

**Follow-up to the hearing on 19 October 2010**

**Information (including relevant documents and records, if any)  
on the following issues**

1. It is noted in paragraphs 44.2 and 58.3(c) of **W40(C)** that post-transaction monthly sampling was conducted to monitor whether risk-mismatch transactions were in compliance with the bank's internal procedures. As recalled by Mr HE, there might be a few cases of non-compliance or deficiencies in respect of the transactions of Lehman Brothers (LB)-related structured financial products during the period from April 2003 to September 2008. Please provide further information on these cases.
  - 1.1 The post-transaction monthly sampling mentioned in paragraphs 44.2 and 58.3(c) of **W40(C)** covered risk-mismatch transactions involving funds, bonds and notes. LB-related structured financial products were only one of the products covered. The few cases of deficiencies were generally related to lapses in filling out the documentation or records required for completing the sale transaction in accordance with the bank's internal procedures, such as omissions in the subscription form or use of a previous version of the internal checklist. All of the deficiencies were followed up and rectified after the deficiencies were identified.
2. Regarding paragraph 1.2 of **F(BOC)2**, please provide the name(s) and post title(s) of the staff in the Product Team who informed the Chief Executive that "having considered the uncertain market conditions in the aftermath of Bear Stearns' takeover by JP Morgan Chase at the time, the product team decided not to propose Series 36 to the Steering Committee for approval". Please also advise on the approximate date when the Product Team discussed this subject.
  - 2.1 The name and position of the staff was Mr. Chow Chak Chee, Deputy General Manager of Personal Banking & Product Management. The product team discussed this subject in around March 2008.
3. It is noted in paragraph 57.1 of **W40(C)** that BOCHK did not allow its relevant RIs to provide investment advice to customers. Please provide a copy of the guidelines available to sales staff to assist them not to give investment advice to customers.
  - 3.1 As mentioned in paragraph 57.3 of **W40(C)**, the guidelines 《代客申請認購票據、債券工作細則》 stated clearly — in Chapter 3, clause 8 — that BOCHK should not give any investment or product subscription advice to its customers or undertake to be an advisor to the customers ( “客戶認購產品主要為客戶的決定。銀行不會向客戶提供任何投資／認購產品的意見或擔任客戶的顧問。 ” ). An extract of the guidelines was attached as Item 57a of **W40(C)**.

4. It is noted from items 7d and 7e of W40(C) that BOCHK had a specified value of sales (銷售金額) for Minibond Series 8 and Pyxis ELN Series 12 at HK\$200 million and US\$15 million respectively. However, according to Mr HE, BOCHK did not have a specific sales target for individual branches or staff (paragraph 49.2 of W40(C)). Please explain the specific arrangements as embodied in the statement "分行指標: 按各分區的指標分配作基準".
- 4.1 As mentioned in paragraph 49.2 of W40(C), BOCHK did not impose any sales quota or sales targets for each branch of BOCHK or for each staff member at different levels involved in the sales of Minibonds. The references in items 7d and 7e of W40(C) to sales amount and branch targets were contained in the product team's pro forma product approval document, as there were sales targets for some of the bank's other products, such as funds. For LB-related structured financial products, the value stated as the sales amount (銷售金額) was the sales projection estimated by the product team. It was the branch management team under Channel Management (formerly Retail Banking Department before March 2007), not the product team, which was responsible for setting sales targets, if any, for applicable products. No sales targets for LB-related structured financial products were set by the branch management team.
5. The attached written questions raised by Mr LEUNG Kwok-hung at the hearing on 19 October 2010.

1 你在 10 月 8 日回答我的提問時，表示雷曼產品並無期權成份，但是，Pyxis 21 和 20, 迷債 35 等產品的發行章程<sup>1</sup>均寫明該產品含有 call option，發行人可在規定的條件發生時行使 call option。為何你卻聲稱沒有期權成份呢？你作為高層人員也不清楚產品性質，實行如何確保前線銷售員工能夠準確地向客戶解釋產品呢？

- 5.1a When Mr Leung asked the relevant question at the hearing of October 8, he mentioned "highly leveraged CDS" and call option, and Mr He asked Mr Leung to clarify his question. However, as Mr Leung did not clarify that question but moved on to another question, Mr He had no opportunity to reply to his question about call option at the hearing.
- 5.1b The call option feature of Minibond Series 35, Pyxis Equity-Linked Notes Series 20 and 21 essentially allows the issuer to call/redeem the issue at a specified price prior to maturity. For Minibond Series 35, the Issuer had a call option to repay the Notes early at 100% of principal amount plus the interest then due. For Pyxis Equity-Linked Notes Series 20 and 21, if the closing price of each underlying share was at or above its respective fixing/call price, the Issuer would redeem the Notes early in cash at 100%

of principal amount plus the fixed coupon payable on the coupon payment date immediately following the relevant observation date.

5.1c The early redemption feature of the products was explained in the products' respective training materials (see eg p.20 of the training materials for Minibond Series 35, which was attached as Attachment 2c to our response dated 14 October 2010 to the Subcommittee's follow-up issues for Mr Lam Yim Nam regarding the hearing on 8 October 2010).

2 貴行將 Pyxis 21 和 20 等產品評為低風險，你不斷解釋是因為 Lehman Brothers Holdings 是抵押品的保證人，而 Lehman Brothers Holdings 的評級分別是 A+和 A1。但是，Pyxis 21 和 20 的抵押品沒有 rating，完全只靠 Lehman Brothers Holdings 作擔保<sup>2</sup>，而 A+和 A1 與美國國債的 AAA 級別有距離，請問如果 A+評為 1 級，那麼 AAA 時，你是否評為負 2 級呢？可惜沒有這個級別。因為你們的錯誤評級，令客戶忽視了作為保證人的信貸風險，貴行是否有責任向購買了 ELN 的客戶作出回購協議？

5.2 Standard & Poor's assigns long-term credit ratings on a scale from AAA to D, with ratings of investment grade between AAA and BBB. Lehman Brothers Holdings Inc, being the swap guarantor and the guarantor of the collateral for the Pyxis Notes, had a credit rating of A+, which was regarded as an indication of its strong capacity to meet its financial commitment.

3 貴行只迷信保證人雷曼的信貸評級，卻沒有探究產品本身及抵押品風險，我向貴行提供一份由「香港證券專業學會」在 2008 年 12 月出版的一篇文章「剖析迷你債券」<sup>4</sup>，內裏對迷債的結構及運作有精闢的剖析，更有圖表說明。相比 2003 年 4 月證監會出版的《Advice to investors on structured notes》(見本人 10 月 8 日提問附件一)，顯示後期的結構產品更形複雜，不單有 option，也有 CDO、CDS，全都是高風險、高槓桿比率的產品，請問貴行有沒有根據類似的內容，圖表，向僱員進行培訓？如有，又有何種文件或機制確保前線工在銷售過程中向客戶清楚解釋呢？

5.3a In order to equip its Relevant Individuals for explaining adequately LB-related structured financial products to customers, BOCHK provided product-specific training for each series to its Relevant Individuals. The training covers the features and key risks of each product series (please see paragraph 23.8 of W40(C)). For example, in the training materials for Minibond Series 35, interest rate risk, credit event risk, collateral risk and the structure that Lehman Brothers Holdings Inc. was the guarantor of the swap arrangements were explained.

5.3b BOCHK required, among other things, its Relevant Individuals to understand customers' needs and provide adequate product information to enable customers to make an informed investment decision. In particular, Relevant Individuals were required to explain to customers the product nature, features, tenor, risks and the related fees to customers in

accordance with the authorized marketing materials and prospectus (please see paragraph 49.4 of W40(C)). A variety of supervision and management measures were adopted to ensure that Relevant Individuals would follow the proper procedures stipulated in the Code of Conduct, other regulatory requirements and BOCHK's internal policies during the selling process (see paragraph 58.3 of W40(C)). Special measures were implemented to protect the interests of vulnerable customers (see paragraphs 39.1 to 39.6 of W40(C)) and customers who bought risk-mismatched products (see paragraphs 44.1 and 44.2 of W40(C)).

4 你書面回答我 10 月 5 日的提問時，你除是說抵押品是 AAA 級外，客戶如要知道抵押品詳情及有關風險，要自己去雷曼本港的寫字樓查閱《F(BOC)2, p.7》，我想問貴行的職員不知道這些重要資料，卻要客戶——特別是長者、主婦、缺乏投資經驗人士——自己去查，貴行究竟有沒有做盡職審責？

5.4a As disclosed to the investors in the issue prospectus and marketing materials, the collateral of Minibonds would be AAA-rated collateralized debt obligation securities, which would be purchased by the issuer on or shortly after the issue date with the funds raised from the proceeds of issue of the Minibonds. Therefore, apart from the criteria for selecting the collateral, no details of the collateral could be made available before the issue of the Minibonds.