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從連動債糾紛探討銀行財富管理業務

A Review of Structured Note Investment Disputes  
- Impact on the Bank Wealth Management Business

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中華民國一〇〇年七月

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## Dedication

I will like to dedicate this thesis wholeheartedly to my beloved family members, my parents Mr. Yuan Hsin Lai and Mrs. Yuan Liu Chiu Yin who have been all time praying and blessing me for good, sacrifice their leisure and devoted endlessly their loves, times and efforts to help and take care of my children for more than eighteen years; my husband Jack Wang Han-Ching, who had given me strength at all times and support me to pursue all my desires; and my three lovely children Raymond Shih-Chun, David Ta-Wei and Tina Tin-An, you are all my proud and comforts; and my sister Rose Mei-Len, brother in-law Yi-Chia, nephew Victor Chen and my brother Ken Fang-Yu and sister-in-law Li-Ting, my niece Pei-Yun and my youngest brother Vincent Hsin-Chi, who had contributed to take care of the family members with patience and loves, all of you have accompanied me all the ways to overcome the difficulties I have faced and give me your hands warmly whenever I am in need. I love you all and feel deeply gratitude for everything you have devoted, assisted and shared with me. My studies in National Chengchi University and completion of this thesis would not be a possible if it is without all of your full supports, understandings, cares and loves.

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Abstract

**A Review of Structured Note Investment Disputes  
- Impact on the Bank Wealth Management Business**

By

YUAN MEI HWA

Wealth Management Business had become a popular business sector to the Taiwan Financial Institution in recent year. The Law governing Bank Conducting Wealth Management Business and Operating Guidelines were promulgated by Financial Supervisory Commission in year 2005, since then most of the Bank in Taiwan stepped into the wealth management business categories and commence to provide wealth management services to their customer.

Through the wealth management services and trust platform channel, foreign Structured Note products were largely introduced by Investment Bank through Banks in local to their wealth management customers or even non-wealth management customers in year 2006. The broke out of the European financial tsunami, primarily the sub-prime issues in the United States, the announcement of the bankruptcy of Lemman Brothers aroused the Structured Note Investment disputes in local financial market.

The disputes in Structured Note Investment had roused high attention of the

local regulators as the numbers of customer complaints received by FSC were more than ten thousands in year 2007 and 2008. Bank in Local were forced by public and local governing regulators to settle the disputes with customers. Eventually banks were ban by local regulators to cease foreign structured notes transactions in mid of 2009 and the Bank wealth-management business has slumped since then and impact directly to the performance of the Bank Wealth Management Business.

The objective of the thesis is to focus on the analysis of the Structured Notes disputes and from the studies of the types of disputes models, we will further conduct a review on regulatory trends on the governing of the relevant business and hopefully, we aim to provide some of the recommendation on the ways that Bank may adopt for its Wealth Management Business for the selling of the investment products, in particularly on the Structured Investment Products in the future.

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# 1. Introductions

## 1.1 Background

Wealth Management Business boosted in Taiwan Financial Market after the announcement of the wealth management rulings by Financial Supervisory Committee (FSC) in year 2005. It is a new business area that Taiwan financial market has relied upon to cope with the low interest rate income at this times for the increase of bank's revenue. The need of wealth management services from local customer also drives the emerging of the wealth management service market. Banks provides wealth management advices, introduces investment products to their customers and charged related services fees, handling fees against its customers who conducted investment transaction or received investment advice related services.

For the protection of local economics, local regulatory bodies set up stringent restrictions to its people on offshore investment. The deregulation of offshore investment through Trust Business platform and Wealth Management Services offered by the Bank, opened up the door for Taiwan people that seek for the opportunities to invest overseas. Subsequently, foreign Structured Note products were introduced to the Taiwan market by foreign investment Bank. Many investors that invested the Structured Notes look forwarding to receiving a higher return from these offshore investments. Unfortunately, the recent US financial crisis-primarily the subprime mortgage crisis<sup>1</sup> that broke out in July of 2008 has broken up these investor's dream of fortune.

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<sup>1</sup> Subprime Mortgage Crisis (visited 28 December 2010)  
<[http://en.wikipedia.org/wiki/Subprime\\_mortgage\\_crisis](http://en.wikipedia.org/wiki/Subprime_mortgage_crisis)>

As a result of the continuing subprime issues, Lehman Brothers Holdings Inc. (Lehman Brother) filed for Chapter 11 bankruptcy protection, which marked the largest bankruptcy in U.S. history. Lemman Brother following the massive exodus of most of its clients, suffered drastic losses in its stock, and devaluation of its assets by credit rating agencies. The overwhelming of US bank solvency, declines in credit availability, and damaged investor confidence had an impact on global stock markets, resulted in the slowed down of economies worldwide during this period as credit tightened and international trade declined<sup>2</sup>. And inevitably, Structured Note investment crisis burst out in the year of 2008 subsequently.

## 1.2 Objective and Methodology

Wealth Management Business is a new Business sector in local market and it is deemed to be a business that may constitute great income revenue for banks, however the disputes of Structured Notes investors has greatly impacted the perform of wealth management business of the Bank. Local investors suffered great losses from Structured Product Investment and criticized bank's responsibility for providing wealth management service.

The purpose of the thesis is to look into the details of the Structured Notes disputes, and by digging and analysis the causes of the disputes, we hope that we can work out some workable way to mitigate future argument in wealth management service and provides some thoughts and recommendation on the management of the wealth management business.

Through the research on articles, studies, books and reading materials and information found on internet on the relevant topics, this thesis will review the development of the wealth management business, regulatory background of the wealth management business in

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<sup>2</sup> Bankruptcy of Lehman Brothers (visited 28 December 2010)

<[http://en.wikipedia.org/wiki/Bankruptcy\\_of\\_Lehman\\_Brothers](http://en.wikipedia.org/wiki/Bankruptcy_of_Lehman_Brothers)>

Taiwan and through the introduce of the Structured Notes Product and the regulatory background for banks providing the service, the thesis will focus on the review and analysis of types of structured note investment disputes through the studies of the actual Structured Note disputes model findings by Bankers Association (“BA”) of Republic of China; and also Structured Notes Civil Judgments issued for the Structured Note dispute claim cases; and basing upon the findings on the investigation report issued by foreign governmental bodies on Structured Note disputes, and through the review of C and U Bank recent business strategy to sought out possible improvement and enhancement of the management for the wealth management business in Taiwan.

### 1.3 Limitation of the study

World economic after experiencing the US financial crisis has not yet fully recovered, and as Structured Note disputes has not come to an end, so as following the introduce of relevant new Laws and Regulations governing the issuance of offshore Structured Products, ,it is difficult to justify at this stage in this thesis, the successful of any bank’s business management strategy, the studies of the current Bank’s wealth management strategy or policy may not be a concrete supportive evidence to show or support the effectiveness of the bank’s wealth management policies.

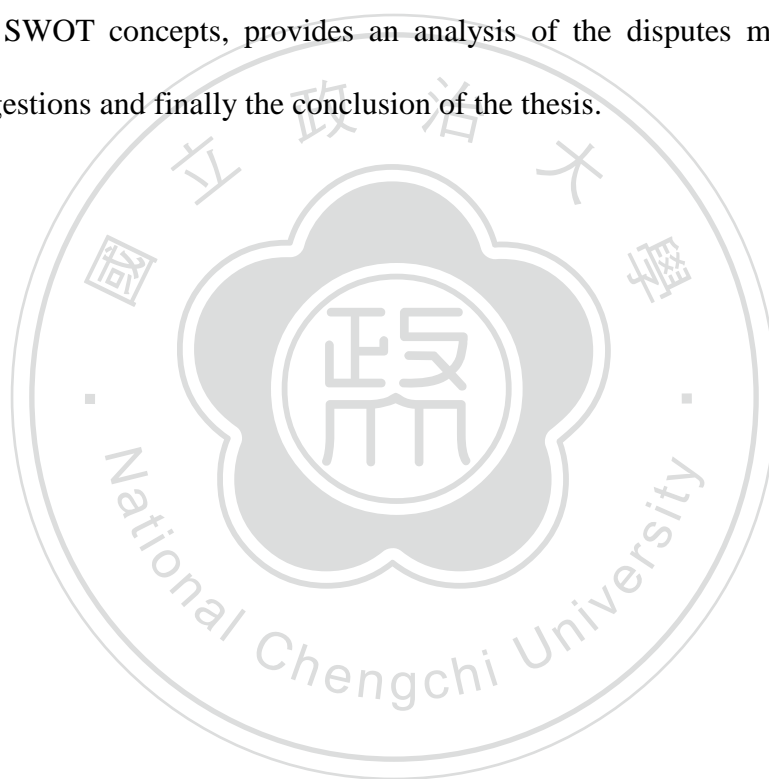
### 1.4 Structure of the thesis

The author begins with the definition of the wealth management and provides the local governing laws and regulations for reviewer’s information in Chapter 2. Following the definition provided also for ‘Structured Note’ in Chapter 3, we introduce the Structured Note Product features for reader’s understanding.

Through the case studies in Chapter 4, author further proceed to identify the Structured Note

Investment disputes models via reviewing the disputes case with Bankers Association Committee, litigation cases with the Taiwan District/High Court and finally the Investigation Report from Singapore Financial Governing Authority.

In the last Chapter, author introduces and conducts a review of the business strategy on customer protection adopted by T and C Bank after the financial crisis, and then provides the latest development of the local laws and regulations on the respective areas. Author by applying the SWOT concepts, provides an analysis of the disputes model identified and provides suggestions and finally the conclusion of the thesis.



## 2. Introduction of Wealth Management Business Environment

### 2.1 Introduction of Wealth Management Business

#### Definition

According to the explanation found on the Wikipedia<sup>3</sup>, the free encyclopedia, Wealth Management is an investment advisory discipline that incorporates financial planning, investment portfolio management and a number of aggregated financial services. High Net Worth Individuals, small business owners and families who desire the assistance of a credentialed financial advisory specialist call upon wealth managers to coordinate retail banking, estate planning, legal resources, tax professionals and investment management. Wealth managers can be an independent Certified Financial Planner, MBAs, Chartered Strategic Wealth Professional, CFA Charter holders or any credentialed professional money manager who works to enhance the income, growth and tax favored treatment of long-term investors.

Wealth management is often referred to as a high-level form of private banking for the especially affluent. One must already have accumulated a significant amount of wealth for wealth management strategies to be effective.

### 2.2. Local Governing Laws and Regulations

The Regulation Governing Bank Engaging in Wealth Management Business<sup>4</sup> (“the Regulation”) was promulgated on 21 July 2005 by Financial Supervisory Commission (FSC),

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<sup>3</sup>Wealth Management (visited 28 December 2010) <[http://en.wikipedia.org/wiki/Wealth\\_management](http://en.wikipedia.org/wiki/Wealth_management)>

<sup>4</sup>銀行辦理財富管理業務應注意事項(visited 30 May 2011)  
<<http://law.banking.gov.tw/Eng/FLAW/FLAWDAT0202.asp>>

Executive Yuan of Republic Of China. The Article number 2 of the Regulation states that “The term "wealth management business" means the provision to high net worth customers by a bank through its wealth managers of financial planning or assets and liability allocation services that match the customer's needs, with a view to offering various financial products and services that the bank is legally authorized to provide.

An individual bank shall have discretion in determining its own thresholds for "high net worth customers" under the preceding paragraph based on its operational strategies. Notwithstanding the foregoing, the bank shall, for internal compliance purposes, clearly define the scope of financial products available for planning for or sale to high net worth and non-high net worth customers. The bank shall also avoid selling to non-high net worth customers financial products that are too risky or too complex in structure. And a bank shall obtain approval from the Central Bank of China for conducting wealth management business that involves operation of foreign exchange business.

Basing upon the Regulations for Bank that wishes to engage Wealth Management Business, they shall require to submit application to FSC for approval and obtained also CBC's for approval if foreign currency is involved in the transaction currencies. Under the Regulations, Bank engaging in the wealth management Business shall set up a specialized Department and equipped with professional wealth management personnel to provide the service to the customer. The specialized Department will be responsible for the planning of the Wealth Management Business strategies and the management of its Wealth Management Sales Representatives. The sales representatives of the wealth management shall need to pass the qualification test as required by local authorities and non wealth management department

sales representative shall not provides wealth management products/services to its wealth management business.

Bank is required under the regulations to set up internal control and risk management policies when running the business. The aforesaid policies shall includes the sales representative management rules, Know Your Customer standard, monitoring of abnormal or suspicious transaction, marketing promotion and risk management of customer's account procedures, prevention of insider trading and conflict of interest mechanism and customer disputes handling process. All details requirements of the internal and risks control process is governed by the Operating Rules for Banks Conducting Wealth Management Business<sup>5</sup>.

### 2.3 Comparison of Local and Foreign Bank

In view of different regulatory environments in governing banking business, the types of financial products and services provided by local banks and banks overseas in the wealth management business or the threshold of defining its wealth management customers may be different.

Take Citibank Private Bank for example, the services includes investing financing, normal banking products and services, Wealth Advisory (including may be tax and accounting advice etc. services), Research and even Wealth Education<sup>6</sup>. While local Bank provides

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<sup>5</sup>銀行辦理財富管理業務作業準則(visited 30 May 2011)

<[http://law.banking.gov.tw/Chi/FINT/FINTQRY04.asp?N2=&sdate=&edate=&keyword=%B0%5D%B4%BA%DE%B2z&datatype=etype&typeid=\\*&page=1&recordNo=6](http://law.banking.gov.tw/Chi/FINT/FINTQRY04.asp?N2=&sdate=&edate=&keyword=%B0%5D%B4%BA%DE%B2z&datatype=etype&typeid=*&page=1&recordNo=6)>

<sup>6</sup>Citi Private Bank ( visited 22 June 2011)

<[https://www.privatebank.citibank.com/cpb/cwslogin/external/publicsite!/ut/p/c5/04\\_SB8K8xLLM9MSSzPy8xBz9CP0os3hjl2AXZzcPIwOLMH8TA0\\_H4DAnQ09\\_QwMDA\\_1wkA6zeAMcwNFA388jPzdVvyA7rxwAZtTjZg!!!dl3/d3/L2dBISvZ0FBIS9nQSEh/](https://www.privatebank.citibank.com/cpb/cwslogin/external/publicsite!/ut/p/c5/04_SB8K8xLLM9MSSzPy8xBz9CP0os3hjl2AXZzcPIwOLMH8TA0_H4DAnQ09_QwMDA_1wkA6zeAMcwNFA388jPzdVvyA7rxwAZtTjZg!!!dl3/d3/L2dBISvZ0FBIS9nQSEh/)>



general traditional bank's products and services, such as deposit, credit card, remittance, sales of investment products (e.g. mutual fund, structured products etc.) etc. areas.

High net worth customers may be provided by Private Banking Services by the Bank. To be qualified as private bank customer for Citibank, their Asset Under Management (AUM) with the Bank shall at least meet the minimum threshold of USD1million (i.e. approximately NTD33millions). While for a general local bank's wealth management business, normally customers with AUM with NTD3millions or above shall be accepted by the banks as wealth management customers.



### 3. Introduction of Structured Note

#### 3.1 Definition

As explained in the Wikipedia<sup>7</sup>, a structured note is a hybrid security that includes several financial products, typically a stock or bond plus a derivative (e.g. a two-year bond tied together with an option contract). The option contract in addition, changes the security's risk/return profile to make it more tailored to an investor's comfort zone.

The introduction of the structured note provided by The Association of Banks in Singapore for investor's knowledge is extracted and provided as below for reference<sup>8</sup>.

A structured note is an investment with return that link to the performance of one or more reference asset(s) or benchmark(s). These reference assets or benchmarks typically include interest rate, foreign exchange rate, market indices, equities, fixed-income products or any combination of the above. Investor may receive in return, the interest amount and/or principal repayment, which are linked to the performance of the underlying asset(s) or instruments. Investor may receive interest or returns at regular intervals throughout the tenor for some of the notes. The payout may be a specified fixed coupon or subject to an equation described in the terms and conditions of the product.

At the maturity of the structured note, except where there is an early redemption, the investor will receive at maturity, either the whole original principal amount invested or an

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<sup>7</sup> Structured Note ( visited 30 May 2011) < [http://en.wikipedia.org/wiki/Structured\\_note](http://en.wikipedia.org/wiki/Structured_note)>

<sup>8</sup> MAS Monetary Authority of Singapore. The Association of Banks in Singapore *Making Sense of Structured Notes* ( last modified 11/2/2010) pg1,3&4  
<[http://www.moneysense.gov.sg/resource/publications/guides\\_publications/MakingSENSEStructuredNotes.pdf](http://www.moneysense.gov.sg/resource/publications/guides_publications/MakingSENSEStructuredNotes.pdf)>

amount calculated based upon the formula stipulated in the product term sheet.

If the issuer of the note has the right to redeem or “call” the notes before the maturity date, the structured note is “callable” at issuer’s discretion, and investor would normally be redeemed at the full value of the original investment amount for such note.

- Examples (types) of structured note:

- Credit-linked Note:

The interest amount and/or principal repayment are linked to the creditworthiness of an entity or portfolio of entities and /or market value of the debt obligations (e.g. loans, bonds etc.) of such entity or portfolio of entities

- Equity Linked Note:

They are Notes that linked to equity indices, e.g. S&P 500, Strait Times Index (STI), or share price of a company, or to a basket of shares or basket of stock indices. Investor may receive shares instead of cash at the time principal is to be repaid.

Structured Notes may also structured to link with foreign exchange rate, interest rate (e.g. London Interbank Offered Rate (LIBOR)), commodities prices and other asset classes. And sometimes, there are notes with returns that are linked to two or more reference assets or benchmarks, for instance interest or principal return depending on both creditworthiness and share price of a group of companies etc.

Structured notes are typically embedded with derivatives instrument such as options or swap contracts. The issuer of the structure note may enter into a derivative contract with

another institution in some structures. As a result, the performance of a derivative instrument shall have a direct impact on the returns of the structured note. In simple, the performance of the underlying asset or bench mark (e.g. credit, equities and commodities) shall impact the note's overall return.

Sometimes, structured note may also be early redeemed in circumstances where there is occurrence of issuer default, i.e. issuer unable to meet payment obligations, or when there is force majeure or extraordinary event occurred, or if on payments are aroused from the product or taxes are imposed on the issuer, or when market value of any collateral falls and is insufficient to secure any or all issuer's obligation under the structured note. In consequence, investor may then receive less than the amount they initially invested.

Structured Note may be issued by a financial institution, e.g. a bank or by a special purpose vehicle that has been set up for the purpose of issuing structured note.

Generally, structured note investment involves risks, depending on the structure of the notes, these risks may include risks such as early redemption risks, reinvestment risks, sub effect of underlying risks, interest rate risks, liquidity risks, credit risks, exchange rate risks, event risks, country risks, inflation risks, call risks, settlement risks and minimum return risks etc.

The below table list some commonly seen structured note and risks associated to each type<sup>9</sup>.

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<sup>9</sup> MAS Monetary Authority of Singapore. The Association of Banks in Singapore *Making Sense of Structured Notes* ( last modified 11/2/2010) pg5  
<[http://www.moneysense.gov.sg/resource/publications/guides\\_publications/MakingSENSEStructuredNotes.pdf](http://www.moneysense.gov.sg/resource/publications/guides_publications/MakingSENSEStructuredNotes.pdf)>

**Table 1 Risks Associated to structured notes commonly seen**

<b>Type of Structured Note</b>	<b>Description</b>	<b>Key Risks Involved</b>
<b>Equity-linked</b>	<ul style="list-style-type: none"> <li>• Equity-linked notes may be linked to a single stock, or a basket of stocks.</li> <li>• Equity-linked notes may also be linked to an equity index (for example, the S&amp;P 500) or a basket of indices.</li> </ul>	<ul style="list-style-type: none"> <li>• Returns are dependent on the performance of the underlying stock or basket of stocks, or equity index or basket of indices.</li> <li>• You are exposed to the risk that the level of the underlying asset does not move in the direction and/or by an amount you anticipated.</li> <li>• Where the returns are linked to more than one reference asset (e.g. a basket of stocks), the returns will often not be based on the average of the basket. For example, the formula may be linked to the worst performing stock. In such cases, investors should note that a larger number of reference assets in the basket may actually increase the risk.</li> <li>• The issuer may also cap returns, or may exercise its right to cap returns if the equity instrument performs far beyond expectations. With returns capped, you bear the risk of foregoing potentially</li> </ul>

		<p>higher returns from investing directly in the underlying stock or basket of stocks.</p> <ul style="list-style-type: none"> <li>• Where the structured notes pay you in the form of shares, you may end up buying shares at a price that is higher than their current market price.</li> </ul>
<b>Interest rate-linked</b>	<ul style="list-style-type: none"> <li>• Returns for such notes are usually linked to a formula that makes reference to a specific floating interest rate (for example, the Singapore interbank Offered Rate).</li> </ul>	<ul style="list-style-type: none"> <li>• Your returns may depend on the direction and/or amount by which interest rates move.</li> <li>• You are exposed to the risk that interest rates do not move in the direction or by the amount you anticipated.</li> </ul>
<b>Credit-linked</b>	<ul style="list-style-type: none"> <li>• The returns are linked to the occurrence of what is known as a "credit event" (for example, if a specified company becomes insolvent or defaults on its loans) and/or to the credit risk/market value of the underlying collateral</li> </ul>	<ul style="list-style-type: none"> <li>• Your returns are exposed to the credit risk of specified entities and/or to the credit risk/market value of the underlying collateral, if any. In some cases, you may lose all, or substantially all, of your original investment amount.</li> <li>• You will need to be able to assess the likelihood of a credit event occurring to the specified entities as well as the entities that constitute the underlying collateral.</li> </ul>

In addition, some of the risks that apply generally to structured notes are listed below<sup>10</sup>. (p.s. this is not an exhaustive list.)

**Table 2 Common key risks apply to structured notes**

<b>Key risk</b>	<b>What this means</b>	<b>What happens then</b>	<b>Redemption Amount</b>
<b>Credit risk of the issuer</b>	The issuer's default on a payment due would constitute an event of default.	This triggers an early (or mandatory) redemption of the notes.	Investors may lose all or a substantial part of their investment amount.
<b>Derivative counterparty defaults</b>	Derivative counterparty becomes unable to make payments due under the derivative transaction (which may be a swap or option), e.g. if it is insolvent or becomes bankrupt.  If the derivative counterparty defaults, the issuer will not receive any payments under the derivative	This triggers an early (or mandatory) redemption of the notes.	Investors may lose all or a substantial part of their investment amount.

<sup>10</sup> MAS Monetary Authority of Singapore. The Association of Banks in Singapore *Making Sense of Structured Notes* ( last modified 11 February 2010) at 6-7  
<[http://www.moneysense.gov.sg/resource/publications/guides\\_publications/MakingSENSEStructuredNotes.pdf](http://www.moneysense.gov.sg/resource/publications/guides_publications/MakingSENSEStructuredNotes.pdf)>

	transaction and may not be able to meet its payment obligations under the notes.		
<b>Certain events adversely affecting the value or performance of the collateral</b>	<p>The assets constituting the collateral suffer a loss in market value thereby leading to a loss in the market value of the collateral as a whole.</p> <p>The issuer of the collateral (e.g. bonds) becomes insolvent or defaults on any of its payment obligations.</p>	This triggers an early (or mandatory) redemption of the notes.	Investors may lose all or a substantial part of their investment amount.

### 3.2 Local Governing Laws and Regulations

In according to the Guidelines for Bank Conducting Financial Derivatives Businesses<sup>11</sup> Article number 2, it explain that “ the term “ financial derivatives” shall mean for contract values derive from an interest rate, exchange rate, stock price, index, commodity, or other interest, or from a combination thereof as well as Structured Products. The term “structured

<sup>11</sup> Directions for Banks Conducting Financial Derivatives Businesses (last Modified 2009.12.31)  
 < <http://law.banking.gov.tw/Eng/FLAW/FLAWDAT01.asp?lsid=FL006459>>



product” as used herein shall mean a combination transaction of fixed-income products and derivatives products sold by a bank to a client as counterparty to the transaction.

Structured Note Products were largely introduced by Banks to its wealth management customer or non-wealth customer starting from year 2005 to 2008 before the broke out of the financial crisis in US. Banks by applying trust license and approval sought from local authorities (i.e. FSC and Central Bank of China (CBC)) will be able to conduct structured notes business with its customers. Normally Bank’s customer would need to open a trust account with the Banks before they are able to invest mutual fund or structured note products (offshore or internal structured note products) offered (issued) by offshore or in country investment bank, entities or financial institutions<sup>12</sup>. In general, Bank’s would need to comply with the Regulations governing Bank Conducting Financial Derivatives Businesses, Regulations for Bank Conducting Wealth Management( or Non-Wealth Management) Business, Operating Rules for Bank Conducting Wealth Management(or Non-Wealth Management) Business, Trust Business Law and Regulation Governing Trust Business In Managing Specified Trust fund( non-discretionary trust)to Invest In offshore Securities<sup>13</sup> and its relevant self disciplinary rules when providing offshore structured note product to its customers.

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<sup>12</sup>銀行銷售雷曼兄弟發行之連動債商品，有關投資人權益問答集 (visited 30 May 2011)

<[http://www.banking.gov.tw/Layout/main\\_ch/News\\_NewsContent.aspx?NewsID=19236&path=2995&LanguageType=1](http://www.banking.gov.tw/Layout/main_ch/News_NewsContent.aspx?NewsID=19236&path=2995&LanguageType=1)>

<sup>13</sup>信託業辦理特定金錢信託投資國外有價證券業務應遵守事項(visited 30 May 2011)

<[http://law.banking.gov.tw/Chi/FINT/FINTQRY04.asp?N2=&sdate=&edate=&keyword=%AFS%A9w%AA%F7%BF%FA%ABH%BOU&datatype=etype&typeid=\\*&page=1&recordNo=7](http://law.banking.gov.tw/Chi/FINT/FINTQRY04.asp?N2=&sdate=&edate=&keyword=%AFS%A9w%AA%F7%BF%FA%ABH%BOU&datatype=etype&typeid=*&page=1&recordNo=7)>

## 4. Case Studies

### 4.1 Customer's Dispute Cases (models) identified by Bankers Association Committee on Leman Brother Structured Note<sup>14</sup>.

(1) Soon after the announcement of bankruptcy protection of the Leman Brothers on 15 Sept. 2008 in US, Financial Supervisory Commission (FSC) of Taiwan, Republic of China was overwhelmed with investor's complaints. According to FSC official records, there were around fifty-one thousand and more investors who had invested Leman Brother's related Structured Products. The total investments were around New Taiwan Dollars 40 Billions, and Taishin Commercial Bank and China Trust Commercial Bank were the two largest Bank that stood for almost two- third of the total investment ( around 27.1 Billions). For investor's protection purpose, FSC at that time requested those Banks that involved in the sales of the relevant Structured Notes to immediately carry out the following actions<sup>15</sup>:

- (i) Bank should proactively inform customer who invested in Structured Note that relates to Leman Brothers
- (ii) Bank should assist investor to claim Leman Brother oversea and the legal costs incurred due to the action should be bore by the Banks

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<sup>14</sup> 銀行公會雷曼兄弟連動債爭議處理態樣(visited 30 May 2011)

<[http://www.banking.gov.tw/Layout/main\\_ch/News\\_NewsContent.aspx?NewsID=21585&path=2995&LanguageType=1](http://www.banking.gov.tw/Layout/main_ch/News_NewsContent.aspx?NewsID=21585&path=2995&LanguageType=1)>

<sup>15</sup> 陸倩瑤、孫中英，「雷曼兄弟連動債 銀行須幫客戶求償」聯合報，台北報導，民國九十七年九月十八日<[http://money.udn.com/wealth/storypage.jsp?\\_ART\\_ID=149504](http://money.udn.com/wealth/storypage.jsp?_ART_ID=149504)>

(iii) Trust Association should set up in their website to provide latest updates of the Lemman Brother Bankruptcy information, status of the incidence and work out a Frequently Asked Questions (Q&A) and answers for customer's information and awareness.

(iv) To work on establishment of an intermediately parties to resolves the disputes/ complaints between the customers and the distributor Banks.

(2) Following all the actions as above-mentioned, FSC and Bankers Association of the Republic of China has further figured out and release the “ nine common seen disputes model”( 九大爭議態樣) of the Lemman Brother's investments as below around mid of December 2008:

(i) Type One: Basing upon the terms of the Lemman Brother's Structured Notes and the age of the investor, if the addition of the terms of the Structured Note Agreement and age of the investor is more than 81 years for female or more than 75 years for male investor, and that they did not have any previous Structured Note investment experience or had they signed the customer consent letter to invest such products;

(ii) Type 2: Bank failed to inform customer at the time where the performance of the Structured Note triggered the lower capped protection threshold;

(iii) Type 3: Bank failed to inform customer that the issuer of the Structured Notes was changed to Lemman Brothers or if the permitted redemption period of the Structured Note was later than the date Lemman Brother had announced bankruptcy protection

and customers who had requested to redeem before and yet Bank failed to negotiate the redemption with the issuer;

(iv) Type 4: Bank that did not provide monthly statement on the net value of the Notes or make public announcement so that customer may aware of their investment status or the latest value of the Structured Notes;

(v) Type 5: Untrue marketing material or Structured Note Investment Agreement was signed by the sales representative of the Bank;

(vi) Type 6: Bank did not understand customer risk appetite in thorough, for customers that stated in written that they do not wish to sustain loss in their principal investment amount or to undertake any investment risks and yet Bank still classified these types of customers as “Aggressive” investor and permitted these types of clients to invest in non-principal guarantee of Leman Brother’s Structured Notes;

(vii) Type 7: Customer who is of high age and insufficient in knowledge, or customer’s age is more than 70 years old at the time of investment and have no experience in either stock market or Structured Note investment experience and is of only high school education standard;

(viii) Type 8: Cases where after FSC inspection considered that there may not fully comply with local requirements;

- (ix) Type 9: Cases where there are actual facts that are enabled to show that Bank sales representatives have mis-sold the Structured Note Products to customers.

## 4.2 Structured Note litigation Cases with Civil Courts

According to a non-official records announced by the BA, there were not more than ten cases with District Courts in R.O.C. that judgments were made in favour to the Structured Notes investors. In this Chapter as we would like to review the customers disputes models that were normally found with the courts, we therefore choose to review three civil Structured Note litigation cases with Taipei Court whereby the three claims we have chosen were cases where Judgments were in favourable to investors. The purpose is also to understand the customer's dispute in common and from the review of the Judgment to understand some of the Judges' thoughts and attitudes on Structured Notes Investment disputes between investors and Financial Institutions.

### 4.2.1. Taiwan District/High Court Civil Judgment on Structured Note Claims

#### (1) Case Number One<sup>16</sup>

(i) Brief Description of the Claim:

Judgment Date: 5 Jan 2010

Judgment No: Taiwan High Court Judgment R.O.C. Year 99 Appeal No. 299

Appellor (i.e. Plaintiff): Mr. ABC (p.s. name replaced for data privacy reason)

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<sup>16</sup> 司法院法學資料檢索系統臺灣高等法院 裁判書 民事類, 臺灣高等法院民事判決 98 年度上易字第 299 號 民國 99 年 1 月 <<http://jirs.judicial.gov.tw/Index.htm>>

Appellee (i.e. Defendant1): Ms. Money (employee of China Trust Commercial Bank)  
(p.s. actual name of the employee replaced for data privacy reason)

Appellee (i.e. Defendant 2): China Trust Commercial Bank

Brief of the Court Judgment: Defendant, China Trust Commercial Bank should pay Appellor (i.e. plaintiff) NTD720,377 plus an interest at 5% commencing from 17 Dec. 2008 until payment date.

(ii) Summary of the facts alleged by Plaintiff:

(a) Plaintiff Ms. ABC engaged into a Trust Contract with China Trust Commercial Bank (“the Bank”) through the introduction of the Bank’s employee, Ms. Money around November of year 2005. After then, Ms. ABC invested NTD 1 million in a Structured Note (Name: CSF B3 HKD Tomorrow Star Structured Note 港幣明日之星連動債) through the Bank.

(b) Ms. ABC alleged that the Bank’s employee understand that she would like to invest only in hundred percent guarantee product but still, the employee by knowing that the investment product was not hundred percent guarantee, induce and cheated her to investment the Structured Note. Ms. ABC claims that she has wrong concept on the investment product due to the fraud behaviour of the employees, and therefore made the decision to invest such product Ms. ABC therefore wanted to revoke the investment contract and requested Bank to pay her back the entire investment amount and compensate her loss for such investment.

(c) Ms. ABC further alleged that Ms. Money did not play her obligation to act a trustee for her investment. Ms. Money failed to explain the product’s nature or fully

disclose the embedded risks in such investment and did not inform her of on fluctuation of the investment product risks performance and therefore she would considered that the employee of the Bank had violated the Trust law Article 22 and Civil law Article 535 i.e. to act in due diligence of a good administrator or appointed agent.

(d) Ms. ABC claimed that the Bank and employee should be held jointly liable for the amount of NTD0.89million and a 5% interest commencing from 17 Dec. 2008 until payment date.

(iii) Defense statement summary from Defendants:

Ms. Money denied of the fraudulent act as alleged by the plaintiff and therefore would not be obliged to any compensation to the plaintiff. She stated that she has told Ms. ABC of the non-principal guarantee nature of the investment product and all risks were fully disclosed to the investor.

(iv) Summary (Extract) of the Court Judgment:

(a) Agreed by both party, investment amount was HKD 1 million and matured date of the investment product was on 30 Dec. 2008. During the investment period, investor was paid with an interest amount of HKD27, 600. After the occurrence of the financial Tsunami, the redemption of the investment amount returned to the investor was only HKD41, 243.33. There were no argument on the content of the trust contracts, term sheet of the investment product and Bank's monthly statements that were delivered to the investor.

(b) According to the Trust contract entered between the Bank and the customer, Bank by charging the Trust fees against the customer should act in due diligence as a good administrator of the investor based upon the Trust Enterprise Law Article 22<sup>17</sup> and Civil law 535<sup>18</sup>. In particular, under the circumstances that Bank is aware that customer has requested principal guarantee products and no risks on lost of entire principal amount, Bank should have under control, the background of the customer that the customer did not have any offshore product investment experience and have no ability to suffer great loss from investment and therefore should provides customer suitable investment service. This services shall includes complete explanation of the Structured Note Contract Terms and Conditions clause by clause and clear notice of associated risks on the nature of the Structured Note Product, such as the possibility of the guarantee of investment principal, and the extent of the non-protection of the investment amount. Bank should not caused any misunderstanding or doubts and during the investment period, to pay attention on the changes of risks on the investment product and to inform customer of such change at appropriate time so as to provide investor necessary information to avoid any investment risks. Court is with the view that the Bank did not act in due care as a good manager, Bank should not introduce non-principal protected structured note product to customer and that Bank had neglected to completely introduce and inform customer the product risks and non-principal protected nature of the

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<sup>17</sup>Trust Enterprise Act Article 22:A trust enterprise shall handle trust activities with the care of a good administrator and in good faith

<sup>18</sup>Civil Act 535: The mandatory who deals with the affair commissioned, shall be in accordance with the instructions of the principal and with the same care as he would deal with his own affairs. If he has received the remuneration, he shall do so with the care of a good administrator



structured note causing misunderstanding from the customer that such Structured Product is principal protected. In additionally, Bank did not update the changes in the investment risks of the product periodically to the customers and failed also to proactively inform customer of the great change of the investment risks after the broke out of the financial tsunami, causing great loss to the customer. Court is of the view that Bank protest that monthly statement with investment information provided to the customer was not sufficient to support Bank's position to prove that Bank had acted in due diligence to have taken care of the customer's investment in this case.

- (c) The Court further states that Bank could not provide evidence, such as record to prove that the employee of the Bank had conducted the introduction or explanation of the Structured Note products, and the signatures on the Structured Note Terms Sheets would not either proved that Ms. Money had completely explained the risks or non-principal protection nature or is it able to proof that customer had read and understand the relevant terms and conditions on such Structured Note Contract. Moreover, the font printed on the Structured Note contract and other relevant documents is apparently tiny and close together and English wording were also included in such documents, it is obviously not easy for customer to understand within a short period of time. As such if customer denied that Bank had given reasonable review time to the customer, Bank shall need to provide other supporting evidence to substantiate her defense statement. The statement model template without the investment information of the customer was unable to show that the Bank had informed customer on the change of the risks of customer's

investment and therefore it is difficult for Court to consider that Bank had exercised her due care on this case.

(d) While for the responsibilities of the Bank's employee, court held the view that the employee was not the contract party of the investment contract and due to lack of evidence to proof that the employee has any fraud intention in this case, court is of the view that the employee should not be held responsible for customer's loss. The Court ordered that Bank should be held responsible for customer investment loss, after deduction of the interest which customer had received during the investment term and principal customer had received after maturity of the Structured Note, Bank should pay customer at NTD 720, 377 and interest calculated at 5% starting from 17 Dec. 2008 until payment date.

(2) Case Number Two<sup>19</sup>

(i) Brief Description of the Claim:

Judgment Date: 23 Nov. 2010

Judgment No: Taiwan High Court Judgment R.O.C. Year 99 Appeal No. 45

Appellor (i.e. Plaintiff): Ms. A, Ms. B and Ms. C

Appellee (i.e. Defendant): China Trust Commercial Bank

Brief of the Court Judgment: Defendant, China Trust Commercial Bank must pay appellor(i.e. plaintiff)Ms. A NTD433,840 and Ms. B NTD3,623,699 and Ms. C NTD 641,604 plus an interest at 5% commencing from 23 Sept. 2008 until payment date.

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<sup>19</sup>司法院法學資料檢索系統臺灣高等法院 裁判書 民事類，臺灣高等法院民事判決 99 年度重上字第 45 號 民國 99 年 11 月 23 日<<http://jirs.judicial.gov.tw/Index.htm>>

(ii) Summary of the facts Claimed by Appellor (Plaintiff):

- (a) The Appellors claims that the Bank's sales were aware that they have intention only to invest in hundred percent guarantee financial products and the Bank's sales have mentioned that all the Structured Notes introduce to them were all hundred percent guarantee and the interest were higher than normal Term Deposits. Furthermore, they have no awareness of the so-called "DM" or Trust Deed or have authorized to deduct any money or to withdraw money from their account for such investment. They claims that the Bank's sales had completed the withdrawal slip without their authorization and invested in different Structured Notes (CALYON 2 年台幣連結全球銀行及保險公司連動債；盧森堡 2 年美元日本類股連動債；盧森堡 2 年台幣精品類股連動債；盧森堡 2 年台幣日本類股連動債；JPI 台幣投資大亨連動債) for NTD3millions, USD30,000, NTD1million respectively on behalf of Ms. A, and NTD 700,000 for Ms, B and NTD10 millions for Ms. C. The appellant claims that there were no agreement of such structured notes investment and therefore the Structured Note Investment Agreements were never in place.
- (b) Appellors further stated that even if the Structured Note contracts were deemed valid in law, however according to the terms and conditions of the specific Structured Products, they were not to be distributed in other countries publicly and were to be sold only to professional investors or institutions. The Bank had never released the above information or had explained to them they are investing Structured Note product or had they been notified that there were risks in principal loss. Appellors further claimed that neither did the Bank explain the contract clause

by clause or did the Bank conducted the “Know Your Customer” process in thorough, and therefore they would revoke the contract that were made under misunderstanding conditions.

(c) Moreover, Appellors alleged that Bank had mis-sold, and did not perform well the obligations of trustee, and never showed them relevant legal documents completely or did they informed them of any investment risks and therefore Bank did not perform to act in due diligence as a prudent trustee should be and hence Appellors claimed to revoke the trust contract and requested Bank to return their principal amount. Nonetheless, if Appellors were not permitted to revoke the contract, Appellors considered that the Bank should compensate their investment loss according to Trust Law Article 23, breach of consumer protection act etc. laws.

(iii) Summary of the defense statement from Defendant:

(a) Bank stated that the sales of the Bank had complied with the sales process by introducing the issuance terms and conditions and investment risks of the Structured Products, and after customers had showed their intention to invest, sale representatives then go through clause by clause again the issuance conditions and risks associated in such investment. Customers then signed on the relevant legal documentations (including product term sheet and trust agreement etc.). In additionally, Bank argued that it was clearly printed on the Structured Note Product term sheet that “This Structured Note is a non-principal protected Note, investor may suffered hundred percent loss in the principal amount” and “This Structured Note may at the time of maturity contain risk of hundred percent loss in the

principal amount” therefore there were no way that customer could have misunderstood. In additionally, Bank had sent monthly statement which includes their investment details and Bank had also remit the interest paid by the issuer to the investor in accordingly; and also customers were able to find out their latest investment price information on their bank website.

(b) Bank further states that there are mutual agreements in such investments and that the Bank sales did not mislead their customer in anyway to believe that they are investing a “term deposit” products and not a non-principal protected structured note product.

(c) Bank further states that they were not the issuer or the guarantor of the Structured Notes and does not involves in any further investment decisions of the Structured Note and that the depreciation of the underlying assets were due to the financial crisis conditions and therefore there was no direct relationship between the investment loss of the customers and the performance of the Bank, i.e. whether or not Bank had acted in due diligence as a prudent trustee or not. Also, as customers had invested the Structured Note via Non-discretionary trust platform of the Bank, the investment performance of the customers would not be applicable to Customer Protection Law in anyway.

(iv) Extract (Brief) of the Court Judgment:

(a) As agreed by other parties, the structured note related legal documents and investment amounts of the Appellors were the same as both parties have presented

to the Court.

- (b) With regard to the argument if contract is in force, from the chops and signatures of the Appellors that shown on the relevant legal documents, Court is of the view that all the investment contract between the customers and the Bank is valid in force. Appellors failed to provide strong evidence to the court that the employees of the defendant (i.e. the Appellee) have chopped the customer's personal seals on these documents without proper authorization from the customer.
- (c) Had Bank violate the due care obligation to act as a trustee? Can Appellors requests compensation from the Bank for loss they had suffered in the investment? Court held the view that Bank should act in due diligence as a trustee to protect investors at their best benefits and provide appropriate services to the customers, these shall include not to mislead or caused any misunderstanding of the customer or to have customers investment on non-principal protected product if Bank is aware that customer's risk appetites is not to invest non-principal protected products or have any foreign investment experience. Additionally, Bank should pay attention to the performance of the customer investment and proactively inform customers with relevant information to enable customers to make appropriate judgment whether or not they should early terminate their structured note investment to mitigate their investment loss. Bank would not be considered had act in due diligence if important investment risks information were only released to the customers after Structured Note Investment value had fallen to the lower capped value of the Note.

(d) Court considered that Bank was unable to prove that they have explained to the customers the risks and non-principal protected nature of the investments product or has given reasonable review time period to the customer and that the signatures on the relevant Structured Notes Contract could only manifest that customers have chopped their seals on these legal documents. In additionally, Court did not accept the defense from the Bank that the DM of the Structured Note product have clearly specified that “ the worst scenario is the total lost of the principal amount but fixed interest shall be paid at 8% per annum” and wordings such as “ Possible loss of all principal amount” so as black and bold wording being highlighted in the product term sheets such as “ This Note is a non-principal protected types of Note, it is possible that investor may suffered 100% loss at the time of maturity”. Court held the view that it is hard for customers to read such small wordings which was squeezed together and English wordings in between the Chinese language unless sufficient time is given to the customer to read through every terms and conditions on the legal document provided by the Bank. Court therefore was of the view that under such conditions, customers would easily misunderstand that they will only benefit from such kind of investment and may not have risks.

(e) Furthermore, it was clearly stipulated in the English Product Term Sheets that “The Note may not be sold or offered in the Republic of China” but it was not shown on Chinese translated product term sheets which were provided to the customers. The Judge of the case did not accept Bank’s defense by saying that Bank was authorized by the customers to purchase such Note overseas as such kind of activity is same as if such Note were distributed and sold in Taiwan to the

customer.

- (f) Bank defense that they have act in due diligence as a trustee since monthly statement that shown the investment information were sent to the customer. Nevertheless, Judge was of the opinion that the information shown on the monthly statement were not sufficient to enable customer to aware of their investment performance as only investment amount and interest payment were shown on the statement. The lack of latest market price/value loss or gain reference index and the small letter wordings specified on the statement to advise customers to access the public internet for update investment information showed that Bank did not proactively inform customer necessary information or have act in due care of a trustee.
- (g) Moreover the Court refuse to consider Bank's defense that besides the monthly statement, they had indeed contacted customer by telephone to inform the occurrence of the worst scenario of the investment products, Judge overruled Bank's defense as Appellors denied to have receive such calls from the Bank and Bank was not able to provide any other supporting evidence to prove that Bank had made such phone calls.
- (h) Bank had also defense that one of the Aappellors had experience in investing foreign mutual fund, but judge considered that mutual fund and Structured Note were different kind of products, there is no excuse of Bank to lessen its obligation to act in due care of these Structured Note investment.



(i) Bank defense that they are not the issuer or guarantor of the Structured Note and that the performance of Structured Notes were subjected to stock market, economic and politician environment or the performance of underlying assets etc. reasons, therefore investment loss sustained by the customer has no relationship with the Bank and Bank should not be held responsible to reimburse customer's investment loss. However, Court did not accept Bank's statement but considered that if the sales of the Bank did not introduce such Structured Notes products to customer or has clearly explained the risks and non-principal protection nature of the investment products, general customers would not invest in such products and suffered investment loss, and therefore Court considered that the loss suffered by the customers were directly caused by the sales of the Bank for not acting in due care to be a trustee of the customer.

(3) Case Number Three<sup>20</sup>

(i) Brief Description of the Claim:

Judgment Date: 10 March 2011

Judgment No: Taiwan Tao-Yuan District Court- Civil Judgment R.O.C. Year 99 Civil

Litigation No. 236

Plaintiff: ABC Company (p.s. Actual name replaced due to data privacy reason)

Defendant 1: First Commercial Bank, Nan-Kan Branch

Defendant 2: Ms. MM (First Commercial Bank's employee) (p.s. Actual name

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<sup>20</sup>司法院法學資料檢索系統臺灣高等法院 裁判書 民事類，臺灣桃園地方法院民事判決 99 年度重訴字第 236 號 民國 100 年 3 月 10 日<<http://jirs.judicial.gov.tw/Index.htm>>

replaced due to personal data privacy reason)

Extract (Brief) of the Court Judgment: Defendant First Commercial Bank should pay Plaintiff ABC Company USD185, 792 plus a 5% interest rate commencing from 29 June 2010 until payment date.

(ii) Summary of the Plaintiff's statements:

(a) Defendant Ms. M had recommended to Ms Sun (who had transferred the rights of the Structured Note to Plaintiff on 21 May 2010) around April of 2007 to transfer her USD term deposit to regular mutual fund investment and on 21 Sept. 2007 Ms. MM signed an document which relates to a 2 years Principal Guarantee USD Structured Note Product (“二年期食全十美計價保本連動債”). Plaintiff alleged that Ms. MM had covered the fact that the investment actually was issued by the American Lemman Brothers Financial Company (“Leman Brother”) and that even on the monthly investment statement that was sent by the Bank, there was no relevant information showing that her investment was related to Lemman Brother Company. Ms. Sun thought that she had invested only the mutual fund and USD term deposit with the Bank.

(b) Only after 18 Sept. 2007 when Lemman Brother announced bankrupt in US and Ms. Sun received a notification from the Defendant, she then realized that she had invested a Structured Note which was issued by the Lemman Brother. Plaintiff claimed that Defendant Ms. MM should not mislead customer and that any marketing material should be clear and not misleading. The sales of the Bank should declared risks associated to the investments and explain all the terms and conditions on the Structured Note. Furthermore, to recommend such a professional

and complicated product, Bank should conduct a “Know Your Customer “Process in order to evaluate customer’s risk profile when recommending any investment product to customer. Plaintiff alleged that Defendant Ms. MM had covered the facts and did not explain the product to her causing her mistake to sign the structured note investment contract with the Bank.

(c) Moreover, Bank as a trustee of the customer should act in due diligence when recommending the investment product to client. Nevertheless, Bank did not either declared the product terms or conditions to the client during sales process or had the Bank conducted the KYC customer risk assessment prior to sales of the product and therefore Plaintiff was not given the chance to understand the product. Plaintiff therefore based on Trust Enterprise Act Article 22 and Civil Law Article 535 to claim that Bank had failed to act as a trustee that shall administer the trust affairs with the care of a prudent administrator and consequently requested that Bank as a employer should be held jointly responsible with her employee to compensate loss they had suffered.

(iii) Summary of the Defendants Statements:

(a) Defendants state that Ms. Sun is an experienced Business Woman and according to the Bank’s record, before Ms. Sun investment the Lemman Brother’s Structured Note in September, she had invested Structured Notes also on 30 April, 21 August and 31 August of 2007 and after Ms. Sun invested the Lemman Brother’s Structured Note, she had further invested another three Structured Note Products. And from the title of the Structured Note document, it clearly shown that it was “specified money

trust (i.e. non-discretionary trust) investing Structured Note Product Terms and Conditions (特定金錢信託投資「連動債券」產品暨約定書), therefore defendant did not believe that customer is unaware of her investment.

(b) Defendant further argued that they had act in due diligence as a good trustee. The customer personal information form showed that they had done the KYC and from the monthly statement sent to the customer, they had exercised their obligation to declare investment related information to the customer. Defendant claimed that though net profit of the Structured Note was not shown on the monthly statement but it was released on the website, customer may access the Bank's internet also to inquiry weekly reference price of the product and that if customer had any query, they can at any time contact the sales representative of the Bank for related Structured Note Product details.

(c) In additionally, Defendant alleged that according to the trust agreement between Bank and the customer, it clearly stipulated that trustee is not responsible for risk on the payment of the principal or interest of the Structured Note issued. As such once Bank had delivered the interest to the Customer, they had fulfilled the obligation of a trustee, and therefore there is no breach of the trust agreement.

(d) Also, according to the Structured Note Product Term Sheet on the Risk Disclosure portion, it was clearly stipulated that “the issuer of this Structured Note is “American Leman Brother Financial Company”, and guarantor was “American Leman Brothers” (Standard & Poor rating A+; Moody's rating: A1; Fitch rating

AA-), investor should bear the credit risks of the issuer and guarantor) so as to evaluate the credit risk of the issuer and guarantor. Moreover Defendant1 claimed that its sales representative has gone through all the possible risks that may associated to the investment to the client, and therefore it is unfair for client to transfer his/her loss to the Bank due to investment risks.

(e) With regard to the down grading of the Lemman Brother rating, Defendant pointed out that upon receiving the down grade information of the Lemman Brother, they had immediately notified client of the situation, which showed that they had performed the duty of a trustee in prudent manner.

(f) Defendant further states that there was no problem on the product features or inappropriate or untrue investment. The loss suffered by client was merely due to the impact of the tremendous financial crisis that broke out in USA.

(iv) Summary (Extract) of the Court Judgment

(a) Court hold the views that Defendant had failed to inform client the nature of the product and the risks associated in such product and did not perform customer risk tolerance assessment (i.e. KYC) and Defendant had failed to act in due care of a prudent administrator as they did not follow up to inform customer relevant information or risks after investment. The Court determined that Defendant should provide to court evidence that showed that the sales representative of the Bank did really disclosure the terms and conditions of the product and had inform to the client the risks that may involved in such investment once plaintiff denied

receiving such information from the Bank.

(b) Additionally, Court did not accept the argument that customer is experience in Structured note investment and therefore client should aware the risks of such investment. Judge considered that the risks may be different for different issuer or guarantor and therefore Bank should fully disclose and explain the terms and conditions and risks associated with the Structured Product concerned.

(c) Furthermore, as plaintiff's intention is to invest in low risk and principal guarantee product, Bank representative should consider customer's investment need and introduce suitable product to the client and most importantly there should be no doubts or misleading conditions. Bank should also at any time monitor change of the structure note status and provide any necessary information to the client to avoid any risks. Judge is of the view that Bank did not properly conducted the KYC as Bank representative basing upon her memory on the conversation she had with the customer and then completed the KYC ( i.e. Customer basic information form) by her own. Subsequently, Judge therefore suspect that the result of such KYC could possibly reflect plaintiff's investment knowledge, experience, financial status and the risk tolerance level.

(d) Judge further considered that Defendant did not provide plaintiff risks information at appropriate time to avoid any investment risks during the investment period. The mailing of the monthly investment report status would not be deemed sufficient as the information provided on the statement did not contain any risks warning or relevant information that informed customer of her investment risks. Judge is of the

view that sales representative of a Bank should be more market sensitive and have more channel to obtain relevant financial information than original person, however the Sales of the Bank did not seem to have the ability to get hold of the relevant market information, and therefore it is obvious that the sales is unable to provide appropriate risks advice or information to the investor.

- (e) From the trust contract which investor had signed, Judge is of the view that the information contain in the contract were relatively misleading that such kind of Structured Product is hundred percent principal guarantee and without any investment risks. As the contract did not clearly specify the risks involved in such Structured Note Product or is there any information that urge investor to take note on the credit risks on the issuer, guarantor or fluctuation risks on the performance of the underlying assets.
- (f) In additionally, Judge also considered that the Bank did not act in due diligence as a prudent trustee as during the investment period, the credit rating of the issuer and guarantor were modified by the credit rating companies to a lower rating but such important credit and financial risks information of the issuer or guarantor were not released to the customer.
- (g) In conclusion, Judge did not accept the view that the loss of the investor was attributable to the financial crisis broke out in US, i.e. the credit risks of the Leman Brother but considered that if Bank had conducted the sales of the Structured Note in due diligence manner, customer may not invest in such kind of Structured Note

product and therefore no such loss will be suffered by the customer.

### 4.3 Investigation Report of Foreign Governmental Bodies on Financial Institution<sup>21</sup>

On 7 July 2009, Monetary Authority of Singapore (MAS) issued an “Investigation Report on the Sale and Marketing of Structured Notes Lined to Lehman Brothers Report” (“the Report”), the Report provides the investigation result of MAS on ten financial institutions (“FIs”, including banks, stock broking firms and finance company, collectively termed “the Distributors” and each term a “Distributor”) who have distributed the credit linked structured notes related to Lemman Brothers.

The scope of the investigation by MAS covered the FIs due diligence on the Notes, the procedures in place at the point of sales, including how these FI ensured that the Notes were sold to clients whose investment objectives and risk tolerance matched the risk profile of the notes, and if training and supervision of the representatives and Local Financial Advisers in relation to the Notes. In additionally, in the course of the investigations, the Authority also identified issues relevant to the FI’s assessment of individual complaints, the complaints resolution framework/process<sup>22</sup>.

#### 4.3.1 MAS Findings on Individual Distributor

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<sup>21</sup> MAS Monetary Authority of Singapore, 7 July 2009. Investigation Report on the Sale and Marketing of Structured Notes linked to Lehman Brothers

<sup>22</sup> MAS Monetary Authority of Singapore, 7 July 2009. Investigation Report on the Sale and Marketing of Structured Notes linked to Lehman Brothers, page ii



#### 4.3.1.1 ABN AMRO Bank N.V Singapore Branch<sup>23</sup>

(1) ABN distributed the Minibond Notes in 2006, at the time of distribution; they had ranked the riskiness of the investments products in three classifications namely “Conservative (low risk)”, “Balanced (medium risk)” and “Growth (high risk)”. While their customers were categorized into corresponding investment risk profiles as follows:

**Table 3 ABN Customer Risk Profiles**

<b>Rating (referred to by ABN as the “Model Portfolio”)</b>	<b>Description</b>	<b>Recommended Asset Allocation (referred to by ABN as the “Strategic Allocation”)</b>
Conservative	The primary objective is to receive a consistent, secure cash flow coming from reliable sources in debt capital market and inflation protection. In order to satisfy income requirements, the client is willing to accept a low level of capital risk, due to the fluctuation in the level of interest rates and some equities.	10% - money market 70% - debt capital market 10% - equities 10% - alternative investments

<sup>23</sup> MAS Monetary Authority of Singapore, 7 July 2009. Investigation Report on the Sale and Marketing of Structured Notes linked to Lehman Brothers, page 22-27

Balanced	The primary objective is to obtain above-average returns in a period of three to five years. To obtain capital appreciation, the client is willing to accept certain volatility in market prices. Equity and debt capital markets take a dominant role in the asset composition. The reinvestment of interest will also represent a significant portion of the total return.	10% - money market 40% - debt capital market 40% - equities 10% - alternative investments
Growth	The primary objective is to obtain growth of capital with a higher return in a period of three to five years. In order to obtain the desired superior returns, the client must be willing to accept a substantial risk and large market fluctuations in capital.	10% - money market 20% - debt capital market 50% - equities 20% - alternative investments

- (2) ABN apply the above 3-category risk classification as well as a new investment product risk categorization with five categories, namely “ Conservative”, “ Moderate”, “ Balanced”, “ Growth” and “ Aggressive” when they distributed series 2 Minibond and fully adopted the five categories for investment product risk categorization when distributing series 3 Minibond.
- (3) It was released in the MAS Report that ABN did not expressly communicate to its sales representative, i.e. Relationship Manager (RM) that series 1 Minibond was rated “Growth” but relied on the general understanding among its RMs on training for other products that non-principal protected structured notes were rated

“Growth”.

- (4) In addition, it was understood that ABN arranged briefings by the product arranger for its RMs on the product feature of Minibond Notes and if RM did not attend the briefing there were opportunities that the product briefing to be conducted internally by Investment consultant internally at branch level. Nevertheless, ABN did not require compulsory attendance of its RMs at product briefings provided by the arranger and did not follow up if those RMs who missed the arranger’s briefing were briefed at branch level.
- (5) In such aspects, given the importance of letting RMs to know the level of risk of an investment product, MAS determined that ABN failed to act in due diligence in carrying out its activities or to take all reasonable steps to ensure its RM complied with the requirements to provide reasonable basis when making recommendation. The Authority also criticized ABN that they failed also to meet the standard that FIs should ensure that the RMs employed are suitably qualified and competent and possesses the relevant professional training or experience to act in the capacity so employed and provide its representatives with relevant training so as to enhance their competence, knowledge and skills.
- (6) For customer risk profile assessment purpose, ABN employed a fact find document named “Financial Needs Analysis for Wealth Management Account-Fact Find” (“FNA”). The FNA contained a risk profiling questionnaire to enable its RMs to determine the investment risk profile of each client. A higher

score indicates that the client has a lower risk tolerance level. The Authority had found that there was error in the risk profiling questionnaire, and as a result a higher score was being given to clients with a higher risks appetite and a lower score was being given for lower risk appetites, when it should have been the other way round. In consequence, MAS determine that ABN failed to meet the standards to act with due care and diligence in conducting its business activities and therefore RMs failed to comply with the requirements that where a recommendation is made there should be a reasonable basis for making the recommendation.

#### 4.3.1.2 DBS Bank Ltd (DBS)<sup>24</sup>

(1). High Note 5 (“HN5”) was issued and arranged by DBS and sold to 1,083 retail customers between 30 March and 30 April 2007. DBS had conducted a formal assessment and product due diligence on HN5 and determine that it carried a “Growth” risk rating on the basis that it is non-principal protected. DBS targeted at “Treasures” and “Emerging Affluence” clients. DBS has communicated to it’s RM on the product risk rating and target client segments.

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<sup>24</sup>MAS Monetary Authority of Singapore, 7 July 2009. Investigation Report on the Sale and Marketing of Structured Notes linked to Lehman Brothers, page 30-37

**Table 4: DBS Customer risk profiles:**

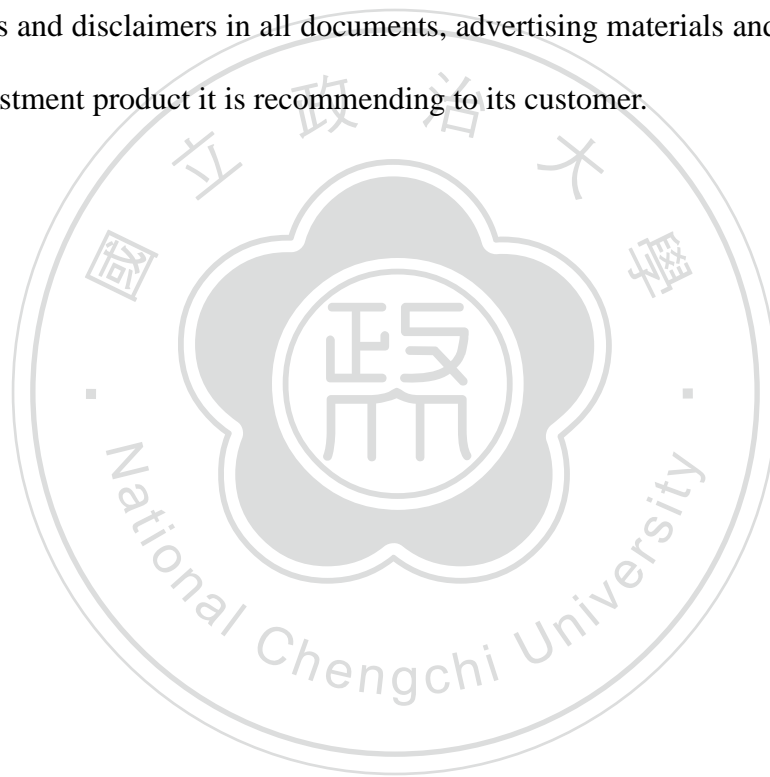
Conservative	I prefer to take very little investment risk such that when the time comes to access my investments, I will not experience a sudden fall in its value. I am able to take small short term price changes to my investments in exchange for a return that is slightly higher than time deposits.
Moderate	I would like the returns on my savings and investments to keep pace with rises in the cost of living. I am able to take some short term price changes to my investments in exchange for potential returns that are moderately higher than time deposits.
Balanced	I would like to balance having stable savings and investments with the aim of achieving some capital growth over a longer period. I am able to accept price changes to my investments over 2 to 3 years in exchange for potential returns that are higher than time deposits.
Growth	I would like my savings and investments to grow over a medium time horizon. I am able to accept price fluctuations to some of my investments within a time frame of 3 years or more, in exchange for a potential return that is much higher than time deposits.
Aggressive	I would like to achieve a high level of returns on my investments. I am able to accept sharp fluctuations in the value of my investments over 3 years or more, in order to increase the potential of high returns. I recognize that there is potential risk of capital loss for some of the investments I undertake.

(2) DBS conducted training and briefed HN5 product features and communicated to its RM the fact that HN5 carried higher risk compared to investments in a single bond/credit linked note or bond fund/basket of bonds because of exposure to the worst credit in the basket. Apart of the training, DBS also required RMs to pass the test before being allowed to advise and sell HN5. However, despite the training and testing

requirements which were in place, there are 28 RMs who did not attend or take the required test, and 21 RMS attended training but did not sit for the test. The aforesaid 49 RMs were nevertheless permitted to sell the HN5 and sold the products to 303 clients. In addition, to ensure compliance of the RM on the sales guidance, which include monitoring RM's attendance at compulsory product training and passing of the required test, the RM's training attendance and test results should be disseminated to the Business Manager. However, the relevant reports did not appear to have been disseminated to the BMs.

- (3) MAS therefore determined that DBS failed to meet regulatory requirements which states that FI should ensure that any person it employs to conduct business with clients is suitably qualified and competent and possess the relevant professional training, and provide its representative with relevant training to enhance their competence, knowledge and skills.
- (4) To access customer risk profile to find out investor suitability, DBS employed a fact finding document "Financial Needs Analysis-Form A" ("FNA"). This FNA contained risk profile questionnaire to enable RMs to determine the investment risk profile of each client. A higher score indicates the client has a higher risk tolerance level and the risk profile determined by the FNA determined which investments would be recommended to client. As revealed in MAS report, HN5's pricing statement and prospectus stated that HN5 was not suitable for inexperienced investors, however according to the MAS investigation, HN5 were sold to 41 client with risks profiles rated below "Growth" and 54 clients with no investment experience. The Authority pointed out that DBS should

explicitly communicated to its RM the important information and therefore considered that DBS had failed to meet the standards to act with due care and diligence and not taking reasonable steps to ensure RM complied with the regulatory requirement. MAS was of the view that due to DBS failure to act in due diligence, its RM had also failed to comply with the regulatory requirements which states that the warning and important information such as nature and risks of the product should be prominently presented and clearly explained to the client. And RMs should draw client's attention to warnings, exclusions and disclaimers in all documents, advertising materials and literature relating to an investment product it is recommending to its customer.



## 5. Management of the Wealth Management Business

### 5.1 Structured Note Dispute Impacts

All local or foreign Banks that had involved in selling Structured Note Investment Products to retail customers may have extensively involves in the negotiation of the customers disputes that either took place at the BA Structured Note Handling Committee or at the Courts, including Civil claims or criminal accusations raised by the Structured Notes investors. Banks had then suffered loss of resources in terms of time, human power and money, and Bank through the process may have learnt one of the important lessons is how Bank could eliminate or at least mitigate or prevent these customers' disputes from happening again?

#### 5.1.1 A review of Customers Protection Scheme Adopted by T Bank<sup>25</sup>

In a seminar to discuss “how Bank should enhance protection to Bank’s financial product investors and financial service customers” hold by Taipei Foundation of Financial on late September 2010, China Trust Commercial Bank (“the Bank”) shared their strategies and policies on how they implement the protection to its customer. There are two major points as below:

(1). To look at Customer’s perspective to work out protection plan

The company reviews all the financial products that will be provided to the customers and review all process that might trigger customer’s rights to work out their protection scheme.

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<sup>25</sup>何慶媛 中國信託商業銀行「銀行如何落實有關金融商品投資人保護」 「金融海嘯後如何加強銀行銷售金融商品投資人與金融服務消費者保護」座談會 民國九十九年九月二十八日



They identified the below risks on the sales process below:

(i) Before financial product is launch or providing service

They identified that risks involved in sales that are not qualified to introduce financial product; and there are inherent risks if they do not understand customer well or did not perform the risks assessment test for their customer. Finally, risks on product side will be to identify products that were not permitted by local authorities or did not go through the product due diligence process.

(ii) Sales of financial products

The Bank identified that there will be risks if sales did not clearly explain the product terms and conditions (e.g. principal guarantee or non-principal guarantee product), associated risks in the product or fees incurred in subscription of the product or customer did not understand the product. In additionally, there are also risks for customer that invested in product risks type that is higher than the customer risks tolerance level.

(iii) Service after sales

Risks identified by the Bank are failure to notify customer product price/value or material information that related to the product. Risks may occur when major events or information related to the investment product is not delivered to the customer or customer is unable to check or inquiry the latest price or value of their investment product. Lastly, the risks incurred with the Bank shall be the effectiveness of the resolution channel in the Bank to handle customer's disputes or complaints.

## (2) Three Major Sales Process Management Steps

After identification of the major risks that involved in the above three sales stages, the Bank worked out the following actions as below:

### (j) The pre-sales process

In specific, the management at this stage is on the product due diligence process, management of sales representatives and understand customer.

(a) The Bank shall look after all its customer as non-professional customer and on the KYC questionnaire, the content shall include age, income, education/working experience and investment etc. important factors; while for the customer's risks profile, the Bank classified its customers to four categories, and if customer falls into the "Aggressive or Growth" (積極或成長型) categories, the Bank shall undergo another review and confirmation process. The risks assessment of the customer will need to be reviewed at least annually.

### (b) Bank Sales representative Management

Bank should ensure that sales are qualified, i.e. sales must passed specific qualification test and taken adequate trainings. With regard to the sales rewards, they will take into consideration the number of customers, growth of the asset under management, customer satisfactory ratio, product suitability, and compliance with sales requirements and number of customer's complaints etc. factors as a whole to decide on the sales representatives rewards.

### (c) The product due diligence process

The Bank had established a Product Review Committee, every type of financial products, including mutual fund, insurance product, Structured Note etc. products must undergo the review and approved by the Committee before these product could be officially launched to the market. The review items on these financial products include the reward, risks volatility, credit rating and risks level etc. factors. The product risks type is classified into 4 levels and Bank shall review and update the risks level periodically.

(d) Investment product terms and conditions

All investment products term sheet or contract should be reviewed by Compliance Department of the Bank, this is to ensure that all terms, risks or fees etc. relevant terms are clear and prominent in the expression. The Bank had also set up contract review period for different kind of financial products, for instant, they will provide customer three days time to review insurance products related agreement and for dual currency structured deposit product to provide seven days or above contract review period for contract terms that exceeded six-months times.

(ii) Management steps for on-going sales process

The important part at this stage is to ensure customers had fully understood the financial product and customer/product suitability issues, this is done by delivering complete set of legal documentation and through controls on customer/product suitability process.

(a) Bank is equipped with system that enables them to control the product type invested

by the customer matches the risks profile of the customer. Customer will not be able to process any investment if KYC process is not done and for specific complicated products (e.g. dual currencies structured deposit (DCD) or other Structured Investment product), unless customer is categorized as professionals, no investment on such type of financial product is permitted.

(b) Bank required RM to manifest in written that they do not encourage or induce customer to invest by taking loan and ensure customers personal data was fully secured without misuse. And for specific investment product such as mutual fund product, Bank also monitored the mutual fund daily transaction to prevent any short-term trading activities.

(c) To confirm transactions are done properly, for specific investment product deals, such as the DCD and Structured Investment Product transaction, tape recording of the transaction are processed. In specific for large amount transaction or elderly customer or customer who invest the first time, all these transaction would required a third party second review and tape recording.

(iii) Management after sales process

The Bank focuses on the release of necessary information to the customer and the management of customer dispute handling after sales process. Customer prospectus, transaction term sheet, transaction confirmation, insurance policy were provided to the customer; monthly statement with investment products latest net value ( including inquiry on internet) and delivering of important matters via special mailing were

provided by the Bank. Whilst for the customer dispute handling process, special handling team is set up to handle customer complaints, the special handling team shall be responsible to contact, investigation and response customer complaints.

### 5.1.2. A review of Customer Protection Scheme Adopted by C Bank<sup>26</sup>

In the same seminar hold by Taipei Foundation of Finance on late September last year, Citibank (Taiwan) Commercial Bank (Citibank or the Bank) also shared their company business experience, in particularly to the customer protection aspects after the financial tsunami:

#### (1). To begin from customer protection perspectives

What specific items do customer care at the time of investment? Citibank analysis that most customers care about: price, quality, security, convenience, fast, value added service and service after sales.

##### (i) Quality means Professionalism

Citibank will make sure all products obtained required internal approval from the Product Review Committee; so as approval from Board of Director. And most importantly the products must be those approved by the authorities.

##### (ii) Price means transparent and open

All products where interest rate, revenue or fees are concerned are all publicly announced on the Bank's internet website and also in the documents that will be delivered to the customer;

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<sup>26</sup> 胡醒賢 花旗(台灣)商業銀行 金融商品包裝銷售之消費費者保護實務「金融海嘯後如何加強銀行銷售金融商品投資人與金融服務消費者保護」座談會 民國九十九年九月二十八日

(iii) Security means risks protections

All relationship managers (RMs) obtained the necessary license in according to the local regulatory requirements. RM shall provide customer the relevant product term sheet and related legal documentation and inform customer risks associated to the investment product and tape record the important parts of the transaction information that customer must be aware.

(iv) Prompt and Convenience means easy and immediate

The Bank provide a variety of investment channel to take care of customer's investment needs ( e.g. phone banking, internet banking etc. channel)and provides also a variety types of investment products with different tenor to enable customers to take care of their investment more flexibly. In additionally, the Bank also provides easy and quick inquiry channel to handle customer's incoming questions.

(v) Value Added

The Bank is equipped with qualified and trained professional relationship manager and a research team that enables to provide value added service to the client. This includes assisting client to identify investment concentration risks, management of the client investment portfolio and to provide asset allocation advice etc. services.

(vi) Service after sales

The Bank will mail the transaction confirmation letter, product maturity advice notification letter, monthly statement with all customers' account and investment

information to the customer for their updates. Customers could at anytime contact the Bank to inquiry the net value of their investment.

(2). Implementation of investors and consumer protection scheme

- (i) In particular, to implement relative protection scheme, the Bank start to control at front end beginning from the product review process. This is done by ensuring internal and external approvals of the product are obtained, and system is able to support and control each specific product features. Secondly, other than the local regulatory license requirements on the RM, the Bank requires their RM to sit for the product trainings and passed the product specific examinations.
- (ii) Whilst for the Know Your Customer process, they required RM to go through the investment risks appetite analysis, customer's personal information verification so as to investigate the product suitability check of the customer. In additionally, they also pay special attention on the age of the customer and ensure that customer provides clear instructions and provides certification on the product they intend to investment during the sales process.
- (iii) The Bank required RM to confirm that investor understood on the product structure and on the suitability of the product introduced to the clients. RM must inform customer the risks associated on the investment and to make sure that greatest risks had been declared to the customer. The Bank forbids its RM to induce investment by confusing Structured Note with times deposit product. They would emphasis also to the customer that there will be no coverage of insurance on their investment

products. The Bank would ensure also that customer had written in person that they totally understood the product they would intend to invest and agree to undertake any risks in such investment.

(ix) With regards to the investment product legal documentation portion, they would provide the product introduction term sheet and customers' need to know information documents. The content of the relative documents would consist of important information such as important summary of the product, risks associated to the products, the transaction details of the products so as the greatest possible loss and scenarios analysis of the products. Fees incurred, process flow information and disputes handling channel information will all released on the legal documentation for customer's awareness and reference. Citibank also adhered to the local rulings on the product/contract review period requirements to its customers. To facilitate customer easy reading and understanding of the important information of the product, the customers' need to know information document is printed in Chinese language and font no smaller than 12.

(3). Enhancement of consumer and investor protection and service after sales

(i) To ensure customers is fully aware of their investments, other than transaction confirmation, product maturity confirmation letter and monthly consolidated statement will also be mailed to the customer. During the course of the investment period, the Bank will inform their clients if there is any major events occurred that is in related to the customer investment.



(ii) For the transparency of fees or price information which they will fully disclosed both in the investment terms sheets and on the Bank's internet, they emphasis also on the prompt and update information sharing. This is done via providing market research, analysis report periodically and investment seminar held from times to times. The customers of the Bank could also linked to the Bank's website to locate the latest financial market information and news where needed.

(iii) Citibank had established also a special customer handling department which deals with customers complaints only. All customers' disputes cases are centralized in this department and they are the contact and response window of the Bank. They aim to feedback customers as fast as they would to settle customer complaints. All complaints/disputes files are kept in record for future inquiry purpose and for future customer satisfactory check/investigation purposes. They are open to their customer and provide them external disputes handling channel information such as the BA Financial Dispute Handling Committee or FSC channel if customer is not satisfied with the dispute handling results.

## 5.2 New Laws and Regulations

Following the Structured Note investment chaos, for the purpose of investor protection and to enhance governmental supervision and monitoring of Banks selling Structured Products, local government, FSC and Central Bank of China ( CBC)have newly announced or revised the relevant Structured Note governing laws and regulations in these two consecutive years( 2008~2010). The new laws and governing regulations primarily include the new

promulgation of the Regulation Governing Offshore Structured Product, revision of the Direction for Banks Conducting Financial Derivatives Business, and Regulations Governing the Scope of Business, Restrictions on Transfer of Beneficiary Rights, Risk Disclosure, Marketing, and Conclusion of Contract by Trust Enterprises and respective Self Disciplinary Rules and related rulings, guidelines and procedures of the above Regulations.

### 5.2.1. Regulation Governing Offshore Structured Products

The Law Governing Offshore Structured Products ( 境外結構型商品管理規則)( “the Rule” ) was newly promulgated on 23 July 2009, the main theme of the ruling includes the following areas<sup>27</sup>:

(1) Unifying the rules governing offshore product for Banks, Securities House or Securities Investment Trust Enterprise and Securities Investment Consultant Enterprise.

(2) Establishment of Master Agent System

For offshore Structured Note, it ruled that the issuer or guarantor must have a subsidiary or branch company in Taiwan to act as the issuer or guarantor’s master agent or the role of issuer. The master agent shall be responsible on the transaction/ legal responsibilities and provides relevant Structured Note Product information to the investor in local.

(3) Establishment of Product Review Approval Process by Relevant Industries

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<sup>27</sup>王立群 金管會銀行局 金融海嘯後強化商品銷售所定規範「金融海嘯後如何加強銀行銷售金融商品投資人與金融服務消費者保護」座談會 民國九十九年九月二十八日

Association

For products that are targeting general customer, it required trustee or distributor agent to undergo internal and external review process. The external review shall means the industrial association the Trustee or distributor agent belongs to, e.g. if the offshore structured note is sold by the trustee( i.e. Bank acting as trustee) to the general customer, other than the internal approval required in the Bank, the products should be reviewed and approved by the Trust Association at the same time. While for offshore product that would only be provided to professional customer, the trustee or distributor agent should at least obtain internal approval.

(4) Categorization of Customer sectors

It required that financial institution to categorize its client into two segments, i.e. Professional investor or non-professional investor (same as general customer). The categorization of the customers shall base upon the customer's risk tolerance level, professional knowledge level and financial status etc. conditions for justification. In general, the rules specify that only simple and stable (low risk) type of offshore Structured Product may be suitable for non-professional customers.

(5) Obligations on Issuer, Master Agent or Trustee and Distribution Agent

The Rule specifies the legal documentation that Issuer, Master Agent, Trustee or Distribution Agent should be providing to the customers. The documentations include Customer Need to know Information (Investor Information Summary), Product introduction Term Sheets and Risk Disclosure declaration etc. These documentations should be presented in Chinese languages to the customers.

(6) Marketing Control

In significant, in order to protect general customer, the Rule specifies that offshore product that are not to be sold to general customer offshore are not permitted also to be sold to the general customer in Taiwan. In additionally, Trustee or distribution agent should not permit customer that is of low risks level to invest in a risky Structured Product that may be higher then their risks tolerance level.

(7) The requirements of public announcement and reporting

Under the new Rule, the Issuer or Master Agent should publicly announce via the Offshore Structured Note Market Observation System set up by the Taiwan Depository and Clearing Corporation (TDCC) on 23 August 2009<sup>28</sup> to upload relevant Structured Note Product Basic information, reference price, daily sales information and material news etc. information for customer's easy inquiry.

5.2.2 Regulations for Banks Conducting Financial Derivatives Business (“the Regulations”)<sup>29</sup>

(1) The Regulations was first announced on 25 April 1995 and following the promulgation of the Regulation Governing offshore Structured Product, FSC further revised the said Regulations at the end of December of 2009 to align with the Rules that were in connected to the Governing of the structured products. In line with the revision, the disciplinary rules of the Regulation are newly announced on mid

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<sup>28</sup>Taiwan Depository & Clearing Corporation, 2010.04. Newsletter Issue 127

<sup>29</sup>金融法規全文檢索查詢系統 行政院金融監督管理委員會銀行局 銀行辦理衍生性金融商品業務應注意事項(last Modified 2009.12.31)  
<<http://law.banking.gov.tw/Eng/FLAW/FLAWDAT01.asp?lsid=FL006459>>

December 2010. The Regulations cover generally all domestic derivatives transactions except those offshore structured products that are separately regulated under the Regulation Governing Offshore Structured Products and those securitization products, structured bond or convertible bond which are of derivatives nature securities products. In particular, the below are the significant revisions of the Regulations:

- (i) The new revised Regulations requested Bank to categorize its customers also into professional and non-professional customer (i.e. general customer). The criteria to meet the professional customer's categorizes is clearly stipulated in the Regulations.
- (ii) New qualification examination requirements for sales that engaged in the sales of structured Products. Other than the original trainings, Sales are required to pass also the specific Structured Product Sales Qualification examination.
- (iii) New requirements which states that Bank should stipulate clearly the calculation method of early termination of derivatives contract, including the requirement to show how the early redemption amount is settled and to reflect the market value at the time of calculation.
- (iv) Specially stipulate in the Regulations that Bank when conducting the relevant Business should act in good faith and exercise due care and fiduciary duty of a good administrator based on the principles of honesty and integrity.

(v) Legal documents in specific format with required contents( for instant product term sheets, investor information summaries, risks disclosure, transaction confirmation etc. ) and internal controls requirements, including marketing and sales process as required for its professional and non-professional customers are clearly stipulated. In specific for sales process controls, banks have to work out the sales process that includes the establishment of KYC and product suitability for their general customer. The risks profile of customers and product should be categorized at least in three different segments. Customer must signed to agree on the customer segment they are classified. And Bank is prohibited to sell any product that does not match customer's risks profile or if product is only to be sold to professional customer only. Sales of standard Structured Product with specific length tenor (more than six months) shall have a contract preview period of not less than seven days. In additionally, Bank is required to read out the content in the Investor Information Summary and maintain such evidence by tape recording when providing Structured Note Business with non-professional customer.

(vi)Bank should not offer Structured Product transaction services in the name of deposits and all transaction documents should be kept record for audit track.

(vii)Specify restrictions on marketing and promotional materials. For marketing materials, the DM should be clear, fair and not misleading and most importantly, the rewards and risks should be released to the customer in a balance manner, Banks should not mislead customer that Structured Note products are guarantee by the

government by expressing that such products are approved by the authorities.

(viii) Complaints/Disputes resolution mechanisms should be established in place and relevant information should be released on transaction document and Bank's internet. If customer is unable to resolve the disputes via Banks internal disputes procedures, customer may approach Banker Association for arbitration or mediation.

## (2) Self Disciplinary Rules for Bank Conducting Derivatives Financial Product Business<sup>30</sup>

The Rules is newly issued around mid-December of 2010, in significant, it regulate to detailing the required context in the relevant Structured Product legal documentations and sales process requirements, the Rules set forth the types of derivatives products that Bank may sold to its non-professional investor. In additionally, the Rules distinguish the Structured Product into "principal protected" and "non-principal protected" and restricts on the types of derivatives that may be linked to the principal or non-principal protected structured note. For non-principal protection structured product, other than the above restrictions, it is also specified in the Rules that the redemption amount at the maturity of the non-principal protected structured product should retain at least seventy-percent of the original investment amount.

### 5.2.3 Regulations Governing the Scope of Business, Restrictions on Transfer of

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<sup>30</sup>法源法律網 銀行辦理衍生性金融商品自律規範 BA (last modified 16December 2010)  
<<http://db.lawbank.com.tw/FLAW/FLAWDAT01.asp?lsid=FL057252>>

Beneficiary Rights, Risk Disclosure, Marketing, and Conclusion of Contract by Trust Enterprises (“the Regulation”)<sup>31</sup>

The Regulation was issued on 16 January of 2008, and revised on 4 February of 2010 and 17 February 2011 to enhance the governing rules for Trust Business enterprise for conducting its trust business with their customers.

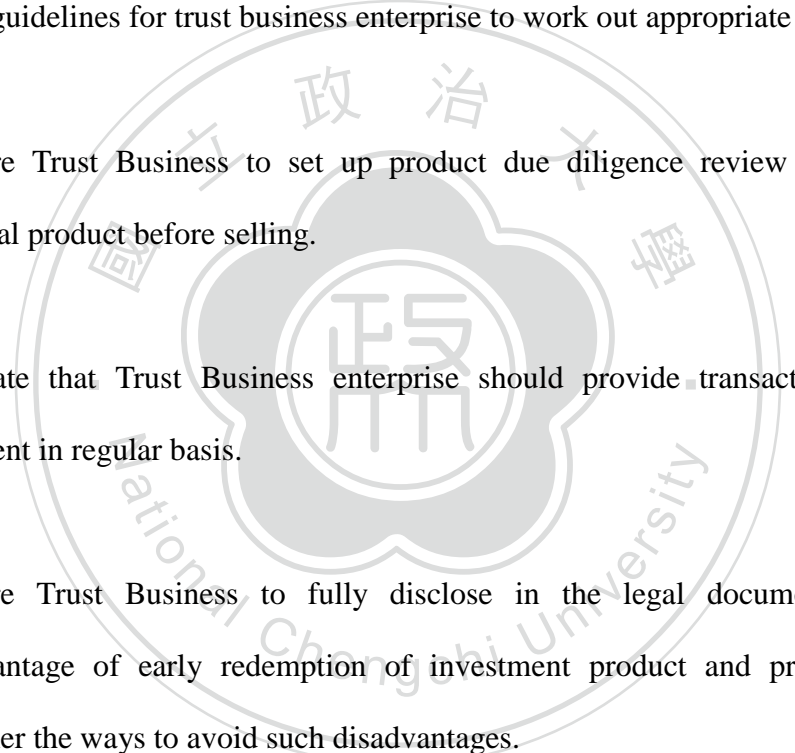
The major revisions of the Regulations include the following:

- (1) To define the scope of the foreign securities under the Rules so as the definition of professional, non-professional investor and professional institutions.
- (2) To stipulate the scope of the investment in foreign securities for professional and non-professional.
- (3) Enhance sales rules, including prohibition to make use of the term deposit information of the customer to solicit investment that is not suitable for the customer and required Compliance Supervisor of the Bank to provide signoff prior to use of any marketing material.
- (4) Restrict business promotion, business solicitation, advertisement of specific investment products for general investor and for recommendation provided to customer, customer must have signed an agreement to agree such recommendation service to be provided by the trustee.

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<sup>31</sup>金融法規全文檢索查詢系統 行政院金融監督管理委員會銀行局信託業營運範圍受益權轉讓限制風險揭露及行銷訂約管理辦法( last modified 17 February 2011)  
<<http://law.banking.gov.tw/Eng/FLAW/FLAWDAT01.asp?lsid=FL046790>>



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- (5) Implement the customer suitability process to protect non-professional customers.
  - (6) Forbid Trust Business to purchase securities, short term bill or domestic structured products and then sell to non-professional customer via non-discretionary trust platform.
  - (7) To set guidelines for trust business enterprise to work out appropriate reward scheme.
  - (8) Require Trust Business to set up product due diligence review team to review financial product before selling.
  - (9) Regulate that Trust Business enterprise should provide transaction reports and statement in regular basis.
  - (10) Require Trust Business to fully disclose in the legal documentation on the disadvantage of early redemption of investment product and provide advice to customer the ways to avoid such disadvantages.

#### 5.2.4 Other Supervisions

In order to effectively supervise WMN banks sales, FSC may set out in the future a formal inspection scheme to verify Sales knowledge on Bank's products. There may be inspector from FSC to inspect bank's sales at ad hoc basis, these inspectors are all FSC's officers,

they will pretend to be customers and drop by at different banks that conduct wealth management business. Through the inspection they will justify if Sales has truly understands those investment product that they are promoting. If FSC identified any unqualified sales, FSC may issue “correction order” to the bank to criticize the internal control of the bank and the worst scenario of the administration punishment will be bank may not be granted new business license or for set up of new branch or license to open offshore branch.

### 5.3 Analysis and Recommendations

- (1) Through the understanding of the nine dispute model classified by the BA on Leman Brothers and three civil court judgments and the investigations carried out by the Singapore Monetary Authority Supervisions on the two financial institutions regarding sales of Minibond and HN5 in Chapter 4, we are able to classify common structured note investment disputes by investors and at the same time we may identified that most of the cause of investment disputes may be attributable to Bank’s failure to comply or perform its obligations in accordance to regulatory requirements when engaging or managing the related business activities.

As the trend to compete in wealth management Business market is still the priority choice to most of the Banks in Taiwan, I would considered that Bank may need to consider its business strategy by applying the SWOT analysis concepts. In brief, bank may by identifying its Strength, Weakness, Opportunities and Tread in its business activities to strengthen and boost up its wealth management business.

From the experience of T Bank and C Bank in Chapter 5, section 5.1.1 and 5.1.2, we may easily find that both Banks had coincidentally worked on its weakness parts ( e.g. internal control parts) and made use of its strengths ( e.g. to make use of system available ) to improve the investment sales process.

The common weakness, deficiency on the investment sales process identified from the above case studies in Chapter 4 could be generally classified as below:

- (i) KYC process was not carried out properly, sales failed to perform customer and product suitability check or errors found in the process, causing mis-selling as a result.
- (ii) Sales had failed to explain the product, its governing terms and conditions and did not fully disclose the risks associated with investment products.
- (iii) Sales are not competent or did not possess sufficient professional knowledge, or are not properly trained to carry out business or to depend on the rewards to perform their sales duties.
- (iv) Sales misconduct to carry out investment without customer's authorization.
- (vi) Customer's did not understand products and look at the possible benefits only on such investment without understanding where risks may be.

- (vii) Customer may be illiterate or low education, high age, or have no investment experience and rely entirely on Bank sales to take care of their investment.
  - (vii) Customers misunderstand structured product investment similar to term deposit products.
  - (viii) Bank failed to control sales professional, training requirements.
  - (ix) Bank lack of internal control and monitoring mechanism on investment products due diligence check or in sales process (including untrue or unclear information in DM, sales marketing material or sales documentations etc.)
  - (x) Bank did not consider or is able to focus on customer protection issues.
  - (xi) Bank did not develop a reasonable rewards scheme on sales performance.
  - (xii) Bank did not set up proper or adequate after sales process monitoring, information providing scheme (e.g. no update of investment performance during the period of investment).
- (2) One of the identified threats of wealth management business activities are no doubts on the structured note disputes issues. Some banks had suffered from the accusation of non-compliance to local regulations by the authorities and ban by the local authorities to conduct related Bank's business e.g. stoppage of trust business

activities for a period of six month. Bank therefore should be alert of the authorities' possible sanction if customer disputes are not handled properly. Moreover, the effect on the weakness in the afore-said structured product transaction activities may result also in litigation risks, reputations risks and eventually on monetary loss of the Bank. Apart of the above, the possible threats as we have indentified from the review of local regulations on governing sales of structured products are on the stringent restrictions on the types of structured product and tedious approval process imposed by local governmental bodies as compared to other countries.

Another threats concern may be lost of customer confidence to the Bank. As we saw from the Structured Note disputes in BA or court, many customers claimed that they relied on what RM had suggested. Hence, when loss occurred, these customers had all considered that RM had deceived them.

All of which as above-mentioned, if not resolved may be hindrance to the Bank in conducting its wealth management business.

(3) Based upon each identified weakness, we may work out possible solutions to improve, enhance or established possible mechanism to overcome these weaknesses. By referencing the experience of T Bank and C Banks business strategies, we may sought out the strengths of a Bank by working on the following areas, i.e. the following may be recommended to bank that provide structured product investment to their customer under their wealth management business and trust business license scope:

(i) Enhancement and Implementation of Internal Monitoring and Control

#### a) Product Suitability

Per local regulatory requirements, Bank is required to set up product review team to determine the risk level of the product, this is normally known as product due diligence check and Bank is required to at least classify its investment product to at least three categories. We would have queried here how we could standardize product that is of the same risk level to the same risk category by all Banks?

We suggest that the standardized basis may be set upon basing on the issuer, guarantor, tenor, complexity of structure, percentage of principal protection, place of issuance, secondary market and nature etc. factors of the structured product. Professionals, product manager of the structured product team from different Banks may gathered together to work out the standard for common types of structured products. Or such kind of categorization could be done by an independently third party (with professional knowledge). By doing so, I trust Bank could base on the product risk level to make recommendation or to introduce Structured Product, and customer could make their investment decision more easily and be better protected.

#### b) Customer Suitability

It is important to base on customer risks appetite to classify customer at different segment and therefore it would be important that the KYC is done in thorough and appropriately. In the case studies we have identified, KYC may not be done properly by the sales or even it is done how it could be done without error and

customer is classified appropriately? We found that in the case studies, KYC was somehow not done by customer themselves or there was error in classifying customer risk tolerance level by the bank.

To overcome these deficiencies, I think clear and standard guidelines on the design of KYC questionnaire should be worked out in the first place. It is required by local regulations that Bank should take into consideration customer's age, income (financial status), investment experience, educational level, professional knowledge etc. criteria to work out their KYC Questionnaire, however there is no standard guidance on the ratios of these evaluation items and therefore the outcome of customer classifications may be variant in different Banks. (e.g. A customer may be classified as lowest tolerance level in B Bank and may be ranked as middle tolerance customer in C Bank). To adjust the possible gaps on the customer risk ranking justification, I think it is recommended also that standardized ratios on different evaluation items to be established, this could be also done by the authorities or independent third party of professionals from the BA. If customer's risks level could be unified, it will help also to reduce mis-selling cases.

In additional to the above, to prevent any manipulate of KYC questionnaire by the sales, customer should be requested to done the KYC by themselves and after completion of the KYC questionnaire, customer should be required to provide a written testimony that KYC was done in true all by themselves without any error and such testimony should be kept file for audit track. We may

also request Bank to obtain evidence to support the KYC questionnaire in a reasonable basis.

To effectively control related sales process, Bank should equipped with system that link the customer KYC result to actual investment products transactions for their customers. In simple, by application of system control, Bank is able to ensure that product risks and customer risks shall be matched for any customer's investment transactions. System shall automatically reject any investment that customer risks tolerance do not match with product risks level.

#### c) Sales Qualification Control

It is relatively common that Bank may recruit staff with no sales experience. These un-experience staff was then required by the Bank to pass the test and trainings within a short period of time. In many circumstance these staff had no actual sales experience or sufficient financial knowledge to provide customer's appropriate financial advice. To develop staff sales competency and experience, other than sufficient financial trainings, I would consider another possible way of helping junior sales in the Bank to play its roles in the wealth management business. This could be done by grouping a senior and junior staff to serve customer at the same time for a period of at least two years time before permitting these junior staff to perform financial advisory to the Bank's wealth management customer independently. These junior staff should undergo and passed the graduation examination test also before she or he could be qualified to play the role of Relationship Manager of the Bank.



Apart from the above, based upon the case studies, e.g. from the investigation report done by MAS on some of the Banks, we may appreciate that RM of the Banks have been required to take trainings and examinations whenever new product is to be launched by the Bank in prior to sales of the specific product to customers, and from the accusation by customer to local court, we may found that there are sometimes mis-selling activities occurred and investment transaction may be done without actual authorization by the customer, we may realize from here that other than there is a need to actual control and monitor sales to fulfill the product training and test requirements, which I will suggest to make use of system controls( e.g. if sales did not pass specific product test, he or she may not be able to sell specific product as system may automatically reject sales inputs of such specific product transaction into the system), there is still a need to enhance staff moral attitudes at work.

Bank should consider providing educational program that emphasis also on moral, compliance to law and regulations etc. fields. Bank should highlight in their training program on the consequential result of willful misconduct or non-compliance, e.g. any sales activities that violate Civil Act or criminal offense may not only result on bank's internal punishment, but may be also sentenced to jail in the worst scenario case depending on the seriousness of the offense. By balancing the education program provided by Bank and emphasize the importance to comply with the Bank's code of conduct to its wealth management sales, I think it will help in a certain level of extent to assist their

sales to have the right mindset on sale's role and at the same time, bank may also mitigate possible mis-selling or fraudulent sales activities in the future.

#### d) Sales Process Control Procedures

From time to times, as revealed in the case studies, customers complaint to BA or to the Court, arguments on clearness of the DM, explanation of product terms and conditions, lack of important or risks disclosures in transaction documentation, it is thus important how Bank could enhance and improve the relative sales process. With reference to the recent change of laws and regulations which we have elaborated in Chapter 5, Section 5.2, our governmental bodies have indeed imposed strict regulated sales process that required Bank to comply, these include also the format, required content in relative documentation which should be provided to the customer and terms and conditions, risks content that should be explained clause by clause or declared to the customer. And to evidence that Bank had act in accordance to regulatory requirements, tape recording for certain type of investment transaction would be necessary. Failure to comply may result in regulatory sanction, e.g. FSC may ban Bank wealth management business or reject the application of branch opening etc.

We would expect from the above that Bank if follow the regulatory requirements strictly would have adequate control in the sales process. Nevertheless, I would point out the possible issues after a deeper review of these processes, it would be how well Bank could implement these control process with quality? Most of the

time, we see that the quality and professional control was focus on front end staff, i.e. the sales representative that face client, but we seldom have query if the supporting unit staff from risk control unit, operation unit or legal and compliance function that support the business, if their skills, professional knowledge or experience are adequate to support the business? Bear in mind that relative DM (marketing material), customer communications material, operational control step and transaction documentation may be prepared, reviewed and approved by the support unit staff, as such I would think that Bank should also conduct a review to justify if these supporting staff have been provided with same and adequate product knowledge and professional trainings opportunities.

Bank should have in place a control mechanism to ensure all related staff are provided with same training opportunities and qualification test control prior to carry out their operating or control tasks in the wealth management business. These related control mechanism and implementation result must be reviewed and approved by highest management team of the Bank as appropriate and shall be checked by independent party in the Bank such as audit department or Supervisors of the Board.

I would consider that if the functions of relative control units (e.g. legal and compliance) that support the wealth management business could perform its functionality in its fullest extent, it will then be a quality assurance to the business and can mitigate possible customer criticism on relevant transaction

document or information released to the customer.

(ii) Developed a customer centric (protection) culture

It may be important that Bank should developed the mindset of protecting customer's rights and benefits besides making profit from the wealth management business. After the financial crisis broke out in US, many countries have made an effort to work out new protection scheme to general investors. For instant in US, under Fed's planning, "Financial Consumer Protection Bureau" was established in July 2009, and UK had also announced in June 2009 that they are planning to set up an independent "Customer Protection and Market Supervision Bureau"<sup>32</sup> and in Singapore, MAS Fair Dealing Guideline was issued in April 2009 to all the financial institutions<sup>33</sup>. Singapore Government required financial institution to embed the fair dealing concept in their business activities. In specific they have encouraged financial institutes to include the fair dealing outcome as the key performance indicator for staff so as senior management and tie the fair dealing outcome with their remuneration scheme on staff and management to raise staff and management awareness and attention on the importance of Fair dealing outcome. And in Taiwan, the legislative Yuan of R.O.C. had passed the "Financial Consumer Protection Law" on 3 June 2011<sup>34</sup>. According to the Law, FSC is required to set up a "Financial Consumer Dispute Handling Institutes" by end of this year, and details of the dispute settlement

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<sup>32</sup> 金融研究發展基金管理委員會 「金融海嘯後如何加強銀行銷售金融商品投資人與金融服務消費者保護」座談會 前言 民國九十九年九月二十八日

<sup>33</sup> MAS Monetary Authority of Singapore, February 2008 Consultation Paper, Proposed Guideline on Fair Dealing-Board and Senior Management For Delivering Fair Dealing Outcome To Consumer

<sup>34</sup> 行政院監督管理委員會銀行局 新聞稿 立法院三讀通過金融消費者保護法民國 100 年 6 月 3 日

scheme shall be further work out and announced by the authorities to financial institutions.

From the above-mentioned, and from the Court Judgment on the Investment dispute cases, where Judge in the Court criticize Bank's failure to perform its obligation to act as a prudent trustee, we may appreciate the trend of customer protection eras has come to the focus of peoples mind. Subsequently, it will be then an important topic as how Bank could consider placing customer in their first priority and provides customer a secure and fair trading investment environment. As we noted also from the dispute models in the case studies, sales tend to mis-sell non suitable product to customers during their course of servicing their client, the reason behind such behaviour may be attributable to unreasonable Bank's reward scheme and policies in sales management. I would thus consider that Banks in Taiwan may reference what was done by Singapore, i.e. to incorporate the "Fair dealing" concepts into Bank's management in wealth management business.

Bank may first review their existing wealth management policies on staff management and based upon the concept, to set out appropriate and reasonable performance rating and remuneration scheme to the staff and also senior management. If "Fair Dealing" value could be accepted by Top management of the Bank and that "Fair Dealing" is accepted by the management to be the core of the business value and promoted by the management to their staff in a proactive manner (e.g. via mandatory training or to set the accomplished of fair

dealing outcome as an key indicator of staff performance etc.), this would assist in the reduction of staff mis-selling cases. In additionally, Bank may need to work out also monitoring and control mechanism to review the result of the implementation of “fair dealing” performance.

(iii) Developed Product Structuring abilities

To take into consideration of the strengths of Bank conducting wealth management business, other than reputation (brand name), stable financial status (good credit rating), strong IT system support etc. strengths Bank may have, one of the key strengths of Bank conducting wealth management Business shall be the ability to provide customers with variety of investment products that fit to different needs of customers. It is understood that in current wealth management business market, banks are lack of the professional to structure investment products. Case Studies in Chapter 4 revealed that customers disputes have occurred due to unsuitable offshore structured product introduced to local customers. With the expectation to accommodate local customer’s need and to satisfy customer’s with different risks appetite, I would consider then that Bank may need to work out appropriate action plan to speed up the ability, i.e. to establish their own task force to produce and introduce their own investment products that is suitable to the local customers. Take into reference from the review of Citibank experience in Chapter 5 Section 5.1.2., Bank may consider setting up first a strong financial research team, and beside recruiting qualified and experience product manager (PM), it is also important for the Bank to enhance PM skills and their professionalism in structuring simple, reasonable

and easy understanding products to non-professional customers. It is also important that Bank to help advance PM's competency to structure more complex or high risks product for customer of higher risk appetite that may wish to gain a higher return in their investment.

(iv) To enhance Customer Financial knowledge

As we have emphasis the enhancement and improvement of Bank's sales monitoring and control process, I think it is also important at the same time to look at customers needs to improve their financial knowledge. Almost in all investment disputes cases, customers had alleged that they do not understand the products they are investing, and that we have found it is a common phenomenon whether or not the customer is highly educated. To reduce customer's disputes in their investment, Bank could provide customer financial knowledge sharing opportunities via seminars, training or to provide financial market information sharing or updates in regular terms. Apart from the above, Bank to act in due diligence in their sales process should ensure that their customer have sufficient knowledge in the investment product they intended to invest. I would suggest that Bank may conduct a simple test of the customer after the Bank's Sales Representative had explained the investment product features and all relevant terms and conditions of the investment. And only after customer had passed the product knowledge test, he or she is then permitted to engage the investment contract with the Bank. In additionally, Customer would be required to provide evidence in written to show that he or she had completed the test without the assistance from Bank.

## 5.4 Conclusion

Despite of the financial storms and structured note disputes crisis that stroke Taiwan wealth management business industry, the stringent laws and regulations imposed by local government in the sales of foreign financial products or structured products, we still find opportunities that Bank may develop its wealth management business in the Taiwan market. In view of the low interest rate market conditions that exist and the needs for wealth advisory services from the Taiwan affluent that increase every year, I believe that Bank by adopting proper management strategy and policies, such as banks to equip with proper and adequate internal control and monitoring process, e.g. application of robust IT systems in the management of the sales process in its wealth management business to overcome any possible errors or fraud in manual operation, enhancement of the professionalism, knowledge experience and proficiency of staff or PM ability in the innovation of investment products types and commitment from the Bank to treat customer in fair manner, Bank may retrieve customer's trust and confidence again for the services provided via their wealth management Business license.

In additionally, the assistance from Banks to devote their efforts also in the upgrading of customer's financial knowledge standard, I believe that it will be a win-win condition for both customers and banks conducting Wealth management Business in the coming future. I look forward to expecting a more developed and mature wealth management business environment in local Taiwan Banking financial Industry and expect that authorities may review their governing policies and make necessary adjustments on any irrelevant or inappropriate laws and regulations limitations to assist the establishment of a sound and mature environment for Taiwan wealth management industry.



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