

Dated 12 July 2010

**WRITTEN RESPONSES OF
MR CHU REN-YEE, ALEXANDER, COUNTRY EXECUTIVE, HONG KONG,
THE ROYAL BANK OF SCOTLAND N.V. TO ISSUES ARISING FROM THE
SUBCOMMITTEE'S HEARING ON 6 JULY 2010**

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

GENERAL REMARKS

I refer to the summons issued by the Subcommittee to me on 26 May 2010 under the Legislative Council (Powers and Privileges) Ordinance (Cap 382) (“**Summons**”) and to my written statement dated 17 June 2010 (“**Written Statement**”), given in response to the Summons. This statement supplements my Written Statement.

Unless otherwise defined, capitalised terms used in this submission have the meanings given to them in my Written Statement.

RESPONSE TO REQUESTS FOR ADDITIONAL INFORMATION

1 Please advise:

(a) **how and when Minibonds were first introduced to ABN/RBS;**

(b) **who/which party introduced Minibonds to ABN/RBS;**

1.1 The first series of Minibonds sold by the Bank was Series 19. At that stage, Minibonds had been in the market for some time. The Bank received requests for Minibonds during late 2004, following which the Product Team contacted the promoter, Sun Hung Kai Investment Services Limited for further details in relation to distributing this product.

1.2 Before distributing any Minibonds, the Bank undertook the product approval process described in the response to Question 7 of the Written Statement. Please refer to Item 13 of the Written Statement for the relevant approval document for the first series of Minibonds sold by the Bank (Series 19).

(c) **how and when the first LB-related non-Minibonds structured financial product was introduced to ABN/RBS; and**

(d) **who/which party introduced the first LB-related non-Minibonds structured financial product to ABN/RBS.**

1.3 The first series of Lehman Products other than Minibonds sold by the Bank was the ELN described in paragraph 2.5 of the Written Statement. This was first sold on 4 October 2007. This followed an introduction from the Lehman Brothers Equity Derivatives team in relation to Lehman Brothers’ structured products.

1.4 Before distributing this ELN, the Bank undertook the product approval process

described in the response to Question 7 of the Written Statement. Please refer to Item 14 of the Written Statement for the relevant approval document for this product.

- 2 As stated in paragraph 9.1 of W37(C), no particular customers were targeted in relation to Lehman products distributed by ABN/RBS, although typically, customers who purchased Lehman products were Van Gogh Preferred Banking (VGPB) customers. Please advise:**
- (a) the eligibility criteria that a customer had to meet to become a VGPB customer;**
 - (b) the number of VGPB customers during the period from April 2005 to May 2008; and**
 - (c) among the customers who had purchased LB products from ABN/RBS, the respective number of customers who were VGPB customers and non-VGPB customers.**
- 2.1 A Van Gogh Preferred Banking customer was generally required to have assets of HKD1million deposited with the Bank.
- 2.2 Van Gogh Preferred Banking customers who purchased Lehman Products from the Bank were also required to complete the client acceptance process. This included:
- 2.2.1 the Bank's mandatory know-your-customer controls described in the CAAML Policy provided in Item 25 of the Written Statement;
 - 2.2.2 the completion of the anti-money laundering-related Risk Assessment Form provided in Item 30 of the Written Statement; and
 - 2.2.3 the completion of the Application Form for Investment Account/Services (including the Personal Investment Analysis) provided in Item 31 of the Written Statement.
- 2.3 Before any customer purchased a Lehman Product, the Bank was also required to undertake all necessary pre-sale procedures, including the suitability questionnaire described in paragraph 33.1.2 of the Written Statement.
- 2.4 The Bank's customers were all Van Gogh Preferred Banking customers. A separate business unit of the Branch provided other services to a small number

of other customers. These services included personal loans and credit cards. They did not involve investment services.

2.5 The number of the Bank's customers as at December of each year between 2005 and 2008 is shown in the following table.

| Year | Number of customers |
|------|---------------------|
| 2005 | 9,699 |
| 2006 | 10,827 |
| 2007 | 13,252 |
| 2008 | 13,591 |

3 Please advise:

(a) the number of customers who had purchased LB-related structured financial products distributed by ABN/RBS from April 2005 to May 2008; and

3.1 The following table shows the number of customers who purchased Lehman Products in each year from 2005 to 2008.

| Year | Number of customers who purchased Lehman Products | Total number of the Bank's customers | Customers who purchased Lehman Products as a percentage of all customers |
|------|---|--------------------------------------|--|
| 2005 | 40 | 9,699 | 0.41% |
| 2006 | 29 | 10,827 | 0.27% |
| 2007 | 1409 | 13,252 | 10.63% |
| 2008 | 492 | 13,591 | 3.62% |

(b) out of the customers in (a), the number of customers who had purchased LB-related products with the proceeds from their time deposits upon maturity.

3.2 The source of funds for the Lehman Products sold by the Bank during the Relevant Period was as follows.

| Source | Proportion of all Lehman Product transactions |
|--|---|
| Existing funds (eg current account or deposit) | 46% |
| Investment redemption proceeds (eg matured ELN) | 36% |
| New funds (eg telegraphic transfer, cash or cheque) | 14% |
| Multiple sources (any combination of the above) | 5% |

4 According to Mr Alexander CHU, the table under paragraph 2.2 of W37(C) shows the number of investment accounts involved in the LB-related structured financial products distributed by ABN/RBS. Please advise:

(a) given the sharp rise in investment accounts during the period from 2006 to 2007, whether ABN/RBS had employed additional staff to handle these accounts; and if yes, the number and ranking of the additional staff; and

4.1 It is important to place the rise in investment accounts that involved Lehman Products during 2007 into the context of the overall number of the Bank's customers with investment accounts during that period. In particular, as shown in the table in paragraph 2.5, the total number of customers increased from 10,827 in 2006 to 13,252 in 2007. This reflected an increase of 22.4%.

4.2 The changes in the number of employees at the branch level were proportionate to this increase in customers and are shown in Item 34 of the Written Statement. Specifically, from 2006 to 2007, the Bank's frontline sales team increased by 30.7%, with:

4.2.1 an additional Branch Manager employed by the Bank;

4.2.2 an additional 7 senior supervisory staff members, who served as team

heads or portfolio consultants (reflecting an increase of 36.8%); and

4.2.3 an additional 23 RMs (reflecting an increase of 29.5%).

(b) the total number of investment accounts of ABN/RBS in each of the year during the period from 2005 to 2008.

4.3 Please refer to the table in paragraph 2.5, which sets out the total number of customers for each year during the Relevant Period. The number of customers during the Relevant Period is generally proportionate to the number of investment accounts.

5 In respect of the customers who had purchased LB-related structured financial products from ABN/RBS through private placement, please advise:

(a) whether these customers had been informed that the LB-related structured financial products were sold to them through private placement;

5.1 The key features of a private placement included that:

5.1.1 the offer documentation was not reviewed by any regulatory authority in Hong Kong for the purposes of an offer to the public; and

5.1.2 the product was only able to be sold to investors where the minimum denomination or consideration was at least HKD500,000 or the product was offered to no more than 50 investors.

5.2 These features were informed to customers through the following measures.

5.2.1 The term sheet for each Lehman Product sold by the Bank through private placement contained a statement that explained to the customer that the term sheet had not been reviewed by any regulatory authority in Hong Kong. For example, each of the term sheets provided in Item 4, Item 5, Item 8 and Item 9 of the Written Statement provided the following warning on the first page.

WARNING

The contents of this termsheet have not been reviewed by any regulatory authority in Hong Kong. You are advised to exercise caution in relation to the Notes referred to in this termsheet. If you are in any doubt about the

contents of this termsheet, you should obtain independent professional advice. Prior to making an investment decision, prospective purchasers should carefully consider the contents of this termsheet, in particular the risk factors set out below.

Prospective purchasers should carefully consider the contents of this term sheet, including the risk factors set out herein. You should refrain from purchasing the notes unless you have fully understood the terms of the notes and the associated risks.

- 5.2.2 These term sheets also explained the selling restrictions that apply to the private placement distribution channel, being the HKD500,000 minimum consideration requirement and/or that the product may not be offered to more than 50 investors.
- 5.2.3 Before accepting an application for any Lehman Products, each RM was required under the SP Manual to make all necessary documents (including the term sheet) available to the customer and invite the customer to read and confirm their understanding of those documents.
- (b) the number of complaint cases, if any, in which the customers alleged that they had not been informed that the LB-related structured financial products were sold to them through private placement; and**
- (c) out of the complaint cases in (b), the number of cases that had audio recording of the selling process.**
- 5.3 During the Relevant Period, private placement was a recognised channel for the distribution of Lehman Products in Hong Kong. It was not a necessary part of the Bank's sales process to draw customers' attention specifically to all of the private placement requirements.
- 5.4 However, as described in the response to Question 5(a), each RM was required to make available all necessary documents to the customer before accepting an application for the customer to purchase Lehman Products. In the case of Lehman Products distributed through private placement, this included the term sheet. The term sheet contained the key features of private placement - namely, it stated that its contents had not been reviewed by any regulatory authority in Hong Kong, and it also set out the relevant private placement restrictions.

6 In respect of the complaint handling procedures of ABN/RBS, please confirm whether the complainants were bound by any confidentiality obligation not to disclose any information about the complaints, including any irregularity identified.

6.1 Where a settlement agreement is reached between the Bank and an individual customer, the customer is asked not to communicate the terms of the offer, the settlement concerned, nor any related confidential information.

6.2 Customers who receive information from the Bank pursuant to a data access request (such as an audio recording) are also advised of the confidential and proprietary nature of that information.

6.3 The Bank is also bound by its duties of confidentiality to its customers.

7 Please advise:

(a) whether the department within ABN/RBS responsible for internal audit had conducted any audit on the selling process of LB-related structured financial products; and

(b) if the answer to (a) is affirmative, please provide a copy of the relevant audit report(s).

7.1 The Bank is currently reviewing its files and will provide this information by 16 July 2010.

8 Please provide the information in the enclosed Tables 1 and 2.

8.1 Please refer to **Item 1** in relation to Table 1 and **Item 2** in relation to Table 2.