

~~STRICTLY PRIVATE AND CONFIDENTIAL~~

**WRITTEN STATEMENT OF
MR WONG HON-HING DEREK,
MANAGING DIRECTOR AND CHIEF EXECUTIVE OFFICER,
DAH SING BANK, LIMITED**

15th October 2010

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

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GLOSSARY OF TERMS

"**Bank**" means Dah Sing Bank, Limited

"**BMD**" means Branch Management Department of RBD

"**Constellation Notes**" means credit linked notes issued by Constellation Investment Limited, and Lehman Brothers Holdings Inc. was one of the underlying credit reference entities

"**HKMA**" means the Hong Kong Monetary Authority

"**ISM**" means Investment Services Management – Wealth Management Team of RBD

"**LB**" is used as a generic description of an entity in the Lehman Brothers Group

"**Minibonds**" means certain credit-linked notes issued by Pacific International Finance Limited, and arranged by Lehman Brothers Asia Limited

"**Octave Notes**" means credit-linked notes issued by Victoria Peak International Finance Limited, with Lehman Brothers Holdings Inc. as one of the underlying credit reference entities

"**PDMD**" means the Product Development and Marketing Department of RBD

"**Private Placement Notes**" means notes issued by Lehman Brothers Treasury Co BV, which were equity index linked, or equity linked

"**ProFund Notes**" means certain fund-linked notes issued by Atlantic International Finance Limited, and arranged by Lehman Brothers Asia Limited

"**Pyxis ELN**" means certain equity-linked notes issued by Pyxis Finance Limited, and arranged by Lehman Brothers Asia Limited

"**RBD**" means the Retail Banking Division of the Bank

"**Relevant Period**" means the period between April 2003 and 15 September 2008

"**SFC**" means the Hong Kong Securities and Futures Commission

"**SPARC Notes**" means first-to-default callable credit linked notes issued by SPARC Limited, and Lehman Brothers Holdings Inc. was one of the underlying credit reference entities

"**WMT**" means Wealth Management Team of RBD

**Written statement of
Mr Wong Hon-hing Derek, Managing Director and Chief Executive Officer
Dah Sing Bank, Limited**

GENERAL REMARKS

During the Relevant Period, LB-related structured financial products were sold to customers of RBD and customers of the private banking business of the Bank. The responses in this statement mainly concern the policies and procedures of, and the explanation relevant to the selling of LB-related structured financial products to the Bank's retail banking customers.

Role of DSB

1. Please provide the following information:

(a) When did DSB become a distributor of the Lehman Brothers(LB)-related structured financial products?

1.1 The Bank first became a distributor of the LB-related structured financial products in June 2003.

(b) Apart from being a seller/distributor of LB-related structured financial products, did DSB act as the sole or joint Arranger of any or all of such products sold by DSB? Please explain the roles and responsibilities of DSB as the Arranger of such products and its relationship with the issuer(s);

1.2 No, the Bank did not act as Arranger of any of the LB-related structured financial products. The Bank only acted as a distributor.

(c) Did DSB acquire the LB-related structured financial products from the issuer(s) before further selling them to customers? If yes, please provide the details; and

1.3 No, the Bank did not acquire the LB-related structured financial products before selling them to its customers.

(d) Did DSB have any involvement in the design of the LB-related structured financial products sold by DSB?

1.4 No, the Bank did not have any involvement in the design of the LB-related structured financial products.

Lehman Brothers-related structured financial products sold by DSB

2. Please provide in tabular form the following information on the investment products distributed by DSB during the period between April 2003 and September 2008:

(a) a list of the different types of LB-related structured financial products sold by DSB from April 2003 to 15 September 2008, the specific products under each type (e.g. all the Series of Minibonds, LB-related ELNs etc. distributed by DSB), and indicate whether the specific products were sold by public offer or private placement;

2.1 A detailed list of these products is enclosed as Appendix 2(a).

(b) the number and aggregate value (in HK\$) of LB-related structured financial products sold by DSB each year during the Relevant Period ;

2.2 Please see the table enclosed as Appendix 2(b).

(c) the first and the last series of the Retail Structured Notes issued by Pacific International Finance Limited (i.e. Minibonds) sold by DSB (together with a copy of the offer documentation (such as the prospectus, etc.) and marketing material for each of the aforesaid first and the last series);

2.3 The first series of Minibonds sold by the Bank was Minibonds Series 5 and the last series of Minibonds sold by the Bank was Minibonds Series 36. Enclosed as Appendix 2(c) are copies of the relevant offer documentation and marketing materials.

(d) the first and the last LB-related non-Minibonds structured financial products sold by DSB (together with a copy of the offer documentation (such as the prospectus, programme memorandum, product booklet, term sheet, etc.) and marketing material for each of the aforesaid first and the last products);

2.4 The first LB-related non-Minibonds structured financial products sold by the Bank was Pyxis ELN Series 2 and the last LB-related non-Minibonds structured financial products sold by the Bank was a Private Placement Note known as "Lehman Brothers 2-Year HKD Index Bonus Fixed Coupon Principal Protected Note" (LMP0025). Enclosed as Appendix 2(d) are copies of the relevant offer documentation and marketing materials.

- (e) whether there were any major differences in design and structure between the first and the last LB-related structured financial products mentioned in (d). If yes, please provide a comparison; and

2.5

Major differences between the first and the last LB-related structured financial products	Pyxis ELN Series 2	Lehman Brothers 2-Year HKD Index Bonus Fixed Coupon Principal Protected Note
Issuer	Pyxis Finance Limited	Lehman Brothers Treasury Co. B.V.
Principal protected if held to maturity	No	Yes
Underlying	Equity-linked: Coupon payment and repayment at maturity linked to the performance of shares of HSBC Holdings Plc	Index-linked: Bonus coupon linked to the positive performance of Hang Seng Index

- (f) as at 15 September 2008 (the collapse of LB), the total value (HK\$) of the outstanding (i) Minibonds, (ii) LB-related non-Minibonds structured financial products distributed by public offer, and (iii) LB-related non-Minibonds structured financial products distributed by way of private placement.

2.6 As at 15 September 2008, the total value (HK\$) of the outstanding Minibonds and other LB-related non-Minibonds structured financial products distributed by the Bank are set out in the table enclosed as Appendix 2(f).

3. Based on the information provided by your bank to the Subcommittee on 14 January 2009, it is noted that the following series of LB-related structured financial products recorded the highest value of sales:

- (i) Minibonds Series 36;
- (ii) LM 2 Yrs HKD Index Bonus Fixed Coupon PPN – Private Placement (LMP0017) – Mini PPN; and
- (iii) 24 months USD Quanto 27.00% p.a. Callable Accrual Note - 9628244.

- (a) Please complete Tables 1 and 2 and provide a copy of the offer documentation and marketing materials for each of the products;

3.1 Please see Tables 1 and 2 enclosed as Appendix 3(a)(i). Copies of the relevant offer documentation and marketing materials are enclosed as Appendix 2(c) (Minibonds 36), Appendix 3(a)(ii) (LMP0017) and Appendix 3(a)(iii) (Callable Accrual Note). It should

be noted that 24 months USD Quanto 27.00% p.a. Callable Accrual Note – 9628244 was, during the Relevant Period, offered and sold by the Bank's private bank division only.

(b) Please explain the structure and cash flow of the particular series of the product in (ii) and (iii); and

3.2 The Private Placement Note mentioned in 3(ii) was issued by Lehman Brothers Treasury Co BV, and was principal protected if held until maturity (subject to the credit risk of Lehman Brothers Treasury Co BV). Lehman Brothers Holdings Inc. was the guarantor of the Notes to guarantee the principal repayment obligation. The note had a 2 year tenor with fixed minimum interest and bonus interest linked to Hang Seng Index positive performance. Investors would receive quarterly fixed coupon payment for 2 years (3.8% p.a.) and 100% of principal plus 0.1% if the Hang Seng Index had positive performance on the maturity date (if the note was held until maturity). The payment of coupon and principal were subject to issuer risk.

The 24 months USD Quanto 27.00% p.a. Callable Accrual Note – 9628244 mentioned in 3(iii) was a non-principal protected equity-linked note issued by Bear Stearns Global Asset Holdings, Ltd. Performance of the note was linked to a basket of 3 underlying shares, namely JPMorgan Chase & Company, Lehman Brothers Holdings Inc. and Merrill Lynch & Co. Inc. such that the coupon payment amount and the final redemption amount on maturity date depended on the worst performing share during the investment period. During the investment tenor of 24 months, investors would be entitled to an interest payment of up to 27.00% p.a. depending on whether the closing price of the worst performing stock was lower than the strike price or not on each trading day. If the note was held until maturity, at maturity, if the closing price of the worst performing stock was at or above the strike price, the note would be redeemed in cash of full principal amount. However, if the closing price of the worst performing stock had dropped below the strike price, the note would be redeemed in shares at the strike price. The redemption of shares and the payment of coupons and principal were subject to issuer risk.

(c) Whether there were any major differences between the first series and the particular series of the products in (ii) and (iii) in terms of the product structure and design.

3.3 There were no major differences in terms of product structure and design between the Private Placement Note mentioned in 3(ii) and LMP0010 (i.e. the first series) sold by the Bank to retail customers. There were, however, variations in the product features, for example, coupon payments.

3.4 The Bank had sold only one series of the Callable Accrual Note issued by Bear Stearns Global Asset Holdings, Ltd during the Relevant Period.

Internal process for approval of offer

4. **Regarding the offer of LB-related structured financial products for sale, please advise:**

(a) how and when Minibonds were first introduced to DSB;

4.1 The Bank was first introduced to Minibonds Series 5 by Sun Hung Kai Investment Services Limited in June 2003.

(b) who/which party introduced Minibonds to DSB;

4.2 The Product Team of Sun Hung Kai Investment Services Limited introduced Minibonds to the Bank.

(c) how and when the first LB-related non-Minibonds structured financial product mentioned in Question 2(d) was introduced to DSB;

4.3 The Bank was first introduced to Pyxis ELN Series 2 by ICEA Capital Limited in June 2003.

(d) who/which party introduced the first LB-related non-Minibonds structured financial product mentioned in Question 2(d) to DSB; and

4.4 The Product Team of ICEA Capital Limited introduced Pyxis ELN Series 2 to the Bank.

(e) whether the same source introduced all other LB-related non-Minibonds structured financial products sold by your bank; if no, please provide the details.

4.5 No. Other LB-related non-Minibonds structured financial products were introduced to the Bank by different parties, namely,

- Private Placement Notes were introduced by Lehman Brothers Asia Limited.
- ProFund Notes were introduced by Sun Hung Kai Investment Services Limited.
- Constellation Notes were introduced by DBS Bank Limited.
- Octave Notes were introduced by ICEA Capital Limited.
- SPARC Notes were introduced by UBS Securities Asia Limited.

5. What were DSB's considerations in deciding to act as a distributor/seller of LB-related structured financial products? To what extent was the need to increase non-interest income a factor?

5.1 As a bank, we aim to provide a wide range of banking services to our customers in response to their demands for a growing range of investment options. We seek to ensure that customers are given the choices that they want, and that the range of services/products available is sufficiently wide so that, if a customer wishes, he or she can diversify his/her investments through us.

The distribution of LB-related structured financial products was therefore in line with this objective. It was not principally driven by a need to increase non-interest income. The Bank had no preference for LB-related structured financial products. As a matter of fact, during the Relevant Period, the Bank made available a range of other structured investment products for our retail banking customers to choose from. It is also relevant to note that LB-related structured financial products were commonly available and offered by other retail banks in Hong Kong at the time.

6. On the mode of sale, banks may offer financial products to clients through "public offer" or through "private placement". Please advise whether it was DSB or any other party (e.g. the issuer) that decided on the mode of sale; and the reasons for such a decision.

6.1 The Bank did not decide on the mode of sale for the LB-related structured financial products. The Bank understands that the decision on whether to offer investment products by way of public offer or private placement was generally made by the issuer or arranger.

7. Regarding the approval process, please advise:

(a) whether all the LB-related structured financial products (Minibonds and non-Minibonds products) sold by DSB had gone through the same approval process. If no, please provide the reasons for different approval processes being adopted and describe how different products/types of products were approved;

(b) if the answer to (a) is yes, please describe the approval process in the form of a flow chart, together with the name(s) and position(s) of the officer(s) responsible for the approval;

(c) if the approval was made by one or more committee(s) or department(s) within DSB, please provide the details of the committee(s) or department(s), including its/their membership, scope of responsibilities and internal guidelines or code of practice that it/they should follow;

(d) please provide the record of deliberations/decisions on approving the following products for sale:

(i) the first series of Minibonds mentioned in Question 2(c);

(ii) the first LB-related non-Minibonds structured financial product mentioned in Question 2(d); and

(ii) the three LB-related structured financial products mentioned in Question 3; and

7.1 A flow chart describing the Bank's product approval process of the LB-related structured financial products (immediately prior to September 2008) is enclosed as

Appendix 7(b)(i). Please see Appendix 7(b)(ii) for name(s) and position(s) of key officer(s) involved in the approval process described in paragraphs 7.1 to 7.11 for the Bank.

By way of brief explanation, we set out below an overview of the Bank's product approval process. During the course of the Relevant Period, there had been continuous enhancements and developments strengthening this process.

Product Origination and Acceptance

- 7.2 The Bank's product origination and acceptance processes principally involved two levels of assessment: one at product type level and one at individual product level.
- 7.3 PDMD is responsible for identifying new product types and individual products which the design and features are consistent with the Bank's business strategy and which meet the customers' needs. Once the preliminary feasibility of the new product types/products is considered satisfactory, PDMD is responsible for driving the product approval process and obtaining the necessary senior management's approval in accordance with the Bank's policies for new product types and products respectively.

Product Type Assessment

- 7.4 Under the Bank's policy on "Risk Policy Manual on Product Policy and Approval", new product types are required to be approved by senior management using the Product Approval Plan ("PAP"). The relevant Risk Policy Manual on Product Policy and Approval (section 9) is enclosed as Appendix 7(c)(i).
- 7.5 Based on the product type assessment performed, PDMD would prepare a PAP, which sets out, amongst other things, information on the product characteristics, risk management etc. A long form PAP would be prepared for any new product types which exhibit a different risk profile to any other approved products and/or the implementation of which would require a significant alteration to the existing procedures or risk profile of the Bank. On the other hand, a short form PAP would be prepared if the new product types exhibit no major differences from a previously approved product type. Both the long and short forms require the same level of approval authority, except that the long form contains more detailed information.
- 7.6 Before the PAP is submitted for senior management's approval, meetings are conducted between PDMD and relevant departments in order to ensure that (i) input from relevant departments are considered and addressed; (ii) different aspects of any new product development plans are evaluated so as to enable the relevant divisions of the Bank to understand the risks inherent within such plan; and (iii) appropriate systems are in place to support the distribution of the product. The product type approval forms the framework upon which individual investment products that fall within a particular product type will be approved before distribution by the Bank.
- 7.7 With respect to LB-related structured financial products, their respective applicable PAPs are enclosed as Appendix 7(c)(ii).

Individual Product Assessment

- 7.8 The distribution of individual investment products of an approved product type is then subject to additional assessment and consideration by the Bank. It was the general practice of the Bank's RBD that the product issuer of individual structured financial products offered by the Bank to customers should have a single "A" or better credit rating by Standard & Poor or Moody's.
- 7.9 In 2007, the product assessment process was enhanced in further aspects. For investment products distributed after January 2007, ISM also conducted an assessment of the level of acceptance of individual investment products which were authorised by the SFC for retail distribution ("**Product Acceptance Scoring**"), which involved a consideration of the major risk attributes associated with the product, such as the issuer's credit worthiness, and the underlyers of the investment products. This is set out in the Bank's user manual on "Investment Products, Acceptance Scoring System", which is enclosed as Appendix 7(c)(iii).
- 7.10 For investment products distributed after October 2007, ISM also conducted an assessment of the risk level of the products, with reference to a "Risk Assessment Table", which is enclosed as Appendix 7(c)(iv). A risk level ranging from level 1 to 4 (4 being the highest risk) was assigned to individual investment products. Please see further the answer to question 18 below regarding the Bank's risk assessment process.
- 7.11 Since October 2007, the criteria and approval process for adoption of any new approved product brokers are encapsulated in the "Due Diligence Policy – Investment Product", which is enclosed as Appendix 7(c)(v). Essentially, under the Due Diligence Policy, a broker would be assessed taking into account criteria such as the broker's registration status with regulators, external credit ratings, the broker's expertise and market experience, and service support expected from the broker.
- (e) if the approval was made by the Board of Directors, please provide the date(s) of its meeting(s) at which such approval was made.**
- 7.12 The Bank's Board of Directors did not approve, nor were they required to approve, any products.
- 8. Regarding the LB-related structured financial products that were launched in a number of series, was DSB's approval of the sale of such products made in respect of each type, or individually per series or both? Please explain.**
- 8.1 As explained in 7.1 -7.12 above, the Bank conducted approvals on a product type level. Individual investment products (each series) of an approved product type were then subject to additional assessment and consideration in line with the evolving market practice and prevailing regulatory requirements.
- 9. When DSB decided to sell LB-related structured financial products, was there any decision on who should be the target clients for (i) Minibonds, (ii) LB-related non-Minibonds structured financial products sold through public offer, and (iii)**

LB-related non-Minibonds structured financial products sold through private placement? If yes, please provide the reasons for the decision and details of the discussion leading to such decision.

9.1 The Bank strives to provide a wide-range of banking services to its retail banking customers, including services related to deposits and loans, life insurance policies, mortgages, credit cards and a number of different investment products. No specific sales strategy is adopted for the distribution of individual investment products (including LB-related structured financial products) and investment products are sold to customers who have expressed their interest in investing in these products and who have investment needs.

10. In view of the worsening financial difficulties of LB in 2008, please advise:

(a) whether DSB had continued to sell any LB-related structured financial products between June and mid-September 2008. If yes, please explain why DSB had decided to continue to sell the LB-related structured financial products in question; and

10.1 The Bank had sold LB-related structured financial products between June and August 2008. As a bank, we aim to make available a wide variety of banking services and products to our retail customers. This was the primary reason for distributing these products to customers. While there were market rumours on LB in mid 2008, its credit rating still maintained at Grade "A" by three well-known credit rating agencies (Standard & Poor: 'A'; Fitch: 'A+'; Moody's: 'A2').

(b) when and why did DSB decide to stop selling LB-related structured financial products? Please describe the decision-making process, including the person(s) or authority within DSB that had made the decision.

10.2 The Bank did not offer for sale further LB-related structured financial products on the day after the ISM became aware that a negative watch warning was issued by Standard & Poor against LB on or about 10 September 2008.

11. On early redemption of LB-related structured financial products, please advise:

(a) before the collapse of LB in September 2008, the total number of requests from investors for early redemption of Minibonds and the number of successful early redemption;

(b) in respect of the successful early redemption of Minibonds in (a) above, the month/year in which each of such early redemption was made and the exit prices of each transaction as a percentage of the original investment amount;

(c) before the collapse of LB in September 2008, the total number of requests from investors for early redemption of LB-related non-Minibonds structured financial products and the number of successful early redemption;

(d) in respect of the successful early redemption of LB-related non-Minibonds

structured financial products in (c) above, the month/year in which each of such early redemption was made and the exit prices of each transaction as a percentage of the original investment amount; and

- (e) whether there were any cases in which the requests for early redemption could not be processed; if yes, please provide the number and the reasons.

11.1 Please see Appendix 11.

Product due diligence

12. Did DSB have any written policy/internal guidelines on how product due diligence should be conducted? If yes, please provide the relevant documentation; if no, the reasons.

12.1 Please refer to paragraphs 7.1 - 7.12 above.

13. Please name the person(s)/department(s) responsible for preparing the written policy/internal guidelines on how product due diligence should be conducted. Was reference made to the requirements of the regulators (e.g. the Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC)) in preparing the relevant written policy/internal guidelines? Was a copy of the written policy/internal guidelines provided to the regulators for record?

13.1 The processes referred to in paragraphs 7.1 – 7.12 were implemented and have been enhanced over time taking into account the Bank's regulatory obligations as required by the HKMA and the SFC. For details of the departments responsible for the documentation mentioned in paragraphs 7.1 – 7.12, please see Appendix 13.

13.2 The documentation referred to in paragraph 13.1 above would have been made available to the regulators upon request, although there were no regulatory requirements for such documentation to be provided to the regulators for record during the Relevant Period.

14. Had any product due diligence been conducted on a LB-related structured financial product before DSB made the policy decision to distribute the product? If no, please provide the reasons; if yes, please provide information on how such due diligence had been carried out.

14.1 Please refer to paragraphs 7.1 -7.12 above.

15. Was product due diligence conducted in respect of each series of a LB-related structured financial product (e.g. Minibonds, ELNs) sold by DSB? If yes, please provide information on how DSB conducted the exercise, including the dedicated team, if any, for such work; if no, the reasons.

15.1 Please refer to paragraphs 7.1 -7.12 above.

16. **Did DSB make any enquiries or obtain any information from the issuer(s) and/or other independent sources about the nature, structure and risks of each LB-related structured financial product to be sold by DSB? If no, please provide the reasons; if yes, please explain using the following products as examples: (i) the first and the last series of Minibonds mentioned in Question 2(c); (ii) the first and the last LB-related non-Minibonds structured financial products mentioned in Question 2(d); and (iii) the three LB-related structured financial products mentioned in Question 3.**

16.1 Yes. The Bank would have made enquiries with and obtained relevant information from the issuer / arranger / co-ordinating dealer about the features and risks of investment products sold by the Bank as necessary in the circumstances. The Bank adopted the same practice for all investment products, including the products mentioned in question 16.

Product risk assessment

17. **Did DSB have any written policy or guidelines on product risk assessment? If yes, please provide the relevant documentation; if no, the reasons.**

17.1 Yes. Product risk assessment was carried out as part of the product approval process. Please refer to paragraphs 7.1 to 7.12 above.

18. **Did DSB assess the risks of each series of (i) Minibonds and (ii) other LB-related non-Minibonds structured financial product sold by DSB? If yes, please give in tabular form DSB's risk ratings of each series of the products at (i) and (ii) and explain how DSB arrived at each of the risk ratings (including all factors and criteria taken into consideration in arriving at the ratings); if no, the reasons.**

18.1 The Bank established a Risk Assessment Table which categorised investment products into 4 levels of product risk: level "1" (conservative); level "2" (balanced); level "3" (growth); level "4" (aggressive). Risk level "4" denoted the highest risk rating.

18.2 Risk levels were assigned through consideration of a number of factors such as the type of the investment products.

18.3 Adopting the classification under the Risk Assessment Table, the risk levels assigned by the Bank with respect to LB-related structured financial products sold were as follows:-

Product	Risk level
Minibond Series 34	3
Minibond Series 35	4
Minibond Series 36	4
Private Placement Notes LMP0006 (Principal Protected Note)	1
Private Placement Notes LMP0007 (ELN)	4

Private Placement Notes LMP0008 to LMP0023 and LMP0025 (Principal Protected Note)	2
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By way of explanation:-

- 18.4 Minibonds series 34, 35 and 36 (being the last series of Minibonds sold) were assigned with the risk levels set out in the above table. Initially, "credit-linked note" was assigned with a risk level of "3". However, the risk level was changed to level "4" in January 2008.
- 18.5 Private Placement Notes no. LMP0007 was assigned with a risk level of "4", as that was an equity-linked, non-principal protected note, which was of higher risk. LMP0006 had a rating of "1" because at the time, the long term credit rating of Lehman Brothers was "A+" and was a principal protected product. The other tranches of the Private Placement Notes distributed (namely, LMP0008 to LMP0023 and LMP0025) were assigned with a risk level of "2" (balanced).
- 18.6 Prior to the development of the Risk Assessment Table, there was no quantitative risk classification for LB-related structured financial products that were distributed. The Bank had a dedicated team responsible for assessing the risks of investment products and explaining the same to sales staff during training. As part of the selling process, sales staff were required to explain to the customers the features and risks of the products so that he/she can make his/her own informed investment decisions.
- 19. Please provide an explanation on the scale of risks assessment adopted by DSB in respect of the LB-related structured financial products sold by DSB.**
- 19.1 Please refer to paragraphs 18.1 to 18.6 above.
- 20. In view of the worsening financial position of LB, the downgrading of its credit rating and the drop in LB's share prices by June/July 2008,**
- (a) did DSB conduct any assessment on the possible impact of the financial difficulties of LB on the outstanding LB-related structured financial products sold by DSB? If yes, please provide the details; if no, the reasons;**
- 20.1 It was the practice of the Bank to continue to monitor issuers' credit rating in conformity with the general practice of RBD that the product issuer of structured financial products should have a single "A" or better rating by Standard & Poor or Moody's. During the Relevant Period, LB maintained a credit rating of "A" or above.
- (b) did DSB revise the risk-ratings of any of the LB-related structured financial products? If yes, please provide details; if no, the reasons; and**
- 20.2 Please refer to paragraphs 18.4 and 18.5. Please also note that it was not the Bank's practice at the time to conduct after-sales risk assessment for investment products.
- (c) were customers who had purchased the relevant LB-related structured financial products informed of DSB's action, if any, in (b).**

20.3 Please refer to paragraph 20.2 above.

Offer documentation and marketing materials

21. Did DSB have any involvement in the preparation of the offer documentation and marketing materials of the LB-related structured financial products sold by DSB (such as the products mentioned in Question 2(d) and Question 3)? If yes, please provide the details.

21.1 No. The Bank was not involved in the preparation of the offer documentation and marketing materials.

22. Did DSB have any mechanism to vet/review the contents and presentation of the marketing materials vis a vis the offer documentation such as the prospectus? If yes, please provide the details and whether DSB ever raised any queries/comments to the issuer(s). If no, how did DSB ensure that there was no misrepresentation of product information and adequate disclosure of risks in such materials?

22.1 Prior to the distribution of investment products, WMT would study the relevant offer documentation and marketing materials and follow-up with the issuers / arrangers / marketing agents for clarification if necessary.

Training and guidance to frontline sales staff

23. Please describe the training arrangements for staff engaged in the sale of LB-related structured financial products, including the following particulars:

(a) whether the training was general or product specific or both;

23.1 The Bank provides both general and product-specific training to sales staff.

(b) if only general, please give the details of the training programme(s);

23.2 Our sales staff were required to attend (i) compulsory training upon joining the Bank and (ii) regular meetings / training sessions.

(i) New joiners training on investment products

23.3 All new sales staff were required to attend new joiners' training.

23.4 The new joiners' training was divided into two parts, altogether lasting for about 3-4 weeks, of which 4 days were specifically devoted to training on investment products.

23.5 Trainers also typically made use of specific investment products (e.g. products that were launched around that time) as examples for the purposes of going through the training materials, making reference to the relevant marketing materials.

- 23.6 The new joiners were also required to attend training in relation to the sale of investment products, covering applicable procedures and guidelines, and in particular there would also be a discussion on the Bank's Branch Operations Manual for Wealth Management System, General Guidelines of Suitability Checking for Investment Services, the Branch Operations Guidelines for Bond/Notes Services and the Risk Assessment Table.
- 23.7 The sales staff would also be trained on the 'dos and don'ts' during the selling process, such as knowing your customers, explaining clearly and ensuring customers understand the product features of the investment products, explaining to the customers the risk disclosure statements in the investment services application forms, and providing customers the relevant offering documentation and marketing materials.
- 23.8 They were also required to attend a session on the regulatory obligations and compliance issues relating to the Securities and Futures Ordinance. In particular, their obligations under the SFC's Code of Conduct (which are incorporated as part of the Bank's Compliance Guidelines), and hypothetical case examples were discussed. In addition, Legal and Compliance Division also provided refresher compliance training which covered, amongst other things, aspects of the selling process from time to time.
- (ii) District meetings
- 23.9 Specific product training was also provided to sales staff through the monthly district meetings. These meetings typically lasted for about 1 to 1.5 hours, and were attended by sales staff of each district, usually in relatively small groups. During these meetings, specific product training was provided covering, amongst other things, new investment products, products' features, commercial terms, risks and general market updates.
- (iii) Sales staff / Relationship Managers / Branch Managers meetings
- 23.10 In addition to the district meetings, relevant staff were required to attend these monthly meetings during which, amongst other things, new products and developments in the Bank's procedures or guidelines were also discussed.
- 23.11 Representatives of the relevant arrangers / issuers / co-ordinating dealers of investment products were often invited to attend these meetings to provide training on these products.
- 23.12 Branch Managers would normally conduct daily morning briefing sessions with the branch staff to review, refresh and discuss matters such as product launches (including investment products) and related business and operational matters.
- 23.13 In addition to the training sessions above, from time to time, the Bank also organised informal ad hoc sharing sessions (investment sharing group) as necessary to staff, as a way to strengthen their product knowledge and knowledge on the selling process.

(c) if product specific, please give details of the training programme(s) for the following products:

- (i) the first and the last series of Minibonds mentioned in Question 2(c);
- (ii) the first and the last LB-related non-Minibonds structured financial products mentioned in Question 2(d); and
- (iii) the three LB-related structured financial products mentioned in Question 3.

23.14 Please refer to paragraphs 23.9 to 23.13 above.

23.15 At the launch of a new product, sales staff would receive information from ISM outlining the product features. For some products, training materials prepared by the issuer/arranger/co-ordinating dealer would also be provided to sales staff. Staff members were expected to review these documents as well as the relevant offer documentation and marketing materials to assist them in understanding the products. Sales staff were encouraged to contact ISM should they have any questions.

23.16 Specific product training on Minibond Series 5 was conducted by Sun Hung Kai Financial in June 2003.

23.17 Training on Minibond Series 36 were held in April 2008.

23.18 ICEA (Co-ordinating Dealer) provided training on Pyxis ELN Series 2 in July 2003.

23.19 For LMP 0017 and 0025, training was conducted in July and August 2008 on Private Placement Notes.

(d) if the training was both general and product specific, please give all details specified in (b) and (c); and

23.20 Please refer to paragraphs 23.1 - 23.19 above.

(e) if there had been changes to the training arrangements, please describe.

23.21 There had been no material changes to the basis of the training arrangements though the contents of the training evolved over the years to adapt to the development in products and the Bank's ongoing enhancements in its selling process.

24. Did the product issuer(s), DSB or any other party conduct any product briefings and/or provide training materials to the frontline sales staff for each of the LB-related structured financial products (e.g. Minibonds, Constellation Notes, ELNs etc.) sold by DSB? If yes, please provide the details; if no, the reasons.

24.1 Please refer to paragraphs 23.1 – 23.19 above.

25. **Did DSB provide any further training to your frontline sales staff for each of the series of (i) Minibonds and (ii) other LB-related structured financial products distributed by DSB prior to the launch of each of the series of such products? If yes, please provide the details; if no, the reasons.**

25.1 Please refer to paragraphs 23.1 – 23.19 above.

26. **Was it mandatory for the frontline sales staff of DSB to attend the product briefing and/or training before they could sell a LB-related structured financial product to customers? If no, please provide the reasons.**

26.1 Yes. As explained in response to question 23 above, sales staff were required to attend the relevant training and meetings.

27. **Did DSB have any procedures to assess the frontline sales staff's knowledge on a LB-related structured financial product before they were allowed to sell the product to customers? If yes, please provide the details; if no, the reasons.**

27.1 Please refer to paragraph 28.1 below.

28. **Please advise/provide:**

(a) whether DSB conducted any post-training quizzes and tests before the frontline sales staff were allowed to sell LB-related structured financial product; and

28.1 All relevant individuals were required to attend at least 5 hours of continuous professional training (CPT) every year. To enhance the process, during the Relevant Period, the Bank introduced an Investment Knowledge Entry Assessment (“IKEA”) for new joiners as part of the requirement for the registration with HKMA.

(b) a specimen copy of the test and quiz, and advise on the respective passing score.

28.2 See Appendix 28(b) for a specimen copy of the IKEA and the passing score for IKEA was 80%.

29. **Did DSB receive any feedback from your sales staff on the training provided to them in relation to the sale of LB-related structured financial products? If yes, please provide the details.**

29.1 The training sessions and meetings set out in paragraphs 23.1 to 23.19 above were interactive in nature, during which there would be ongoing discussions and sharing of ideas. The sales staff could also directly call members of ISM and/or WMT if they have any particular issues or questions with respect to the sale of any products.

30. **Did DSB provide any sales scripts to your frontline sales staff for the sale of (i) Minibonds and (ii) other LB-related structured financial products? If yes, please provide a copy of the script. If no, the reasons.**

30.1 No, the Bank did not provide any sales scripts to sales staff for the sale of Minibonds and / or other LB-related structured financial products. The Bank expected sales staff to explain to the customers the features and risks of the structured financial products and to make available to customers relevant information so that they could make informed investment decisions. As explained in our response to question 23 above, selling techniques and procedures were discussed with sales staff at the regular training sessions and meetings.

31. **Please provide a copy of the operational guidelines, manual, internal memoranda, instructions or any other documents prepared by DSB to the staff engaged in the sale of LB-related structured financial products to assist them in complying with the *Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission* (the Code of Conduct). If such guidelines, manual, memoranda, instructions and documents were product specific, please supply them in respect of each of the following products:**

- (a) **the first and the last series of Minibonds mentioned in Question 2(c);**
- (b) **the first and the last LB-related non-Minibonds structured financial products mentioned in Question 2(d); and**
- (c) **the three LB-related structured financial products mentioned in Question 3.**

31.1 Please find enclosed as Appendices 31(i), 31(ii), 31(iii) and 31(iv) the key relevant guidelines and manuals:

- (i) Branch Operations Guidelines for Bonds/Notes Services
- (ii) Branch Operations Manual for Wealth Management System ("**Branch Operations Manual**")
- (iii) General Guidelines of Suitability Checking for Investment Services ("**Suitability Checking Guidelines**")
- (iv) Compliance Guideline on Regulated Activities ("**Compliance Guidelines**")

31.2 These guidelines were applicable to, and were required to be followed by all sales staff and they were developed and put in place with the Bank's regulatory obligations in mind.

31.3 All sales staff, as relevant individuals registered with the HKMA, were expected to comply with the applicable guidelines and obligations as set down by the HKMA and the SFC from time to time. Please also refer to paragraph 40.1 below.

32. **Did DSB have any policy/procedures to ensure that your sales staff would meet the Fit and Proper Guidelines, the Guidelines on Competence and the Guidelines on Continuous Professional Training issued by SFC? If yes, please provide the details of such policy/procedures; if no, the reasons.**

32.1 Yes. Please refer to Compliance Guidelines as Appendix 31(iv). All sales staff were relevant individuals registered with the HKMA. They were accordingly required to comply with the applicable guidelines and obligations as set down by the HKMA and the SFC from time to time.

33. **Did DSB involve the legal/compliance team in vetting the product training materials (including those provided by the issuer(s))? If no, please provide the reasons. If yes, did DSB detect any false/inaccurate/misleading information contained in the training materials for a particular LB-related structured financial product which was not consistent with the information in the offer document for the product?**

33.1 ISM was primarily responsible for reviewing the training materials as the team had the requisite product expertise. The Bank's Legal and Compliance Division would be involved in the process in advising ISM on specific legal and compliance issues identified upon their review. The Bank did not identify any false, inaccurate or misleading information contained in the training materials for a particular LB-related structured financial product which was inconsistent with the information in the offer documentation for the product.

Know your customers

34. **Did DSB have any policy/procedures to ensure that your frontline sales staff did conduct risk profiling exercise with the customers to assess their risk appetite? If yes, please provide the details; if no, the reasons.**

34.1 Yes, the Bank had policies and procedures in place during the Relevant Period to ensure frontline staff would conduct risk profiling exercise with the customers which were essentially set out in the Branch Operations Manual (see Appendix 31(ii)).

34.2 Under the Branch Operations Manual, if a customer approached the Bank to show interest in our wealth management services, the relevant staff must check the customer's risk assessment record in the Bank's wealth management system and conduct risk assessment if:-

- (i) the customer has not conducted a risk assessment under the wealth management system previously;
- (ii) the customer's risk assessment record on the wealth management system has expired (i.e. over one year old); and
- (iii) the customer requests a renewal of his/her risk assessment.

- 34.3 Customer risk profiling was conducted by way of completing a Risk Assessment Questionnaire.
35. **Did DSB require the risk profiling exercise be conducted in relation to the customers only once when they opened an investment account, or continuously at regular intervals? If continuously, how did DSB ensure compliance by each staff member?**
- 35.1 Customers were required to have customer risk profiles / assessment completed within one year before purchasing of the investment products from the Bank. If the current risk assessment was over 1 year-old, customers would be required to complete an updated profile before they are permitted to make any purchase.
- 35.2 The Assistant Branch Manager was required to verify that the risk profiling was valid.
36. **Please provide a sample copy of the questionnaire used in the risk profiling exercise and explain the scoring methodology of the questionnaire.**
- 36.1 A sample copy of the Risk Assessment Questionnaire is enclosed as Appendix 36.
- Based on the answers provided by customers, the system would categorize customers into 4 different risk tolerance levels namely:- 1 –Conservative, 2 – Balanced, 3 – Growth and 4 – Aggressive.
37. **Did DSB have any internal mechanism to conduct periodic review of the risk profiling questionnaire and scoring system? If yes, please provide the details; if no, the reasons.**
- 37.1 The Bank's internal procedures on customer profiling and suitability checking were reviewed and updated from time to time.
38. **Did DSB require your sales staff to assess the customers' specific needs and personal circumstances in addition to the risk profiling questionnaire? If no, please provide the reasons.**
- 38.1 Yes. Sales staff needed to understand the customers' specific needs and personal circumstances when they introduced different investment products to customers. In particular, additional suitability checking was conducted with respect to the following two circumstances, namely (1) vulnerable customers and (2) customers who invested in products that did not match their investment experience / risk profiles, concentration and liquidity requirements with respect to the investment product.
39. **What were the measures, if any, adopted by DSB in selling LB-related structured financial products such as Minibonds to vulnerable customers (e.g. elderly persons, illiterate customers etc.)?**
- 39.1 Yes. Additional measures adopted by the Bank included the requirement of (i) additional witness, (ii) transaction to be referred to supervisor for additional checking and (iii) the signing of an Investment Product Explanation Memorandum.

Suitability of recommendation and solicitation

40. **Were the Questions and Answers on Suitability Obligations of Investment Advisers (FAQ) published by SFC in May 2007 brought to the attention of the sales staff of DSB? Were they briefed on the FAQ?**
- 40.1 Yes. The FAQs were specifically drawn to the attention of all business compliance representatives and all sales staff.
41. **Did DSB have any internal controls to ensure suitability of the recommendations and solicitations for investment in LB-related structured financial products? If yes, please provide the details; if no, the reasons.**
- 41.1 Sales staff were not allowed to provide recommendations and investment advisory services to customers. During the Relevant Period, the Bank had internal controls in place to address suitability of investment products to be purchased by customers. Please refer to the relevant guidelines and manuals at Appendix 31(iii).
- 41.2 In essence, a risk assessment has to be performed, the details of which are set out in the Branch Operations Manual. The Suitability Checking Guidelines further required additional suitability checking with respect to the following groups of clients, namely:
- (i) vulnerable customers (being customers who are over the age of 65, visually impaired, or illiterate); and
 - (ii) customers who would like to invest in products that did not match their investment experience / risk profiles, or where there was a mismatch in terms of customers' liquidity requirements and the period of commitment / tenor with respect of the investment product in question.
- 41.3 In addition, sales staff were expected to comply with the applicable guidelines and obligations as set down by the HKMA and the SFC from time to time. In that regard, please refer to the Compliance Guidelines (see Appendix 31(iv)).
42. **Did DSB have any system to require the sales staff to document the reasons for the recommendation given to the customers? If yes, please provide the details; if no, the reasons.**
- 42.1 Sales staff were not allowed to provide recommendation and/or investment advisory services to customers. Sales staff were required to complete various documentation with customers, which served as part of the records retained by the Bank in respect of the sale of the investment products. These included records of customers risk profiling and suitability checking. Sales staff however did not typically keep separate records of their discussions with customers.
43. **Did DSB have any measures to ascertain whether the customers were fully aware of the nature and risks of the LB-related structured financial products recommended by your sales staff? If yes, please provide the details; if no, the reasons.**

43.1 Sales staff were not allowed to provide recommendation or investment advisory services to customers. Nevertheless, the Bank had internal procedures in place which all sales staff were required to follow in the sale of investment products. All sales staff were expected to explain to the customers the features and risks of the LB-related structured financial products and to make available to customers relevant information so that they could make informed investment decisions. Suitability checks (including additional suitability checking for certain types of customers) were also conducted so that customers would be aware of the nature and risks of the products being purchased. Customers agreed to the purchase and confirmed their understanding thereof by signing the documents required for the transaction.

44. Did DSB have any internal controls to identify transactions in which there was a mismatch between the product risk rating and the customer's risk profile? If yes, please provide the details; if no, the reasons.

44.1 Yes, internal controls were in place since the implementation of the Risk Assessment Table to verify and ensure that the relevant documentation was executed by customers in risk mismatch cases.

45. Were customers whose risk tolerance level did not match the risk ratings of the LB-related structured financial products able to purchase such products? If yes, please provide details, including whether any special approval was required.

45.1 Yes. Sales staff were additionally required to explain and customers were required to sign an Investment Product Risk Declaration Form in circumstances where the risk level of the investment product did not match the customer's risk tolerance level to confirm that they fully understood and acknowledged that the risk level of the investment products they sought to subscribe had exceeded their risk tolerance level derived from the Risk Assessment Questionnaire and its related impact.

45.2 No transactions were permitted to be undertaken with the customer if the risk mismatch between product risk and the customer risk profile exceeded two levels, e.g. customers with a risk level "1" (conservative) could not purchase investment products with a risk level "4" (aggressive).

Sale of products

46. Did all your frontline staff engaged in the sale of LB-related structured financial products sit and pass the relevant examinations for representatives to be licensed by SFC? If no, did DSB set any qualifications (e.g. seniority, rank, experience, education, and training courses attended) when selecting frontline staff to engage in the sale of the aforesaid products?

46.1 Yes. All sales staff were relevant individuals, registered with HKMA.

47. Was the sale of LB-related structured financial products all conducted by staff members who were Relevant Individuals (RIs) registered with HKMA?

- 47.1 Yes. All sales of LB-related structured financial products were conducted by relevant individuals registered with HKMA.
48. **Please provide the information in the enclosed Tables 3 and 4.**
- 48.1 Please see enclosed as Appendix 48.
49. **Please describe DSB's sales strategies of Minibonds, which should include the following particulars:-**
- (a) **the target group of customers in terms of age, education level, net worth and relationship with DSB;**
- 49.1 As a bank, we strive to provide a wide-range of banking services to our retail banking customers. We made various investment products available to customers who have expressed to us their interest in investing in financial instruments and who have investment needs such as alternative interest-earning products other than traditional deposits. The Bank did not set a particular target customer segment for the sale of Minibonds.
- (b) **the sources of information used for locating individual customers of the target group;**
- 49.2 Please refer to paragraph 49.1.
- (c) **the quantitative sales targets, if any, set for a specific time period for each branch of DSB and for each staff member at different levels involved in such sales;**
- 49.3 The Bank did not have specific quantitative sales targets with respect to the sale of Minibonds.
- (d) **the features of Minibonds emphasized in DSB's marketing or promotional materials;**
- 49.4 The Bank did not produce any marketing or promotional materials for Minibonds. These materials were provided to the Bank by the relevant arrangers / marketing agents. The key features included, amongst other things, the product terms and features and the risk factors inherent in investing in Minibonds.
- (e) **the typical process of a successful sale (from approaching a target customer for the first time to the settlement of all relevant transactions);**
- 49.5 As mentioned in paragraph 49.1 above, the Bank did not have target customer segments for Minibonds. Sales staff were required to follow the procedures set out in paragraphs 34.1 to 34.3 and 41.1 to 41.3 above in the sale of Minibonds. In essence, the sales process would involve understanding the customers' needs, completing the relevant customer risk profiling and suitability checking procedures, explaining the

terms, features and risks of the products to customers, and the completion of the necessary documentation for the transaction.

(f) details of the incentive scheme(s) for

(i) staff on the basis of the amount of sales of Minibonds achieved;

49.6 There were no specific sales targets or incentive schemes directly referable or particular to Minibonds. At the relevant time, sales staff were entitled to an incentive, which was by reference to their overall performance.

**(ii) investors on the basis of the amount of Minibonds they purchased;
and**

49.7 Special gifts for the purchase of Minibonds were provided by the arranger. The Bank did not have an incentive scheme specifically for Minibonds.

(g) if such incentive scheme(s) have changed over time, please give details of each stage of the scheme(s) in chronological order;

49.8 Please refer to paragraph 49.6 above.

(h) the officer(s) (name(s) and position(s)) in charge of the overall strategy of staff deployment for the sale of Minibonds;

49.9 The Bank did not have a strategy of staff deployment for the sale of Minibonds. The Head of BMD was responsible for the overall strategy of staff deployment in our branch network to provide all banking product sales and services to our customers.

(i) the officer(s) (name(s) and position(s)) in charge of the overall supervision of the marketing or promotion of Minibonds;

49.10 As a distributor, the Bank was not involved in the preparation of the marketing and promotion materials of Minibonds.

(j) the officer(s) (name(s) and position(s)) responsible for ensuring the achievement of sales targets;

49.11 The Head of BMD was responsible for ensuring the achievement of sales targets of all retail banking products.

(k) how DSB ensured that the applicable law and regulations were complied with in the entire sale process; and

49.12 The Bank had always treated compliance with legal and regulatory requirements strictly and expects staff to comply at all times.

The Bank had in place the following measures to ensure its selling process complied with the applicable law and regulations:

- policies and procedures governing the selling process as mentioned in paragraphs 31.1 to 31.3 above;
- training provided to sales staff as mentioned in paragraphs 23.1 to 23.19 above;
- supervision and management measures as mentioned in paragraphs 58.1 to 58.2 below.

(l) what records were made after each successful and unsuccessful transaction.

49.13 Records for the purchase of the Minibonds typically included an Investment Services Application Form, a Purchase Order and (where applicable) an Investment Product Risk Declaration Form and an Investment Product Explanation Memorandum. Successful investment transactions were also reflected in the monthly statements of the relevant customers accounts. It was not the Bank's practice to keep records of unsuccessful transactions.

50. Please describe how DSB had conducted the sale of LB-related structured financial products by way of private placement, including the following particulars:

(a) how DSB had identified the target customers (using the first and the last LB-related structured financial products mentioned in Question 2(d) and the three LB-related structured financial products mentioned in Question 3 as illustration, describe the target customers (in terms of age, education level, net worth and relationship with DSB) in the sale of each of the products);

50.1 As a bank, we strive to provide a wide-range of banking services to our retail banking customers. We made various investment products available to customers who have expressed to us their interest in investing in financial instruments and who have investment needs such as alternative interest-earning products other than traditional deposits. The Bank did not set a particular target customer segment for the sale of LB-related structured financial products by way of private placement (that is, the Private Placement Notes).

(b) the criteria adopted to designate certain customers as professional investors, and whether the customers were aware that they were so classified;

50.2 The Bank did not designate any of its retail banking customers as professional investors.

(c) how DSB had approached the target customers (e.g. making telephone calls, by invitation in writing or personal visits);

50.3 As explained in paragraph 50.1, the Bank did not set a particular target customer segment for the sale of the Private Placement Notes.

(d) the preparatory work undertaken before private placement could take place,

e.g. what promotional materials were prepared and how the staff were trained;

50.4 The Bank did not prepare any promotional materials for the distribution of the Private Placement Notes. Sales staff typically made use of and provided the Indicative Term Sheets (which were prepared and provided to the Bank by the issuer) to customers during the selling process.

The Bank provided training (both generic and specific) to the sales staff with respect to these products. Please refer to paragraphs 23.1 to 23.19.

(e) the features of the LB-related structured financial products emphasized in the relevant marketing or promotional materials used by DSB;

50.5 The features of the Private Placement Notes were emphasised and set out in the Indicative Term Sheets for the product, which were prepared and provided to the Bank by the issuer. The key features included, amongst other things, the product terms and features and the risk factors inherent in investing in the Private Placement Notes.

(f) the typical process of a successful sale (from approaching a target customer for the first time to the settlement of all relevant transactions);

50.6 As mentioned in paragraph 50.1 above, the Bank did not have target customer segments for the Private Placement Notes. Sales staff were required to follow the procedures set out paragraphs 34.1 to 34.3 and 41.1 to 41.3 above in the sale of the Private Placement Notes. In essence, the sales process would involve understanding the customers' needs, completing the relevant customer risk profiling and suitability checking procedures, explaining the terms, features and risks of the products to customers, and the completion of the necessary documentation for the transaction.

(g) how such private placements were organized (e.g. by bank branches, by sales teams or by designated officers);

50.7 Branch managers, BMD and ISM would take part in organising and monitoring the sale of Private Placement Notes. In particular, in relation to Private Placement Notes which were offered through the private placement pursuant to the exemption under the Companies Ordinance (Cap. 32) to less than 50 retail banking customers (the "Mini-PPNs"), an offer log sheet was maintained by ISM (so as to keep track of the number of offers not exceeding 50), and indicative term sheets would be provided to sales staff (a record of which would also be made) who have indicated that customers have expressed an interest in these products and who would like to present these products to the customers. ISM would then be informed of a successful transaction and documents would then be reviewed, and records would be reconciled.

(h) how such private placements were monitored (e.g. at different levels, by a team leader or branch manager or department head or designated officer);

50.8 Please refer to paragraph 50.7 above.

- (i) the quantitative sales targets, if any, set for a specific time period for each branch of DSB and for each staff member at different levels involved in such sales;
- (j) details of the incentive scheme(s) for:
 - (i) staff on the basis of the amount of sales of LB-related structured financial products achieved; and
 - (ii) investors on the basis of the amount of LB-related structured financial products they purchased;
- (k) if such incentive scheme(s) changed over time, please give details of each stage of the scheme(s) in chronological order;
- (l) was there a different incentive scheme if the LB-related structured financial products were sold to professional investors or where the subscription amount in a single transaction was HK\$500,000 or more;
- (m) the officer(s) (name(s) and position(s)) in charge of the overall strategy of staff deployment for the sale of LB-related structured financial products;
- (n) the officer(s) (name(s) and position(s)) in charge of the overall supervision of the marketing or promotion of LB-related structured financial products;
- (o) the officer(s) (name(s) and position(s)) responsible for ensuring the achievement of sales targets;
- (p) how DSB ensured that the applicable law and regulations were complied with in the entire sale process; and

50.9 In response to question 50(i) – (p), please refer to paragraphs 49.3 and 49.6 – 49.12 above.

- (q) what records were made after each successful and unsuccessful transaction.

50.10 Records for the purchase of the Private Placement Notes typically included an Investment Services Application Form, a Purchase Order, a Private Placement Notes – Letter of Undertaking, and (where applicable) an Investment Product Risk Declaration Form and an Investment Product Explanation Memorandum.

An unsuccessful order would be logged for record if the offer was made under the “50 offer rule” private placement.

51. In respect of the customers who had purchased LB-related structured financial products from DSB through private placement, please advise whether these customers had been informed that the LB-related structured financial products were sold to them through private placement.

- 51.1 Yes. Sales staff were required to explain and customers were required to complete a "Private Placement Notes – Letter of Undertaking" at the time when they purchased the Private Placement Notes and to confirm that they understood that no offering document or prospectus had been prepared in connection with the offering of the Private Placement Notes and that no prospectus in relation to the issuer or the Private Placement Notes had been delivered to the Registrar of Companies for registration nor will such a prospectus be registered under the Companies Ordinance (Cap. 32). Such document would form part of the records for the customer's purchase of the Private Placement Notes.
52. **Please set out in the form of a chart the organizational structure of the staff (including all sales teams or units and the number of staff) engaged in the sale of LB-related structured financial products. If the organizational structure varied over time, please provide a chart for each of the following stage:**
- (a) **the sale of the first and the last series of Minibonds mentioned in Question 2(c);**
- 52.1 Please see organisation charts at Appendix 52(a).
- (b) **the sale of the first and the last LB-related non-Minibonds structured financial products mentioned in Question 2(d); and**
- 52.2 Please refer to Appendix 52(b).
- (c) **the sale of the three LB-related structured financial products mentioned in Question 3.**
- 52.3 Please refer to Appendix 52(c).
53. **Besides the prospectuses and advertising materials authorized by SFC, did DSB provide other marketing materials, such as posters, promotional letters and leaflets, to customers for the sale of Minibonds? If yes, please provide the details and a copy of the relevant materials.**
- 53.1 For Minibonds, the Bank only used, and provided customers with, the offer documentation and marketing materials authorised by the SFC and supplied by the arranger.
54. **Besides the offer documentation and marketing material, did DSB provide any other materials, such as posters, promotional letters and leaflets, to customers for the sale of other LB-related non-Minibonds structured financial products? If yes, please provide the details and a copy of the relevant materials.**
- 54.1 For other LB-related non-Minibonds, the Bank only used, and provided customers with, the relevant offer documentation, term sheets and/or marketing materials supplied by the issuers / arrangers / co-ordinating dealers.

55. **Please provide a sample copy of the following documents:**

(a) subscription form(s) for LB-related Minibonds to be signed by the customer; and

55.1 Please see a sample copy of the relevant subscription form enclosed as Appendix 55(a).

(b) subscription form(s) for LB-related non-Minibonds structured financial products to be signed by the customer.

55.2 Please see sample copy of the relevant subscription form enclosed as Appendix 55(b).

56. **On the time spent by the sales staff of DSB in explaining LB-related structured financial products to customers, please advise:**

(a) whether DSB had set any minimum duration of time that a sales staff had to spend to explain to their customers the nature and risks of LB-related structured financial products. If yes, please provide the details; if no, the reasons;

56.1 Given that each customer's level of knowledge and experience is necessarily different, the Bank did not set any minimum duration for product explanation. As a general rule, our staff were required to spend sufficient time to explain to the customers the nature and risks of LB-related structured financial products prior to a transaction.

(b) whether DSB had ever made an estimation on the minimum time required to make an adequate explanation of the nature and risks of such products; if yes, please provide the estimation; and

56.2 No such estimation was made.

(c) whether DSB had ever checked, or collected any information on, the time normally taken by a sales staff to explain to a customer the nature and risks of a LB-related structured financial products in the sales process; if yes, please provide the information gathered by such checking or collection.

56.3 No such data was ever collected.

57. **In the sale process of LB-related structured financial products, please advise:**

(a) when selling (i) Minibonds and (ii) other LB-related structured financial products, whether the sales staff were allowed to provide investment advice or merely to provide investment information;

57.1 Sales staff were not allowed to provide investment advisory services.

(b) whether the approach mentioned in (a) will be different when the product is sold on public offer or by way of private placement; and

57.2 No, the approach remained the same.

- (c) whether the bank has issued any written guidelines/manuals and training materials about the approach mentioned in (a); if yes, please provide a copy of such document.**

Yes, please refer to the Compliance Guidelines (see Appendix 31(iv)).

58. Did DSB have any supervision or management measures to ensure that the frontline sales staff would follow the proper procedures stipulated in the Code of Conduct, as well as relevant manuals/guidelines, if any, during the selling process? If yes, please provide the details; if no, the reasons.

58.1 Yes. First of all, as mentioned in paragraphs 31.1 to 31.3, the Bank had policies and procedures in place to govern the sales process complied with the applicable law and regulations. General and product specific training was provided to sales staff as mentioned in paragraphs 23.1 to 23.19 above. Sales staff were required to follow these policies and procedures in selling investment products to customers.

58.2 Staff supervision and management were primarily carried out through day-to-day interaction and guidance provided to frontline sales staff by the branch management. In addition to the day-to-day supervision performed by senior members of staff, the Bank had in place the following control measures to track staff compliance in the sales process:-

- (1) Documentation of every investment product transaction was examined to track that sales staff had followed the relevant policies and procedures for the Bank when selling investment products;
- (2) BMD conducted regular branch visits to randomly check the completeness and quality of sales documentation maintained by the branches and service quality of sales staff;
- (3) Each branch was required to conduct a quarterly self-assessment on compliance matters, which covered the completeness and accuracy of various forms/ documents and phone order instructions etc.;
- (4) Legal and Compliance Division conducted branch compliance reviews in order to ensure that independent surveillance checks were being performed on the selling practices and procedures adopted by branch personnel from a regulatory compliance perspective; and
- (5) Internal Audit Division conducted audit on different aspects of the selling process of investment products at various times.

The above checks and balances were in place as separate control functions to monitor sales staffs' compliance and conduct during the sale of investment products.

59. Please advise:

(a) whether the department within DSB responsible for internal audit had conducted any audit on the selling process of investment products, in particular LB-related structured financial products, during the period between April 2003 to September 2008; and

(b) if the answer to (a) is affirmative, please provide a copy of the relevant audit report(s).

59.1 Yes. Please find enclosed as Appendix 59 copies of the excerpts of the relevant internal audit reports prepared by the Bank's Internal Audit Division during the Relevant Period.

60. Please advise:

(a) whether the department within DSB responsible for compliance had conducted any compliance review on the selling process of investment products, in particular LB-related structured financial products, during the period between April 2003 to September 2008; and

(b) if the answer to (a) is affirmative, please provide a copy of the relevant review report(s).

60.1 Yes. Please find enclosed as Appendix 60(b) a sample copy of a compliance review report prepared by the Bank's Legal and Compliance Division during the Relevant Period.

61. Please advise:

(a) whether DSB had conducted any independent mystery shopper exercise in respect of the sale of investment products, in particular LB-related structured financial products, during the period between April 2003 to September 2008; and

(b) if the answer to (a) is affirmative, please provide a copy of the relevant review report(s).

61.1 Yes. Please find enclosed as Appendix 61(b).

62. How did DSB assess the performance of sales staff? What key aspects of performance (e.g. revenue, customer growth) were assessed? Please explain the respective weighting of the various key aspects for assessing staff performance, and provide the relevant score card/performance appraisal form, if any, for such assessment.

62.1 In general, the performance of sales staff was evaluated based on a combination of factors:- (a) job factors (b) personal factors (c) compliance (d) team management and (e) service quality. No specific weighting is assigned to each factor. See Appendix

62 for a sample Performance Appraisal Report.

63. **Under the existing regulatory regime, regardless of how financial products are offered (such as through private placement or public offer), the conduct of sale by intermediaries has to comply with the Code of Conduct. How did DSB ensure that your sales staff were aware of their obligations and complied with the requirements under the Code of Conduct, including FAQ, when selling LB-related structured financial products?**

63.1 Please refer to paragraphs 58.1 to 58.2 above.

Handling of complaints

64. **Please advise:**

(a) **has DSB put in place any written policy/procedures on handling and investigating complaints lodged by customers who have purchased investment products from DSB?**

(b) **if yes, please provide a copy of such policy/procedures and a flow chart on DSB's complaint handling and investigative process in relation to LB-related structured financial products sold by DSB;**

64.1 After the collapse of LB, a number of modifications were made to the then existing general complaint handling process in order to address the LB-related complaint cases, as set out in "Guideline on Lehman Brothers Customer Complaint Handling". A copy of the "Guideline on Lehman Brothers Customer Complaint Handling" is enclosed as Appendix 64(a)(i). A flow chart is enclosed as Appendix 64(b) providing an overview of the procedures adopted by the Bank in handling complaints concerning LB-related structured financial products.

64.2 Following the agreement reached on the repurchase of Minibonds between SFC, HKMA and 16 distributing banks (including the Bank) on 22 July 2009, our Bank further enhanced the customer complaint handling procedures. The enhanced procedures are set out in the "Guidelines on Enhanced Customer Complaint Handling for Investment Products". A copy of the "Guidelines on Enhanced Customer Complaint Handling for Investment Products" is enclosed as Appendix 64(a)(ii) setting out the procedures adopted by the Bank in handling complaints concerning investment products (including but not limited to LB-related structured financial products). Please also see Appendix 1 of the Guidelines on Enhanced Customer Complaint Handling for Investment Products for a flow chart setting out the complaints handling flow for the selling practice of investment products complaint cases.

(c) **are such policy/procedures required to be endorsed by the regulators (such as HKMA)? If no, is a copy of such policy/procedures provided to the regulator(s) for record?**

64.3 The Guidelines on Enhanced Customer Complaint Handling for Investment Products had to be endorsed by HKMA. The Guideline on Lehman Brothers Customer Complaint

Handling was not required to be endorsed by the regulators though it would have been made available to regulators upon request.

- (d) the details of the enhanced complaint handling procedures as required under the Minibonds repurchase agreement between 16 banks and HKMA and SFC to resolve complaints in relation to the sale of Minibonds; and**

64.4 In essence, the guidelines provide that:-

- (i) Upon receipt of a complaint relating to the selling practice of investment products, it shall be passed to File Creation & Overall Management Team for follow-up / record.
- (ii) Acknowledgement Letter shall be sent to the complainant by the Customer Complaint Correspondence Team and the Customer Interview Team shall interview the complainant/witness and document the details of interview.
- (iii) The Document Collection Team shall collect all documentation, phone recordings (if any), sales staff statement (if any), evidence and proof related to the complaint from the concerned branch / department.
- (iv) The Complaint Investigation Team shall conduct a complete review on all documentation and evidences made available from the bank internally as well as from the complainant to assess aspects including customer suitability, customer allegations, any documentation deficiency or inadequacy, any deficiency in the selling process and the compliance of applicable regulatory guidelines. It shall make a preliminary determination by completing an “Investigation Report for Investment Products Complaint” and pass the same to other staff at supervisory level for review
- (v) The Panel Review Team shall review and endorse or comment with other determination to conclude the report. It may further escalate the report to Senior Management’s for further guidance.
- (vi) Senior Management shall make final determination and direction for complaint cases escalated.
- (vii) Complainant shall be notified with the investigation result. If it is accepted, a reply letter will be issued by the Customer Complaint Correspondence Team. If it is not accepted, complainant can submit new allegations and relevant documents to the Bank for further review. The Bank will go through the investigation and review processes on the complaint case again

with any new allegations and supporting documents.

- (viii) If a complainant does not accept the final review result, he/she will be advised with the further steps or actions available under the existing regulatory regime.
 - (ix) Settlement meeting will be arranged with complainants where necessary.
- (e) whether the enhanced complaint handling procedures in (d) above also applied in resolving complaints in relation to the sale of other LB-related non-Minibonds structured financial products.**

64.5 Yes. The guidelines also applied to resolving complaints in relation to the sale of other LB-related non-minibonds structured financial products.

65. Before the collapse of LB in mid-September 2008, did DSB receive any complaints in relation to alleged mis-selling of LB-related structured financial products? If yes, please provide the details, including the number of cases and particular series involved.

65.1 No. The Bank did not receive any complaints by their customers in relation to alleged mis-selling of any of the LB-related structured financial products prior to mid-September 2008.

66. Please provide the number of customers who had purchased (i) Minibonds and (ii) other LB-related non-Minibonds structured financial products from DSB and who were affected by the collapse of LB.

66.1 The number of customers who had purchased (i) Minibonds and (ii) other LB-related structured financial products from the Bank and were affected by the collapse of Lehman Brothers was 2,401 and 1054 respectively (joint holders being counted as one customer unit).

67. Please provide the information in the enclosed Table 5.

67.1 Please see enclosed as Appendix 67.

68. It is noted that DSB is one of the distributing banks that signed the agreement with HKMA and SFC in relation to the repurchase of Minibonds in July 2009. Please provide further information as follows:

- (a) of the unresolved complaints relating to Minibonds in item (2)(d) of Table 5, a breakdown of the number of complaints (i) under mediation, (ii) under arbitration, (iii) under negotiation between DSB and the investors concerned, and (iv) rejected;**

68.1 As of 7 October 2010, in terms of number of customers, we have 26 unresolved Minibonds complaints, all of which are under negotiation between the Bank and the customers concerned.

(b) the expected time-frame to resolve these outstanding complaints; and

68.2 The Bank continues to maintain active contact with the outstanding complainants and continues to use its best efforts in trying to resolve these cases. If the matter cannot be resolved through the ongoing discussions, we will consider recommending the approach of mediation to the complainants.

(c) whether DSB had followed up the progress of the work of the trustee and the estimated timeframe for recovering the underlying collateral. If yes, please provide details; if no, the reasons.

68.3 As a member of Hong Kong Association of Banks (HKAB) Task Force in relation to the LB Incident, we have, through the Task Force, been closely following-up with the trustee and understand that the expected timeframe for recovering the underlying collateral is yet to be determined.

69. It is noted that DSB is one of the distributing banks that reached a resolution with HKMA and SFC in relation to the repurchase of certain LB-related principal protected notes (PPNs) in December 2009. Regarding the complaints involving LB-related non-Minibonds structured financial products, please provide further information as follows:

(a) of the unresolved complaints in item (2)(d) of Table 5, a breakdown of the number of complaints (i) under mediation, (ii) under arbitration, (iii) under negotiation between DSB and the investors concerned, and (iv) rejected;

69.1 As of 7 October 2010, in terms of number of customers, we have 15 unresolved LB-related non Minibonds structured financial products complaints, all of which are under negotiation between the Bank and the customers concerned.

(b) the expected time-frame to resolve the outstanding complaints;

69.2 The Bank continues to maintain active contact with the outstanding complainants and continues to use its best efforts in trying to resolve these cases. If the matter cannot be resolved through the ongoing discussions, we will consider recommending the approach of mediation to the complainants.

(c) whether a broad-based settlement similar to the repurchase of Minibonds and PPNs would be reached in respect of all other LB-related structured financial products. If yes, please provide the details; if no, the reasons; and

69.3 No. The Bank remains committed to trying to resolve each complaint case through the enhanced complaint handling procedure.

(d) whether a broad-based settlement in relation to a particular type of LB-related structured financial products or a particular series of such a product similar to the repurchase of certain LB-related PPNs would be reached. If yes, please provide the details; if no, the reasons.

69.4 No. The Bank remains committed to trying to resolve each complaint case through the enhanced complaint handling procedure.

70. **Did DSB detect any substantiated non-compliance cases in relation to the sale of LB-related structured financial products during its internal investigations into the complaints filed by investors of such products? If yes, please provide the number and key particulars of such cases.**

70.1 Whilst there might have been isolated cases of inconsistency with internal procedures, the Bank did not detect any substantiated non-compliance cases in respect of complaints received.

71. **In respect of the customers who had purchased LB-related structured financial products from DSB through private placement, please advise:**

(a) the number of complaint cases, if any, in which the customers alleged that they had not been informed that the LB-related structured financial products were sold to them through private placement; and

71.1 We are only aware of isolated cases of this particular allegation.

(b) out of the complaint cases in (a), the number of cases that had audio recording of the selling process.

71.2 It was not the Bank's practice at the time to require audio recording of the selling process prior to the issuance of the HKMA circular on 9 January 2009.

72. **It is noted that HKMA launched a LB-related products mediation and arbitration scheme in November 2008 for investors whose complaints have been referred by HKMA to SFC. Please inform the Subcommittee of the following:**

(a) under what circumstances DSB would agree to take part in the abovesaid mediation or arbitration;

72.1 The Bank considers mediation to be appropriate in the following circumstances:-
(i) encouraged by regulator; (ii) requested by customer; or (iii) the Bank felt that an agreement could be reached through mediation.

(b) the latest number of cases, if any, in respect of which mediation with customers had been arranged;

(c) the number of cases settled by mediation, the number of investors and the amount (HK\$) involved;

(d) a breakdown of the settled cases in (c) showing the amount settled as a percentage of the investment amount;

72.2 Please see Mediation Table enclosed as Appendix 72.

(e) the reasons why mediation was unsuccessful;

72.3 It was mainly due to both parties were unable to arrive at a settlement within the prescribed time of the mediation session.

(f) the latest number of cases in respect of which arbitration with customers had been arranged;

72.4 The Bank did not refer any case to arbitration.

(g) the number of cases resolved by arbitration, the number of investors and the amount (HK\$) involved; and

72.5 Please refer to paragraph 72.4.

(h) a breakdown of the settled cases in (g) showing the amount settled as a percentage of the investment amount.

72.6 Please refer to paragraph 72.4.

73. Please inform the Subcommittee of the following:

(a) the number of staff who had been involved in the sale of Minibonds and LB-related non-Minibonds structured financial products and who had left the employment of DSB after 15 September 2008;

73.1 The number of such former staff members was 58.

(b) out of the former staff referred to in (a),

(i) the number of staff who were involved in complaint cases in relation to Minibonds;

73.2 The number of such former staff members was 43.

(ii) the respective number of such complaint cases for Minibonds;

73.3 In terms of number of transactions, the number of such complaint cases was 571.

(iii) the number of staff who were involved in complaint cases in relation to non-Minibonds products;

73.4 The number of such former staff members was 48.

(iv) the respective number of such complaint cases for non-Minibonds products; and

73.5 In terms of number of transactions, the number of such complaint cases was 258.

(c) out of the complaint cases in (b), the number of cases in which DSB was unable to contact the responsible staff members who had left employment.

73.6 Under the procedures of handling LB-related complaints, it was generally not required to contact former staff.

Regulatory oversight and compliance

74. **It is noted that since 2000, HKMA has adopted the practice of holding prudential meetings with the boards of directors of local banks once a year to the extent possible. Please advise:**

(a) From 2000 to September 2008, how many such prudential meetings were held with DSB?

74.1 From 2000 to September 2008, the HKMA had three meetings with the Bank's Board of Directors, and one meeting with the Audit Committee, a board-level committee.

(b) The date (month/year) of these meetings and whether HKMA held these meetings with the board of directors or any committee of DSB; and

74.2 The HKMA's meetings with the Bank's Board of Directors:

- 7 August 2001
- 3 March 2003
- 27 August 2007

The HKMA's meeting with the Audit Committee
8 February 2006

(c) at these prudential meetings, did HKMA express concerns or raise suggestions about boosting the bank's non-interest income? Please explain.

74.3 HKMA did not specifically express concerns or raise suggestions about boosting the bank's non-interest income during these prudential meetings.

75. **Prior to the collapse of LB in September 2008, did HKMA, in the course of its on-site and off-site examinations, relay to DSB any concerns in the following areas in relation to the sale of structured financial products (such as LB-related products) sold by DSB:**

(a) product due diligence;

- (b) training and guidance to staff;
- (c) handling customers;
- (d) information about customers;
- (e) suitability of recommendation and solicitation; and
- (f) supervision of sales process.

If yes, please explain.

- 75.1 The HKMA had shared comments, namely, its recommendations mainly focusing on assisting the Bank in making ongoing enhancements to the product due diligence and suitability assessment process. The enhancements and modifications implemented by the Bank have been explained in the answers above.
76. **It is noted that HKMA issues from time to time advice and circular letters to all Registered Institutions (for example, the circular letter dated 1 March 2005 on "The Securities and Futures Commission's Report (the Report) on Selling Practices of Licensed Investment Advisers" and the circular letter dated 3 March 2006 on "Retail Wealth Management (RWM) Business"). Does DSB have any arrangements in place to take heed of and/or follow up the regulatory concerns raised by HKMA? If yes, please provide the details; if no, the reasons.**
- 76.1 Generally, our Legal and Compliance Division has the responsibility of bringing up the new regulatory requirements to the attention of the relevant departments, and making suggestions to the departments where applicable procedures and policies should be enhanced.