

**Legislative Council Panel on Financial Affairs**

**Policy Issues relating to Suspension of Trading and Subsequent Buyback of Four Derivative Warrants Linked to the Nikkei 225 Index issued by Goldman Sachs Structured Products (Asia) Limited**

This note provides updated information in response to the motion passed by the Legislative Council Panel on Financial Affairs at its 9 June 2011 meeting, in relation to the subject of “Policy issues relating to suspension of trading and subsequent buyback of four derivative warrants linked to the Nikkei 225 Index issued by Goldman Sachs Structured Products (Asia) Limited”.

Regulation of Derivative Warrants

2. The principal function of the Stock Exchange of Hong Kong Limited (the Exchange) is to provide a fair, orderly and efficient market for the trading of all securities (including structured products). This is carried out through the Exchange’s administration of the Exchange Listing Rules which are designed to ensure that investors have and can maintain confidence in the market, in particular, that applicants are suitable for listing, and potential investors are given sufficient information to enable them to make an informed assessment of an issuer and the securities listed.

3. The Exchange is subject to the oversight of the Securities and Futures Commission (SFC). Chapter 15A of the Listing Rules was approved by the SFC under the Securities and Futures Ordinance and that Chapter sets out the regulatory framework and requirements regarding listed structured products in detail. In accordance with the January 2003 MOU Governing Listing Matters Between the SFC and the Exchange, the Exchange will approve listings of structured products, and, in order not to duplicate regulatory effort, the SFC will only review draft listing documents upon request from the Exchange. The Exchange may refer structured products listing documents to the SFC in respect of any new or novel types of structured products or where there are any new or novel issues in the structure of a previously approved listed structured product.

4. The Listing Committee of the Exchange approves issuers of structured products on the basis of a report from the Listing Division indicating that the issuer meets the eligibility criteria laid down in the Listing Rules. The Listing Division approves an issue of structured product and in doing so, it will vet an application for compliance with the Rules. Having approved the launch of a structured product, the Division will vet the relevant launch announcement and supplemental document for compliance with the quantitative criteria in the Rules.

5. Derivative warrants are subject to the terms and conditions approved by the Exchange. The Listing Rules prescribe a number of quantitative criteria in relation to issues.<sup>1</sup> Modifications to the terms and conditions must be approved by the Exchange.

#### Goldman Sachs' Warrants

6. In relation to the four derivative warrants over Nikkei 225 Stock Average Index launched by Goldman Sachs Structured Products (Asia) Limited (GS) on 11 February 2011, their base listing document contains the terms and conditions. In particular, condition 9(b) provided for modification of the warrants in the following circumstances:

***“The Issuer may, without the consent of the Warrantholder, effect (i) any modification of the provisions of the Warrants or the Instrument which is not materially prejudicial to the interests of the Warrantholder or (ii) any modification of the provisions of the Warrants of the Instrument which is of a formal, minor or technical nature, which is made to correct an obvious error or which is necessary in order to comply with mandatory provisions of the laws of Hong Kong (as defined below) or such other jurisdiction where any Shares included in the Index are listed, or the issuer(s) of any Shares included in the Index is/are incorporated. Any such modification shall be binding on the Warrantholder and shall be notified to them by the Agent as soon as practicable thereafter in accordance with Condition 10.”***  
(emphasis added)

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<sup>1</sup> These include: (1) Minimum issue price of HK\$0.25; (2) Minimum lifespan of 6 months; (3) Maximum lifespan of 5 years; and (4) Where the underlying asset is an index the warrant must be cash-settled and the board lot must be 10,000 warrants.

Such “modification clause” in Condition 9(b) is common in structured products issued by the Exchange and on overseas exchanges.

7. According to GS’ announcement, GS took the view that the error in the formulae for Cash Settlement Amount was both a technical and obvious error, and they were permitted under condition 9(b) of the terms and conditions of the Warrants to correct this error. The Exchange has further learned that this view was supported by an opinion from GS’s solicitor which is a leading international law firm, and confirmed by an opinion from a Senior Counsel who is also Queen’s Counsel.

8. The Exchange obtained a legal opinion from a senior counsel it appointed, independent of GS’ legal counsel. Counsel’s opinion was that condition 9(b)(ii) in the terms and conditions of the Warrants gave GS that contractual right to correct the Cash Settlement Amount formulae because there had been an “obvious error”, otherwise, the settlement amount would have no rational or commercial connection with the exchange rate between Japanese yen and Hong Kong dollar. A copy of these legal opinions provided to GS and the Exchange has been given to the SFC for its reference.

#### GS’ Buyback Offer

9. The Exchange has no legal power to impose compensation arrangements on GS. It does, however, have the responsibility for ensuring an orderly market, for preserving market confidence and the power to discipline GS for allowing the incident to occur. The Exchange offered GS general guidance on the principles it believed GS should follow in formulating a compensation proposal to warrant holders in the interests of maintaining confidence in a fair and orderly warrant market. The principles were that any proposal should:

- (a) ensure that warrant holders were compensated for a lack of a market for their warrants;
- (b) be fair and seen to be fair so as to restore confidence on the Issuer and maintain confidence in the market generally;
- (c) leave individuals free to pursue any legal claims that they might consider they had against the Issuer if their warrants expire in the money; and

- (d) give warrant holders sufficient time to consider the Issuer's proposals.

The SFC has endorsed these principles.

10. According to the information provided by GS to the Exchange, the latest claim situation under GS' buyback offer is at Annex A.

11. The SFC agrees that GS' compensation arrangement is a matter between GS and warrant holders and it is for the warrant holders to assess the best course of action to take having regard to their own particular circumstances. GS has advised the Exchange that all warrant holders who accepted the compensation arrangement had received compensation from GS. Any warrant holders (including those individual holders who have accepted the buyback proposal) disagreeing with the validity of the amendment by GS may take the matter to the courts, as any such disagreement would be a contractual dispute.

#### Follow-up Actions

12. The Exchange intends to investigate GS' error with a view to considering whether disciplinary action is warranted. It will follow due process necessary for ensuring procedural fairness. The investigation and any subsequent disciplinary proceedings will thus take time.

13. On 27 June 2011, the SFC and the Exchange met with representatives of GS to discuss further progress on the compensation arrangements. GS has prepared a report at Annex B setting out why it considered its buyback offer to be fair and reasonable.

14. The Exchange will engage warrant issuers in discussions about best practices in the derivative warrants market, including the areas of documentation, liquidity provision obligations, issuers' programs and controls, investor education and communication.

**Financial Services Branch, Financial Services and the Treasury Bureau  
Securities and Futures Commission  
Hong Kong Exchange and Clearing Limited  
July 2011**

## Annex A

Following GS' announcement of the results of buyback offer on 2 June 2011, it accepted one more claim from a holder with 20,000 warrants on GS-N225@EC1109 (stock code: 10073) whose claim was previously overlooked. Details of the breakdown as at 22 June 2011 are as follows:

|  | 10073          |              | 10074          |              | 10075          |              | 10076          |              | All 4 Warrants              |              |
|--|----------------|--------------|----------------|--------------|----------------|--------------|----------------|--------------|-----------------------------|--------------|
|  | No. of holders | Net Position | No. of holders | Net Position | No. of holders | Net Position | No. of holders | Net Position | No. of holders <sup>1</sup> | Net Position |
| <b><i>(i) Investors who have accepted the buyback offer<sup>2</sup></i></b>      |                |              |                |              |                |              |                |              |                             |              |
| <b>Accepted</b>  | 61             | 19,890,000   | 9              | 3,610,000    | 20             | 3,260,000    | 35             | 4,880,000    | 91                          | 31,640,000   |
| <b>% of Grand Total</b>  | 74.1%          | 36.5%        | 90.0%          | 98.1%        | 74.1%          | 65.6%        | 72.9%          | 61.8%        | 75%                         | 44.5%        |
| <b><i>(ii) Investors who have not accepted the buyback offer<sup>3</sup></i></b> |                |              |                |              |                |              |                |              |                             |              |
| <b>Non-accepted</b>  | 20             | 34,590,000   | 1              | 70,000       | 7              | 1,710,000    | 13             | 3,020,000    | 29                          | 39,390,000   |
| <b>% of Grand Total</b>  | 25.9%          | 63.5%        | 10.0%          | 1.9%         | 25.9%          | 34.4%        | 27.1%          | 38.2%        | 25%                         | 55.5%        |
| <b>Grand Total</b>   | 81             | 54,480,000   | 10             | 3,680,000    | 27             | 4,970,000    | 48             | 7,900,000    | 120                         | 71,030,000   |

Items in grey are updated figures.

Notes:-

<sup>1</sup> There are in total 120 warrant holders who hold one or more than one Warrant. If the number of warrant holders is counted on per Warrant basis (without elimination of multiple counting of holders who hold more than one issue), the aggregate total of holders would be 166.

<sup>2</sup> Per GS announcement, these are warrant holders who have accepted its buyback offer.

<sup>3</sup> These are warrant holders who have not accepted the buyback offer. Two major warrant holders (one investment bank and one investor) account for a total of 33.28m shares (22m shares and 11.28m shares respectively) or 84.5% of the total shares held by those non-accepted holders.

**GOLDMAN SACHS'****REPORT ADDRESSING THE FAIRNESS AND REASONABLENESS OF  
THE BUYBACK OFFER FOR THE FOUR DERIVATIVE WARRANTS LINKED TO THE  
NIKKEI 225 INDEX ISSUED BY GOLDMAN SACHS STRUCTURED PRODUCTS (ASIA) LIMITED**

1. On 27 June 2011, representatives of Goldman Sachs ("**GS**") met with representatives of the Hong Kong Exchanges and Clearing Limited (the "**Exchange**") and the Securities and Futures Commission (the "**SFC**") to discuss the buyback proposal in respect of four derivative warrants linked to the Nikkei 225 index issued by Goldman Sachs Structured Products (Asia) Limited (Stock code: 10073, 10074, 10075 and 10076; together the "**Warrants**").
2. At that meeting, GS was asked to submit a report addressing the fairness and reasonableness of the buyback offer announced by GS on 21 April 2011 (the "**Buyback Offer**").
3. This paper is provided in response to that request and addresses in turn:-
  - (a) the background to the Warrant suspension and GS' Buyback Offer;
  - (b) the reasons why GS' Buyback Offer was and is fair and reasonable;
  - (c) the outcome of the Buyback Offer;
  - (d) GS' conduct and communication of the Buyback Offer; and
  - (e) the nature and handling of complaints received by GS regarding the Buyback Offer.

**Background**

4. The Warrants were issued on 17 February 2011.
5. In the morning of 31 March 2011, an error was discovered in the Japanese Yen to Hong Kong Dollar conversion within the "Cash Settlement Amount per Board Lot" and "Cash Settlement Amount" formulae in the Launch Announcement and Supplemental Listing Document for each of the Warrants (referred herein as the "**Drafting Error**").
6. Following discussions with the Exchange, trading in the Warrants was suspended at 10:52a.m. on 31 March 2011.
7. The Drafting Error was an obvious, technical error such that GS was entitled to correct it by amendment which it did the same day on 31 March 2011. Its entitlement to do so was confirmed by a leading international law firm and a Hong Kong Senior Counsel. It is noted that the independent legal advice received by the Exchange from its own Senior Counsel also concluded that GS had the contractual right to amend the terms because this was an "obvious error".
8. Following the suspension of the Warrants, GS devoted a high-degree of effort into resolving the issue in a manner that was fair to investors and supported the integrity of, and confidence in, the market. On Wednesday 6 April 2011, the third business day following the suspension, GS issued an announcement through the Exchange informing investors that it understood investors' concerns at the continuing lack of a market in the Warrants and was finalizing an arrangement designed to ensure that investors would not be prejudiced by the suspension.

9. The period between 31 March 2011 and the announcement of the Buyback Offer on 21 April 2011 was occupied by very active and continuous dialogue and consultation between GS and the Exchange (and to a lesser degree, the SFC) in which the terms of the proposal were explained and discussed. GS maintained regular communication with investors through Exchange announcements, newspaper advertisements and the telephone hotlines staffed by GS and Ernst & Young throughout this period.
10. The Buyback Offer was the subject of a detailed Exchange announcement issued on 21 April 2011 in which investors were informed that:
- (a) **No trading:** Trading in the Warrants would not resume as it was not considered possible to ensure fair and orderly trading given the potential for speculative trading.
  - (b) **Buyback offer:** GS would, at the election of existing holders of the Warrants, buyback the Warrants at the higher of: (i) 110% of the total net purchase price paid by each holder for their Warrants; or (ii) 110% of the total "Buyback Value". "Buyback Value" was calculated by reference to the most advantageous level of the Nikkei 225 Index (i.e. highest for the call Warrants or lowest for the put Warrants) on each trading day during the period from and including 30 March 2011 to and including 21 April 2011, as adjusted to take into account our estimate of the volatility of the Index as at 30 March 2011 (being the date with the highest volatility during this period) and of the time decay (to take into account the passage of time). This methodology used for the calculation of the Buyback Value has been designed to seek to ensure that Warrant holders participating in the Buyback Offer will get the benefit (but not the downside) of any market movements in the Nikkei 225 Index during the relevant period. Further, institutional, but not individual, holders of the Warrants were required as a condition of acceptance of the offer to waive any claims against GS. Each holder of Warrants repurchased under the Buyback Offer would also receive an additional administrative fee of HKD5,000.
  - (c) **Retention:** Alternatively, if holders of Warrants wished to hold their Warrants until expiry, they would receive the Cash Settlement Amount, if any, under the correct and amended formula, due to them as at expiry.
  - (d) **New Warrants:** New warrants would be issued on identical key economic terms to enable investors who wished to maintain exposure to the Nikkei Index to continue to participate in the usual way.
11. Investors were initially given until 16 May 2011 to decide whether to participate in the Buyback Offer. However, on 11 May 2011, in response to feedback from certain investors and the Exchange that more time should be allowed for investors to decide whether to participate in the Buyback Offer, GS issued a further announcement informing investors that the Buyback Offer Period would be extended to 27 May 2011 (giving investors a total of 36 calendar days).

**The reasons why the Buyback Offer was and is fair and reasonable**

12. In designing and implementing the Buyback Offer, GS ensured that it addressed the guiding principles discussed with the Exchange, namely that the offer should:
- (a) ensure that warrant holders were compensated for a lack of a market for their warrants;

- (b) be fair and seen to be fair so as to restore confidence in the issuer and maintain confidence in the market generally;
  - (c) leave individuals free to pursue any legal claims that they might consider they had against the issuer if their warrants expire in the money; and
  - (d) give warrant holders sufficient time to consider the issuer's proposals.
13. **No prejudice to investors who traded pre-31 March 2011:** It was clear that the Drafting Error did not affect the pricing of the Warrants prior to 31 March 2011. Prior to that date, GS provided liquidity, and the Warrants traded, in accordance with the intended cash settlement formula. This is demonstrated by comparing the performance of Warrant 10073 with the performance of the equivalent warrant issued by Deutsche Bank (stock code 10035). There was accordingly no prejudice to investors who traded prior to 31 March 2011. Nevertheless, investors who purchased Warrants before 31 March 2011 were entitled to participate in the Buyback Offer.
14. **Investors compensated for lack of liquidity between suspension and announcement of Buyback Offer:** In order to ensure overall fairness, it was a central feature of the Buyback Offer that no holders of warrants at the time of suspension would suffer any loss on their investment. To that end, the price offered to all holders of the Warrants was the higher of: (a) 110% of the purchase price paid by the warrant holder; or (b) 110% of the "Buyback Value". The "worst-case outcome" was therefore a 10% return on the price paid.
15. **Windfall return inappropriate:** This level of (worst-case) return appropriately compensated investors affected by the suspension and resulting absence of liquidity. It would not have been appropriate or in the interests of market stability to offer a higher "windfall" return to accepting holders. A windfall return would: (a) be arbitrary; (b) may have aggrieved holders who had sold out before the suspension; and (c) would be inconsistent with market integrity by setting a precedent that would encourage price speculation if such issues arise in the future.
16. **Calculation methodology adopted favourable parameters:** Warrant holders were compensated for the lack of a market in the Warrants through the methodology used for the calculation of the Buyback Value. This was calculated by using the highest (for the call Warrants) or lowest (for the put Warrants) level of the Nikkei 225 Index on each trading day from 30 March 2011 through to the announcement of the Buyback Offer on 21 April 2011. In addition, the calculation factored in the volatility level as of 30 March 2011 (being the date with the highest, and most favourable, volatility during the period for the assessment of the Buyback value) as well as the time value Warrant holders may suffer during the period of suspension. This methodology therefore assumed that holders chose to sell their warrants at the highest theoretical value over this period. Warrant holders were therefore compensated for the absence of a market by assuming in their favour the best possible trading outcome during this period, notwithstanding the fact that each of the "favourable" factors was unlikely to have occurred at the same point in time. As noted in the newspaper advertisement issued by GS dated 27 May 2011, KPMG was engaged to independently calculate the theoretical value of the Warrants as at the close of business on 26 April 2011 and 23 May 2011. The Buyback Values of the Warrants on those dates were in excess of the theoretical values that KPMG calculated using an accepted industry valuation model.



17. **Administrative fee:** In addition, a HKD5,000 administrative fee was offered to all accepting holders of the Warrants as an ex gratia payment for any inconvenience caused and to cover costs incurred (e.g. brokerage fees). Many brokerages offer packages that cap brokerage fees on warrants traded during a month to below HKD5,000. This was a fixed administrative fee that applied irrespective of the number of the Warrants held.
18. **No release required from individuals:** Individual holders of warrants were not required as a condition of acceptance of the offer to waive any claims against GS. That condition applied only to institutional investors. Individual, retail holders of warrants were not required to waive rights because it was recognized that they (unlike institutional investors) might not have ready access to legal advice so as to make an informed assessment of the waiver.
19. **New warrants issued:** In addition to giving Warrant holders the option of selling their position back to GS as summarized above, GS launched four new warrants on identical terms to the Warrants to allow investors that wanted to retain comparable economic exposure to the Nikkei Index to do so. Investors were therefore given the ability to reinvest and maintain exposure to the Nikkei index on the same terms.
20. **Generous acceptance period:** Originally, the Buyback Offer was open for a period of 21 days which, by analogy, is the time period for accepting takeover offers for Hong Kong listed companies. However, on 11 May 2011, in response to feedback from certain investors and the Exchange that more time should be allowed for investors to decide whether to participate in the Buyback Offer, GS extended the Buyback Offer Period, by 11 days, to 27 May 2011. Investors were informed of the extension by a formal Exchange announcement and by newspaper announcements. Investors were therefore given over 5 weeks to consider the Buyback Offer.
21. **Independent advisor appointed:** To ensure independence and fairness, GS appointed Ernst & Young Transactions Limited ("**E&Y**") to act as an independent advisor in respect of the implementation and administration of the Buyback Offer.
22. For all of the above reasons, GS considers the Buyback Offer and arrangements for the Warrants to be fair, reasonable and transparent, and considers that the Buyback Offer has fully addressed each of the principles discussed with the Exchange, set out above.

#### **The outcome of the Buyback Offer**

23. The Buyback Offer Period closed on 27 May 2011.
24. Out of a total of 120 Warrant holders, 91 accepted the Buyback Offer, an acceptance ratio of over 75%.

| <b>Warrant</b> | <b>Number of Existing Holders who have accepted the buyback Offer</b> | <b>Number of Warrants held by Existing Holders who have accepted the Buyback Offer</b> |
|----------------|---|--|
| 10073.HK       | 61  | 19,890,000   |
| 10074.HK       | 9   | 3,610,000  |
| 10075.HK       | 20  | 3,260,000  |
| 10076.HK       | 35  | 4,880,000  |
| Total          | 91*   | 31,640,000   |

\*Please note that some Existing Holders hold more than one series of Warrants.

25. Of these 91 acceptances, around 26 (or approximately 28%) were from individual holders who appear to be registered with the SFC<sup>1</sup> and were therefore acceptances by holders who can be assumed to have a degree of financial sophistication<sup>2</sup>.
26. The holders who chose not to accept the offer (i.e. those who responded by rejecting the Buyback Offer and those who did not respond to the Buyback Offer) included the largest holder, which is an international financial institution holding 22 million warrants<sup>3</sup>. As a consequence, the acceptance ratio by reference to total number of warrants was approximately 44%. Excluding this institution, the acceptance ratio by reference to total number of warrants was 64.5%.

**The returns achieved by investors who accepted the Buyback Offer**

27. As noted above, the Buyback Offer was designed to ensure that no investors would suffer any loss on their investment.
28. Consistent with this objective, the return achieved by Warrant holders who chose to accept the Buyback Offer ranged from 11% to 749%. The average return for accepting investors was 90% and over 60% of accepting investors would receive more than 50% return under the Buyback Offer.
29. Set out below is an analysis of the return received by the accepting Warrant holders.

| Return (x)             | Number of Holders | %      |
|------------------------|-------------------|--------|
| $x \leq 50\%$          | 36                | 39.56% |
| $50\% < x \leq 100\%$  | 34                | 37.36% |
| $100\% < x \leq 200\%$ | 12                | 13.19% |
| $200\% < x \leq 300\%$ | 7                 | 7.69%  |
| $300\% < x$            | 2                 | 2.20%  |
| Total                  | 91                | 100%   |

30. The fairness and reasonableness of the Buyback Offer to investors is further emphasized by the fact that three of the four Warrants are presently (as at 29 June 2011 and also at the time of the Buyback Offer) "Out of the Money". Put another way, there would be zero return to holders of those Warrants if the underlying economics were to remain the same through to the expiry dates of the Warrants.
31. As already noted, Deutsche Bank had issued a warrant (stock code 10035) linked to the Nikkei 225 Index which had equivalent economic terms to Warrant 10073. As at 27 May 2011 (the closing date of the Buyback Offer Period), the Buyback Value of Warrant 10073 (HKD 0.07) was 7 times higher than the closing price of the Deutsche Bank warrant 10035 (HKD 0.01).

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<sup>1</sup> GS has checked the Warrant holder's English and Chinese names against the register of licensed persons maintained by the SFC. Not all of these Warrant holders hold active licences.

<sup>2</sup> Indeed, based on the acceptances received under the Buyback Offer, at least 40% of the trades executed on 31 March 2011 appear to have been executed by SFC licensed personnel (although not all of them hold active SFC licences).

<sup>3</sup> In addition, 3 of the individuals who accepted the offer are, to GS' knowledge, employees on the warrants desk of the international financial institution, holding a further 3,370,000 Warrants.

32. In order to further illustrate the attractiveness of the economic terms of GS' Buyback Offer, GS has compared the return under the Buyback Offer with comparable investments during the period between 31 March 2011 (the date of the suspension of the Warrants) and the end of the buyback period. The comparables are listed below and consistently demonstrate the superiority of the return under GS' Buyback Offer.

- (a) Nikkei 225 options listed on the Osaka Stock Exchange;
- (b) The underlying Nikkei 225 Index;
- (c) The local benchmark Hang Seng Index; and
- (d) HKD deposit rate (as of 31 March 2011).

33. Osaka Stock Exchange. The following table shows the daily closing level of listed options on Osaka Stock Exchange that are also referenced to the Nikkei 225 Index. The options have comparable terms to the Warrants. As is evident from the column headed "Return for the period", from 31 March 2011 to the end of the buyback period, all the listed options (both call and put) have a negative return.

| Listed Option Series on Osaka Stock Exchange | Comparable warrants | Closing price as of 31 March 2011 (JPY) | Closing price as of 27 May 2011 (JPY) | Highest closing price within the period (JPY) | Lowest closing price within the period (JPY) | Return for the period (Based on the closing prices of 31 Mar and 27 May 2011) | Maximum Return (Based on closing prices) | Minimum Return (Based on closing prices) |
|--|---------------------|---|---------------------------------------|---|--|---|--|--|
| Sep 11,000 Call                              | 10073.HK            | 135                                     | 20                                    | 135   | 17   | -85.19%   | 0.00%                                    | -87.41%                                  |
| Dec 12,000 Call                              | 10074.HK            | 65                                      | 13                                    | 65  | 11   | -80.00%   | 0.00%                                    | -83.08%                                  |
| Sep 10,000 Put                               | 10075.HK            | 730                                     | 655                                   | 820   | 465  | -10.27%   | 12.33%                                   | -36.30%                                  |
| Dec 9,000 Put                                | 10076.HK            | 500                                     | 340                                   | 500   | 290  | -32.00%   | 0.00%                                    | -42.00%                                  |

Source: Bloomberg

34. Nikkei 225 Index. The following table shows the maximum theoretical return of trading in the long position of the Nikkei 225 Index itself during the same time period.

| Closing Level as of 31 March 2011 | Closing Level as of 27 May 2011 | The highest closing level of the period | The lowest closing level of the period | Return for the period (Based on the closing levels of 31 March and 27 May 2011) | Maximum return (Based on closing levels) | Minimum return (Based on closing levels) |
|-----------------------------------|---------------------------------|---|--|---|--|--|
| 9,755.10                          | 9,521.94                        | 10,004.20                               | 9,422.88                               | -2.39%  | 2.55%                                    | -3.41%                                   |

Source: Bloomberg

35. Hang Seng Index. Similarly, when compared against the Hang Seng Index, the maximum theoretical return which assumes buying on the 31 March 2011 and selling at the highest price during the period is 3.69%, again significantly lower than the minimum 10% return offered by GS' Buyback Offer and the average return for the period is also a negative figure.

| Closing Level as of 31 March 2011 | Closing Level as of 27 May 2011 | The highest closing level of the period | The lowest closing level of the period | Return for the period (Based on the closing levels of 31 March and 27 May 2011) | Maximum return (Based on closing levels) | Minimum return (Based on closing levels) |
|-----------------------------------|---------------------------------|---|--|---|--|--|
| 23,527.50                         | 23,118.10                       | 24,396.07                               | 22,711.02                              | -1.74%  | 3.69%                                    | -3.47%                                   |

Source: Bloomberg

36. For completeness, we also set out below the Hong Kong Association of Banks Hong Kong Interbank Offered Rate (HIBOR) Fixings for HKD (as of 31 March 2011) which show that the interest rate return is significantly lower than the return achieved through participation in by GS' Buyback Offer.

| Time period           | Interest rate |
|-----------------------|---------------|
| 1 month HIBOR Fixing  | 0.21036% p.a. |
| 2 months HIBOR Fixing | 0.24% p.a.    |
| 3 months HIBOR Fixing | 0.26% p.a.    |

Source: Bloomberg

#### **Communication with investors during the buyback period**

37. GS communicated with investors consistently through various channels from the date of suspension of the Warrants through to completion of the buyback proposal as noted below.
38. First, following the suspension of trading in the Warrants on 31 March 2011, GS' Hong Kong warrant hotline was staffed from 9:00a.m. to 6:00p.m., including during weekends, to log and

answer queries concerning the Warrants. After the announcement of the Buyback Offer, the hotline remained staffed during office hours on business days and a dedicated email account was also set up to answer and log inquiries.

39. Second, in addition to the hotline, GS communicated promptly and regularly with investors through Exchange announcements, newspaper advertisements and the GS warrant website ([www.gswarrants.com.hk](http://www.gswarrants.com.hk)). A chronology of investor communications, through both formal Exchange announcements or media notifications, is at **Appendix 1**. As apparent from this chronology, there were 6 formal Exchange announcements between 31 March 2011 (suspension of trading) and 27 May 2011 (end of the Buyback Offer Period) and GS has published 93 newspaper announcements on 14 days in 8 different newspapers during the same period. GS maintained a continuous dialogue with media throughout.
40. Third, and bearing in mind that GS did not know the identity of all the individual holders of the Warrants but did know the identities of the brokers through whom they traded, E&Y – who as noted above was appointed by GS as an independent advisor in respect of the implementation and administration of the Buyback Offer:
- (a) sent full details of the Buyback Offer to all brokers who held the Warrants;
  - (b) maintained close communication with representatives of each of these brokers to ask them to ensure that their clients were aware of the Buyback Offer and that they (i.e. the brokers) understood what they needed to do to facilitate the Buyback process and were aware of the deadline for acceptance; and
  - (c) contacted each of the individuals who called GS' Hong Kong warrant hotline to ensure there is a direct and clear line of communication;
41. Fourth, GS actively engaged in dialogue with any holders of the Warrants, or their representatives, who approached GS. This included:
- (a) Meeting with the Honourable James To and a group of 11 individual Warrant holders on 13 May 2011;
  - (b) Responding to 12<sup>4</sup> complaints received about the Buyback Offer, systematically by phone and in writing.
42. In view of the above steps taken by GS to communicate with holders of the Warrant, GS considers its communication of the Buyback Offer to investors to be appropriate and that it has been receptive and responsive to investor feedback throughout the incident.

#### **The handling of complaints received by GS during the process**

43. To date, GS has received only 12<sup>4</sup> complaints by telephone, email and letter, relating to the Buyback Offer.
44. These complaints fall into six broad categories.

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<sup>4</sup> This figure refers to the number of inquiries GS received either directly or through referral by E&Y. It does not include any further queries that may have been handled by E&Y.

45. The first category were requests, including from an international financial institution, to negotiate their own buyback offer for "better terms". GS declined all requests to negotiate terms with individual holders of Warrants because it was committed to ensuring that all holders of the Warrants were treated fairly and equally.
46. The second category of complaints were requests for GS to resume trading in the Warrants. As explained in the Exchange announcement dated 21 April 2011, GS (in consultation with the Exchange and the SFC) decided not to resume trading in the Warrants before expiry because it considered that it would not be possible to ensure fair and orderly trading in the Warrants if trading were to resume, which would be contrary to the interests of the market and investors as a whole. If trading in the Warrants were to resume, trading in the Warrants in the market could be highly speculative and, given the warrant market in Hong Kong is by and large a retail market, retail investors in particular could be at a disadvantage when compared to other investors. Accordingly, GS also declined this category of complaints.
47. The third category were requests for GS to honour the original, incorrect terms of the Warrants. GS declined such requests because the error was obvious and had been corrected by amendment. The Warrants would have been very different, highly-leveraged, exotic products had the Drafting Error been intended, and they would have been priced and traded on a quite different basis.
48. The fourth category were complaints that the Buyback Offer Period was not sufficient. These feedback were promptly dealt with and GS extended the Buyback Offer Period by 11 days.
49. Fifth, that the wording of the acceptance letter, in particular in connection with whether individual investors would be required to release GS from claims, was unclear. In response, GS, through E&Y explained the position verbally, and also amended the acceptance letter to make the position (no release required from individuals) clear.
50. The final category of complaints were general complaints that the buyback price was "unfair". We hope we have explained in the preceding sections the rationale behind the formulation of the Buyback Offer and the reasons why GS firmly believes that the Buyback Offer was fair and reasonable.

### **Conclusion**

51. GS' buyback proposal offered investors a choice between (i) accepting the Buyback Offer and exiting their investments at a profit; (ii) maintaining their exposure to the Nikkei 225 Index by rolling into the four identical new warrants issued and (iii) retaining the position until maturity.
52. The terms of the Buyback Offer were formulated in such a way to ensure that investors were able to capture the upside (but not the downside) of market movements in the Nikkei 225 Index. Under the Buyback Offer, no investor would suffer any loss and all would at least get a 10% premium plus HKD5,000. In view of the fact that 3 out of 4 of the Warrants are currently out of the money, and as compared with other comparable investments available during the same period, the economic terms of the Buyback Offer are fair and reasonable – even attractive.

53. GS regrets that this incident occurred but has worked hard to formulate and communicate a buyback proposal that is, on any analysis, fair and reasonable and which properly compensates all affected investors for the lack of a market in the Warrants and for any inconvenience that may have been caused.

**6 July 2011**

## APPENDIX 1

### CHRONOLOGY OF INVESTOR COMMUNICATIONS

**\*All newspaper advertisements were in Chinese\***

| Tab | Date                            | Published in <sup>1</sup> | Summary of Content   |
|-----|---------------------------------|---------------------------|--|
| 1   | 31 March 2011,<br>11:05         | HKEx                      | Trading in the Warrants have been suspended at 10:52 a.m. today (31/3/2011).   |
| 2   | 31 March 2011,<br>14:13 & 14:16 | HKEx                      | <p>2 Amendment Notices (1 for call, 1 for put) stating the correct formula for "Cash Settlement Amount per Board Lot" and the correct definition for "Cash Settlement Amount" in the Launch Announcement &amp; SLD.</p> <p>Statement that the Amendment Notice does not affect any other information in the Launch Announcement &amp; SLD.</p> <p>Statement that the liquidity provider has been quoting prices of the Warrants using the correct formula since the issue of the Warrants.</p> |
| 3   | 31 March 2011,<br>15:42         | HKEx                      | Notice of suspension of trading in the Warrants with effect from 10:52 a.m. until further notice.  |
| 4   | 3 April 2011                    | Newspaper                 | <p>GS expresses regret over the technical error in the Warrants.</p> <p>GS has amended the technical error under the Terms and Conditions of the Warrants.</p> <p>GS is proactively discussing the matter with HKEx.</p> <p>GS will suspend issuance of new warrants in order to focus on this matter.</p> <p>GS will continue to provide liquidity for the issued warrants.</p> <p>Investors may contact the GS hotline at 2978 2978 (9am to 6pm) for queries.</p>                            |
| 5   | 6 April 2011,<br>22:36          | HKEx                      | <p>Holding Announcement</p> <p>Investors were informed that GS is working</p>  |

<sup>1</sup> Please refer to separate table for publication details.



| <b>Tab</b> | <b>Date</b>       | <b>Published in<sup>1</sup></b> | <b>Summary of Content</b>  |
|------------|-------------------|---------------------------------|--|
|            |                   |                                 | <p>with various parties to finalise an arrangement in respect of the Warrants.</p> <p>GS is in active discussions with the applicable regulators.</p> <p>GS will ensure that when formulating the relevant arrangement, existing holders of the Warrants are not prejudiced by the period of suspension.</p> <p>Details of the arrangements will be published as soon as possible.</p> <p>In the meantime, trading in the warrants will continue to be suspended until further notice.</p> |
| 6          | 21 April 2011     | HKEx                            | Launch Announcements for the New Nikkei Warrants   |
| 7          | 21 April 2011     | HKEx                            | <p>Buyback Offer Announcement</p> <p>Trading will not resume before expiry because of concerns that it would not be possible to ensure fair and orderly trading in the Warrants.</p>   |
| 8          | 22 April 2011     | Newspaper                       | Summary of buyback scheme  |
| 9          | 26 April 2011     | Newspaper                       | Summary of buyback scheme (same as 22 April 2011)  |
| 10         | 28 April 2011     | HKEx                            | SLDs for New Nikkei Warrants   |
| 11         | 3 May 2011        | Newspaper                       | <p>Substantially the same as 22 April 2011 and adding:</p> <ul style="list-style-type: none"> <li>- A statement that the buyback scheme is appropriate and reasonable.</li> <li>- A summary of investor's return under the buyback scheme.</li> </ul>  |
| 12         | 6 May 2011        | Newspaper                       | FAQs on buyback scheme   |
| 13         | 9 May 2011        | Newspaper                       | FAQs on buyback scheme (Same as 6 May 2011)  |
| 14         | 11 May 2011, 0713 | HKEx                            | Announcement of extension of buyback offer period.   |

| <b>Tab</b> | <b>Date</b> | <b>Published in<sup>1</sup></b> | <b>Summary of Content</b>   |
|------------|-------------|---------------------------------|---|
| 15         | 12 May 2011 | Newspaper                       | Extension of buyback offer period & FAQs (Substantially the same as 6 May 2011)   |
| 16         | 16 May 2011 | Newspaper                       | Extension of buyback offer period & FAQs (Substantially the same as 12 May 2011)  |
| 17         | 17 May 2011 | Newspaper                       | Same as 12 May 2011.  |
| 18         | 19 May 2011 | Newspaper                       | "8 days left" – Same as 12 May 2011.  |
| 19         | 24 May 2011 | Newspaper                       | "4 days left".<br><br>Hotline extended to 8pm.<br><br>Buyback offer period will not be extended further.<br><br>Acceptance of offer will not prejudice investor's legal rights against GS.  |
| 20         | 25 May 2011 | Newspaper                       | "3 days left". Other content substantially the same as 24 May 2011.   |
| 21         | 26 May 2011 | Newspaper                       | "2 days left"<br><br>Over 50% of existing holders have registered to show interest in the buyback scheme.<br><br>Other content substantially the same as 24 May 2011.   |
| 22         | 27 May 2011 | Newspaper                       | "Last day today"<br><br>Around 2/3 of existing holders have registered to show interest in the buyback scheme.<br><br>GS has engaged KPMG to value the 4 warrants (sets out table).<br><br>Other content the same as 24 May 2011. |
| 23         | 2 June 2011 | HKEx                            | End of buyback announcement   |

## Publication of Newspaper Advertisements

| Newspaper/Date | 3-Apr | 22-Apr | 26-Apr | 3-May | 6-May | 9-May | 12-May | 16-May | 17-May | 19-May | 24-May | 25-May | 26-May | 27-May |
|----------------|-------|--------|--------|-------|-------|-------|--------|--------|--------|--------|--------|--------|--------|--------|
| Apple Daily    | QP    | FP     | QP     | QP    | QP    | QP    | QP     | QP     | QP     | QP     | QP     | QP     | QP     | QP     |
| Oriental Daily | QP    | FP     | QP     | QP    | QP    | QP    | QP     | QP     | QP     | QP     | QP     | QP     | QP     | QP     |
| Ming Pao       | QP    | FP     | QP     | QP    | QP    | QP    | QP     | QP     | QP     | QP     | QP     | QP     | QP     | QP     |
| Sing Tao       | QP    | FP     | QP     | QP    | QP    | QP    | QP     | QP     | QP     | QP     | QP     | QP     | QP     | QP     |
| HKET           |       | FP     | QP     | QP    | QP    | QP    | QP     | QP     | QP     | QP     | QP     | QP     | QP     | QP     |
| HKEJ           |       | FP     | QP     | QP    | QP    | QP    | QP     | QP     | QP     | QP     | QP     | QP     | QP     | QP     |
| Metro Daily    |       |        |        |       | QP    | JP    | JP     | JP     | JP     | JP     | JP     |        |        |        |
| Headline       |       |        |        |       |       |       |        |        |        |        |        | JP     | JP     | JP     |
| Sun Daily      | QP    |        |        |       |       |       |        |        |        |        |        |        |        |        |
|                | 5     | 6      | 6      | 6     | 7     | 7     | 7      | 7      | 7      | 7      | 7      | 7      | 7      | 7      |

QP = Quarter Page

FP = Full Page

JP = Junior Page