

財經事務及庫務局局長



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19 February 2009

Miss Polly YEUNG
Clerk to Subcommittee to Study Issues Arising from
Lehman Brothers-related Minibonds and Structured Financial Products
Legislative Council
8 Jackson Road
Hong Kong

Dear Miss YEUNG,

**Subcommittee to Study Issues Arising from Lehman Brothers-related
Minibonds and Structured Financial Products ("Subcommittee")**

I refer to your letter dated 17 February 2009 requesting for further information on the Council of Financial Regulators ("CFR") and Financial Stability Committee ("FSC").

Further to my letter of 11 February 2009 attaching my written statement of my response to the issues set out in Appendix IV to your letter dated 23 January 2009, please find attached the Terms of Reference and latest Membership lists of CFR and FSC at Annex A. As regards the relevant minutes and papers of CFR and FSC meetings, please note that such documents are confidential in nature. We have therefore prepared a summary of the relevant extracts of the CFR and FSC discussions at Annex B for Members' reference.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'K.C. Chan', with a long horizontal flourish extending to the right.

(Professor KC Chan)
Secretary for Financial Services and the Treasury

Encls.

Annex A**Council of Financial Regulators****Terms of Reference**

With the objective of contributing to the efficiency and effectiveness of regulation and supervision of financial institutions, the promotion and development of the financial markets and the maintenance of financial stability in Hong Kong, the Council of Financial Regulators shall

- facilitate cooperation and coordination among its members;
- share information and views on regulatory and supervisory issues and important trends in the financial system, particularly those which may have a cross-sectoral impact;
- minimize duplication or gaps in the regulation and supervision of financial institutions, paying close attention to the need to keep regulatory costs to a minimum;
- review international developments in financial sector regulation and to draw lessons for Hong Kong;
- discuss regulatory and supervisory issues relating to individual financial institutions that may have a cross-sectoral impact; and
- oversee trends, issues and developments which may have implications for financial stability in Hong Kong.

Membership

Chairman : Financial Secretary
Members : Representatives from –
Hong Kong Monetary Authority
Securities and Futures Commission
Office of the Commissioner of Insurance
Mandatory Provident Fund Schemes Authority
Financial Services and the Treasury Bureau

Financial Stability Committee

Terms of Reference

Bearing in mind the importance of financial stability to Hong Kong, the Financial Stability Committee shall

- a) monitor on a regular basis the functioning of the financial system of Hong Kong, including the banking, debt, equity, insurance and related markets;
- b) deliberate on events, issues and developments with possible cross market and systemic implications, and where appropriate, formulate and co-ordinate responses; and
- c) report regularly, and at any time where necessary, to the Financial Secretary covering matters in (a) and (b) above.

Membership

Chairman : Secretary for Financial Services and the Treasury

Members : Representatives from –

Hong Kong Monetary Authority
Securities and Futures Commission
Office of the Commissioner of Insurance

CONFIDENTIAL**Annex B****Summary of the Relevant Discussions at the Council of Financial Regulators and the Financial Stability Committee****Council of Financial Regulators (CFR)****Relevant Discussions****December 2004**

The Council noted that there had been major developments in areas such as implementation of Basel II, the deposit protection scheme and the Commercial Credit Reference Agency. On the cross-sector regulatory issue concerning regulation of Authorized Institutions' (AIs) securities business, the Council noted that the cooperation between the Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC) had been working well, and there had not been many concerns raised recently.

June 2006

The Council noted that there had been continued cooperation between the HKMA and the SFC on the regulation of securities business. The Council noted that the regulator was not aware of other cross-sector regulatory issues which warranted the meeting's attention.

December 2008

Following the collapse of Lehman Brothers (LB), regulators reported on the latest progress of handling the Minibonds (MBs) incident and its ongoing developments. The Council also considered differences among standards of disclosure and selling processes of different financial products and their regulatory implications.

CONFIDENTIAL**Financial Stability Committee (FSC)****Relevant Discussions since August 2007**

Regulators started to report at the FSC the implications of the subprime mortgage problems in August 2007, when Hong Kong dollars strengthened as a result of heavy unwinding of carry trades triggered by the US subprime mortgage problems. Since then, implications of the subprime problem and assessments were reported to the FSC from time to time.

Following the collapse of LB in September 2008, the FSC meeting discussed the credit risk arising from this incident and its implications on Hong Kong's banking system. The regulators did not report any other issues relating to the risks of the retail sale of LB-related MBs and structured financial products by intermediaries to small investors at that meeting.

At another FSC meeting in September 2008, members discussed various follow-up actions stemming from the failure of LB, including the MBs incident. The meeting agreed to work closely together to manage the crisis and agreed to ensure transparency of and effectiveness in handling the complaints.

There were no specific reports from the regulators or substantial discussions on issues relating to any gaps between the SFC and HKMA in regulating banks' selling of structured financial products (including LB-related MBs and structured financial products) during FSC meetings.