

SFC, HKMA and Citibank reach agreement on Lehman Brothers-issued market-linked notes and equity-linked notes

8 Jul 2011

The Securities and Futures Commission (SFC) and the Hong Kong Monetary Authority (HKMA) announced today that an agreement has been reached with Citibank (Hong Kong) Limited (Citibank HK) in relation to its distribution of market-linked notes (MLNs) and equity-linked notes (ELNs) issued by Lehman Brothers (collectively referred to as "LB Notes") between March 2007 and June 2008 (Notes 1, 2 & 3).

Without admitting any liability, Citibank HK has agreed to make a repurchase offer to eligible customers holding outstanding LB Notes distributed by Citibank HK at a price equal to 80% of the total value of each eligible customer's investment in the Notes (Note 4).

The total value of Citibank HK's repurchase offer is estimated to be about HK\$1.06 billion, covering about 92% of Citibank HK customers holding outstanding LB Notes (Note 5).

The offer price will exclude the amount of coupon already paid to eligible customers but include an additional amount representing the interest that would have been earned if the amount invested in LB Notes had been invested with Citibank HK on a fixed term deposit (Note 6).

Although Citibank HK's written guidelines to staff in relation to the sale of securities were comparatively sound and provided a foundation for compliance with key regulatory requirements, the SFC had a number of concerns regarding the bank's implementation and supervision of those guidelines and associated procedures and controls which posed risks that regulatory requirements would not be met.

Specifically, the SFC had concerns in the following areas:

- the adequacy of disclosure of credit risk of Lehman Brothers to customers;
- the sufficiency of the assessment of customers' experience and some customers' level of tolerance to risk for LB Notes, including risk profiling procedures before the purchase of LB Notes; and
- the overall monitoring of the sale process of LB Notes.

Under the repurchase scheme, Citibank HK will also pay top-up payments to those customers of outstanding LB Notes with whom Citibank HK has already entered into settlement agreements but would otherwise have been eligible to receive a repurchase offer to the extent that such payments are needed to ensure those customers are treated in the same way as other customers participating in the repurchase scheme.

In entering into this agreement under section 201 of the Securities and Futures Ordinance, the SFC has taken into account:

- Citibank HK's comparatively sound and detailed written guidelines and procedures in respect of risk disclosure and suitability assessment;
- LB Notes were less complex than credit-linked notes;
- there is no distributable collateral for the LB Notes. As such, there is less chance for LB Notes customers to receive any substantial payment or dividend in the Lehman Brothers bankruptcy proceedings (Note 7);
- the repurchase scheme will enable the great majority of LB Notes customers to receive a reasonable portion of what they invested without the costs and risks of separate legal proceedings;
- this outcome could not have been achieved through formal disciplinary action by the SFC against Citibank HK and/or its staff, even if such action was successful; and
- the agreement will bring the matter to an appropriate end for the benefit of Citibank HK and those customers who participate in the repurchase scheme.

"While sound internal guidelines dealing with what is required and expected in the sale of investment products is an essential compliance tool for intermediaries, adequate guidelines alone are not

sufficient. Good controls and supervision together with sound experience and judgement are needed to ensure recommended investment products are suitable for customers," the SFC's Acting Chief Executive Officer, Mrs Alexa Lam said.

"This outcome is a demonstrably good one for affected customers and brings the matter to an appropriate conclusion," she added.

Mr Arthur Yuen, Deputy Chief Executive of the HKMA, said, "The HKMA welcomes the resolution. The HKMA believes that this resolution is a reasonable and practical one and is in the interests of investors and in the public interest. Eligible customers are encouraged to consider the offers positively."

In view of the repurchase scheme, the SFC will not impose disciplinary sanctions against Citibank HK and its current or former officers or employees in relation to the distribution of LB Notes, save for any acts of dishonesty, fraud, deception or conduct that is criminal in nature.

The HKMA has also informed Citibank HK that it does not intend to take any enforcement action against their executive officers and relevant individuals in connection with the sale of LB Notes to customers who have accepted the repurchase offers or the top-up payments under the repurchase scheme, except for any acts of dishonesty, fraud, deception or conduct that is criminal in nature.

End

Notes:

1. Citibank HK is a registered institution under the Securities and Futures Ordinance (SFO) to carry on business in Type 1 (dealing in securities) and Type 4 (advising on securities) regulated activities.

2. MLNs and ELNs were issued by Lehman Brothers Treasury Co. B.V. and guaranteed by Lehman Brothers Holdings Inc. They were distributed by Citibank HK on a private placement basis with a minimum subscription amount of HK\$500,000.

3. MLNs were structured notes offered in USD/HKD/AUD/NZD with a tenor from 2.5 to 4.75 years. The potential return of MLNs was linked to the performance of the underlying equities, which might be a basket of stocks traded in Hong Kong, or some market indices. MLNs were principal protected, i.e. the issuer will pay back 100% of the principal amount to the investor at the maturity date.

In respect of ELNs, they were structured notes offered in USD/HKD/GBP with a tenor from eight months to one year. The potential return of ELNs was linked to the performance of a basket of stocks traded in Hong Kong. They were not principal protected and at maturity, they might be redeemed by the physical delivery of the worst performing stock at the strike price upon certain triggering events.

Both ELNs and MLNs were senior and unsecured debt obligations of the issuer. They were not backed by any collateral and subject to the credit risk of the issuer/guarantor.

4. Eligible customers are Citibank HK customers who have open position(s) in the LB Notes purchased through Citibank HK. Eligible customers will not include professional investors, corporate/non-individual investors and experienced investors, meaning Citibank HK customers who, in the three years preceding their first purchase of the LB Notes, executed five or more transactions in structured products and leveraged products or a combination of these products (please refer to the attached [FAQ](#)). The definition also excludes those customers who have previously settled claims in relation to LB Notes with Citibank HK.

5. Between March 2007 and June 2008, Citibank HK distributed 19 series of MLNs and 52 series of ELNs of which US\$204.7 million (equivalent to approximately HK\$1.60 billion) worth remains outstanding. The outstanding LB Notes are held by over 1,400 customers.

6. The calculation of the interest is based on the full nominal value of the customer's total investment in outstanding LB Notes, using the average of counter rates from Citibank HK on a 12-month USD time deposit for the period between the issue date of the relevant LB Notes and 30 June 2011, to be paid up to 30 June 2011.

7. In the unlikely event that it is determined at a later date that a customer accepting a repurchase offer would have received a greater amount as an unsecured creditor in the Lehman Brothers bankruptcy proceedings, Citibank HK has agreed to pay the difference to that customer, such that no customer shall be disadvantaged by participating in the repurchase scheme.

Page last updated : 1 Aug 2012

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Questions and answers about the Repurchase Scheme offered by Citibank (Hong Kong) Limited in relation to Lehman Brothers-issued Market Linked Notes and Equity Linked Notes

1. What is Citibank HK's Lehman Brothers-issued Market Linked Notes and Equity Linked Notes Repurchase Scheme?

The Repurchase Scheme is the result of an agreement between the SFC, the HKMA, and Citibank (Hong Kong) Limited (Citibank HK) pursuant to section 201 of the Securities and Futures Ordinance (SFO) to resolve the regulatory concerns of the SFC. Under the agreement and on a no admission of liability basis, Citibank HK agrees to make a repurchase offer to eligible customers holding outstanding market-linked notes (MLNs) or equity-linked notes (ELNs) issued by Lehman Brothers (collectively referred to as "LB Notes") distributed by Citibank HK at a price equal to:

- 80% of the total value of their investment in outstanding LB Notes:
 - less the amount of coupon payments already made to them as a result of holding of the LB Notes; and
 - plus interest calculated in accordance with FAQ 5 below between the issue date of the relevant series of LB Notes and 30 June 2011.

Citibank HK also agreed to offer top up payments to customers who had previously reached settlement with Citibank HK in relation to LB Notes and would otherwise be eligible for the repurchase offer but for the previous settlement they reached with Citibank HK in relation to their purchases of LB Notes.

2. What are those LB Notes covered in the Repurchase Scheme?

The Repurchase Scheme covers all LB Notes distributed by Citibank HK in Hong Kong between March 2007 and June 2008 that were outstanding (i.e. uncalled or unredeemed), at the time of the Lehman Brothers bankruptcy filing on 15 September 2008. A list of the LB Notes covered by the Repurchase Scheme can be found at this [link](#).

3. Who is eligible to receive a repurchase offer from Citibank HK?

A repurchase offer will only be made to customers who have open position(s) in the outstanding LB Notes purchased through Citibank HK but do not include customers who:

- (a) are professional investors or corporate/non-individual investors;
- (b) have in the three years preceding their first purchase of LB Notes, executed five or more transactions in Structured Products and Leveraged Products, or a combination of these products; or



- (c) have previously settled their claims in relation to the distribution of LB Notes with Citibank HK (see FAQ 6 below).

4. What are the meanings of Structured Product and Leveraged Product for determining eligibility for the Repurchase Scheme?

Under the Repurchase Scheme:

- “Leveraged Product” comprises exclusively: (i) foreign currency leveraged investment; and (ii) foreign exchange margin trading; and
- “Structured Product” comprises exclusively: (i) credit-linked notes, (ii) market-linked notes; (iii) equity-linked notes; and (iv) private placement notes, and does not include any listed securities.

5. How is the interest earned from fixed term deposit calculated?

The interest payment is calculated based on the full nominal value of the customer’s total investment in outstanding LB Notes using the average of counter rates from Citibank HK on a 12-month USD time deposit for the period between the issue date of the relevant series of LB Notes and 30 June 2011, to be paid up to 30 June 2011.

6. How about customers who had previously settled with Citibank HK in relation to LB Notes?

A top up payment will be made to each of the customers who had previously reached settlement with Citibank HK in relation to LB Notes and would otherwise be eligible for the repurchase offer but for the previous settlement they reached with Citibank HK in relation to LB Notes, to the extent that such payments are needed to ensure those customers are treated in the same way as eligible customers covered by the Repurchase Scheme.

7. On what terms can the repurchase offer be accepted?

On accepting a repurchase offer, customers will be asked to:

- give up all civil claims/discontinue legal proceedings against Citibank HK and/or its present and past officers and employees in relation to LB Notes; and
- withdraw complaints about LB Notes lodged with Citibank HK, the SFC, the HKMA, the Consumer Council and other relevant authorities (excluding the Police).

8. For a joint account, if only one of the joint account holders is an eligible customer, is the joint account entitled to a repurchase offer? How will the repurchase amount be apportioned?



The joint account is entitled to a repurchase offer in this case. The apportionment of the amount received is a private matter between the joint account holders.

9. Is it advisable to accept Citibank HK's repurchase offers?

Customers receiving Citibank HK's repurchase offer should carefully consider the terms of the offer, the conditions for acceptance, and their personal circumstances before deciding whether to accept the repurchase offer. If necessary, they should consider seeking independent professional advice before accepting the offer.

10. When will Citibank HK issue the repurchase offers/top up payment offers?

The Bank will, on or before July 22, 2011, send a notification letter on their eligibility of the Repurchase Scheme to clients with outstanding LB Notes bought from the Bank. The Bank will send to eligible clients an offer letter setting out details of their respective offer within 5 weeks of the date of the notification letter,

11. How does a customer accept or reject the repurchase offer/top up payment offer?

The steps for accepting or rejecting the repurchase offer/top up payment offer are set out in Citibank HK's offer letter. The acceptance form and rejection form will be enclosed with each offer letter.

A customer has 60 days to return the acceptance form or the rejection form to Citibank HK. If no acceptance form or rejection form is received by Citibank HK by the stipulated deadline, the customer is deemed to have rejected the repurchase offer/top up payment offer.

Customers may return the acceptance form or the rejection form to Citibank HK via the mail or deposit the forms with any Citibank HK branch office in Hong Kong.

12. Can the acceptance contained in the acceptance form be qualified?

No, any qualifications made in relation to the acceptance form will be treated as a rejection of the repurchase offer/top up payment offer.

13. Can a customer accept Citibank HK's repurchase offer in relation to some but not all of the LB Notes in which they purchased?

No, the customer cannot accept the repurchase offer/top up payment offer in respect of some but not all of the relevant series of LB Notes. Any acceptance of the repurchase offer/top up payment offer in respect of some but not all of the relevant series of LB Notes will be treated as a rejection of the offer.

14. What can a customer do if the offer is rejected?

An eligible customer who rejects a repurchase offer made under the Repurchase Scheme will not receive a repurchase payment. The rejection will not affect his/her pre-existing legal rights, if any. He/she may complain or maintain a complaint with



the HKMA. The HKMA will handle complaints made by eligible customers who reject a repurchase offer or LB Notes customers who are not eligible for an offer if it has not already done so. However, HKMA has no power to order a bank to pay compensation. A customer who wants to take their own action against Citibank HK should seek legal advice.

A rejection of the top up payment offer by a settled customer will not affect his/her rights and obligations under the settlement agreement previously entered into between him/her and Citibank HK.

15. What is the deadline for a customer to accept or reject the repurchase offer/top up payment offer?

Customers have 60 days from the date of the offer letter to consider Citibank HK's repurchase offer(s)/top up payment offer(s).

16. Will customers who are not eligible for the repurchase offers/top up payment offers be notified?

The Bank will, within 14 days, send a notification letter on their eligibility of the Repurchase Scheme to clients with outstanding LB Notes bought from the Bank. Customers who are not eligible for any repurchase offers/top up payment offers will be notified accordingly.

17. What if the date for accepting Citibank HK's repurchase offer/top up payment offer is missed?

If a customer decides to accept Citibank HK's repurchase offer/top up payment offer, he/she should do so within 60 days from the date of the offer letter. Otherwise the repurchase offer/top up payment offer will lapse except for customers who can provide a valid explanation as to why he/she was prevented from accepting the offer within the stipulated deadline.

If the customer can offer a valid explanation acceptable to Citibank HK, Citibank HK will treat the repurchase offer/top up payment offer as being open for acceptance for another 30 days. If the customer again fails to accept the repurchase offer/top up payment offer within the new deadline, the offer will lapse permanently.

18. If customers accept the offer, when will they receive the repurchase payment or top up payment?

Citibank HK has agreed to make payments within 30 days from the day Citibank HK receives a valid acceptance form from a customer and the payment will be paid into the customer's account with Citibank HK. In the case of persons who do not maintain an account with Citibank HK, they will be paid by cheque.

19. What is the currency of payment?

The payment will be made in Hong Kong Dollars, Australian Dollars, New Zealand Dollars, Pounds Sterling or US Dollars depending on the denomination of relevant series of LB Notes.



20. How does a customer contact Citibank HK in relation to the Repurchase Scheme?

If a customer who purchased LB Notes has any queries about the Repurchase Scheme (including his/her eligibility or the terms of the repurchase offer or top up payment offer) or any complaint about the way the Repurchase Scheme is administered, he/she should contact Citibank HK through:

Hotline: (852) 2860-0125

The hotline service is available from 9:00 a.m. to 5:00 p.m., Monday to Friday (except public holidays).