB. Following some research and consultation work performed by my colleagues, the MA had instructed me and my colleagues to work with the Hong Kong International Arbitration Centre to implement the LB-related Products Dispute Mediation and Arbitration Scheme to provide assistance to the affected investors.

- (c) Separately, the MA had also instructed me to provide full support to the Hong Kong Special Administrative Region (HKSAR) Government's buy-back proposal on Minibonds, including participating in the meetings with the relevant RIs and providing inputs to the HKSAR Government.
- (d) As requested by the Financial Secretary (FS), the MA organised a review of the distribution of structured products by RIs in Hong Kong and produced a review report to the FS. In this connection, the "Report of the Hong Kong Monetary Authority on Issues Concerning the Distribution of Structured Products Connected to Lehman Group Companies" ("the HKMA's Review Report") was submitted to the FS on 31 December 2008. Following the issuance of the HKMA's Review Report, the MA instructed me orally that the recommendations of the HKMA's Review Report, to the extent possible, should be implemented as soon as practicable, particularly the 9 recommendations indicated in the circulars¹ issued by the HKMA on 9 January 2009 and 25 March 2009 (Annexes 21 and 25 to W6(C)), which did not require any amendments to related legislations.
- (e) The MA had also instructed me to monitor closely the development of other credit-linked investment products and take actions to ensure that information relating to the products released by the issuers was disseminated to investors by the distributing banks in a timely manner.

¹ See Annexes 1 and 2 in circulars on 'Report of the HKMA on Issues Concerning the Distribution of Structured Products Connected to Lehman Group Companies' and 'Implementation of recommendations in the HKMA's Report on Issues Concerning the Distribution of Structured Products Connected to Lehman Brothers ("the HKMA's Report")' M16

4. *Please provide, where applicable:*

- (c) the practices adopted by RIs in providing commission/incentives to their staff involved in the sale of LB-related structured financial products;*
- (d) the rate(s) of commission or monetary reward offered by RIs to their staff for the sale of each series of LB-related structured financial products.*

Items (c) and (d)

4.1 According to the HKMA's records, among the 19 RIs² which sold LB-related Minibonds and structured financial products and were the subject of customer complaints since the collapse of LB, none of them had specific sales targets and associated incentive scheme for products issued by specific issuers (such as LB-related structured financial products). In general, the incentive scheme was based on the total sales of investment products (including both LB-related and non-LB related investment products) and/or other financial products (e.g. deposits and loans products) offered by the RIs. The common practices adopted by the RIs are set out below:

- In most of the RIs concerned, the sales target and the associated incentive scheme were based on the total sales of a wide range of product categories, including investment products, insurance products, deposits and loan products. The incentive payment was linked with the aggregate sales amount/commission revenue generated from the sale of various categories of products or the aggregate "points"³ earned by the sales staff for the sale of various categories of products. In general, the "points" earned by staff in the sale of structured products are in line with those earned in selling

² According to the list of RIs in the "Table Showing Information Required In Respect of Outstanding Lehman Brothers-related Products (Up to 8 December 2008)" (SC Ref. No. M1(C)).

³ The sales amount or commission revenue generated from sales in each product category was converted into "points" based on a conversion formula for each product category.

other investment products such as unit trusts and mutual funds.

- A few RIs had individual sales targets and associated incentive schemes for each category of products (such as insurance products, investment products, credits cards, deposits and loans, etc. instead of a specific product such as the minibonds) and the sales staff were entitled to an incentive payment upon meeting the sales targets.
- In certain RIs, no incentive scheme was made available to their sales staff.

4.2 Non-compliance issues committed by the sales staff were also taken into account by all the RIs concerned for considering the eligibility of (and/or actual amount granted to) the sales staff for receiving incentive or bonus payment.

4.3 As the incentive was calculated based on the total sales over a wide range of products or individual categories of products (instead of a specific product or issuer-specific products), no specific rates of commission or monetary reward were set for the sale of individual LB-related structured financial products.