

**Motion on**  
**“Assisting the victims of the Lehman Brothers incident”**  
**at the meeting of the Legislative Council on 22 October 2008**

**Progress Report**

**Purpose**

At the Legislative Council meeting of 22 October 2008, the motion moved by Hon Jeffrey Lam Kin-fung, as amended by Hon Kam Nai-wai, Hon Wong Kwok-hing and Hon Alan Leong Kah-kit, on “Assisting the victims of the Lehman Brothers incident” was carried. This paper seeks to brief Members on the progress made by the Government in assisting the aggrieved investors of the Lehman Brothers incident.

**Investigation into complaints of alleged improper sales practices**

2. The Hong Kong Monetary Authority (HKMA), the Securities and Futures Commission (SFC), the Commercial Crime Bureau of the Hong Kong Police (Police), and the Consumer Council have received complaints from the investors of the Lehman Brothers related investment products (Lehman products), alleging the distributing banks and brokerages of improper sales practices. The HKMA, the SFC, the Police and the Consumer Council have been making coordinated efforts in handling the complaints as quickly as possible, subject to the need to observe due process.

*Investigation by the HKMA*

3. The HKMA is responsible for investigating the complaints in relation to the sale of Lehman products by banks. It has been regularly (at least weekly) publishing the progress of investigation on its website. On 22 September 2008, the HKMA set up a hotline to assist individual investors. The HKMA has, up to 11 December 2008, received 19 734 complaints concerning Lehman products, of which 3 919 cases have been formally opened for investigation. After detailed review, the HKMA has

referred 213 cases to the SFC for follow-up.

4. As part of the HKMA's continuing supervisory function, it will make sure that banks continue to observe the requirements of the codes and guidelines issued by the SFC and the Supervisory Policy Manual and circulars issued by the HKMA.

5. According to the "Questions and Answers on Suitability Obligations" promulgated by the SFC in May 2007, senior management of investment advisors should ensure adequate systems and controls are in place to identify issues that may be detrimental to a client's interest, for example cases in which investment advice may have been given merely to meet sales targets or may be driven by financial or other incentives. The HKMA's Supervisory Policy Manual Module OR-1 entitled "Operational Risk Management" also provides that an authorized institution's remuneration policies and performance incentives should include consideration of risk management, and that it should not provide incentives to people to operate contrary to the desired risk management values. The HKMA will take follow-up actions as deemed appropriate should the banks fail to comply with these requirements.

#### *Investigation by the SFC*

6. To respond quickly to the maximum number of complaints in the shortest possible time, the SFC has commenced a systematic top-down investigation examining whether the sale of Lehman products was the result of any systemic weakness or malpractice in the management controls over the sale processes employed by any of the distributors of Lehman products. Shortly after the collapse of Lehman Brothers, the SFC announced the commencement of formal investigations into the conduct of three SFC-licensed brokerages which had distributed the Lehman products. The SFC has also commenced further investigations following the receipt of the referrals from the HKMA. In addition, for those cases involving criminal offences, if the enforcement of which is outside the purview of the Securities and Futures Ordinance (SFO), the SFC will refer such cases to the Police for follow-up as appropriate.

7. The SFC has reminded banks and brokerages concerned to deal with complaints on a timely manner and is closely monitoring the progress they make in this regard. The SFC has also encouraged distributing banks and brokerages to help accelerate the investigation process into alleged mis-selling of Lehman products. In this respect, the SFC encourages banks and brokerages to undertake their own internal inquiries into their selling practices, to speak to the SFC about the scope of these enquiries and, if necessary, to engage external consultants to conduct a review. The SFC has asked banks and brokerages to take steps to speed up their internal investigations and reviews, and report progress to the SFC.

8. If the weaknesses amount to a breach of the Code of Conduct for Persons Licensed or Registered with the Securities and Futures Commission (the Code), the SFC will take appropriate enforcement actions. Where appropriate, the SFC will also make timely disclosure as to the nature of, and the parties in, the cases involving improper sales practices and violation of the Code.

9. Furthermore, the SFC is examining whether any facts, matters or circumstances that should have been disclosed to the SFC were not disclosed to the SFC at the time the offer prospectuses and marketing materials for each series of Minibonds were submitted for vetting. The SFC will take necessary follow-up actions as deemed appropriate.

#### *Investigation by the Police and the Consumer Council*

10. Apart from the HKMA and the SFC, the Police and the Consumer Council have also received complaints related to improper sales practices of Lehman products by banks and brokerages. The Police and the Consumer Council are assessing the complaints and have referred cases of suspected mis-selling to the HKMA and the SFC as appropriate for their follow up action.

11. In addition, the Police has submitted some representative cases to the Department of Justice for legal advice on sufficiency of evidence to substantiate the commission of any possible criminal offence(s). If there is sufficient evidence for criminal charges in any cases, the Police will

take prosecution actions in accordance with the law.

### **Assistance for the aggrieved investors**

12. The Government has been coordinating and mediating among the relevant parties and playing a facilitator role to secure the best arrangements for the aggrieved investors of the Lehman Brothers incident. We have –

- prompted the disclosure of the relevant information to the investors;
- put up a proposal whereby the distributing banks and brokerages of the Lehman Minibonds would offer to buy back the Minibonds at their current investment value from the investors;
- facilitated settlement between distributing banks and brokerages of the Lehman Minibonds and the investors; and
- given aggrieved investors access to legal remedies by providing financial support and legal assistance through the Consumer Legal Action Fund (CLAF).

### *Disclosure of information to the investors*

13. The trustees of the Lehman products are required under the trust deed to safeguard the interests of the note holders and have the power to enforce the right of the note holders, including, but not limited to, enforcing the security over the collateral. We understand that the trustees have provided the information relating to the identity/nature of the collateral of the Minibonds to the distributing banks and brokerages for onward transmission to the investors concerned.

14. In addition, the HKMA has urged the distributing banks of the Lehman products to be as transparent and forthcoming as possible in providing information to the investors, including details of the collateral and the latest situation with regard to these products. In this regard, the distributing banks have set up dedicated telephone hotlines to answer investors' enquiries and have been providing them with written information on the financial products. The list of telephone enquiry

lines established by the banks is published on HKMA's website<sup>1</sup>.

15. The SFC has published on its investor portal a list of outstanding retail structured products<sup>2</sup> (including the unlisted retail structured notes issued by or related to Lehman Brothers) for which offer documents and marketing materials have been authorized for issue by the SFC. The list contains a brief description of the product type, the underlying assets, the total issue size or outstanding amount, and (where applicable) the ultimate counterparty. The SFC has also published the contact information of the SFC-licensed brokerages which distributed the Lehman Minibonds, on the Commission's website<sup>3</sup>.

### *The Buy-back Proposal*

16. The Hong Kong Association of Banks (HKAB) has set up a Task Force on Lehman Minibonds Incident which is advised by an independent financial advisor and a legal advisor on the technical and legal feasibility of the buy-back plan. Having carefully considered the feasibility of the proposal, the risks and other related factors, 16 distributor banks announced their decision on 17 October to accept the buy-back proposal.

17. We understand from the Task Force that the Trustee of the Minibonds received a letter dated 25 November from the lawyers that act for the liquidator of Lehman. The lawyers alleged that, according to the US Bankruptcy Code, the Trustee's action since 15 September (the date which Lehman went into bankruptcy) might be invalid; and that the Trustee might not lawfully realize the collateral and pay the money to Minibond investors, and should refrain from taking any further action.

18. Notwithstanding the legal challenges, we hope that the Task Force would continue to mobilize its professional knowledge in helping the Minibonds holders. We also urge the Trustee to take all necessary action to safeguard the assets of the Minibonds holders and realize their current values as soon as practicable. The Administration is of the view that with the legal issues settled, the buyback option remains the best

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<sup>1</sup> <http://www.info.gov.hk/hkma/eng/new/lehman/lehman.htm>

<sup>2</sup> [http://www.invested.hk/invested/en/html/section/products/structured/unlist\\_cls.html](http://www.invested.hk/invested/en/html/section/products/structured/unlist_cls.html)

<sup>3</sup> [http://www.sfc.hk/sfc/html/EN/general/general/lehman/lehman\\_structure\\_products.html](http://www.sfc.hk/sfc/html/EN/general/general/lehman/lehman_structure_products.html)

option to the investors and trust that HKAB would continue to work closely with all relevant parties in the interest of the investors.

#### *Settlement between distributors and the investors*

19. According to figures collected by the HKMA as of 10 December 2008, 616 voluntary settlements involving a total principal of around HK\$257 million have been reached by the distributing banks with their customers. The HKMA has engaged the Hong Kong International Arbitration Centre to make available mediation and arbitration services on disputes between investors and distributors relating to Lehman products, and will pay the share of the fee for these services on behalf of the investors who have met the relevant criteria (including those whose complaints have already been initially substantiated).

#### *Provision of legal assistance through CLAF*

20. As at 5 December, 13 related applications for assistance under the CLAF have been received<sup>4</sup>. The Consumer Council is processing the cases. In parallel, it has examined the complaint cases received in relation to the allegations of improper sales practices by the banks and brokerages, identifying suitable cases for further analysis, and examining if the cases should be submitted to the CLAF for consideration for legal assistance.

21. At present, the CLAF has a balance of around \$16 million. The Government is maintaining close liaison with the Consumer Council and is closely monitoring the financial situation of the CLAF. The Government will apply to the Finance Committee for injection of funds to the CLAF, if necessary.

### **Review of the existing regulatory regime**

22. In view of the public concern arising from the Lehman Brothers incident on the existing regulatory regime of financial products, the Financial Secretary has earlier asked the HKMA and the SFC to submit a

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<sup>4</sup> Two of such applications have been withdrawn by the applicants.

report to him by the end of this year on the observations, lessons learned and issues identified during the process of investigating the complaints concerning the Lehman Minibonds. The Government will then conduct a full and comprehensive review, and consider what can be done, on a policy level, to further improve our regulatory framework and enhance investors' protection and education. We have already commenced the relevant work and will consult the Legislative Council as and when necessary.

**Financial Services Branch**  
**Financial Services and the Treasury Bureau**  
**December 2008**