

**Responses to Range of Issues Raised by the Subcommittee for the Hearing  
on 10 November 2009**

*Exercise of powers by Monetary Authority (MA) under section 55 of the Banking Ordinance (Cap.155) (BO) and section 180 of the Securities and Futures Ordinance (Cap. 571) (SFO) in regulating the regulated activities of Registered Institutions (RIs)*

1. *According to section 2.2.4 of the module titled "Supervision of Regulated Activities of SFC-Registered Authorized Institutions" of the Supervisory Policy Manual published by the Hong Kong Monetary Authority (HKMA) (SC Ref. No. SC(1)-M1), the general power to conduct examination of AIs comes from section 55 of BO, but MA also has a specific power under section 180 of SFO in respect of the inspection of RIs, their associated entities and related corporations. Please advise on the following:*

- (a) Since the commencement and implementation of the Banking (Amendment) Ordinance 2002 and SFO in April 2003, what are the circumstances under which HKMA have invoked/will invoke section 180 of SFO in regulating the regulated activities of RIs, particularly in conducting examination/inspections on them?*
- (b) The criteria and guidelines, if any, adopted by HKMA in deciding whether section 55 of BO, or section 180 of SFO, should be relied upon in regulating the regulated activities of RIs; and*
- (c) The arrangements in place, if any, to safeguard against arbitrariness and to ensure that the appropriate statutory provisions (i.e. section 55 of BO or section 180 of SFO) are invoked in connection with HKMA's supervision of RIs.*

## Items (a) & (b)

- 1.1 Section 180 of the Securities Futures Ordinance (SFO) may be used by an authorized person for the purpose of ascertaining whether an intermediary (including a registered institution (RI) which is an authorized institution (AI) registered under section 119 of the SFO) or an associated entity of an intermediary is complying or has complied with, or is likely to be able to comply with, the requirement specified in section 180(2) of the SFO, including to ascertain whether the RI is in compliance with any of the terms and conditions of its registration under the SFO. Section 180 allows the Monetary Authority (MA) as a relevant authority to authorize a person as an authorized person to, among other things, enter the premises of a RI, to inspect, make copies or otherwise record details of any record or document relating to the business or any transaction or activity which was undertaken in the course of, or which may affect, the business conducted by the RI or its associated entity or to make inquiries of them.
  
- 1.2 Section 7(2)(g) of the Banking Ordinance (BO) provides that the MA shall take all reasonable steps to ensure that any banking business, any business of taking deposits, or any other business, carried on by an AI is carried on with integrity, prudence and the appropriate degree of professional competence and in a manner which is not detrimental, or likely to be detrimental, to the interests of depositors or potential depositors. "Any other business" of an AI as referred to in section 7(2)(g) of the BO includes its securities business. Therefore, the MA has been using primarily section 55 of the BO for all on-site examinations of AIs' business, including their banking business, securities business and insurance business. Section 55, among other things, gives the MA the necessary powers to examine the books, accounts and transactions of any AI at any time with or without prior notice.

1.3 An on-site examination of a RI, including an examination of its securities business, always has a wider scope than just dealing with compliance with the requirements set out in section 180(2) of the SFO as it is also necessary to examine the impact of a RI's securities business on the institution as a whole. In addition, RIs generally engage in selling of SFO-regulated investment products as well as other investment products that fall outside the ambit of the SFO such as foreign currency-linked deposits and interest rate-linked deposits. Use of section 180 of the SFO alone can only cover SFO-regulated activities and does not provide sufficient power to allow the MA to achieve all of its supervisory objectives. Therefore, section 55 of the BO has always been used by the MA in conducting all on-site examinations (including thematic examinations) of RIs as the section is broad enough to allow the MA to obtain all required information, including information relating to the regulated activities of RIs.

Item (c)

1.4 As mentioned above, the MA has been using primarily section 55 of the BO for all on-site examinations of the businesses of AIs (including RIs), including their banking business, securities business and insurance business, because of the reasons mentioned in the response to items (a) and (b) above. However, if the scope of an examination might cover any associated entity of a RI, section 180 of the SFO would also be used together with section 55 of the BO as the latter section does not cover such an entity. There is no question of arbitrariness and this is wholly consistent with section 39(1) of the Interpretation and General Clauses Ordinance which provides that where any Ordinance confers any power or imposes any duty, then the power may be exercised and the duty shall be performed from time to time as occasion requires.

2. *In respect of the following thematic examinations listed in Table 1 of MA's "Response to item (e) (Follow-up issues arising from the hearing on 14 April 2009)" (SC Ref. No. SC(1)-M20), i.e.*

- *Retail Wealth Management Business (3 rounds);*
- *Investment Advisory Activities;*
- *Investment Advisory and Dealing Activities in Credit-linked Investment Products; and*
- *Compliance Function in relation to Regulated Activities under the SFO.*

(a) *Please advise whether section 180 of SFO has been relied upon in conducting any of the examinations or any part of such examinations; and*

(b) *When conducting examinations/inspections on banks, is MA required, or is it a practice of HKMA, to inform the subject institution that the examination is carried out pursuant to section 55 of BO or section 180 of SFO?*

Items (a) & (b)

2.1 For the reasons given above in response to Question 1, section 55 of the BO has been used for conducting all on-site examinations of AIs, including all thematic examinations of the securities business of RIs. Section 180 of the SFO was also used for all the thematic examinations mentioned in this Question except in the Retail Wealth Management Business (3 rounds) thematic examinations. This is because the scope of the Retail Wealth Management Business (3 rounds) thematic examinations only focused on the selling practices of the retail wealth management products of the RIs examined but not the activities of any of

their associated entities and therefore the power under section 55 of BO was already wide enough to cover the above Retail Wealth Management Business examinations.

- 2.2 When conducting on-site examinations or inspections on AIs (including RIs), it is a general practice of the MA to inform the subject institution in writing of the section(s) of the related ordinance(s) used to conduct the examination or inspection.

*Summaries of findings of thematic examinations conducted by MA in respect of the RIs set out in MA's "Response to item (e) (Follow-up issues arising from the hearing on 14 April 2009)" formally produced to the Subcommittee on 15 May 2009 (SC Ref. No. SC(1)-M20 and its Annexes 1(A), 1(B), 1(C), 1(D), 1(F) and 1(H) only)*

*Annex 1(A): Summary of Findings of the Thematic Examinations on Retail Wealth Management Conducted in April to November 2005*

3. Paragraph 7 of the summary states, "In respect of 6 of the RIs examined, the teams identified individual cases through the sampling review where the customer's risk profile could be updated on a more timely basis or omissions of certain information were found in some of the sampled customer profiles." Please advise:
- (a) the extent of the two problems identified, i.e. number of individual cases identified against the number of samples examined; and
  - (b) the types of information omitted in sampled customer profiles.

Item (a)

3.1 The respective numbers of individual cases identified for the two issues are provided below.

|    | <b>Issue</b>  | <b>Number of individual cases identified</b>   |
|----|---|--|
| 1. | Customer's risk profile not updated on a timely basis | A total of 10 individual cases were found in 3 RIs.<br><br>(In 9 out of the 10 cases, the client risk profile documents had been updated in writing on a timely basis, but there were delays in updating the related records in the computer systems.) |
| 2. | Omission of certain information in customer profiles  | A total of 10 individual cases were found in 4 RIs.<br><br>(In 4 of the 10 cases, the customer refused to provide information for risk profiling.)   |

3.2 With respect to the number of samples examined, as the working papers of the examinations which contain the details of the relevant examination

work and findings are no longer available or maintained by the Hong Kong Monetary Authority (HKMA), the HKMA is unable to provide the information requested. As a general practice for Tier-2 and thematic examinations on the regulated activities of RIs, the average sample size selected for review during an examination is around 50 cases. The examination team may also exercise discretion and its professional judgment to take into account relevant factors in the sample selection process to increase the sample size (for example, up to around 200 to 300 cases in certain previous examinations) if the team considers it necessary.

Item (b)

3.3 Types of information omitted in the sampled customer profiles varied from case to case. Overall speaking, the types of information omitted included investment experience and investment horizon.

4. *Paragraph 9 of the summary states, “On risk disclosure, the teams examined the precautionary measures adopted by RIs in handling the transactions with vulnerable customers and transactions involving a risk mismatch. The teams noted a number of RIs performed additional suitability assessment on such cases and would request additional risk acknowledgment from customers to confirm their understanding of the risks involved. .... Through the sampling review, the teams also identified possible areas of improvement for individual RIs, for example, in one RI, the team found that there were cases where the necessary risk acknowledgement from the customer was not obtained.” Please advise:*

- (a) the number of RIs which performed additional suitability assessment;*
- (b) the possible areas of improvement for RI other than the example quoted; and*
- (c) the number of cases found in relation to the RI who failed to obtain from the customer the necessary risk acknowledgement and the number of samples examined in respect of the RI concerned.*

Item (a)

4.1 According to the records of the HKMA, the examination teams noted 9 RIs (out of the 13 RIs examined in this round of thematic examinations) which performed additional suitability assessment in handling transactions with vulnerable customers and/or transactions involving a risk mismatch.

Item (b)

4.2 The major improvement recommended for RIs other than the example quoted included additional safeguards for transactions involving vulnerable customers and/or risk mismatch (e.g. inviting vulnerable



customers to be accompanied by their family members, relatives or close friends in the selling process).

Item (c)

- 4.3 According to the records of the HKMA, there were 3 cases found in relation to the RI who failed to obtain from the customer the necessary risk acknowledgement.
- 4.4 Regarding the number of samples examined, as the working papers of the examination which contain the details of the relevant examination work and findings are no longer available or maintained by the HKMA, the HKMA is unable to provide the information requested. As a general practice for Tier-2 and thematic examinations on the regulated activities of RIs, the average sample size selected for review during an examination is around 50 cases. The examination team may also exercise discretion and its professional judgment to take into account relevant factors in the sample selection process to increase the sample size (for example, up to around 200 to 300 cases in certain previous examinations) if the team considers it necessary.

5. *Please provide the recommendations given to RIs concerned in this round of thematic examinations and provide a summary of the review findings on the implementation of recommended measures.*

5.1 The following is a summary of the recommendations given to the RIs concerned:

Customer suitability management

5.2 On customer profiling, the recommendations given to the relevant RIs included timely update of customer's risk profile, and enhancements to risk profiling system by adopting objective pre-determined benchmark.

5.3 On risk disclosure, the recommendations given to the relevant RIs included enhanced controls over documentation for the selling process and additional safeguards for transactions involving vulnerable customers and/or risk mismatch.

5.4 On management oversight of the suitability assessment, the recommendations given to the relevant RIs included enhanced regular compliance reviews of the securities business and the need to enhance their Management Information System.

Know-your-customer Documentation

5.5 On anti-money laundering controls, the recommendations given to the relevant RIs included enhanced controls procedures for tracking and following up of outstanding account opening documents from customers,

and maintenance of proper audit trail for independent review of account opening documents.

### Complaint Handling Procedures

- 5.6 On complaint handling procedures, the MA recommended that the relevant RIs should ensure compliance with the time limit of sending written acknowledgement and responses to the complainants according to the regulatory and internal requirements.
- 5.7 As set out in paragraph 14 of the Annex 1(A) to the MA's response dated 13 May 2009 to item (e) of the Subcommittee's information requests regarding follow-up to the hearing on 14 April 2009 (SC Ref. No. M20), once the planned actions of the RI examined were agreed with the HKMA, the relevant case officers monitored the implementation of the recommended measures. In addition, the HKMA reviewed in its next round of examination to ensure that appropriate follow-up actions had been effectively taken by the RIs concerned to implement the improvements required. The HKMA's review findings on the implementation of recommended measures for this round of thematic examinations revealed that all of the recommended measures had been implemented by the institutions concerned.

**Annex 1(B): Summary of Findings of the Thematic Examinations on Retail Wealth Management Conducted in March to September 2006**

6. Please give each of the number of RIs which is generalized as “several RIs”, “some RIs”, “many of the RIs” in paragraphs 5, 6, 7 and 8 of the summary.

6.1 In respect of the 22 RIs examined in this round of thematic examinations, the respective numbers of RIs referred to in the relevant paragraphs are indicated in the table below.

| Paragraph | Number of RIs referred to  |
|-----------|--|
| 5         | <ul style="list-style-type: none"> <li>The examination, however, identified some room for improvement in the case of <u>several RIs (7 RIs)</u>, including ambiguous wordings used in some questions of their customer profiling questionnaires, unclear or lack of formal policy for mapping the risk tolerance level to the product risk rating, and the need to ensure more frequent updating of customer risk profiles.</li> </ul> |
| 6         | <ul style="list-style-type: none"> <li>Recommendations were made to <u>several RIs (8 RIs)</u> to extend the precautionary measures to cover illiterate or visually impaired customers and to strengthen such measures for risk mismatch transactions.</li> </ul>  |
| 7         | <ul style="list-style-type: none"> <li>Good practice was observed where <u>some RIs (6 RIs)</u> engaged an independent party to regularly review their risk profiling and suitability assessment tools (i.e. the profiling questionnaire and product mapping framework).</li> </ul>  |

| Paragraph | Number of RIs referred to  |
|-----------|--|
| 8         | <ul style="list-style-type: none"><li data-bbox="486 230 1332 443">• <u>Many of the RIs (9 RIs)</u> established internal management reports to assist the management in reviewing transactions involving vulnerable customers and risk mismatch.</li></ul> |

7. *Paragraph 9 of the summary states, “Room for improvement was observed in a number of cases concerning the documentation of this process or in relation to the due diligence process to be conducted for products developed internally.” Please give the number of cases where room for improvement are observed in due diligence process and the recommendation made by MA in each case.*
- 7.1 Room for improvement in relation to the due diligence process was observed in 6 RIs (out of the 22 RIs examined in this round of thematic examinations).
- 7.2 For the recommendations made by the MA in each case, section 120 of the BO imposes restrictions on the MA’s ability to disclose supervisory information of the type requested that was obtained in the course of the exercise of the MA’s functions under the BO. Nevertheless, section 120(5)(a) of the BO provides one of the gateways through which the MA may disclose such information provided that it is disclosed in the form of a summary so as to prevent particulars relating to the business of any particular AI being ascertained from it. To assist the Subcommittee in its inquiry, we have therefore summarized the recommendations made by the MA regarding room for improvement in relation to the due diligence process identified in this round of thematic examinations.
- 7.3 Major recommendations in relation to the due diligence process included maintenance of adequate documentation on evaluation and assessment of investment products originated from external vendors, and enhancements to the guideline on investment product assessment and acceptance criteria (e.g. factors for assessing financial status of the external vendor).

*Annex 1(C): Summary of Findings of the Thematic Examinations on Retail  
Wealth Management conducted in 2007*

8. *Paragraph 7 of the summary states, “Recommendations were made to individual RIs to further strengthen their internal control systems...”. Please give the number of RIs which received such recommendations.*

8.1 In respect of the 18 RIs examined in this round of thematic examinations, there were 4 RIs which received such recommendations.

*Annex I(D): Summary of the Findings of the Thematic Examinations on Investment Advisory Activities Conducted in September to November 2006*

9. *Paragraph 22 of the summary states, “The management and control of the RIs in this area were generally acceptable except for one RI where room for improvement was noted in the documentation of the complaint handling process.” Please state the problems identified and recommendation given.*

9.1 The information requested in the Question is concerning the matters of one RI. Section 120 of the BO imposes restrictions on the MA’s ability to disclose the requested supervisory information that was obtained in the course of the exercise of the MA’s functions under the BO. Nevertheless, to assist the Subcommittee in its inquiry, the HKMA can provide information on the general standards in relation to the documentation of the complaint handling process. In general, the MA expects RIs to maintain sufficient information related to each of the complaint cases to provide an audit trail on the process of handling these cases, including any reviews performed by the compliance function. Where the MA finds any deficiency in this regard, the MA will recommend the RI concerned to enhance the relevant documentation and audit trail. The MA might also recommend that the Compliance Department of the relevant RI review all complaint cases received since a specified date, if the MA considers it necessary.



**10. *Please provide the recommendations given to RIs in this round of thematic examinations and provide a summary of the review findings on the implementation of recommended measures.***

10.1 The following is a summary of the recommendations given to the RIs concerned:

Information about client

10.2 The relevant RI(s) should capture more details of the client's investment experience in different types of investment products through the risk profiling exercises.

Selling practice and product suitability

10.3 Relevant recommendations made to the relevant RI(s) included:

- the RIs concerned should take into account the client's investment horizon when selling investment products to clients, and review the appropriateness of the risk tolerance rating assigned to vulnerable customers;
- the relevant private banks should enhance their assessment process for classifying a client as a "professional investor", and maintain a central log to keep track of the offer of each product under the private placement regime; and
- the relevant private banks should provide prospectuses and annual reports of mutual funds, in addition to the product term sheets, to clients unless the clients expressly refused to receive the documents.

### Management supervision

- 10.4 Recommendations made to the relevant RIs included:
- adequate staff resources should be allocated to perform regular compliance reviews on their private banking activities; and
  - improvement should be made in the coverage of the internal management reports.

### Complaint handling

- 10.5 Please refer to the response to Question 9 above for the MA's recommendations given to the RI where room for improvement was noted in the documentation of the complaint handling process.
- 10.6 As set out in paragraph 23 of the Annex 1(D) to the MA's response dated 13 May 2009 to item (e) of the Subcommittee's information requests regarding follow-up to the hearing on 14 April 2009 (SC Ref. No. M20), once the planned actions of the RI examined were agreed with the HKMA, the relevant case officers monitored the implementation of the recommended measures. In addition, the HKMA reviewed in its next round of examination to ensure that appropriate follow-up actions had been effectively taken by the RIs concerned to implement the improvements required. The HKMA's review findings on the implementation of recommended measures for this round of thematic examinations revealed that all of the recommended measures had been implemented by the institutions concerned.

*Annex 1(F): Summary of Findings of the Thematic Examinations on Investment Advisory and Dealing Activities in Credit-linked Investment Products in February to August 2008*

11. *Paragraph 6 of the summary states, “Up to 27 April 2009, suspected mis-selling cases involving 52 customers were identified and referred to the HKMA’s securities enforcement team for appropriate action.” Please provide the information as to the types of 52 customers (e.g. vulnerable customers and professional investors) involved in these suspected mis-selling cases.*

11.1 Among the 52 customers involved in the suspected mis-selling cases in the Question, 6 were vulnerable customers, 1 was a professional investor, and the remaining 45 were neither vulnerable customers nor professional investors at the time of the relevant transactions.

***12. Please provide the recommendations given to RIs in this round of thematic examinations and provide a summary of the review findings on the implementation of recommended measures.***

12.1 As mentioned in paragraph 1 of Annex 1(F) to the MA's response dated 13 May 2009 to item (e) of the Subcommittee's information requests regarding follow-up to the hearing on 14 April 2009 (SC Ref. No. M20), this round of thematic examinations was intended to cover 11 RIs but only 4 examinations were eventually completed due to redeployment of some regulatory resources to conduct an urgent and unscheduled round of thematic examinations on stock accumulators and the collapse of Lehman Brothers in September 2008. The HKMA continued to follow up the findings arising from the fieldwork and gather further related information from the RIs examined after the collapse of Lehman Brothers.

12.2 With respect to the internal control issues identified, the MA's major recommended measures included:

- (1) suspension of the sale of the related investment products by the relevant business units of the RIs;
- (2) conduct of an independent review of the relevant business activities by the RIs' internal audit department or an external audit firm. The scope of the independent review covered the effectiveness of relevant internal controls over the sale of investment products and, where there was prima facie evidence of mis-selling by individual staff, the examinations of previous transactions handled by the staff and/or the branch involved;

- (3) where the RIs considered any relevant individual to be not fit and proper as a result of the independent review, notification to the HKMA in writing to remove the particulars of the relevant individual from the HKMA register; and
- (4) setting up an action plan to rectify the internal control issues identified from this round of thematic examinations.

12.3 The measures recommended by the MA to the relevant RIs for inclusion in their action plans to rectify the internal control issues identified from this round of thematic examinations are summarised below.

- (a) The relevant RIs should ensure proper disclosure of the risks and features of the products to clients during the selling process by providing the relevant product documents to clients and proper explanation of the front-line staff.
- (b) The relevant RIs should adequately train their staff on proper documentation related to the selling process and ensure that checkers perform proper review of documentation before a transaction is executed.
- (c) The RIs concerned should establish and maintain more comprehensive documentation of the product due diligence process and of the rationale for product risk ratings assigned (including any subsequent changes to the product risk ratings).
- (d) The relevant RIs should enhance their training programmes to improve product knowledge of staff.

- (e) The RIs concerned should enhance their regular internal reviews over the selling of investment products.

12.4 As mentioned in paragraph 6 of Annex 1(F) to the MA's response dated 13 May 2009 to item (e) of the Subcommittee's information requests regarding follow-up to the hearing on 14 April 2009 (SC Ref. No. M20), in relation to the findings of this round of thematic examinations, suspected mis-selling cases involving 52 customers were identified and referred to the HKMA's securities enforcement team for appropriate action.

12.5 As set out in paragraph 8 of the Annex 1(F) to the MA's response dated 13 May 2009 to item (e) of the Subcommittee's information requests regarding follow-up to the hearing on 14 April 2009 (SC Ref. No. M20), once the planned actions of the RI examined were agreed with the HKMA, the relevant case officers monitored the implementation of the recommended measures. In addition, the HKMA would review progress in its next round of examination to ensure that appropriate follow-up actions have been taken by the RIs concerned to implement the improvements required. The HKMA's review findings on the implementation of recommended measures for this round of thematic examinations revealed that most of the recommended measures had been implemented by the institutions concerned. Implementation of the remaining recommended measures is in progress in accordance with the respective schedules agreed with the HKMA.

*Annex 1(H): Summary of Findings of the Thematic Examinations on the Compliance Function in relation to Regulated Activities under the SFO in March to August 2008*

*13. Please provide the recommendations given to RIs in this round of thematic examinations and provide a summary of the review findings on the implementation of recommended measures.*

13.1 The following is a summary of the recommendations given to RIs in this round of thematic examinations:

(a) The RIs concerned should engage adequate resources to perform the compliance function.

(b) The relevant RIs should enhance the frequency and coverage of the compliance reviews, including improvements to the regular checks of the selling of investment products.

13.2 As set out in paragraph 8 of the Annex 1(H) to the MA's response dated 13 May 2009 to item (e) of the Subcommittee's information requests regarding follow-up to the hearing on 14 April 2009 (SC Ref. No. M20), once the planned actions of the RI examined were agreed with the HKMA, the relevant case officers monitored the implementation of the recommended measures. In addition, the HKMA would review progress in its next round of examination to ensure that appropriate follow-up actions have been taken by the RIs concerned to implement the improvements required. The HKMA's review findings on the implementation of recommended measures for this round of thematic examinations revealed that most of the recommended measures had been implemented by the institutions concerned. Implementation of the remaining recommended measures is in progress in accordance

with the respective schedules agreed with the HKMA.



*Repurchase scheme of Lehman Brothers Minibonds from eligible customers jointly announced by HKMA, Securities and Futures Commission (SFC) and 16 distributing banks on 22 July 2009*

*Scope and eligibility*

14. *The repurchase agreement announced on 22 July 2009 covers Minibonds only. Please advise on the plans and actions taken, if any, by HKMA (or in conjunction with SFC) to negotiate with relevant banks to achieve similar repurchase schemes or remediation arrangements for other Lehman Brothers-related structured products (notably Constellation Notes, Octave Notes and equity-linked notes).*

14.1 The Minibond Repurchase Scheme announced on 22 July 2009 was the result of an agreement made under section 201 of the SFO (the “Settlement Agreement”), which allows the Securities and Futures Commission (SFC) to resolve disciplinary matters by way of agreement where it considers it appropriate to do so in the interest of the investing public or in the public interest. The BO contains no provision similar to section 201 of the SFO. Therefore, the role of the HKMA as the front-line supervisor of RIs was to facilitate the negotiations and entering into of such agreement and to monitor and supervise the implementation of the same.

14.2 All settlement negotiations, if any, have to be conducted on a confidential and without prejudice basis. Any disclosure of the negotiations may also affect the process in reaching the final agreement as well as the interest of the investors involved. It is therefore not in the public interest for the HKMA to disclose whether there are currently any negotiations and the details of any such

negotiations.

15. *Under the repurchase scheme, a customer who has, in the three years preceding his first purchase of Minibonds, executed five or more transactions in leveraged products, structured products or a combination of these products is not eligible to receive a repurchase offer. Please explain the rationale for adopting such thresholds in delineating a person as “experienced investor”.*

15.1 The terms of the Minibond Repurchase Scheme were set by agreement among the various parties involved as a result of negotiation. The threshold of excluding investors with certain experience in leveraged and/or structured investment products is part of the terms agreed. In general, investors with material experience in leveraged and/or structured investment products are believed to have considerable understanding of the nature and risks of such products and therefore were excluded from the scope of the repurchase scheme.

## Enforcement action

16. *As stated in the announcement on the repurchase scheme on 22 July 2009, “it is not the intention of the HKMA to take any disciplinary or enforcement action under the Banking Ordinance in relation to the complaint of any Eligible Customer who accepts the offer under the Scheme”. Please advise on the number of complaints in which HKMA has decided not to take disciplinary or enforcement action as a result of the repurchase agreement.*

16.1 Out of around 14,000 complaints related only to Minibond received by the HKMA, there were about 12,000 complaints (as at 22 October 2009) of which the complainants had accepted the offer made under the repurchase scheme or the voluntary offer made by the distributing banks. It is not the intention of the MA to take any disciplinary or enforcement action under the BO in relation to the complaint of any Eligible Customers who have accepted the Distributing Banks’ offer of settlement under the repurchase scheme or the voluntary offer made by the Distributing Banks, unless dishonesty, fraud or other criminal elements were involved.

17. *Under the repurchase agreement, each of the 16 banks has undertaken to engage an independent reviewer to review its systems and process relating to the sale of structured products and to engage a qualified third party to review and enhance complaint handling procedures, as well as to implement the recommendations. What measures, if any are taken by HKMA to ensure that banks complete these initiatives in a reasonable timeframe? Have all the “independent reviewers” and “qualified third party” been approved by HKMA and SFC? If not, the respective number of reviewers and qualified third parties approved up to 9 October 2009?*

17.1 Following the signing of the Settlement Agreement on 22 July 2009, each of the 16 Distributing Banks has proceeded to identify potential independent reviewers for conducting the reviews on its systems and processes relating to the sale of structured products and complaints handling procedures. After initial consideration by the HKMA, the choice of independent reviewers proposed by the 16 distributing banks is under consultation with the SFC.

17.2 It is the regulators’ objective that the engagements of the independent reviewers are to be finalised as soon as practicable after completion of the due diligence exercise to ascertain their suitability for the review. Once the reviews commence, the HKMA will be in contact with the reviewers and the banks from time to time to monitor the progress of the reviews. The HKMA expects that the independent reviews should generally be completed by the first quarter of 2010.

*Realization of collaterals for Minibonds*

*18. It is noted from the press release on the repurchase agreement issued by HKMA/SFC that the 16 banks have committed to take reasonable steps to expedite the return of the collaterals. What action, if any, is being taken by HKMA in monitoring the progress of recovering the collaterals?*

18.1 As part of the commitment to take reasonable steps to expedite the return of the collateral of the Minibonds, each of the 16 Distributing Banks is to make available an amount equivalent to the commission income received by it as a distributor of the outstanding Minibonds to the trustee of the Minibonds to assist in the recovery of the underlying collateral. The HKMA has been following the relevant discussions between the banks and the trustee.

18.2 It is noteworthy that the overall progress of the recovery of the collateral will inevitably be dictated by the liquidation process of Lehman Brothers. The HKMA will continue to maintain contacts with the trustee and the banks to keep abreast of the developments.