

**HKMA's response to information requests of
Legislative Council Panel on Financial Affairs
Follow-up to Special meeting on 23 February 2009**

I. Circumstances specific to Hong Kong leading to the large number of retail investors investing in Lehman Brothers-related Minibonds

There do not appear to be absolute restrictions on the sale of structured products to the retail public in any of the major markets (the UK, the US, Australia, Singapore, the Netherlands and Germany). However, it is important to note that the choice of and demand for investment products by retail investors in different markets may vary according to the unique factors of each specific market, such as retail investors' investment objectives, risk appetite and investment experience, the availability and efficiency of distribution channels for different investment products, investment choices available in individual markets, and market conditions (e.g. interest rate level, performance of the stock market, etc).

2. In Hong Kong, it should be noted that bank deposit rates¹ were at a low level between 2004 and mid-2008. There was also a growing awareness among retail customers of the need for financial planning and wealth management (such as retirement planning and children's education planning) during this period. These factors may have contributed to an increasing demand from retail customers for various types of financial products which can enhance their investment yield, diversify investments and achieve their investment objectives. Driven by such a growing demand, various types of financial products such as equity-linked notes, credit-linked notes (including Minibonds), hybrid securities and index-linked notes were launched in the market to meet the needs of customers with differing investment objectives and risk appetites.

¹ During the period of 2004 to mid of 2008, the Hong Kong dollar six-month time deposit rate was: less than 1% during January 2004 to May 2005, 1.12% - 2.92% during June 2005 to February 2008, and less than 1% from March 2008 onwards. (Source: Hong Kong Monetary Authority Statistical Bulletin)

3. A rising trend in retail structured financial products has also been observed in overseas markets in the past few years. According to information available in the “StructuredRetailProducts.com” website, a significant growth in the launch of retail structured financial products in terms of volume and number of issues was recorded in Germany, Spain, the US, Japan and Singapore during 2002 to 2007, as summarized in the table below:

Countries	Retail structured financial products: number and volume of products launched in year 2007 compared to year 2002	
	% Change in Number of Products Launched in 2007 over 2002	% Change in Total Volume of Products Launched in 2007 over 2002
Germany	+ 89 590%	+ 7 379%
Spain	+ 352%	+ 68%
US	+ 10 593%	+ 952%
Singapore	+ 1 093%	+ 787%
Japan	+ 358%	+ 142%

4. Lehman-related structured products were also distributed to retail investors in other markets, including Singapore, Germany, Spain, Taiwan and US. Some examples are summarized below.

Singapore

5. According to the Monetary Authority of Singapore, Minibonds were sold to retail investors through nine distributors and there were 8 000 retail investors holding the Minibonds with total nominal amount of S\$375 million (around HK\$1.9 billion). In addition, there were also 1 750 investors holding Lehman-related structured notes with nominal value of S\$126 million (around HK\$0.63 billion)².

² Source: FAQ on Lehman Brothers’ Structured Products published by the Monetary Authority of Singapore on 14 November 2008

Germany

6. 60 000 retail investors in Germany have invested in Lehman-related retail products named “Zertifikate” with a total size of about EUR500 million (around HK\$4.9 billion)³.

Spain

7. More than 15 000 investors in Spain invested in Lehman-backed structured bonds and more than 30 financial firms were involved in the distribution of such products with an estimated volume of EUR3.6 billion (around HK\$35 billion)⁴.

Taiwan

8. Taiwan’s Financial Supervisory Commission reported that wealth management clients from domestic financial institutions in Taiwan hold NT\$40 billion (around HK\$8.8 billion) outstanding amount of structured notes connected with debt claims for Lehman Brothers⁵. A total of about 51 000 retail investors were reported to have purchased Lehman-related structured notes in Taiwan⁶.

US

9. Lehman Brothers sold over US\$900 million (around HK\$7 billion) of retail structured products in 2008 in US market⁷.

³ Source: Paragraph 14.3.2(b) of “ Issues Raised by the Lehmans Minibonds Crisis – Report to Financial Secretary” issued by SFC in December 2008 quoted report of the Berlin-based German Institute for Investor Protection

⁴ Sources: News from StructuredRetailProducts.com on 7 Jan 2009

⁵ Sources: Press Release of Financial Supervisory Commission of Taiwan on 15 September 2008

⁶ Source: Wall Street Journal (Chinese Edition) 10 October 2008

⁷ Source: Paragraph 14.3.3(a) of “ Issues Raised by the Lehmans Minibonds Crisis – Report to Financial Secretary” issued by SFC in December 2008 quoted report of “StructuredRetailProducts.com” website

II. HKMA's survey in late 2007 on the sale of credit-linked products by authorized institutions

In view of the significant changes in market conditions arising from the sub-prime crisis and the increasing attention of the Hong Kong Monetary Authority (“HKMA”) to sub-prime related and collateralized debt obligations (“CDO”) related products, the HKMA conducted a survey during December 2007 to early 2008 to gather information about the sale by registered institutions (“RIs”)⁸ of retail credit-linked notes (“CLNs”) (i.e. CLNs of which the issue prospectuses were authorized by the Securities and Futures Commission (“SFC”)) with sub-prime mortgages as underlying collateral and retail CLNs the collateral of which was, or might consist of, CDOs (hereafter referred to as “relevant CLNs”). The survey covered 16 RIs (i.e. excluding on materiality ground two RIs which only distributed one of the relevant CLNs) and those relevant CLNs the issue prospectuses of which were authorized by the SFC from 1 January 2006 to 27 November 2007.

2. The survey results revealed that a total of around US\$1.2 billion had been subscribed by customers through the 16 RIs during 2006 to 2007. The survey did not collect information on the number of customers investing in these products. Regarding complaints, among the surveyed RIs, two RIs received one complaint each during the period (i.e. from 2006 to 2007), while the other surveyed RIs did not receive any complaint about the selling of such products during 2006 to 2007.

3. The HKMA also obtained information on the product risk rating assigned by the RIs distributing such products (i.e., including the two RIs not covered in the survey mentioned above) to the relevant CLNs. Based on the information collected, the HKMA noted that some RIs adopted a “high” risk rating classification for these products. In the light of the market conditions prevailing at that time and to enhance uniform and prudent treatment among RIs, the HKMA advised the other RIs which distributed retail credit-linked products without full principal protection to adopt a “high” risk rating classification for these products.

⁸ Registered Institutions refers to authorized institutions which are registered under the Securities and Futures Ordinance (“SFO”) to conduct securities intermediary activities. Under the existing regulatory framework authorized in the SFO and Banking Ordinance, the HKMA is the front-line supervisor of registered institutions.

III. The progress of handling and investigations of Lehman-related complaints

Statistics on Lehman-related Complaints (as at 26 March 2009)

	No. of cases
Preliminary assessment completed	20 380
Commenced investigation <i>(including 414 cases referred to SFC)</i>	5 677
Cases in which one or more type of necessary information cannot be obtained <i>(Necessary information includes i) investment concentration, ii) investment experience, iii) education level, iv) age, v) income, and vi) occupation of the complainant)</i>	3 770*
Referred to SFC	414

* *This figure does not include cases that cannot proceed because complainants refuse to provide any further information for investigation purposes. Such cases amount to 654.*

Hong Kong Monetary Authority
March 2009