

Prevention of Financial Crime, Management of Risk and Corruption Seminar

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Thank you for inviting me today.

The weekend's announcements about Lehman Minibonds and the enhanced returns based on the collateral fulfil a long term strategy set in train by the SFC over 18 months ago.

September 2008

Prior to September 2008, about 30,000 Hong Kong investors, most of whom were retail investors, had invested substantial sums of money in Minibonds, a complex structured product, as an alternative to fixed deposit accounts or other simpler and more traditional forms of saving or investment.

Following the collapse of Lehman Brothers, Minibonds were in default, triggering large scale losses of savings and investments.

The size of the losses was difficult to determine. The common view was that all the money was lost. But that was neither entirely true nor accurate because Minibonds were secured, in part, by asset backed securities like collateralised debt obligations (CDOs).

The common view that losses were total and absolute held sway (this view continues to bedevil debate about Minibonds, even amongst sophisticated commentators). In reality, a precise quantification of the losses was not possible. These assets were very hard to value given the collapse of the global markets which meant the market price for such assets was at rock bottom, but that was not necessarily an accurate assessment of their value.

The Collateral

Complicating matters was that the collateral assets were not in Hong Kong. They were held by a custodian bank in London, Bank of New York. Additionally, the Minibonds trustee, HSBC Trustee, was also not in Hong Kong.

Further complications arose in late December 2008 when the lawyers for Lehman in New York issued a 'cease and desist' letter warning the custodian, Bank of New York, that any distribution of the collateral to the Minibond holders would violate US bankruptcy law.

This step meant the custodian was unwilling to distribute the collateral assets to the trustee so as to realise and then distribute the proceeds to the Minibond holders in Hong Kong.

The result was that we found a large number of concerns, all of which are summarised in the announcement we made on 22 July 2009, where we announced that we had entered into a resolution with the 16 distributor banks (the Minibond Agreement).

I will not rehearse the concerns that we identified in our investigations nor will I downplay

The Enhanced Complaints Handling Process was designed to ensure the banks conducted thorough investigations of each person's complaint. This was important because it was clear that most customers focused on the wrong issue when making a complaint. Their major complaint was that they had lost money which, on its own, is not a sufficient ground for complaint. This made it too easy for many complaints to be dismissed. The Enhanced Complaints Handling Process required each bank to investigate the whole sales process from every regulatory angle in respect to each complaint no matter what issue was raised by the complainant. As well, the process required each bank to explain the outcome to each complainant and, where there was fault, to consider making a compensation offer.

In short, the banks had to remember the complainants are in fact their customers.

The Outcome

The weekend's announcements close the circle on the strategy embedded in the Minibond Agreement.

The deal, which remains conditional, will repatriate the collateral and fund substantial second tranche distributions to all those investors who accepted the repurchase offer as well as ensure returns of over 70% at least to the remaining 10% or so who did not accept the repurchase offers or who were not eligible. All Minibond customers in the relevant series will benefit.

The returns will be enhanced by the additional payments to be made by the distributing banks which are being made voluntarily. These payments reflect the goodwill of the banks towards their customers for the hardships they have endured and signal the banks' determination to form stronger bonds with their customers.

In total, under the Minibond Agreement:

- about 29,300 customers accepted repurchase offers in an amount of approximately \$5.5 billion. This does not include the additional payments that will be made out of the collateral under the weekend's announcements (subject to the conditions being satisfied).

- as at February 2011, an additional \$590 million had been paid out by the banks under the Enhanced Complaints Handling Process.

- every bank has completed an overhaul of its systems and processes over the sale of structured products conducted by independent expert reviewers engaged and directed by the regulators. The banks are required to implement all recommendations and the implementation is being supervised by the HKMA;

- a fighting fund representing the revenue earned by the banks in selling Minibonds was established to recover the collateral and the fighting fund will remain in place to facilitate additional work by the Minibond trustee; and

- subject to conditions, the collateral value of the Minibonds will be repatriated to Hong Kong and will fund substantial payments to all Minibond customers in the relevant

series with returns totalling over 85% for most retail customers and, in many cases over 90%.

Yesterday Bank of China announced that its likely net loss in funding these initiatives under the Minibond Agreement will be in the order of \$1 billion. This is more than three times the revenue earned by all 16 distributing banks let alone three times the profit (if we take the highest fine that could have been imposed by the SFC under the current law).

Closing

There are some who would have preferred all of these outcomes to have been implemented as well as disciplinary actions imposing fines in the order of \$millions. Under the current law, this is impossible. We chose outcomes that provided tangible financial outcomes for each person holding one of these troubled Minibonds in a way that also forced wholesale changes