

From: Patricia GOMES
Sent: Friday, September 12, 2008 8:30 AM
To: Agnes Y L LAU; Chris K COMPTON; David BOYCOTT; Ed M FLANDERS; Edward J C G OULTON; Guy BRIDGE; Jack Vongkitbuncha; Joseph Travaglione; Martin NICHOLSON; Nicholas J TAYLOR; Priya KINI-BHALERAO; Rhydian H COX; Sander SLOTEMA; Shaleen MAHAR; Susan M SAYERS; Theron G WILLIAMS; Wan Thonh CHOW
Subject: Fw: Project Milan

Update on Project Milan:

Cat A and PSL in ASP - We have executed the cash deed to secure all HK and India facilities. The money will move into the secured account on tuesday morning, until then it is with HSBC MMK deposit. We can not move before that because the document was signed too late HK time today and monday is a public holiday so no HKD payments. Milan have indicated they will place \$153.85m in the HK deposit account (liabilities being secured are \$144.375m). On tuesday we will look to replicate and execute the cash deed for the Mauritius facility (\$20m).

Rgds,
P.

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cc

Subject
Re: Fw: Project Milan

Our Ref

Your Ref

To ASP insiders on Milan,

A) Milan has released preliminary 3Q results and strategic restructuring. Main points are:

- * Net loss (\$3.9bln)
- * MTM adjustment (net) of (\$5.6bln)
- * Shareholders Equity up to \$28.4bln from \$26.3bln
- * Net Leverage Ratio at 10.6x vs. 12.1x in Q2
- * Gross Leverage Ratio at 21.1x vs. 24.3x in Q2
- * \$42bln Liquidity Pool
- * Tier 1 at 11% vs. 10.7% in Q2
- * Significant reduction of assets: a) Residential mortgages down by 47% to \$13.2bln, b) Commercial Real Estate down by 18% to \$32.6bln, and c) High Yield Acquisition Finance down by 38% to \$7.1bln

Restructurings:

* Spin-off to Milan's shareholders of c. \$25bln - \$30bln of Commercial Real Estate assets via a new independent company "Real Estate Investments Global". Will not be subject to MTM. Lehman will inject the equity and initial funding which may then be syndicated into public markets once they normalise.

* Sell of 55% of the Investment Mgmt Division being negotiated (which includes Neureberger Berman) which is expected to contribute c. \$3bln of tangible book value

Market reaction:

* "Lehman gained almost 15 percent to \$8.95 at 8:57 a.m. in New York trading, while the cost to protect against a default by Lehman rose to a record.

Credit-default swaps on Lehman jumped 115 basis points to 590 basis points as of 8:08 a.m., according to broker Phoenix Partners Group. That surpassed a previous peak of 580 basis points in March after the collapse and emergency sale of Bear Stearns Cos. to JPMorgan Chase & Co."

B) Update on progress of Project Milan in ASP and new guidelines:

* We have today sent Milan a Cash deed document to secure all outstanding Cat A and PSL in HK and India. We will aim to have this signed by this Friday. In the meantime, \$147m has been placed on MMK deposit with HBAP HKH until Tuesday, 16th September.

* New trading guidelines have been received via Global FIG which will be implemented at open of play tomorrow morning in ASP:

1) We will give Milan 48 hours to execute the pending CSAs, post which there will be no more trading under lines that do not have CSA (in CSA'able jurisdictions).

2) For India (non-CSA'able jurisdiction) - we will put all non-plain vanilla, non-short term trading on refer to RM immediately with the view that no more longer term exposure is to be booked. We should keep any further trading to short term FX linked to our activity as custodian. Shaleen / Priya - Please give me a call at your open of play so we can discuss in detail. For HASE we will pass the same guidance, i.e. no non-plain vanilla, non-short term trading.

Furthermore we have been asked to review all Threshold amount on existing CSAs and bring these down to zero. As well as provide detailed information of all outstandings inclusive of MTM data to London on their business open tomorrow.

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Subject

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All,

In light of the recent events on Milan (downgrades, share price fall, etc), I just wanted to update the ASP team on where we are on Project Milan and securing our position in ASP:

* Yesterday HBEU finalised the negotiations and executed the cash deed document with Milan. We have received a copy overnight and are working to adapt it to the ASP specific case. We expect to have this document with Milan's ASP Treasurer today and will make every effort to have this signed and implemented for ASP by COB on Friday. In the meantime, the US\$147m (HKD equivalent) is sleeping with us overnight on MMK which the company continues to roll daily.

* We have not received any further guidance from Global FIG / CRF to chance our position in terms of trading, i.e. guidelines remain to continue trading within existing limits.

I will inform all as things progress and if there is any change to the guidelines issued.

Many thanks,
P.

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To: HSBC ASP insiders on Project Milan

We are now in dialogue with ASP Milan Treasurer who is cooperating with us on getting Project Milan executed in ASP.

Please find below the updated information on the status of Milan in Asia.
Again, I reiterate that the guidance received by senior mgmt globally is to action Cat A and PSL only at this stage and to leave all trading lines in

place, with global markets cat B / TSL operating in "business as usual" mode.

1) Hong Kong

- * \$20m MMK line has been cancelled.
- * \$13m Guarantee line - Milan has instructed us to cancel the gtee. We have given 10 business days notice (as per contract) to the HKFE upon which gtee will be cancelled and the line can be cancelled in our systems.
- * \$112.5m PSL line - We are working on cash deed document to secure this line. The goal is to have this in place by the end of the week (Sept 5). In the meantime Milan has been (and will continue) keeping MMK o/n deposits with HBAP (ranging from \$80m - \$180m).

[attachment "Milan HK Strategy by Business Line - v.2.doc" deleted by Patricia GOMES/IBH CIB/HBAP/HSBC]

2) India

- * \$195k Guarantee line to Milan Services - Milan has informed they will be placing cash collateral with HBAP India.
- * \$13.75m Guarantee line to Milan Securities (which is already 50% cash collateralised in HBAP India) - Milan has asked that the additional 50% cash collateral required by HSBC be placed in cash deposit in HBAP HK as part of cash deed document. We are working with legal on this as it will involve making the cash deed document into a multi-entity document on both sides and also an SBLC to be issued by HBAP HK to HBAP India due to exchange control regulations (reg capital has been consulted and advise is on no negative impact for HSBC).
- * \$50m PSL line to Milan Securities and Milan Capital - Utilisation on this line has actually been more around \$15-\$20m. Milan are to advise what figure they can work with and then place cash collateral. Milan have asked that same solution be adopted as for Gtee above, i.e. cash collateral be placed as part of same document in HK.

[attachment "Milan India Strategy by Business Line - v.2.doc" deleted by Patricia GOMES/IBH CIB/HBAP/HSBC]

3) Mauritius

- * \$20m PSL line for 3 Milan entities - We have informed Milan that we need cash collateral to continue operating the PSL. Again, Milan have asked that we include amount under HK cash deed. We are working with legal on this.

4) Indonesia, Singapore, Japan, Thailand

- * No action being taken as all global markets activities.

5) China

- * \$887k of fronting L/C from Milan Commercial Paper Inc in connection with CWT loan - no action being taken.

6) Documentation

After a full analysis of the documentation, we have found 2 gaps:

a) CSA between Lehman Brothers Inc and HSBC Hong Kong, Tokyo and Singapore branches. (A multibranch ISDA is already in place).

b) Amend the CSA between Lehman Brothers Special Financing Inc and HSBC (multibranch CSA) to include HSBC Bangkok. (mitigated by the fact that the MTM on HBAP Thailand's position is actually \$5m in favour of Milan).

Both the above negotiations have started and both sides are aware of their urgent nature.

There are 2 negotiations already under way which are closed to being finalised:

c) CSA for Lehman Brothers Finance SA and HSBC Hong Kong.

d) ISDA for Lehman Brothers Netherlands Horizons BV and HBAP India.

7) HASE

HASE exposure to Milan is:

(USDMio) Limit O/S

CAT A Nil Nil

NIC 3.5 0.7

XPR * 3.0 1.4

(* XPR represent CAT B limits captured in CRISP system including IRS and FX products)

No action will be taken at present. HSBC will inform HASE (Patrick K T Ip and Jack Tai Keung Cheung on insiders list of Milan) if guidance changes from senior mgmt.

8) Summary ASP credit position for HSBC

[attachment "Lehman Brothers - Credit Summary - v.2.xls" deleted by Patricia GOMES/IBH CIB/HBAP/HSBC]

Actions taken lately have reduced Cat A from USD 198.4m to USD 33.4m (the remainder of which we are looking to 100% cash collateralise).

Cat B remains at \$551m and Cat S at \$964m. Of this Cat S, \$182.5m is PSL which we will reduce and cash collateralise the remainder.

Please let me know if there are any questions. I will send further updates as appropriate.

Rgds,

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Subject
Project Milan

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All,

You should all be aware of Project Milan. In that context, please find attached the latest documents on:

a) Summary of Lehman credit limits in HBAP (still waiting for HASE)
[attachment "Lehman Brothers - Credit Summary.xls" deleted by Patricia
GOMES/IBH CIB/HBAP/HSBC]

b) HK exit strategy

[attachment "Milan HK Strategy by Business Line.doc" deleted by Patricia
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c) India exit strategy

[attachment "Milan India Strategy by Business Line.doc" deleted by Patricia GOMES/IBH CIB/HBAP/HSBC]

* I have a copy of all ISDA, CSA, OLSA, Guarantees documentation with me, as agreed with Theron and Agnes.

* I am having a conversation today with ASP Treasurer of Milan to agree ASP exit strategy and will keep the above informed of progress.

Many thanks,
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