

For information  
on 13 October 2008

**Special Meeting of  
the House Committee of the Legislative Council**

**Minibonds arranged by Lehman Brothers**

**Purpose**

This paper briefs Members on the actions being taken by the Government, the Hong Kong Monetary Authority (“HKMA”) and the Securities and Futures Commission (“SFC”) on the Lehman Brothers’ minibond incident.

**Background**

2. On 15 September 2008, Lehman Brothers Holdings filed for bankruptcy protection in the United States. This has caused repercussions to the world’s financial markets. In particular, minibonds arranged by Lehman Brothers (“the Minibonds”) have resulted in default in Hong Kong as well as in other parts of the world. Some of the investors of the Minibonds in Hong Kong alleged that the distributors had not properly informed them of the potential risks involved in investing these products during the selling process, which had made them suffer from monetary losses.

3. Over the past weeks, the investors being affected have been requesting the Government, HKMA and SFC to investigate into the complaints on the mis-selling process of the distributors. They also requested the Government, HKMA and SFC to assist them in getting back their compensation. There have also been concerns over the adequacy of the existing regulatory regime in protecting investors.

4. The Minibonds are credit linked products which fall under the definition of “debentures” under the Companies Ordinance (Cap. 32). The term “Minibonds” was the brand name used by Lehman Brothers. They were issued by an offshore special purpose vehicle (Pacific International Finance Limited) with Lehman Brothers as the swap guarantor. The swap arrangement enables the issuer to service the periodic coupons in accordance with the terms of the notes and to pay the redemption amount at maturity.

## **Responses**

5. The Government empathises with investors who have been affected by the collapse of Lehman Brothers. Playing the role of an active facilitator, we have been taking prompt actions in collaboration with HKMA, SFC as well as the banking and securities industries to address the concerns of the affected investors as well as the general public.

### Assistance to the affected investors

6. Our most important task at this juncture is to assist the affected investors. The Government has put up a proposal under which the distributing banks and brokers of the Minibonds would offer to buy back the Minibonds at their estimated value. It aims to avoid the need for investors to go through a long and tedious liquidation process and enables investors to get some of their money back quickly. Throughout the process, we expect that there should be an independent auditor who would ensure that investors are adequately protected at each stage, such as valuation of collaterals.

7. At the same time, the Financial Services and the Treasury Bureau, HKMA and SFC have been maintaining close liaison with the trustee and distributors of the Minibonds, and have asked the latter to be more transparent, proactively contact the affected clients, keep them posted of the latest developments and deal with their enquiries and complaints expeditiously. With the Government’s advocacy, the Hong Kong

Association of Banks has set up a task force to follow up the Minibond issue and provide assistance to holders of the Minibonds.

8. As at 12 October 2008, HKMA and SFC have respectively received about 9 280 and 1 970 complaints of alleged mis-selling of investment products related to Lehman Brothers. HKMA and SFC have devoted additional resources to deal with investors' enquiries and complaints expeditiously. In this regard, HKMA has set up a designated complaint hotline to assist investors who might have complaints in relation to the sale by banks of the Minibonds. If, after investigation, complaints of mis-selling are substantiated, appropriate actions will be taken by the regulators.

9. We consider it not appropriate to compensate individual investors by taxpayers' money. Instead, the "buy back option" in paragraph 6 above, which is market based, is the most practical solution that will directly mitigate the immediate problem that investors are facing. We hope that investors as well as distributors will find this arrangement fair and acceptable.

#### Maintaining a stable financial system

10. With the global financial crisis underway, the Government is prepared to do all it can to protect our financial system. HKMA has adjusted the formula for determination of the Base Rate<sup>1</sup>, leading to a cut in the interest rates for borrowings through the Discount Window by 100 basis points. This followed the five temporary measures for providing liquidity assistance to licensed banks in Hong Kong to ensure that our banks have ready access to funding when necessary to tide over a very difficult period. In the event that the situation deteriorates, we are prepared to introduce further measures to maintain the stability and integrity of our financial system.

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<sup>1</sup> The Base Rate is the reference on which the interest rates charged by the HKMA for different types of borrowings by licensed banks through the Discount Window are calculated.

## **Way Forward**

11. The Government strives for continual improvement of our regulatory regime which is of paramount importance to our position as an international financial centre. HKMA and SFC will submit reports to the Financial Secretary, by end of 2008, on their observations, lessons learned and issues identified during the process of investigating the received complaints regarding the Minibonds. Upon receipt of their reports, the Government will undertake a full and comprehensive systemic review and to consider, on a policy level, what can be done to further improve our regulatory framework and to enhance investor protection and education.

Financial Services Branch  
Financial Services and the Treasury Bureau  
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