

立法會
Legislative Council

LC Paper No. CB(1)1979/10-11

Ref: CB1/PL/FA

Panel on Financial Affairs
Special meeting on 21 April 2011

**Background brief on the Lehman Brothers Minibonds
collateral recovery agreement and related issues**

Purpose

This paper provides background information relating to the Lehman Brothers Minibonds collateral recovery agreement announced on 28 March 2011 by the Receivers of the collateral securing Minibond series 10 to 12, 15 to 23 and 25 to 36, and provides a summary of the relevant discussions by the Council, the House Committee and the Panel on Financial Affairs ("FA Panel").

Background

Nature of Minibonds

2. "Minibond" is the name used to describe credit linked notes ("CLNs") issued by a special purpose vehicle, Pacific International Finance Limited¹ ("Pacific"), and arranged by a Hong Kong subsidiary of Lehman Brothers Holdings Inc. ("Lehman Holdings"). The CLNs are structured debt instruments under which payment of interest, principal or both, are affected, amongst other things, the occurrence of a credit event on a basket of companies. Minibonds are secured on collateral and swap arrangements with another Lehman subsidiary guaranteed by Lehman Holdings. Funds raised were used to purchase collateral that was AAA rated at the time of purchase. A more detailed description of Minibonds is given in **Appendix I**.

¹ PIFL is incorporated in the Cayman Islands.

Collapse of Lehman Brothers

3. The collapse of the sub-prime market of the United States ("US") in 2007 triggered a spate of banking and financial crises. Lehman Holdings, one of the leading investment banks in the US and operating a network of offices around the world, filed for bankruptcy protection on 15 September 2008². One of the aftermaths is that the Lehman Brothers-related entities have defaulted in respect of their obligations under Minibonds and other structured financial products. In Hong Kong, Pacific had issued approximately HK\$13.9 billion of Minibonds to Hong Kong's retail investors. A total of 32 series of Minibonds had been issued. When Lehman Holdings filed for bankruptcy, three of the 32 series of Minibonds had matured and one series had been the subject of an early call.³ There remained Minibonds with a nominal value of HK\$12.6 billion in the hands of approximately 34 000 investors.⁴

Government's buy-back proposal in October 2008

4. On 6 October 2008, the Government proposed to the Hong Kong Association of Banks ("HKAB") a buy-back proposal for their consideration to provide assistance and relieve Minibond holders of the waiting time and anxieties. Under the buy-back proposal, the banks would purchase the Minibonds from the retail investors at their estimated market value so as to allow Minibonds holders to realize the current value of their investment as quickly as possible. After the buy-back, the banks would use their expertise to work together with the Trustee to extract the best value out of the Minibonds in the liquidation process. Any liquidation proceeds received by the banks over and above the original offer price would be returned to the retail investors. The buy-back arrangement was not meant to be a form of compensation for mis-selling. On 17 October 2008, 16 Minibonds distributing banks ("the Distributing Banks") announced their decision to accept the buy-back proposal.

5. On 25 November 2008, the lawyers that act for the liquidator of Lehman Holdings issued a letter to the Trustee of the Minibonds (HSBC Bank, USA, National Association) claiming that, according to the US Bankruptcy Code, the Trustee's action since 15 September 2008 might be invalid; and that the Trustee might not lawfully realize the collateral and pay the money to Minibond investors, and hence the Trustee should refrain from taking any further action.

² The bankruptcy petition was filed under Chapter 11 of the US Bankruptcy Code.

³ In respect of these four series, investors were repaid the principal amount of their investments amounting to approximately HK\$1.3 billion.

⁴ The figure is based on the number of accounts at banks and licensed corporations holding Minibonds. There may be duplication if customers hold Minibonds in more than one account.

6. In view of the abovementioned claim, the Distributing Banks decided, after consultation with the Government, to delay the buy-back arrangement. The Distributing Banks indicated that they would continue liaising with the Trustee regarding the status of the Minibonds and the proposed steps to be taken to protect the interests of the investors, and had asked the Trustee to exercise its discretion to protect the interests of the investors. The Distributing Banks also indicated that they were prepared to provide finance to the Trustee of up to HK\$100 million to assist it in the performance of its duty to protect the interests of the Minibonds investors.

Agreement in relation to the repurchase of Lehman Brothers Minibonds from eligible customers in July 2009

7. The Securities and Futures Commission ("SFC"), the Hong Kong Monetary Authority ("HKMA") and 16 Distributing Banks⁵ jointly announced on 22 July 2009 that they had reached an agreement in relation to the repurchase of Lehman Brothers Minibonds from eligible customers⁶. The relevant press release is at **Appendix II** and the agreed arrangements include the following –

- (a) each of the Distributing Banks will make an offer to repurchase from each eligible customer all outstanding Minibonds⁷ at a price equal to 60% of the nominal value of the original investment for customers below the age of 65 or at 70% of the nominal value for customers aged 65 or above as at 1 July 2009. Customers will be entitled to retain any coupon payments received to date;
- (b) once the underlying collateral is recovered and paid to the Distributing Banks, each of them will make a further payment of initially up to 10% (depending on recoveries) of the nominal value of the Minibonds to eligible customers below the age of 65 and, if recoveries exceeded 70%, the Banks will pay the entire excess amount to eligible customers who had accepted the repurchase offer; and

⁵ The Banks are: (1) ABN AMRO Bank N.V.; (2) Bank of China (Hong Kong) Ltd; (3) Bank of Communications Co Ltd; (4) The Bank of East Asia, Ltd; (5) Chiyu Banking Corporation Ltd; (6) Chong Hing Bank Ltd; (7) CITIC Ka Wah Bank Ltd; (8) Dah Sing Bank Ltd; (9) Fubon Bank (Hong Kong) Ltd; (10) Industrial and Commercial Bank of China (Asia) Ltd; (11) Mevas Bank Ltd; (12) Nanyang Commercial Bank, Ltd; (13) Public Bank (Hong Kong) Ltd; (14) Shanghai Commercial Bank Ltd; (15) Wing Hang Bank Ltd; and (16) Wing Lung Bank Ltd

⁶ Eligible customers will not include professional investors, corporate/non-individual investors (with specified exceptions) or experienced investors (meaning investors who in the three years preceding their first purchase of Minibonds, executed five or more transactions in Leveraged Products, Structured Products or a combination of these products). The definition also excludes those customers who have previously settled claims in relation to Minibonds with the Banks.

⁷ Outstanding Minibonds refers to the following series of Minibonds: series 5-7 inclusive, series 9-12 inclusive, series 15-23 inclusive, series 25-36 inclusive.

- (c) each Distributing Bank will make available an amount equivalent to the amount of commission income received by it as a distributor of the outstanding Minibonds to the trustee of the Minibonds to assist in the recovery of the underlying collateral for each outstanding series of Minibonds; and
- (d) in consideration of the agreement, SFC will discontinue its investigations into the sale and distribution of Minibonds by the Banks, and it is not HKMA's intention to take any enforcement action against the Banks in relation to Minibond cases that involve eligible customers who accept the offer.

8. According to SFC, at the time of negotiating the agreement, both SFC and HKMA have made reference to the information contained in the report on the structure and pricing of Minibonds prepared by Ernst & Young, which was submitted to the FA Panel by the Lehman Incident Task Force of HKAB on 29 December 2008. Pages 17 and 18 of Ernst & Young report contain a table setting out the remaining value of each particular series of Minibonds as at 21 November 2008, a copy of which is at **Appendix III**.

9. According to a press release issued by HKMA on 9 July 2010, the Distributing Banks had begun since 7 August 2009 issuing repurchase offer letters to eligible customers (about 25 000 customers) under the Repurchase Scheme. Up to 30 June 2010, 24 774 customers had responded to the repurchase offers, of whom 24,523 customers or 99.0% had accepted the offers.

10. In October 2009, a Minibond investor applied for leave to seek judicial review of SFC's decision to discontinue its investigations into the 16 banks as a result of the repurchase agreement. The application was heard on 22 March 2010. The Court of First Instance handed down its judgement on 30 April 2010 refusing to grant leave as there were insufficient exceptional circumstances to justify entertaining the issues raised by the applicant. The Court was also mindful of the disruption caused to those Minibond investors who had accepted the repurchase offers should the repurchase agreement be challenged in court.

Discussions at the House Committee, Council meetings and the Panel on Financial Affairs in 2008 and 2009

11. Given the widespread concerns caused by the Lehman Brothers incident and the magnitude of its ensuing problems, a special House Committee meeting was held on 13 October 2008 to receive a briefing by the Government,

HKMA, SFC, HKAB and over 20 financial institutions on the latest state of play of the Minibonds Incident. The key issues discussed include regulatory arrangements for the sale of Minibonds and structured financial products, alleged mis-selling by banks, complaints investigation and applicable sanctions, assistance to affected investors, and possible impact of the incident on Hong Kong's financial and banking systems.

12. At the House Committee meeting on 17 October 2008, Members endorsed the appointment of the Subcommittee to Study Issues Arising from Lehman Brothers-related Minibonds and Structured Financial Products⁸. A motion was passed by the Council on 12 November 2008 authorizing the Subcommittee to exercise the powers conferred by section 9(1) of the Legislative Council (Powers and Privileges) Ordinance (Cap. 382) for performing its functions.

13. A motion was passed at the Council meeting on 22 October 2008 on "Assisting the victims of the Lehman Brothers incidents". The terms of the motion are given at **Appendix IV**.

14. Noting from press reports in early December 2008 that the buy-back proposal might have to be deferred or abandoned due to the legal challenge faced by the Trustee of the Minibonds, the FA Panel held two meetings on 18 December 2008 and 30 December 2008 to discuss the subject. Panel members expressed concern about the determination of the market value of the Minibonds in the light of the claim of the Lehman's legal counsel in the US in respect of the right of priority over the realized proceeds of the underlying collaterals for the Minibonds. They were also concerned about the alternative measures to assist the affected investors if the "buy-back" proposal could not proceed as planned due to the legal uncertainties. Noting that HSBC played the role as the Trustee of the Minibonds and provided corporate service to the issuer of the Minibonds as well, members expressed concern whether there was conflict of interests. Representatives of HSBC clarified that the two roles were separate.

15. On 2 February 2009 and 23 February 2009, the FA Panel discussed the reports prepared by HKMA and SFC on the Lehman Brothers Minibonds Incident and submitted to the Financial Secretary in December 2008. The Panel noted the major findings and recommendations in the reports and the action plan of the Financial Services and the Treasury Bureau to follow up the recommendations. Some members expressed concern about the effectiveness of the existing regulatory regime for the securities regulator to take disciplinary actions against misconduct of financial institutions in the sale of structured

⁸ The Subcommittee provided two progress reports to the House Committee on 23 October 2009 and 22 October 2010. The Subcommittee is currently in the last phase of collecting evidence from witnesses.

financial products. There were also concerns about the extensive impact of the Incident on retail investors in Hong Kong compared with overseas jurisdictions, and the circumstances specific to Hong Kong leading to the large number of retail investors investing in the Minibonds.

16. On 2 November 2009, the Administration briefed the FA Panel on the progress of the action plan. Some Panel members considered that a fundamental issue revealed in the Lehman Brothers Minibonds Incident was that the protection of ordinary retail investors under the current disclosure-based regulatory regime was inadequate. In this regard, a member suggested that reference should be made to the practice of advanced economies of prohibiting the offering of investment products with returns disproportionate to the high risk involved to ordinary retail investors. Members also raised concerns about the lack of market transparency of unlisted investment products, and urged the Administration to put in place suitable measures. As regards the present arrangement of having two regulators, namely HKMA and SFC, to regulate financial institutions in the sale of investment products, members considered that this arrangement had given rise to coordination and other problems, and requested the Administration to review this aspect of the regulatory regime. Noting that the majority of the complaints relating to the Lehman Brothers Minibonds had been resolved through the settlement arrangement offered by distributing banks, members urged HKMA and SFC to deploy more resources to deal with the complaints relating to the sale of other Lehman-related investment products, in particular, equity-linked notes. Members also urged the regulators to enhance the efficiency and transparency in their investigation work.

Lehman Brothers Minibonds collateral recovery agreement

17. On 30 June 2009, the Trustee appointed Messrs Ted Osborn, Anthony Boswell and Jan Blaauw, partners of PricewaterhouseCoopers (PwC) Hong Kong, as Receivers of the collateral securing Minibond series 10 to 12, 15 to 23 and 25 to 36.

18. On 20 December 2010, Ted Osborn, Anthony Boswell and Marie Rowbotham of PwC Hong Kong were appointed receivers of the collateral which secures the Minibond series 5 to 7 and 9. With this action of the Trustee, Receivers have been appointed over the collateral relating to all outstanding series of Minibonds issued by Pacific in Hong Kong with the purpose of realizing the value of that collateral for Noteholders.

19. To support the work of the Trustee, the Distributing Banks signed an Expense Funding Agreement on 30 October 2009 by providing a sum of approximately \$291 million, which according to the Distributing Banks was

equivalent to the amount of commission income they received as distributors of Minibonds.

20. The Receivers announced on 28 March 2011 that they have reached a conditional agreement with Lehman Brothers Special Financing Inc. in respect of the collateral of the Minibond series 10 to 12, 15 to 23 and 25 to 36 ("Relevant Series"). According to the information in the Receivers' press release and on the Receivers' website on the Minibonds, the estimated recovery to Minibond investors from the collateral ranges from approximately 70% to 93% of the principal amount invested, and the implementation of the Collateral Recovery Agreement would be subject to the following two conditions:

- (a) the US Bankruptcy Court's confirmation that a December 2008 order which deals with settlement of Lehman derivatives claims applies to a settlement of claims relevant to the Minibonds; and
- (b) Noteholders must pass an extraordinary resolution at a special meeting of Noteholders for each and every Relevant Series in order for the agreement with Lehman Brothers to become effective. A majority of Noteholders consisting of 75% or more of the votes cast at the meeting must vote in favour of the agreement for each and every Relevant Series in order for the extraordinary resolution to be passed.

21. The Distributing Banks also made an announcement on 28 March 2011 entitled "A proposal relating to the final resolution of certain series of Lehman Brothers Minibonds". According to the announcement, in addition to the collateral recovery amount, the Banks will offer an ex gratia payment scheme to Eligible Customers⁹ of the Minibonds series 10 to 12, 15 to 23 and 25 to 36. The ex gratia payment to which each Eligible Customer will be notionally entitled is equal to 50% of any shortfall in the recovery of the amount invested ("Ex Gratia Payment"). Based on the rates of recovery of between 70% and 93% as advised by the Receivers, the total level of recovery to Eligible Customers, after taking into account the offer of the Ex Gratia Payments by the Banks, will be in the range of 85% to 96.5% of the principal amount of their investment. The Banks have also increased the funding amount available to the Trustee from approximately \$291 million to approximately \$662 million to pay all fees, expenses and other amounts which may be incurred in connection with the recovery of the collateral of the outstanding Minibonds and the Trustee's role in respect of the Minibonds.

⁹ Eligible Customers are either those investors who were eligible to participate in the Repurchase Scheme or those who would have been eligible under the Repurchase Scheme had they not previously reached a settlement with the Banks on a case-by-case basis.

Recent development

22. The FA Panel will hold a meeting on 21 April 2011 to discuss the Lehman Brothers Minibonds collateral recovery agreement and related issues with the Administration, HKMA, SFC, the Distributing Banks, the Trustee and the Receivers.

Relevant papers

23. A chronology of the relevant events, together with references of the relevant papers is at **Appendix V**.

Council Business Division 1
Legislative Council Secretariat
19 April 2011

Extract from
Report of SFC entitled "Issues raised by the Lehman Minibonds crisis -
Report to the Financial Secretary" (December 2008), LC Paper No. CB(1)709/08-09(01)



16. What is a Minibond?

- 16.1 Minibonds is the name used to describe credit linked notes ("CLNs") issued by Pacific, which were arranged by a Hong Kong subsidiary of Lehman Holdings. These CLNs are structured debt instruments under which payments of interest, principal or both, are affected by, amongst other things, the occurrence of a credit event on a basket of companies (referred to as reference entities) such as HSBC, Hutchison Whampoa, DBS Group Holdings Ltd., Swire Pacific Ltd., Sun Hung Kai Properties Ltd., Goldman Sachs Group Inc. and Morgan Stanley. Credit events normally include situations where an entity in the basket of reference entities becomes insolvent or fails to repay loans etc..
- 16.2 Minibonds are secured on collateral and swap arrangements with another Lehman subsidiary guaranteed by Lehman Holdings. Funds raised were used to purchase collateral that was AAA rated at the time of purchase.
- 16.3 Complexity of the structure of a product does not necessarily mean that the product is an unduly risky investment in normal market conditions. The risks associated with Minibonds were set out in some detail in the prospectuses that provided general warnings to investors in plain language:
- 16.3.1 "Our Notes are not principal protected; you could lose part, and possibly all, of your investment";
- 16.3.2 "Our notes are not suitable for everyoneBefore applying for any of our Notes, you should consider whether our notes are suitable for you in light of your own financial circumstances and investment objectives. If you are in any doubt, get independent professional advice."
- 16.4 In addition, the prospectuses included disclosures advising investors as to specific risks.
- 16.4.1 Credit event of a reference entity - as Minibonds are linked to the credit risk of the reference entities, when there is a first credit event by one of the reference entities of Minibonds there will be early termination. The redemption price is calculated by reference to the price of the borrowing obligations of the reference entity which has suffered the credit event. Usually, the price of borrowing obligations of the affected entity will drop when the circumstances leading to the credit event becomes known. The value of Minibonds and amount holders receive is likely to be less or significantly less than their principal investment.
- 16.4.2 Early termination - when there is early redemption the swap arrangements will be early terminated and the collateral will be sold to make payment. Holders will only receive their share of the proceeds from the sale of the collateral after other payments. If there is a termination amount payable under the swap, the swap counterparty's claims against the collateral will be paid ahead of the Minibond holders' claims. As the only assets which back Minibonds are the collateral and swap arrangements, the amount eventually received by holders may be significantly less than the principal amount of Minibonds held by them.



- 16.4.3 Early redemption occurs when:
- (i) there is a credit event (see 16.4.1);
 - (ii) there is an event of default under Minibonds;
 - (iii) the collateral or the underlying securities of the collateral is repaid early;
 - (iv) Cayman Islands (where Pacific is incorporated) imposes taxes on Pacific or Minibonds; or
 - (v) the swap arrangements are terminated due to, e.g., liquidation of the swap counterparty.
- 16.4.4 Decline in market value of the collateral – the market value of the collateral depends on its liquidity. Although the collateral was AAA rated at the time it was purchased, its credit rating and value may decline subsequently. In the event of an early redemption, the collateral will be sold to make the redemption to holder. Holders will only receive their share of the proceeds from the sale of the collateral after other payments. If the market value of the collateral falls (e.g., when the credit quality of the collateral falls), the amount a holder will receive may be less or significantly less than the principal amount.
- 16.4.5 Where the collateral consists of collateralised debt obligations (“CDO”) and there is an early termination of the CDO arising from credit events of its reference entities, there would be an early termination of Minibonds even though no credit event has occurred to any of the Minibond reference entities.
- 16.4.6 Holders may not be able to sell their Minibonds or they may receive less than the amount invested if they sell their Minibonds before maturity as there is no liquid trading market for Minibonds.

**Press release of SFC on "Agreement in relation to the repurchase of
Lehman Brothers Minibonds from eligible customers" issued on 22 July 2009**

22 July 2009

SFC, HKMA and 16 banks reach agreement on Minibonds

The Securities and Futures Commission (SFC), the Hong Kong Monetary Authority (HKMA) and 16 distributing banks (the Banks) (Note 1) today jointly announce that they have reached an agreement in relation to the repurchase of Lehman Brothers Minibonds from eligible customers (Note 2).

The Banks have agreed with the SFC and the HKMA without admission of liability that (Note 3):

- each of the Banks will make an offer to repurchase from each eligible customer all outstanding Minibonds (Note 4) at a price equal to 60% of the nominal value of the original investment for customers below the age of 65 or at 70% of the nominal value for customers aged 65 or above as at 1 July 2009. Customers will be entitled to retain any coupon payments received to date;
- once the underlying collateral is recovered and paid to the Banks, each of them will make a further payment of initially up to 10% (depending on recoveries) of the nominal value of the Minibonds to eligible customers below the age of 65 and, if recoveries exceed 70%, the Banks will pay the entire excess amount to eligible customers who have accepted the repurchase offer (Notes 5 and 6);
- each Bank will make available an amount equivalent to the amount of commission income received by it as a distributor of the outstanding Minibonds to the trustee of the Minibonds to assist in the recovery of the underlying collateral for each outstanding series of Minibonds;
- each of the Banks will immediately implement special enhanced complaints handling procedures to resolve, in a fair and reasonable manner, all complaints in relation to the sale and distribution of other structured products (Note 7); and
- to demonstrate their commitment in serving the investing public with the highest standards of conduct, each of the Banks: (i) will engage an independent reviewer, to be approved by the SFC and the HKMA, to review its systems and processes relating to the sale of structured products, to report to the SFC and the HKMA and will commit to the implementation of all recommendations by the independent reviewer; and (ii) will engage a qualified third party, as approved by the SFC and the HKMA, to review and enhance complaints handling procedures, and will commit to the implementation of all recommendations by such third party.

People who have previously reached settlement with the Banks in relation to Minibonds will not qualify for the repurchase offer. However, the Banks have undertaken to the HKMA to make ex gratia payments to those customers that have already entered into settlements with the Banks and who would have been eligible to receive the repurchase offer where those customers have received settlement

amounts less than they would have received under this agreement. The intention is to bring those customers in line with eligible customers under this agreement.

In consideration of the agreement, the SFC will discontinue its investigations into the sale and distribution of Minibonds by the Banks. The HKMA has also informed the Banks that as the agreement contains detailed arrangements for the settlement of claims and the implementation of robust systems for selling unlisted structured products and dealing with related customer complaints in future, it is not its intention to take any enforcement action against the Banks in relation to Minibond cases that involve eligible customers who accept the offer.

The SFC considers that this agreement meets the SFC's criteria for resolution under section 201 of the Securities and Futures Ordinance for the following reasons:

- The repurchase scheme should ensure that eligible customers who accept the repurchase offer will, subject to the recovery and distribution of the underlying collateral, receive a total amount that is equal to or greater than what they would otherwise recover if they were simply paid the current market value of the collateral.
- The agreement takes into account that the recoverable value of the collateral is not certain. Even if the recoverable value of the collateral is below the values estimated by experts engaged by the Hong Kong Association of Banks in late 2008, the proposal will still deliver a return for the eligible customers that is equal to or exceeds 60% of their investment (or 70% for customers aged 65 or above).
- The agreement includes a commitment by the Banks, as noteholders, to take reasonable steps to expedite the return of the collateral. It is important that any claim on the collateral that might reduce its recoverable value is negotiated robustly.
- The agreement represents an opportunity to resolve outstanding investigations involving 16 banks in a way that will bring benefits to nearly all holders of outstanding Minibonds.
- The agreement includes special measures in which the Banks will investigate and resolve in a fair and reasonable manner all complaints involving the sale and distribution of other structured products.
- The agreement also remediates the Banks' systems and processes to meet the highest standards that will provide enhanced protection to the investing public in the future and give the investing public an assurance that the parties are determined to ensure these events are not repeated.
- The SFC and the HKMA believe that the repurchase offer by the Banks is a reasonable one and is in the public interest.

"Strong markets, like Hong Kong's, need strong regulations. This agreement will provide substantial benefits for the vast majority of customers holding Minibonds that would not otherwise be received by them and, given the number of Banks and customers involved, the agreement is a watershed in the regulation of financial services in Hong Kong," said the SFC's Chief Executive Officer, Mr Martin Wheatley.

“Specifically, the agreement paves the way for customers who hold Minibonds to receive a substantial return of their capital. Secondly, the financial support of the Banks, using the commission income received in the sale of Minibonds, will expedite the return of the underlying collateral to Hong Kong Minibond holders. This aligns the interests of the Banks and customers holding Minibonds. Thirdly the agreement provides the framework for the Banks to develop higher standards of practice in the future and to resolve complaints in relation to other structured products. For these reasons, the SFC firmly believes it is an appropriate resolution of the Minibond issue with these banks,” remarked Mr Wheatley.

Mr Y K Choi, Deputy Chief Executive of the HKMA, said: “The HKMA welcomes and supports the repurchase scheme and considers it to be practical, reasonable and in the interests of the great majority of Minibond investors. The HKMA encourages eligible customers to consider the repurchase offer by the Banks.”

Dr The Hon Sir David Li Kwok Po, Chairman and Chief Executive of The Bank of East Asia, Ltd, said on behalf of the Banks: “The Banks are pleased to have reached this agreement with the SFC and the HKMA which we believe will benefit Hong Kong as an international financial centre. It evidences our joint effort to assist the Minibond investors in Hong Kong who have been impacted by the sudden collapse of the Lehman Brothers Group, and to reinforce public confidence in Hong Kong’s banking, financial and regulatory systems. This agreement demonstrates our unwavering commitment to the good of Hong Kong and the welfare of our customers. We will continue to work with the SFC and the HKMA to maximise the confidence of our customers in Hong Kong’s banks, and to ensure that the standards maintained by Hong Kong’s banks will be in line with international best practice.”

The SFC acknowledges the substantial assistance of the HKMA in the investigation of these cases.

End

Notes :

1. The Banks are: (1) ABN AMRO Bank N.V.; (2) Bank of China (Hong Kong) Ltd; (3) Bank of Communications Co Ltd; (4) The Bank of East Asia, Ltd; (5) Chiyu Banking Corporation Ltd; (6) Chong Hing Bank Ltd; (7) CITIC Ka Wah Bank Ltd; (8) Dah Sing Bank Ltd; (9) Fubon Bank (Hong Kong) Ltd; (10) Industrial and Commercial Bank of China (Asia) Ltd; (11) Mevas Bank Ltd; (12) Nanyang Commercial Bank, Ltd; (13) Public Bank (Hong Kong) Ltd; (14) Shanghai Commercial Bank Ltd; (15) Wing Hang Bank Ltd; and (16) Wing Lung Bank Ltd.

2. Eligible customers will not include professional investors, corporate/non-individual investors (with specified exceptions) or experienced investors (meaning investors who in the three years preceding their first purchase of Minibonds, executed five or more transactions in Leveraged Products, Structured Products or a combination of these products. The definition also excludes those customers who have previously settled claims in relation to Minibonds with the Banks.

3. Please follow this [link](#) for the Questions and answers about Lehman Brothers Minibonds Repurchase Scheme by Distributing Banks.

4. Outstanding Minibonds refers to the following series of Minibonds: series 5-7 inclusive, series 9-12 inclusive, series 15-23 inclusive, series 25-36 inclusive.

5. Table setting out the projected recovery (%) by eligible customers below the age of 65 as at 1 July 2009:

Collateral amount recovered	0%	5%	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
Total recovery by eligible customers	60%	65%	70%	70%	70%	70%	70%	70%	70%	80%	90%	100%

6. Table setting out the projected recovery (%) by eligible customers aged 65 or above as at 1 July 2009:

Collateral amount recovered	0%	5%	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
Total recovery by eligible customers	70%	70%	70%	70%	70%	70%	70%	70%	70%	80%	90%	100%

7. The Code of Conduct for Persons Licensed by or Registered with the SFC provides that licensees and registered institutions should ensure customer complaints are handled in a timely and appropriate manner, steps are taken to investigate and respond promptly to complaints and, where a complaint is not remedied promptly, the client is advised of further steps available under the regulatory system.

Appendix III

Table on the remaining value of each particular series of Minibonds as at 21 November 2008, extracted from the Report on the Structure and Pricing of Minibonds prepared by Ernest & Young

Structure and Pricing of Minibonds

Table 3.1-2

Pricing Date: 21-Nov-2008		
Series	Tranche	Minibond Pricing
5		0.82%
6		0.82%
7	A	0.82%
7	B	0.82%
9	A	0.82%
9	B	0.82%
10	A	71.89%
10	B	71.79%
11	A	78.31%
11	B	77.36%
11	C	77.43%
11	D	75.57%
12	A	71.81%
12	B	71.42%
15	A	14.79%
15	B	13.67%
16	A	13.79%
16	B	12.93%
17	A	13.14%
17	B	12.78%
18	A	11.48%
18	B	11.19%
19	A	69.12%
19	B	67.64%
20	A	58.51%
20	B	56.93%
20	C	54.07%
20	D	53.18%
21	A	55.87%
21	B	54.29%
21	C	55.38%
22	A	71.49%
22	B	70.80%
22	C	69.02%
23	A	65.37%
23	B	65.07%
23	C	66.95%
23	D	67.14%

Structure and Pricing of Minibonds

Table 3.1-2 (continued)

Pricing Date: 21-Nov-2008		
Series	Tranche	Minibond Pricing
25	A	63.65%
25	B	64.27%
25	C	64.49%
25	D	65.21%
26	A	66.16%
26	B	65.17%
26	C	62.21%
27	A	61.27%
27	B	61.08%
27	C	61.55%
27	D	60.47%
28	A	56.82%
28	B	60.78%
28	C	57.78%
28	D	56.03%
29	A	60.28%
29	B	60.70%
29	C	61.51%
29	D	59.59%
30	A	68.03%
30	B	66.75%
30	C	64.57%
30	D	63.59%
31	A	59.74%
31	B	61.12%
31	C	59.64%
31	D	58.95%
32	A	58.95%
32	B	60.79%
32	C	59.93%
32	D	59.14%
33	A	64.48%
33	B	65.44%
33	C	62.40%
33	D	62.11%
34	A	52.34%
34	B	52.34%
35	A	73.10%
35	B	72.57%
36	A	74.15%
36	B	72.97%

**Motion passed at the Council meeting on 22 October 2008 on
"Assisting the victims of the Lehman Brothers incidents"**

(Translation)

**Motion on "Assisting the victims of the Lehman Brothers incident" moved
by Hon Jeffrey LAM Kin-fung at the Legislative Council meeting of
Wednesday, 22 October 2008**

**Motion as amended by Hon KAM Nai-wai, Hon WONG Kwok-hing and
Hon Alan LEONG Kah-kit**

That, under the existing financial monitoring mechanism, there is still a large number of bank clients and investors complaining against the banks and securities companies using misleading marketing practices, which have led to their purchasing of financial products such as Lehman Minibonds and notes without knowing the potential risks, resulting in their suffering substantial losses when the company went bankrupt; this incident has not only caused many members of the public to lose confidence in the above financial institutions and the system for monitoring banks and the financial system, but has also seriously affected Hong Kong's reputation as an international financial centre; in this connection, this Council condemns the Government for its inadequate monitoring, and urges the Government to immediately take the following actions:

- (a) using all possible means, including setting up an inter-departmental response team to assume overall responsibility for providing comprehensive assistance to affected small investors and protecting their interest;
- (b) urging distributors to expeditiously disclose information on the underlying assets of Lehman Minibonds or related financial products, including the nature of the underlying assets, their prices and liquidity;
- (c) expeditiously completing a comprehensive investigation into whether the distributors of Lehman Minibonds and related financial products have violated the relevant regulatory rules or guidelines, including whether these distributors have used improper sales practices to mislead the investors and whether they have breached the regulations or deviated from the guidelines, and expeditiously disclose the nature and number of cases involving improper sales practices and violation of and deviation from the guidelines; if it is proved that they have violated the relevant rules or guidelines, the Government should pursue the matter and seek compensation on behalf of the victims;

- (d) urging the Police to expeditiously complete their investigations for the authorities concerned to institute prosecutions against illegal acts, so as to severely penalize such acts;
- (e) urging various distributors to expeditiously propose to their clients compensation options for improper sales practices and violation of regulations;
- (f) with reference to the practice of Singapore in handling disputes resolution in the financial sector, considering the setting up of an independent commission or institution to provide one-stop service for disputes resolution, so as to enable the victims to seek compensation through such means as mediation and adjudication;
- (g) supporting the Consumer Council to conduct a study of the suspected cases involving misleading practices and, where necessary, use the Consumer Legal Action Fund to seek compensation from the banks and securities companies concerned for the small investors;
- (h) demanding the authorities to urge the trustees and distributors concerned to appoint an independent notary agency to properly handle the assets of holders of Lehman Minibonds or related financial products, thereby providing the best protection for the interest of small investors; and
- (i) at the same time conducting an investigation into whether there is dereliction of duty on the part of the Financial Secretary, the Financial Services and the Treasury Bureau, the Hong Kong Monetary Authority and the Securities and Futures Commission in this incident, and making recommendations on how to improve the mechanism for monitoring the sales of financial products, strengthen the protection of investors' interests and prevent the recurrence of similar incidents;
- (j) expeditiously providing the details about implementing the plan for distributors to buy back the bonds from the bond-holders and the implementation timetable;
- (k) also expeditiously completing a comprehensive investigation into the issuers and sponsors etc of Lehman Minibonds and related financial products and, if it is proved that they have violated the rules or regulations, the Government should pursue the matter and seek compensation on behalf of the victims; and
- (l) demanding the Hong Kong Monetary Authority to investigate the unreasonable management measures adopted by the relevant banks to coerce their employees to achieve sales targets of the bonds concerned,

establish channels for employees of banks to reflect such situations to the Hong Kong Monetary Authority and, at the same time, monitor bank management not to use high-handed and target-oriented approach in marketing products to protect front-line employees from becoming scapegoats, so as to restore public confidence in banks; and

(m) demanding the authorities to appoint, with the highest efficiency and within the shortest possible time, independent persons of credibility and authorize them to deal with the following tasks respectively:

- (i) monitoring the process of various banks for investigating complaint cases; and
- (ii) with the consent of the parties concerned, arbitrating those cases which cannot be settled by way of conciliation,

so as to reduce the anxiety and dissatisfaction of the affected persons.

Panel on Financial Affairs

Chronology of events relating to the Lehman Brothers Minibonds Incidents

Date	Issue	Relevant documents
15 Sept 2008	The Lehman Brothers Holdings Inc., filed for bankruptcy protection in the US.	
13 Oct 2008	The House Committee received a briefing by the Government, the Hong Kong Monetary Authority (HKMA), the Securities and Futures Commission (SFC), the Hong Kong Association of Banks (HKAB) and over 20 financial institutions on the latest state of play.	Verbatim record
17 Oct 2008	The House Committee endorsed the appointment of the "Subcommittee to Study Issues Arising from Lehman Brothers-related Minibonds and Structured Financial Products".	Minutes (paragraph 60): Paper
22 Oct 2008	The Council passed a motion on "Assisting the victims of the Lehman Brothers incidents".	Motion passed Progress report
12 Nov 2008	The Council passed a motion authorizing the Subcommittee to exercise the powers conferred by section 9(1) of the Legislative Council (Powers and Privileges) Ordinance (Cap. 382) for performing its functions.	Motion passed
18 Dec 2008 And 30 Dec 2008	The Panel on Financial Affairs (FA Panel) discussed the Government's "buy-back" proposal for Lehman Brothers-related minibonds.	Meeting on 18 Dec 2008 Agenda Verbatim record Meeting on 30 Dec 2008 Agenda Verbatim record
2 Feb 2009 And 23 Feb 2009	FA Panel discussed the reports prepared by HKMA and SFC on the Lehman Brothers Minibonds incident.	Meeting on 2 Feb 2009 Agenda Verbatim record (at Appendix) Meeting on 23 Feb 2009 Agenda Verbatim record (at Appendix)
22 July 2009	SFC, HKMA and 16 distributing banks jointly announced that they had reached an agreement in relation to the repurchase of Lehman Brothers Minibonds from eligible customers.	Press release

Date	Issue	Relevant documents
2 Nov 2009	FA Panel discussed the progress of the Administration's action plan on recommendations in the reports prepared by HKMA and SFC on the Lehman Brothers Minibonds Incident.	Agenda Minutes (paragraphs 8 – 38):
30 Apr 2010	Judgement of the High Court on an application for leave for judicial review by a Lehman Brothers victim filed on 22 October 2009, which concluded that the leave should be refused.	Judgement
9 Aug 2010	Judgement by a the US District Court for the Southern District of New York on a class action suit against HSBC Inc. regarding Minibonds. The judgement reserved the denial of leave to replead and vacated an order stipulated by the United States Bankruptcy Court for the Southern District of New York.	Judgement The summary report
27 Mar 2011	Joint press release by HKMA and SFC on welcoming Minibond collateral recovery agreement.	Press release
28 Mar 2011	Announcement by the 16 Distributing Banks on "A proposal relating to the final resolution of certain series of Lehman Brothers minibonds"	Announcement
	Announcement issued by PricewaterhouseCoopers entitled "Receivers from PwC reach agreement with Lehman Brothers in respect of Minibonds Collateral"	Announcement

Council Business Division 1
Legislative Council Secretariat
15 April 2011