

Dated 27 May 2010

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

**RESPONSE TO THE SUBCOMMITTEE'S LETTER DATED 17 MAY 2010 FROM
MR HUNG PI-CHENG, BENJAMIN, EXECUTIVE DIRECTOR AND
CHIEF EXECUTIVE OFFICER,
STANDARD CHARTERED BANK (HONG KONG) LIMITED (SCBHK)**

FOLLOW-UP TO THE HEARING ON 14 MAY 2010

1. ***It is noted from paragraph 53.2 of W30(C) that as at 7 April 2010, SCBHK has settled 152 cases out of the 1231 complaints received in relation to Lehman Brothers(LB)-related equity linked notes (ELNs) transactions. Please advise:***

(a) the number of cases settled with 100% of investment amount; and

1.1 The 152 cases referred to in paragraph 53.2 of W30(C) are cases which have been approved for settlement by the Bank. Of these 152 cases, 137 cases have been settled and the Bank is in the course of processing the remaining 15 cases with its customers. Of the 137 settled cases, 19 of them were settled at 100% of the invested amount.

(b) a breakdown of the other cases settled with different percentages of the investment amount.

Settlement %	No. of customers
Below 50%	25
50% to below 70%	76
70% to below 100%	32
100%	19
Total*	152

* includes the 15 cases approved for settlement mentioned in paragraph 1.1 above.

2. ***As stated by Mr Benjamin HUNG at the hearing on 14 May 2010 and in paragraph 45.21 of W30(C), the performance of frontline sales staff were measured based on, amongst others, balanced-portfolio revenue achievements. Product level incentives were also available for products. Please provide a copy of SCBHK's written policy or internal document(s) on the sales incentives available to staff.***

2.1 As mentioned in paragraph 45.21 of W30(C), the performance of all sales staff was measured based on a balanced scorecard, which incorporated various aspects of an individual's performance. These included Individual sales revenue achievements across all products (including investments, insurance, mortgages, deposits and loans), balanced product portfolio growth, branch profitability, customer service and compliance and control. Please refer to item 1 for a sample of the balanced scorecard.

2.2 Incentive payments were calculated by applying an incentive rate (see item 2 for the incentive rate table) on the individual's total revenue achievement. For staff who met their total revenue target on investment products, additional Non Funded Income (NFI) incentives were designed to reward diversification of products and a balanced portfolio. Please refer to item 3.

2.3 Periodic incentives were also available for a number of products (e.g. investment, insurance, mortgage and deposit products). In respect of structured notes, the payout percentage ranged from 0.05% to 0.1% of the subscription amount.

3. ***Please provide the following information:***

(a) a breakdown of the number of transactions in relation to investment products conducted by each of the sales staff during the period from 18 to 20 February 2008; and

- 3.1 A table of a breakdown of the total number of investment products conducted by each sales staff is enclosed in item 4. Investment products sold include unit trusts, structured notes, bonds and currency, equity and rate linked structured deposits, but exclude execution-only products, e.g. securities trading.
- (b) out of (a), a breakdown of the number of transactions in relation to Lehman Brothers 1-Year HKD/USD All Weather Coupon Daily Callable ELN – Series 17 conducted by each of the sales staff during the period from 18 to 20 February 2008.**
- 3.2 This information is also provided in the table enclosed in item 4.
4. **With reference to the personal financial profile (item 16 of W30(C)), please provide the profile of an investor, as reflected in the answers to the various profiling questions, to whom LB ELNs are considered suitable.**
- 4.1 The structured note asset classes will be listed as possible investment solutions for the customer's consideration if and only if he/she answered the following questions in the following manner:
- Q1. Selected "No" for "Are you a US citizen or residing in U.S."; and
- Q3. Selected "I have adequate regular income to meet my needs. I do not rely on my investments to generate regular income"; and
- Q5. Selected "...I have investment funds and equities" experience; and
- Q5. Selected "...I have debt securities (e.g. bonds, notes, etc)" experience; and
- Q6. Selected "I can tolerate a loss of about 15% or worse in a year"; and
- Q7. Selected "Yes, I wish to exercise my current view to invest in a particular market or a product"; and
- Q9. Selected an appropriate investment horizon.
- 4.2 If any of the customer's answers is different from the above, the relevant structured note asset classes will not be shown as one suitable for the customer's consideration.
5. **Out of the 1231 complaints received after the collapse of LB, please advise:**
- (a) the number of complaints in relation to the staff member with the highest number of complaints; and**
- 5.1 Out of 1,231 customer complaints, the highest number of complaints in relation to a staff member was 27.
- (b) the number of complaints in relation to the bank branch with the highest number of complaints.**
- 5.2 Out of 1,231 customer complaints, the highest number of complaints in relation to a bank branch was 55.
6. **As stated by Mr Benjamin HUNG at the hearing on 14 May 2010, a so-called "spot quiz" was conducted twice at bank branches every year. Please provide:**

- (a) *a sample copy of the questions used in the "spot quiz" during the period between August 2006 and June 2008; and*
- 6.1 A sample copy of the questions used is enclosed in item 5.
- (b) *the results of the "spot quiz" during the period between August 2006 and June 2008.*
- 6.2 During the Relevant Period, a total number of 132 sales staff, representing 38% of the sales force, was interviewed and all passed the "spot quiz".
7. *It is noted from paragraph 50.3(e) of W30(C) that the Compliance & Assurance teams conducted risk-based compliance reviews on a regular basis, which included mystery shopping exercise. Please provide the report of each mystery shopping exercise conducted during the period between August 2006 and June 2008.*
- 7.1 There were four mystery shopping exercises conducted during the period between August 2006 and June 2008 covering (1) Marketing of Hedge Funds in Retail Branches; (2) "0" Mortgage and Link One; (3) Marketing of Mortgage Products in Retail Branches; and (4) Marketing of Mutual Fund in Retail Branches. The reports relating to (1) and (4) are enclosed in item 6.
8. *As stated in paragraph 52.1 of W30(C), SCBHK received one complaint of alleged mis-selling in respect of LB ELN prior to the collapse of LB. Please advise:*
- (a) *the nature of this complaint and the amount involved; and*
- 8.1 This is related to a complaint of alleged failure of the sales staff to disclose certain features of the investment product to the customer. The amount involved was HK\$500,000.
- (b) *the outcome, including whether and why any compensation or amount was paid/or not paid to settle the complaint.*
- 8.2 The Bank and the customer reached an amicable settlement of the complaint. The reason for settling this complaint was dependent on legal advice and is therefore subject to a claim of legal professional privilege.
9. *Please inform the Subcommittee of the following:*
- (a) *a breakdown of the number of frontline staff and management staff involved in the sale of LB ELNs who had resigned on their own accord or terminated by SCBHK after the collapse of LB in September 2008;*
- 9.1 78 frontline staff and 2 management staff resigned on their own accord; 1 management staff resigned upon mutual consent.
- (b) *out of the resigned and terminated staff in (a), the respective number of these former staff who were under complaint in relation to the sale of LB ELNs, and the respective number of such complaint cases; and*
- 9.2 Out of the staff in (a), 68 former staff were under complaint in relation to the sale of LB ELNs, comprising 329 complaint cases.

- (c) *out of the complaint cases in (b), the number of cases in which SCBHK was unable to contact the responsible staff members who had left the employment of SCBHK.*
- 9.3 Out of the 329 complaint cases in (b), 18 were cases where the Bank had not been able to contact the relevant former staff.
10. *It is noted that reporting channels were available for staff to report any suspected violation of a law, regulation or ethical standard (Annex 4 to item 13 of W30(C)). Please confirm whether any case had been reported through these reporting channels; if yes, the details of the case(s) and the follow-up action undertaken.*
- 10.1 None of the LB ELN complaints were escalated through the above reporting channels.
11. *It is noted that HKMA met the Audit Committee of SCBHK on 29 May 2006 (paragraph 56.2 of W30(C)) and prudential meetings were held between HKMA and senior management of SCBHK during the period from 2006 to 2008 (paragraph 56.3 of W30(C)). Please provide*
- (a) *the relevant parts of the minutes of the meeting between HKMA and the Audit Committee of SCBHK held on 29 May 2006 in relation to the discussion of the sale of investment products by SCBHK; and*
- 11.1 During the meeting, there was no discussion specifically on the sale of investment products by the Bank. However, the HKMA presented on its banking supervisory focuses for the coming year. Included in these was the prevention of mis-selling and its close cooperation with the SFC in this area. An extract of the relevant meeting minutes is enclosed in item 7.
- (b) *the relevant parts of the minutes of prudential meetings held between HKMA and senior management of SCBHK during the period from 2006 to 2008 in relation to the discussion of the sale of investment products by SCBHK.*
- 11.2 Prudential interviews were held between the HKMA and the Bank's senior management in 2006, 2007 and 2008 respectively. However, there was no discussion specifically in relation the sale of investment products by the Bank during these prudential interviews. In the 2006 meeting, HKMA indicated that at the macro level it would be focusing on Basel, AML and mis-selling when it outlined its supervisory approach and priorities for 2006. An extract of the relevant meeting minutes is enclosed in item 8.
12. *It is noted from paragraph 55.1 of W30(C) that material inconsistency with internal standards which impacted the customer's investment decision was one of the factors taking into consideration for approving settlement of the 152 cases.*
- (a) *Please provide the number of those settled cases involving material inconsistency with internal standards which impacted the customer's investment decision, and give a more detailed explanation on the so-called "internal standards" and the "material inconsistency" detected; and*
- (b) *Of the settled cases in (a), please provide a breakdown of those cases involving former staff members, and the respective internal standards and material inconsistency.*

- 12.1 The number of settled cases involving material inconsistency with internal standards that impacted the customer's investment decision was 87. The 87 cases involved 17 former staff members. As to what constituted material inconsistency with internal standards, the Bank has obtained and relied on legal advice in this respect and is not in a position to comment further and/or produce any document on the ground that the same is protected by legal professional privilege.
13. ***It is noted from paragraph 53.2 of W30(C) that 152 cases were settled out of 1231 complaints received, and that SCBHK's current stance is to assess complaints on a case-by-case basis. Please provide:***
- (a) ***the number of cases that the possibility of reaching a settlement still exists;***
 - (b) ***the number of cases that the possibility of reaching a settlement is ruled out; and***
 - (c) ***with regard to those cases in (b), an explanation of the reasons why they cannot be settled.***
- 13.1 We have completed the investigation of all 1,231 LB ELN complaints received by the Bank and, as set out in the response to Question 1 above, the number of cases settled or in the course of processing for settlement as at 7 April 2010 is 152. However, the Bank remains open to reviewing new evidence or information as and when this is provided. As each case will turn on its facts, it is difficult to predict the exact number where mutually acceptable resolution will be reached.
- 13.2 The Bank assesses complaints and considers settlement on a case by case basis and the reason for settling or not settling in each case is dependent on legal advice and is subject to a claim of legal professional privilege.
14. ***Please provide the most up-to-date information in the enclosed Table 1.***
- 14.1 The completed Table 1 is attached.

Table 1

Information on the involvement of former SCBHK staff in relation to the sale of three series of LB ELNs

Former staff and complaints	Lehman Brothers 1-Year HKD All Weather Coupon Daily Callable ELN – Series 17 (390+1800)	Lehman Brothers 1-Year USD All Weather Coupon Daily Callable ELN – Series 17 (390+1800)	Lehman Brothers 1-Year HKD All Weather Coupon Daily Callable ELN – Series 18 (390+1800+2800)
(1) The number of frontline staff involved in the sale of LB products who had left SCBHK after the collapse of LB in September 2008 (a) total number; (b)(i) voluntary resignation; (ii) termination of employment by SCBHK.	(a) 40 (b)(i) 40 (ii) 0	(a) 20 (b)(i) 20 (ii) 0	(a) 19 (b)(i) 19 (ii) 0
(2) The number of senior management staff involved in the sale of LB products who had left SCBHK after the collapse of LB in September 2008 (a) total number; (b)(i) voluntary resignation; (ii) termination of employment by SCBHK.	(a) 1 (b)(i) 1 (ii) 0	(a) 1 (b)(i) 1 (ii) 0	(a) 0 (b)(i) 0 (ii) 0
(3) The number of former staff in (1) and (2) who were under complaint in relation to the sale of the listed series of LB ELNs	(1) 31 (2) 1	(1) 12 (2) 0	(1) 13 (2) 0
(4) The number of complaint cases involving former staff	(1) 58 (2) 1	(1) 14 (2) 0	(1) 22 (2) 0
(5) Out of the complaint cases in (4), the number of cases in which SCBHK was unable to contact the former responsible staff members	3	1	2
(6) Out of the complaint cases in (4), the number of settled cases	2	0	5
(7) Out of the complaint cases in (4), the number of cases in the process of mediation	5	0	1