

Dated 26 April 2010

RESPONSE TO LEGCO SUBCOMMITTEE LETTER
DATED 20 APRIL 2010

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

Unless otherwise stated, capitalised terms in this response have the meanings ascribed in the Written Submissions of Ms Amy Yip, Chief Executive Officer of DBS Bank (Hong Kong) Ltd. dated 26 March 2010 (the "Submissions").

- 1 It is noted that the NPSP of DBSHK was issued in July 2003. Please advise whether the NPSP was reviewed and updated in the light of the guidance provided by the Suitability FAQ issued by SFC in May 2007. If yes, please provide relevant document(s) that recorded such a review and a copy of the updated version of NPSP.
 - 1.1 When the Suitability FAQ was issued, emails were sent to all business and supporting units to ensure that they were apprised of the new regulatory requirements (see paragraph 31 of the Submissions).
 - 1.2 In addition, CB conducted a thorough review of the Bank's internal policies and procedures for the sale of investment products. DBSHK was satisfied that the existing sales procedures were in compliance with the requirements stipulated in the Suitability FAQ. The NPSP policy was considered in the context of this review but it was not thought necessary to amend the policy.
- 2 It is stated in paragraph 6.1 of W26(C) that one of the requirements of the primary target customers is "possessed sufficient knowledge and experience in trading securities and securities derivative instruments". Please advise whether DBSHK has any written guidelines on "sufficiency" of knowledge and experience for reference of sales staff. If yes, please provide the relevant document(s).
 - 2.1 Sales staff were required to conduct a thorough customer suitability assessment. Through the account-opening process, and through the completion of an IPQ on at least an annual basis, sales staff would gain a good understanding of a customer's financial status and investment experience. Through this process, sales staff would be in a position to assess whether a customer did, in fact, have "sufficient knowledge and experience". See paragraph 30 of the Submissions.
 - 2.2 The requirement that customer suitability assessments be conducted and, specifically, that "Know Your Customer" checks be undertaken were set out in various internal policies and ethical training materials. See, by way of examples, the extracts of materials on CB People Forum (item 9 enclosed with the Submissions), p.16 of the policy on Notes DBS4P (item 20 enclosed with the Submissions) and p. 25 of the CB Internal Control and Compliance Handbook enclosed as item 1 of the Appendix 1.
- 3 Please advise on the series of Lehman Brother-related CLN Notes the collaterals of which comprised collateralized debt obligations (CDO).
 - 3.1 Series 34-37, 43-46, 55-58, 59-62, 63-66, 67-70, 71-74 and 78-81.
- 4 Please provide the following documentation, if any:
 - (a) marketing materials (e.g. product flyers) of the relevant series of LB-related CLN Notes that contained a warning that investors might incur a total loss of their principal in the event of a default of one or few of the underlying collaterals; and
- 4.1 The risk that all or substantially all of a customer's principal investment might be lost, or, at the very least, a statement as to the non-principal protected nature of the product, were

clearly disclosed in all of the marketing materials in respect of the LB-related CLN Notes. These materials were vetted by the SFC. Such materials include the issue prospectus, leaflet, poster, and print advertisements. A set of these documents in respect of Series 34 was produced as item 30 with the Submissions. By way of a quick reference guide to the relevant disclosures, please see item 2 of the Appendix 1.

- 4.2 Specifically in relation to collateral risk, by way of examples, please see the Issue Prospectus for Series 34 provided as item 27 of the Submissions (p.37) and the FAQ for Series 34 (p.3). The FAQ is enclosed as item 3 of the Appendix 1.

Item 30
Annex 2
W26(C)

(b) the suggested scripts of the relevant series of LB-related CLN Notes provided to sales staff that contained a warning that investors might suffer a total loss of their principal in case a credit event occurred in respect of one of the reference entities.

- 4.3 All sales scripts prepared in respect of the LB-related CLN Notes stipulate that CLN Notes are not principal protected, i.e. the customer might suffer the total loss of his investment. (For example, see p.2 of the sales script for Series 34 provided as item 27 enclosed with the Submissions.)

- 4.4 As explained in paragraph 17.4 of the Submissions, and as illustrated by item 2 of the Appendix 1, apart from the sales scripts, other components of the Sales Aid Material, including sales kits, launch emails and FAQs, also contain unequivocal warnings that investors might suffer a total loss of their principal. The sales kit and launch email for Series 34 were produced as item 27 enclosed with the Submissions. The FAQ used for distributing Series 34 is enclosed as item 3 of the Appendix 1.

- 5 As stated in paragraph 42.3 of W26(C), an annual mystery shopper exercise was performed since 2004. Please provide:

(a) the findings of the mystery shopper exercise in 2004 and 2005; and

- 5.1 The average score achieved by the sales staff reviewed in the Mystery Shopping Study in 2004 was 63 per cent. The achievement rate in providing a complete explanation of information in relation to investment products was 91 per cent. An identified shortcoming of the relevant staff members' performance related to the completion or explanation of the IPQ which was established a few months before the Study was conducted.

- 5.2 The average score achieved by the sales staff reviewed in the Mystery Shopper Study in 2005 was 87 per cent. Sales staff demonstrated significant improvements in utilising the IPQ in conducting customer suitability assessments. There was also improvement in the quality of the explanations of products to customers. However, in certain instances deviations from the prescribed sales process were identified. Please note that additional information in relation to the Mystery Shopping Studies will be provided in response to request 2 of your letter to Ms Linda Wong dated 26 April 2010.

(b) the relevant documents showing the rectification and follow-up actions taken by DBSHK to address the irregularities identified in the annual mystery shopper exercise.

- 5.3 In response to the mystery shopping results, relevant units reminded the sales staff of the importance of full compliance with internal and external guidelines. As illustrated below, internal policies were enhanced and additional operation manuals and guidelines were prepared for staff:

- (i) in March 2005, a CB Internal Control & Compliance Handbook was produced (see item 1 of the Appendix 1);
 - (ii) from March 2006, sales staff were required to attend the quarterly People Forum where important messages regarding requirements on selling process were conveyed by the Head of CB (see item 9 enclosed with the Submissions);
 - (iii) a new policy document describing the investigation and disciplinary procedures was promulgated in June 2005 (see item 4 of the Appendix 1).
- 6 It is noted that when the CLN Notes were first distributed in September 2003, all sales staff were required to attend one of the training sessions on the CLN Notes conducted by the Global Financial Group (GFM) and complete a quiz after attending the training sessions (paragraph 17.2 of W26(C)).**
- (a) **Please advise whether training sessions were conducted by GFM when a new series of the CLN Notes was launched; if yes, please provide the details, including copies of the training materials, if any.**
- 6.1 GFM provided training to DBSHK in respect of each series of CLN Notes as explained in paragraph 12 of the Submissions. In particular, representatives from GFM provided details of each series of the CLN Notes and explained any new features and risks of the relevant series to the product due diligence team at weekly and monthly meetings. GFM also assisted in producing a sales kit containing an explanation of the features and risks of the relevant series to assist sales staff. GFM also supported ongoing training provided to sales staff by participating in ISM meetings and interactive briefings. Copies of sample sales kit materials were enclosed as items 26 to 28 of the Submissions.**
- (b) **In respect of the post-training quiz, please provide:**
 - (i) **the passing score of the quiz;**
- 6.2 70 per cent.**
- (ii) **the percentage of sales staff having passed the quiz; and**
- 6.3 99.24 per cent.**
- (iii) **a specimen copy of the quiz.**
- 6.4 Please see enclosed in item 5 of the Appendix 1.**
- 7 Out of the complaints received after the collapse of Lehman Brothers (i.e. complaints from 2,775 customer accounts as mentioned in paragraph 44.2 of W26(C)), how many of them related to transactions in which the customer's risk tolerance level did not match with the risk level of the product?**
- 7.1 None.**
- 8 It is noted that additional approval from senior staff would be required if a customer intended to invest in a product with a risk level above his/her risk tolerance level. Had the internal controls of DBSHK identified any case in which it was confirmed that the products were not suitable for the customers and the additional approval should not have been given for the transaction?**

- 8.1 As stated in paragraph 7.1 above, out of the 2,775 customer accounts, there were no transactions in which the customer's risk tolerance did not match the risk level of the product.