

羅兵咸永道會計師事務所

PricewaterhouseCoopers
22/F, Prince's Building
Central, Hong Kong
Telephone +852 2289 8888
Facsimile +852 2810 9888
pwchk.com

12 May 2011

Legislative Council
Legislative Council Building
8 Jackson Road
Central
Hong Kong

CB(1)2169/10-11(01)

Attention: Ms Anita Sit, Clerk to Panel

Dear Sirs

**Panel on Financial Affairs
Follow-up to Special Meeting held on 21 April 2011
Lehman Brothers Minibonds Collateral Agreement and Related Issues**

Thank you for your letter of 3 May 2011.

Set out below is our response to question 1 in your letter which is addressed to us as Receivers of the collateral for series 10 to 12, 15 to 23 and 25 to 36 of Minibonds (the **Relevant Series**). We have not responded to those questions that are addressed to other attendees at the 21 April 2011 special meeting.

Capitalized terms used but not defined in this letter have the meaning given to them in the Notices of Meeting, an example of which was provided to you prior to the 21 April 2011 special meeting and which is attached again for your reference.

Response to Question 1

The difference between the current market value of the Underlying Collateral and the amount that will be paid to the Minibond holders under the settlement agreement entered into between (amongst others) the Receivers and various Lehman Brothers entities (the **Settlement**) is explained as follows:

1. A payment is required to be made to Lehman Brothers out of the Underlying Collateral in order to:
 - (i) satisfy the Issuer's contractual obligations to pay amounts to Lehman Brothers Special Financing Inc. (**LBSF**) under the terms of the top level Swaps, such payment obligations having priority over the claims of the Minibond holders in all circumstances; and
 - (ii) procure an unconditional release of all and any further claims that Lehman Brothers has against the Underlying Collateral, including the claim that amounts payable under the terms of the lower level swaps have priority notwithstanding the Flip Clause, which claims must be resolved by agreement or litigation before BNYM will release the Underlying Collateral and make it available for distribution to the Minibond holders.

2. The proportions payable to the Minibond holders vary for each Relevant Series and by tranches within such Relevant Series due to differences in the characteristics of the Swap contracts relating to each Relevant Series, causing the amounts payable to LBSF under the terms of the top level Swaps to vary due to differences in the:

- (i) the reference entities against which credit protection was sold;
- (ii) maturity dates; and
- (iii) the relevant currency denomination of each tranche.

The recovery for each Relevant Series has been calculated on the basis of the value of the Underlying Collateral for that Relevant Series less:

- (A) the amount payable to LBSF in respect of the top level Swap for that Relevant Series (as calculated by an independent expert engaged by the Receivers)¹, such amount being payable in priority to all of the Minibond holders' claims in any event; and
- (B) the remainder calculated on the basis of the relative value of the Underlying Collateral for each Relevant Series which is available for distribution to the Noteholders after deduction of the amount referred to in sub-paragraph (A) above.

Under the terms of the Settlement, the Receivers are required to keep the amount payable to Lehman Brothers strictly confidential. The Receivers understand that this is the position that Lehman Brothers have consistently adopted in other similar derivative settlements. The need to respect such confidentiality has recently been recognised in the Australian Courts². The Receivers are unable to disclose details of the calculations because to do so would breach the relevant confidentiality obligations under the Settlement.

Next Step

The next step in the collateral recovery process is for the Minibond holders to approve the Resolutions at each of the meetings convened for this purpose to be held on 18, 19 and 20 May. Subject to the requisite approval being obtained, the Settlement with Lehman Brothers will become unconditional. Thereafter, it is envisaged that the collateral will be released and available for distribution to Minibond holders in June of this year.

¹ It should be noted that LBSF's claims under the top swaps may substantially exceed these amounts based on LBSF's own calculations, but the Receivers have used independent calculations from a recognised market expert based on assumptions which the Receivers believe to be reasonable.

² The confidentiality of the settlement amount that was agreed between Lehman Brothers and Perpetual Trustees (in a matter based on a similar investment structure to the Minibonds) in December 2010 was upheld by the Federal Court in Australia in March 2011.

羅兵咸永道會計師事務所

Yours faithfully



Ted Osborn,

**Receiver acting as agent of Pacific International Financial Limited
without personal liability**