

For information
on 21 April 2011

**Special Meeting of
Legislative Council Panel on Financial Affairs**

**Lehman Brothers Minibonds collateral recovery agreement
and related issues**

Purpose

This paper briefs Members on the response of the Administration, the Hong Kong Monetary Authority (“HKMA”) and the Securities and Futures Commission (“SFC”) to the Lehman Brothers Minibonds collateral recovery agreement and related issues.

Background

2. On 22 July 2009, SFC, HKMA and 16 Lehman Brothers’ Minibonds distributing banks (“the Banks”) reached an agreement, under which the Banks undertook to repurchase Minibonds from eligible customers (“Repurchase Agreement”).

3. According to the relevant provisions of the Repurchase Agreement, the Banks are obliged to maximise the value to be recovered from the Minibonds collateral. In this regard, the Banks have made use of the commission income received from the sale of the Minibonds to set up a fund to assist the Trustee (HSBC Bank USA, National Association) for recovery of the Minibonds collateral. The Trustee has appointed a professional third party (PricewaterhouseCoopers (“PwC”)) as the Receiver to negotiate with the liquidator of Lehman Brothers with a view to maximising the value to be recovered from the Minibonds collateral.

4. On 27 March 2011, the 16 Banks and the Receivers made separate announcements concerning the recovery and proposed

distributions of the net value of the underlying collateral assets of Minibonds series 10 to 12, 15 to 23 and 25 to 36 (“the relevant series”). The proposed distributions, if approved, will provide substantial recoveries for all customers who held Minibonds issued in the relevant series, including those who were ineligible to receive repurchase offers under the Repurchase Agreement.

5. In addition, the 16 Banks have agreed to make additional ex-gratia payments to customers who were classified as eligible customers in the Repurchase Agreement. The additional ex-gratia payment will increase the level of recovery of eligible customers to 85% to 96.5% of their initial investment.

Response of the Administration and the Regulators

6. We are pleased with the high rate of recovery in the value of the Minibonds collateral. We welcome the final resolution for the vast majority of the Minibonds noteholders and the ex-gratia payment as a gesture of goodwill by the Banks.

7. PwC is expected to maintain high professional and ethical standards in discharging its duties as a receiver. It is obliged to act in the best interest of the noteholders and to maximise the value to be recovered from the Minibonds collateral. Furthermore, according to the final resolution proposed by the Banks, the Banks would offer eligible customers an ex gratia payment. Under this arrangement, the higher the value to be recovered from the relevant collateral, the smaller the amount of ex gratia payment will be borne by the Banks. The interests of the Banks and the Receiver are in line with that of the investors in maximising the value to be recovered from the Minibonds collateral. There is no divergent views on the matter. This ensures that investors’ interests will be safeguarded.

8. Therefore, we do not see the ground for the Administration and/or the regulators to engage another third party to value the Minibonds collateral. Engagement of another third party to do a valuation will only delay the process of collateral recovery.

Advice Sought

9. Members are invited to note our response in paragraphs 6 to 8 above.

Financial Services Branch, Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
Securities and Futures Commission
18 April 2011