

**3 JUNE 2009**

**UPDATE TO CLIENT MONEY FAQs:  
EXAMPLES & ADMINISTRATORS' VIEWS**

*amended on 5 June 2009*

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## 1 Introduction

- 1.1 On 1 May, 2009 the Administrators issued an application in the High Court (the “**Application**”) seeking directions on certain issues relating to the “client money” held by LBIE at administration, including in particular the “client money pool” created under CASS 7.9.6R (the “**CMP**”).
- 1.2 This update sets out practical examples illustrating issues raised in the Application. These examples are designed to assist potential client money claimants and general creditors of LBIE in determining whether they may be affected by the outcome of the issues raised in the Application and, therefore, whether they wish to appear as respondents to the Application. Many of the issues which have arisen are material because of the likely shortfall in the CMP caused by the possible loss of US\$1bn (due to the failure of Lehman Brothers Bankhaus AG (“**Bankhaus**”)) and by other potential shortfalls. Accordingly, many client money claimants will have an interest in trying to ensure that the CMP is increased to the largest size possible to give them the greatest recovery, whereas the interest of the general creditors will generally be to minimise payments out of the estate.
- 1.3 References to issues by number below are to the numbering of the issues in paragraph 1 of the Application (so that, for example, issue 6 is the issue set out in paragraph 1.6 of the Application).
- 1.4 On an issue by issue basis, it is often clear that one class of client money claimants/creditors is likely to argue for one outcome and another class of client money claimants/creditors for another. Examples of such classes would be unsegregated client money claimants, under-segregated client money claimants, segregated client money claimants and general creditors.
- 1.5 In this update, unless the context otherwise requires:
  - 1.5.1 “unsegregated client money claimants” means persons for whom client money ought to have been segregated but was not,
  - 1.5.2 “under-segregated client money claimants” means persons for whom an insufficient amount of client money was segregated, and
  - 1.5.3 “segregated client money claimants” means persons for whom the appropriate amount of client money was segregated.
- 1.6 A particular client may be a client money claimant for some claims and a general creditor for others. In addition, a client money claimant may be segregated for some money claims and not for others. Accordingly, the outcome which gives a particular client the greatest recovery may depend on the aggregate of that client’s positions and claims on LBIE’s estate. It may also depend not only on that client’s positions but those of all other clients in aggregate. Where this document indicates the outcome which a particular class of client money claimant or creditor would argue for, this should be read as the outcome which the Administrators consider a hypothetical client money claimant or creditor in that class would be likely to take where it had no other claims. It should be noted that the outcome most favourable to a particular client on one issue may also be dependent on the outcome of a different issue.

- 1.7** The Administrators' current views are set out below, based on the facts as currently known to the Administrators and on the basis of the legal advice they have received to date. It should be noted that these views are subject to change and, in any event, client money claimants, general creditors, their advisers and, ultimately, the Court may take a different view. Creditors/client money claimants should therefore seek their own legal advice where they consider it appropriate.
- 1.8** Pending confirmation of which creditors and client money claimants wish to make representations to the Court in the Application and in relation to which issues, the Administrators have not yet decided what role they will play in the Application. Their current preference would be to remain neutral, explaining the issues and practical consequences of particular arguments (if accepted) but without arguing for any particular outcome. However, to enable them to do that, there will need to be parties willing to represent all positions. A possible alternative approach would be for the Administrators to argue the position most favourable to the general creditors. In the circumstances, clients and creditors should not be deterred from expressing interest in making representations to the Court merely because their views coincide with the current views of the Administrators as expressed in this document.
- 1.9** Please note that the dates, figures and exchange rates used in the examples below are fictitious. However, the scenarios set out in the examples all either illustrate situations already encountered by the Administrators, or situations which the Administrators believe could arise. At page 35, the position of one of LBIE's actual clients is set out, although the numbers have been changed to protect client confidentiality.

## 2 Overview of Administrators' views

The table below provides an overview of the Administrators' current views on the issues. Clients and creditors should not rely on this overview as a substitute for reading the document in full, which they are encouraged to do.

Issue no	Brief description of issue	Administrators' current view
1 - 4	What client money is and is not part of the CMP.	The Administrators believe that all client money in LBIE's segregated client bank accounts and client transaction accounts is pooled, such that the total amount of money in the CMP is likely to be in excess of US\$2.17bn, although this will not be the total amount available to be distributed due to shortfalls.
[5]	<i>Not addressed in examples</i>	
6 & 7	Whether LBIE may withdraw money from the CMP in order to 'reimburse' itself for monies paid out immediately prior to administration.	The Administrators believe that LBIE is not now permitted to withdraw money from the CMP ahead of paying other clients their entitlements.
8	Whether LBIE must adjust the CMP to reflect changes in clients' net equity balances on margined transactions during the period between LBIE's last lock up of client money and the time of administration.	<u>Global Trader</u> suggests LBIE is required to adjust the CMP in these circumstances, but the Administrators are seeking directions from the Court in the context of LBIE's administration.
9	Whether LBIE must adjust the CMP to reflect other market movements during the period between LBIE's last segregation of client money and the time of administration.	<u>Global Trader</u> suggests LBIE is required to adjust the CMP to take account of changes in clients' net equity balances on margined transactions. If that is right, then the Administrators do not think it necessarily follows that adjustments for other market movements are also required and so are seeking directions on this issue.
10	Whether LBIE must now top-up the CMP for unsegregated monies.	<u>Global Trader</u> suggests LBIE is not required to top up in these circumstances, and the Administrators share that view.
11	Whether LBIE should top-up the CMP to reflect events that have occurred since the time of administration.	<u>Global Trader</u> suggests LBIE is not required to top up to take account of these changes, and the Administrators share that view.
[12]	<i>Not addressed in the examples.</i>	
13 & 14	Whether clients' entitlements or distributions should be reduced to reflect events that have occurred since the time of administration.	The Administrators believe that in circumstances where, for example, a client has (since administration) received the securities for which money was segregated at the time of administration, that client should either not have an entitlement or should not receive a distribution. In the case of other changes, the Administrators think the position is less clear.
15	Whether a client for whom some client money was segregated can claim against the CMP for both the client money which was segregated and the money that was not.	The Administrators believe clients' entitlements should be calculated on a position by position basis and that clients should only have an entitlement where money for a particular position was segregated.
16	Whether clients who were not entitled to client money protection but for whom LBIE segregated money as client money have a client money entitlement against the CMP.	The Administrators believe such clients should have a client money entitlement against the CMP but only in respect of money which was clearly identified as having been segregated for them.
17	Whether unsegregated clients for whom identifiable money exists outside of the CMP have a client	The Administrators do not believe such clients have a client money entitlement against the CMP. If clients are

	money entitlement against the CMP.	able to trace, then the Administrators believe those clients may be able to recover that money in full.
18	Whether clients who were at one time segregated but were wrongly desegregated prior to administration have a client money entitlement against the CMP.	The Administrators do not believe such clients have a client money entitlement against the CMP but they recognise that <u>Global Trader</u> did not definitively resolve this issue.
19	Whether unsegregated clients (for whom no identifiable money exists outside of the CMP and who were never segregated) have a client money entitlement against the CMP.	<u>Global Trader</u> suggests that such clients do not have a client money entitlement against the CMP and the Administrators share this view.
20	Whether, where LBIE segregated money for a client's underlying clients but not for that client's proprietary positions, that client has a client money entitlement against the CMP in respect of its proprietary positions.	The Administrators do not believe that such clients have a client money entitlement against the CMP in respect of their proprietary positions in these circumstances.
21	At what time and date should clients' client money entitlements against the CMP be calculated.	In <u>Global Trader</u> , clients' client money entitlements against the CMP were calculated at the time of administration and the Administrators believe this approach should be adopted in LBIE's administration.
22	Whether LBIE may calculate client money entitlements against the CMP in a common currency of its choice by applying an appropriate spot rate of exchange.	As the majority of the monies constituting the CMP and clients' client money entitlements against the CMP are in US Dollars, the Administrators consider that the conversion of claims into US Dollars at the spot rate prevailing at the time of administration will facilitate efficient distribution.
23	How clients' client money entitlements against the CMP should be calculated and in particular: - whether they are to be calculated by reference to the amount contained in the CMP in respect of each client; and - whether, in calculating clients' 'individual client balances', a client's liabilities to LBIE should be taken into account.	The Administrators believe that: - a client's client money entitlement against the CMP should be calculated by reference to the amount which LBIE's books and records show as having been segregated for a particular client; and - LBIE should be permitted to offset money owed by a client to LBIE in certain circumstances.
24	Whether LBIE may distribute the CMP in the currency of its choice.	In circumstances where the majority of the monies constituting the CMP and clients' client money entitlements against the CMP are in US Dollars, the Administrators consider that distribution in US Dollars will be the most efficient means of distribution.
25	How LBIE should calculate the amount to be distributed to each client.	The Administrators propose to calculate clients' distributions by: - calculating what rateable proportion of the CMP a client is entitled to receive (having converted all clients' claims into a notional Dollar amount as at the time of administration); and - calculating the value of the CMP (which is held in multiple currencies) by converting it into a notional Dollar amount as at the time of distribution.
26 & 27	Whether LBIE's affiliates were entitled to client money protection.	This issue is only of relevance to this application if the Court determines that LBIE is under an obligation to top-up the CMP for unsegregated clients (Issue 10) or that unsegregated clients nevertheless have a claim against the CMP (Issue 19). Given the Administrators' views on these issues, they do not believe the affiliates will have a valid claim against the CMP for their own unsegregated monies.

## Identification of the client money pool

### 3 Issues 1 - 4

- 3.1** Issues 1 – 4 deal with identifying which client money is and is not part of the CMP. The following example illustrates why this is important.
- 3.2** LBIE held client money in the following accounts:
- 3.2.1** up to 21 bank accounts, which were regularly included in LBIE's client segregation system which LBIE used in performing its daily reconciliation of client money;
  - 3.2.2** approximately 300 bank accounts, which LBIE broadly treated as client segregated accounts, 26 of which were held in the names of subsidiary nominee companies, instead of LBIE; and
  - 3.2.3** transaction accounts across 10<sup>1</sup> different exchanges/clearing houses which were used only for trading undertaken by LBIE on behalf of its clients.
- 3.3** If all of these are "client money accounts" under CASS 7.9.6R, then the total amount of money in the CMP (subject to any shortfall and any adjustments required) is likely to be in excess of US\$2.17bn. If, however, only those accounts referred to in paragraph 3.2.1 above constitute "client money accounts", then the total amount of money in the CMP (again subject to any shortfall and any adjustments required) will be in the region of US\$1.89bn.
- 3.4** It is probable that LBIE also held client money in its 'house' accounts. At least some client money will be identifiable in a house account (because, for example, it was received so shortly before the time at which the Administrators were appointed).
- 3.5** If the Court were to hold that house accounts containing client money as at the time of the administration were 'client money accounts' (at least to the extent of the client money contained in them), then the total amount of client money in the CMP could be more (depending on how much 'client money' was ultimately identified in the house accounts). Alternatively, the Court may conclude that where client money is identifiable in a house account, such client money does not form part of the CMP but a client can trace that money in the house account and claim it in full.
- 3.6** **Comment:** Issues 1 to 4 deal with the scope of the CMP, i.e. which client money in which accounts constitutes the CMP. The Application identifies various types of account which may or may not be client money accounts. In some cases the Administrators consider that the status of the accounts is clear (as being client money accounts or not, as to which, see below), but are nevertheless seeking the Court's confirmation in view of the amount of money involved. In general, client money claimants will have an interest in arguing that as much client money should be in the CMP as possible so as to maximise their share of that CMP. However, a client money claimant who is able to point to identifiable client money held in a house account may prefer to argue that the house account (and all sums in it) be excluded from the CMP, leaving the client free to assert a claim to trace that money and recover it in full (rather than have it form part of the CMP and share in the likely

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<sup>1</sup> In paragraph 58 of Andrew Clark's first witness statement, reference was made to LBIE operating client transactions across eight clearing houses and brokers. In fact, this should have been a reference to ten clearing houses and brokers.

overall shortfall on the CMP). General creditors will wish to resist both claims with a view to keeping such money as part of the estate.

### **3.7 Administrators' current view:**

It is the Administrators' current view that:

- 3.7.1 client bank accounts and client transaction accounts are "client money accounts" under CASS;
- 3.7.2 all bank accounts which LBIE treated as client segregated accounts constitute "client bank accounts";
- 3.7.3 if any account is not a "client bank account" by reason only of the fact that it was opened in the name of a nominee company, then it is nevertheless a "client money account"; and
- 3.7.4 where a clearing house or intermediate broker maintained separate accounts for LBIE's proprietary and client transactions then the account for client transactions is a "client transaction account"; but where the clearing house or intermediate broker operated a single account for all of LBIE's trading (whether proprietary or client trading), then that account is not a "client transaction account".

Accordingly, the total amount of client money in the CMP (subject to any shortfall and any adjustments required) is likely to be in excess of US\$2.17bn.

## 4 Issues 6 and 7

**4.1** Issues 6 and 7 deal with the question of whether LBIE may withdraw money from the CMP in order effectively to reimburse itself for money paid out from LBIE's house accounts to its clients in the period immediately prior to administration. In the ordinary course, this money would have ceased to have needed to be segregated as client money and so been moved by LBIE to its house accounts on 15 or 16 September<sup>2</sup>. However, as a result of the administration, this did not occur.

**4.2** Issues 8, 9 and 11 are related, as they address the question of whether the CMP can be adjusted to take account of other events which have occurred since the time at which LBIE last adjusted the CMP prior to administration.

### **4.3 Examples:**

- On 11 September, LBIE received a US\$50 dividend on stock held for Client A, a custody client. It then segregated US\$50 as client money for Client A on 12 September. However, after LBIE had already segregated US\$50, Client A instructed LBIE to pay the money out to Client A's bank. LBIE paid US\$50 out of other accounts to Client A on the afternoon of 12 September. In the ordinary course, LBIE would have been entitled to withdraw the US\$50 from the client money accounts to reimburse itself on 15 September.
- On 10 September, LBIE settled a sale of securities for Client B, a custody client, for US\$200. Whilst awaiting instructions from Client B as to where to pay the proceeds of sale, LBIE segregated US\$200 as client money on 11 September. On 12 September, Client B instructed LBIE to pay the proceeds to Client B's bank, which it did, making the payment from other accounts on the afternoon of 12 September. In the ordinary course, LBIE would have been entitled to withdraw the US\$200 from the client money accounts to reimburse itself on 15 September.

**4.4 Comment:** The issue is whether the money which would have been withdrawn by LBIE on, say, 15 September may now be withdrawn. (The question of whether the individual clients in respect of whom the money was segregated have a claim in respect of the full amount that had been segregated is addressed elsewhere: in some cases, the Administrators believe that it will be clear (once the Court has given directions on Issues 13-14 and 23) that such clients have no claim against the CMP for the amount that had been segregated by LBIE.) If the money can now be withdrawn by LBIE, that would benefit the general creditors. On the other hand, if it must remain within the CMP, then it will benefit the other client money claimants – even though LBIE has a claim on the CMP for this money, its claim ranks behind the claims of clients under CASS 7.7.2R.

**4.5** If money can now be withdrawn from the CMP, then issue 7 addresses the question of how much of the money can be withdrawn. The general creditors will wish to support withdrawal of the full amount of money due, whereas the client money claimants will wish to restrict withdrawal to a pro rata share (i.e., taking into account all shortfalls in the CMP) or to traceable money if this would yield a lesser amount.

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<sup>2</sup> All dates referred to are to 2008 unless otherwise stated.

- 4.6** The total amount that LBIE would, in the ordinary course, have been entitled to withdraw from its client money accounts on 15/16 September in scenarios such as those set out above is currently estimated to be in the region of US\$45m. In other words, if LBIE is now entitled to deduct the full amount, that would result in a reduction of the amount of money available to be distributed to claimants by US\$ 45m. If, however, LBIE is only entitled to withdraw a pro rata amount from the CMP taking into account any shortfall, then this would result in a reduction of around US\$22.5m (assuming a shortfall of US\$1bn in a US\$2bn CMP). If LBIE is not entitled to withdraw any money, then in effect the client money claimants will recover a higher percentage of their client money.
- 4.7 Administrators' current view:** The Administrators believe that the better interpretation of CASS is that LBIE is not now permitted to withdraw money from the CMP, ahead of paying other clients their entitlements. However, in Global Trader<sup>3</sup>, Sir Andrew Park said<sup>4</sup> that if there had, between the time at which the company performed its final reconciliation and the time at which administrators were appointed, been a net decrease in the credit balances of segregated clients, he would have ordered a transfer from the client bank accounts to the house accounts. In these circumstances, the Administrators have been advised that the point is not beyond doubt, and so are seeking the Court's directions on it.

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<sup>3</sup> Re Global Trader Europe Limited (in liquidation) [2009] EWCH 602 (Ch). In common with the situation faced by LBIE, there was a timing gap between the last reconciliation performed by Global Trader Europe Limited ("**Global Trader**") and the time at which the administrators were appointed. In Global Trader, the last reconciliation was carried out (using the normal approach provided for in CASS) at the close of business on 14 February 2008 and the administrators were appointed at 12:56pm on 15 February 2008. However, the only issue which required to be determined in Global Trader was whether movements in the notional value of margined transactions required an adjustment to the CMP, which is a question addressed in Issue 8.

<sup>4</sup> At paragraph 116 of the judgment.

## 5 Issue 8

**5.1** Under CASS, LBIE was (broadly) required to segregate as client money an amount equal to its clients' net equity balances on certain margined derivative transactions (i.e. the amount which, ignoring non-cash collateral, would have been owed by LBIE to a client if the client's margined derivative positions had been closed out). However, the last time that LBIE itself segregated any money for such balances was on 12 September, based on close of business positions on 11 September. And so, no money was segregated by LBIE for any net increase in clients' net equity balances between then and administration. Likewise, LBIE did not withdraw any money from the CMP in relation to any net decrease in clients' net equity balances. Issue 8 deals with the question of whether LBIE is now obliged to adjust the CMP to reflect net increases/decreases in its clients' net equity balances over this period. The scenario set out below illustrates this issue.

**5.2** Note that where money was segregated for margined transaction clients in client transaction accounts, the balances on those accounts would have continued to be adjusted to reflect market movements and other events following close of business on 11 September. Accordingly, movements in the net equity balances of a significant number of LBIE's margined transaction clients continued to be captured up to and following the time of administration. Issue 8 is therefore concerned only with margined transaction clients for whom money was not segregated in client transaction accounts.

### **5.3 Examples:**

- Client C had a portfolio of open Eurex-traded, margined transactions with LBIE. The net equity balance on this portfolio (as at close of business on 11 September) was US\$500. On 12 September, LBIE segregated US\$500, being an amount equal to Client C's net equity balance. Over the course of 12 September, Client C's net equity balance increased to US\$600 (with some positions increasing in value, while others decreased). In the ordinary course, LBIE would have segregated an additional US\$100 as client money on 15 September to reflect this increase. As the administration intervened, it did not do so, and accordingly, the amount segregated at administration in respect of Client C's margined transactions was less than Client C's net equity balance at administration.
- In addition to the market movements described above, Client C withdrew US\$200 in cash from its margined transaction account with LBIE on 12 September. LBIE paid Client C this amount out of a house bank account. Taking the above market movement and the withdrawal into account, in the ordinary course, LBIE would have moved US\$100 from its client money accounts back to its house accounts on 15 September.

**5.4 Comment:** During the period between close of business on 11 September and the time of administration, some clients' account balances for margined transactions increased, while others decreased. These movements will have been caused by a combination of changes in free cash balances, margin amounts and market movements. Overall, during the course of Friday 12 September, clients' net equity balances for margined transactions decreased in value on a net basis by nearly US\$300m. The Administrators do not currently have figures for these account

balances as at the time of administration, but it is believed that, on an overall net basis, their values would likely have reduced further between 12 September and the time of administration.

- 5.5** General creditors would normally wish to argue that LBIE should now be entitled to withdraw money from the CMP to reflect any net decrease in clients' net equity balances on relevant margined derivative transactions so that that money is available to the estate. Client money claimants will wish to oppose such a view, since any withdrawal will reduce the size of the CMP and the amount they will receive in due course by way of distribution.
- 5.6 Administrators' current view:** As noted above, Global Trader provides some support for the view that a withdrawal may be made from the CMP in these circumstances. However, the circumstances in Global Trader were somewhat different, since they concerned a top-up to the CMP rather than a withdrawal. In addition, the factual context in which the question arises in the context of LBIE's administration is much more complicated than the circumstances considered by Sir Andrew Park, and the sums in issue are large and will have a substantial effect on the size of the CMP and thus the amount of the distribution which will be made in due course to those clients entitled to share in it. For these reasons, the Joint Administrators are inviting the Court to give further consideration to Issues 8, 9 and 12 (insofar as it relates to them) rather than simply seeking to rely on such guidance as is provided by the decision in Global Trader.

## 6 Issue 9

**6.1** Issue 9 deals with the question of whether LBIE is now obliged to pay further money into, or is entitled to withdraw money from, the CMP to reflect events on 12 September and prior to administration (other than those dealt with under Issue 8). The following scenarios illustrate examples of possible increases/withdrawals due to other events.

### 6.2 Examples:

- On 11 September, LBIE received a CHF50 dividend on Swiss shares held in custody for Client D. LBIE then segregated US\$45 as client money for Client D on 12 September (i.e., having translated the CHF50 receipt into USD at a spot FX rate of US\$1:CHF1.1). On 12 September, the Swiss Franc increased in value against the US Dollar to US\$1:CHF1. In the ordinary course, LBIE would have segregated an additional US\$5 as client money on 15 September to reflect this increase. As the administration intervened, it did not do so, and accordingly, the amount segregated at administration in respect of Client D's CHF dividend was less than it would otherwise have been.
- On 10 September, LBIE was due to settle a purchase of 100 securities for Client E. Client E paid LBIE the purchase monies of US\$400 on 10 September. As LBIE had agreed contractual settlement with Client E, it credited Client E's securities account with LBIE with 100 securities. However, on reconciling its custodian/depot accounts, LBIE discovered that it had only received 90 securities for Client E, not 100 (a so-called 'depot break'). So, to protect Client E while it resolved this, LBIE segregated US\$40 (the value of the missing 10 securities) as client money on 11 September. On the afternoon of 12 September, LBIE received sufficient securities to resolve the 'depot break'. In the ordinary course, LBIE would have been entitled to withdraw the US\$40 from the client money accounts on 15 September.
- On 11 September, LBIE segregated Euro 40 in respect of a depot break for Client F representing 20 missing securities. During 12 September, the value of these securities increased from Euro 2 each to Euro 2.5. In the ordinary course, LBIE would have adjusted the money segregated by it such that the amount held for Client F would have been shown as having increased to Euro 50 on 15 September.

**6.3 Comment:** The Administrators do not currently know the overall value of these events as at the time of administration. However, during the course of 12 September, it appears that:

- 6.3.1** US\$2.6m worth of the US\$7.8m segregated by LBIE for fails were resolved and the Administrators believe it likely that further fails would have been resolved during the course of the weekend of 13/14 September; and
- 6.3.2** Nearly US\$138m worth of depot breaks were resolved and the Administrators believe that it likely that further depot breaks would have been resolved during the course of the weekend of 13/14 September.

- 6.4** However, it is also likely that new fails and depot breaks would have occurred during the course of 12 September for which LBIE would not have segregated money prior to administration.
- 6.5** Pending confirmation of the legal position, the Administrators have not calculated details of currency movements in respect of client money received by LBIE in one currency and segregated by it in another for any part of the period between close of business on 11 September and the time of administration.
- 6.6** For these reasons, the Administrators are not presently able to calculate whether the net effect of these types of events which occurred on 12 September and prior to administration would in the ordinary course have required LBIE to increase the amount of money segregated by it as client money on 15 September for the above situations or whether it would have entitled LBIE to reduce that amount.
- 6.7** **Administrators' current view:** Global Trader provides support for the view that adjustments should be made to take account of changes in clients' net equity balances on their margined transactions for the period between close of business on 11 September and the time of administration. However, it does not necessarily follow that similar adjustments should be made to take account of other changes or events during the same period and so the Administrators are seeking directions on this issue.

## 7 Issue 10

**7.1** Issue 10 deals with the question of whether LBIE is now obliged to segregate money which it should have segregated prior to administration, but did not. The following are examples of situations where the Administrators are aware that failure to segregate occurred or may<sup>5</sup> have occurred:

### **7.2 Examples:**

- Affiliate 1 engaged in futures and options trading with LBIE for its own account. Although LBIE would ordinarily segregate certain amounts as client money in relation to margined derivative transactions with its clients, it did not do so for Affiliate 1.
- Affiliate 2 engaged in futures and options trading with LBIE for the account of its underlying customers. Although LBIE segregated certain amounts as client money in relation to margined derivative transactions for some of these underlying customers, it did not do so for all such customers.
- Affiliate 3 engaged in a series of financing transactions (e.g. repurchase agreements) with LBIE. Cash amounts appear to have fallen due and payable between the parties from time to time. While some payments may have been made between the parties; others were not. LBIE did not segregate as client money any unpaid amounts which were due and payable by it to Affiliate 3.
- Client G entered into an OTC equity swap with LBIE under an ISDA master agreement. Client G provided cash as margin for its obligations under the swap. This was provided under a total title transfer arrangement (pursuant to CASS 7.2.3R) and so was properly not segregated as client money. The swap subsequently increased in value for Client G, and was still open and in-the-money as at the time of administration. LBIE had not segregated any client money in respect of the unrealised gain on the swap, such gains being arguably not caught by any total title transfer arrangement.
- LBIE purchased securities from Client H on 4 September. It was due to settle the purchase on 8 September, by paying GBP250 to Client H's bank. LBIE procured an affiliate to pay the money to the bank, but without indicating to which account the money should be credited. The bank returned the money to the affiliate which recognised in its records that the money was related to a client of LBIE's. LBIE did not then process a further payment, nor did it segregate an equivalent amount to the unpaid purchase monies prior to administration.

**7.3** Please note that in relation to some clients, LBIE relied on CASS 7.2.3R, which provides that money is not client money where full ownership is transferred as collateral. Certain of LBIE's client documents contained a provision seeking to rely on this rule and additionally certain letters were sent to clients also seeking to rely on this rule. Where reliance was properly placed on this rule, there would have been no obligation to segregate any money and hence no failure to do so.

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<sup>5</sup> For example, in the case of affiliates, it is not clear whether money ought to have been segregated at all. See Issues 26 and 27.

- 7.4 Comment:** Client money claimants whose money was not segregated at all (or was under-segregated) may wish to argue that LBIE should top-up the CMP for such monies. General creditors will generally wish to oppose such top-up.
- 7.5** Overall, the amounts which LBIE arguably should have segregated, but did not, run into billions of US Dollars.
- 7.6 Administrators' current view:** Global Trader indicates that a top-up is not required in these circumstances. The Administrators consider that this is the correct interpretation of CASS on this point, and intend not to top-up the CMP for these amounts unless the Court directs them to do so.

## 8 Issue 11

**8.1** Issue 11 addresses the question of whether LBIE should add further money to the CMP because of events which have occurred since administration. The following examples are illustrations of such events.

### **8.2 Examples:**

- On 12 September, LBIE segregated US\$100 of client money in respect of Client I's net equity balance for futures as at close of business on 11 September. Client I's net equity balance did not change in the period between close of business on 11 September and the time of administration. However, Client I's futures increased in value on 15, 16 and 17 September, when they were all closed out vis-à-vis LBIE under the exchange's default rules. The closing cash balance was US\$130.
- On 12 September, LBIE segregated US\$200 of client money for Client J, a custody client. This represented the proceeds of the sale of a bond, denominated in Norwegian Kroner. The sale proceeds had been NOK1,200, but LBIE had segregated in US Dollars (at an exchange rate of US\$1:NOK6, being the appropriate spot exchange rate as at close of business on 11 September). The value of the Norwegian Kroner against the Dollar stayed constant between close of business on 11 September and the time of administration. However, subsequent to the time of administration, the Norwegian Kroner increased in value against the US Dollar – to an exchange rate of US\$1:NOK5.
- On 12 September, LBIE had segregated US\$40 of client money for Client K in relation to a depot break – the US\$40 represented 5 securities worth US\$8 each as at close of business on 11 September. The value of these securities did not change during the period between close of business on 11 September and the time of administration. However, since the time of administration, the securities have now increased in value to US\$10 each.

**8.3 Comment:** Client money claimants for whom the amount of client money segregated by LBIE appears to be inadequate due to events after the administration may wish to argue that LBIE should top-up the CMP for such amounts. General creditors will generally wish to oppose such top-up. The Administrators cannot currently calculate the values of any such top-ups – for example, the CMP continues to be subject to currency movements. This issue of withdrawals or reductions in clients' entitlements to take account of post-administration events is addressed in Issues 13 and 14 referred to below.

**8.4 Administrators' current view:** Global Trader indicates that no adjustment is required in these circumstances. In that case, Sir Andrew Park held that when a client's position was closed at a profit to the client, a contractual debt became owed by Global Trader to the client, but the amount equal to the profit did not thereby become client money.<sup>6</sup>

**8.5** The Administrators currently consider that the correct interpretation of CASS on this point does not require the CMP to be adjusted (by top-up or withdrawal as the case

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<sup>6</sup> See paragraph 127 of the judgment.

may be) to take account of post-administration events or developments and so the Administrators do not therefore propose to do so unless the Court directs them otherwise.

## 9 Issues 13 and 14

**9.1** Issues 13 and 14 address the question of whether the amount of client money from the CMP which a client is entitled to receive is or should be reduced because of events which have occurred since administration.

### 9.2 Examples:

- On 12 September, LBIE segregated US\$100 of client money in respect of Client L's net equity balance for futures as at close of business on 11 September. Client L's net equity balance did not change between close of business on 11 September and the time of administration. However, Client L's futures declined in value on 15, 16 and 17 September, when they were all closed out vis-à-vis LBIE under the exchange's default rules. The closing cash balance was US\$50.
- On 12 September, LBIE segregated US\$500 of client money for Client M, a custody client, representing the proceeds of the sale of a bond, denominated in Norwegian Kroner. The sales proceeds had been NOK3,000, but LBIE had segregated in US Dollars (at an exchange rate of US\$1:NOK6 being the appropriate spot exchange rate as at close of business on 11 September). The value of the Norwegian Kroner against the Dollar stayed constant between close of business on 11 September and the time of administration. However, since the time of administration, the Norwegian Kroner has decreased in value against the US Dollar – to an exchange rate of US\$1:NOK7.
- On 12 September, LBIE segregated US\$80 of client money for Client N in relation to a depot break – the US\$80 represented 8 securities worth US\$10 each (being the value of those securities as at close of business on 11 September). The securities did not change in value between close of business on 11 September and the time of administration. However, since the time of administration, the securities have decreased in value to US\$5 each.
- On 12 September, LBIE had segregated US\$100 of client money for Client O in relation to a depot break – the US\$100 represented 10 securities worth US\$10 each (being the value of those securities as at close of business on 11 September). The securities did not change in value between close of business on 11 September and the time of administration. However, following administration, the depot break was resolved – the securities were located and delivered to Client O.

**9.3 Comment:** This is effectively the same issue as in the examples set out under Issues 8 and 9, but the relevant events occur after rather than before administration. Where the client does not have a claim (or the claim is reduced), the next issue is whether LBIE may now withdraw the money from the CMP. If it can now be withdrawn, that would benefit the general creditors. On the other hand if it must remain in the CMP, it will benefit the other client money claimants – even though LBIE has a claim on the CMP for this money, its claim ranks behind the claims of the clients under CASS 7.7.2R and, given the likely shortfall on the CMP, it is unlikely that LBIE would receive anything.

- 9.4** If money can now be withdrawn from the CMP, then Issue 7 addresses the question of how much of the money can be withdrawn. The general creditors will wish to support withdrawal of the full amount of money due whereas the client money claimants will wish to restrict withdrawal to a pro rata share (i.e. taking into account shortfalls) or to traceable money if this would yield a lesser amount.
- 9.5** It is not currently possible to place a value on all of these events, since some (such as currency movements and the values of securities against which LBIE segregated money) continue to change. However, in relation to futures (all of which have now been closed-out), the Administrators currently estimate the overall reduction in value from the time of administration to the time of close out to be in the region of US\$200m. Accordingly, if LBIE were to be entitled to deduct either the full amount or a pro rata amount from the CMP, this could reduce the amount of money available to be distributed to claimants significantly. If LBIE is not entitled to withdraw any money, then in effect the client money claimants will recover a higher percentage of their client money.
- 9.6** **Administrators' current view:** The Administrators believe that these examples raise difficult issues – in some cases (e.g. where a client's depot break has been resolved), the client should not have a claim on the CMP for the amount of money segregated, as this would otherwise result in the client recovering twice. However, it is less clear that this is the correct result in other situations. As a result, they do not propose to make any deductions unless the Court directs that such deductions are permitted.
- 9.7** Global Trader provides only limited guidance. Sir Andrew Park held that, where clients' positions had closed at a value less than the notional value as at the time of administration, with the result that those clients were constituted debtors of Global Trader in the amount of the post-appointment fall in the value of their positions, the liquidators could set off those losses against the distributions to those clients out of the segregated fund.<sup>7</sup> His conclusion was based on the terms and conditions on which Global Trader traded. Sir Andrew Park referred in his judgment to setting off sums referable to adverse movements in the value of positions against the deductions which would otherwise have been made from the CMP. However, the Administrators question whether the reliance on Global Trader's contractual terms should not have resulted in the set-off being made against the client's client money entitlement. Done this way, the client would have received a distribution calculated by reference to the resulting net figure, rather than a deduction from the distribution from the CMP in the full amount of any adverse movement.
- 9.8** In the circumstances, the Administrators propose to invite the Court to consider this issue in light of the more complex and difficult facts of the LBIE administration.
- 9.9** For whose benefit the sums withheld from clients with a client money entitlement should accrue may turn upon whether the post-administration events are taken into account at the point of calculation of client money entitlements or at the time of distribution (as explained in paragraph 105 of Mr Clark's witness statement of 14 May 2009). It would seem to follow from Sir Andrew Park's judgment (where he points out that CASS 7.9 makes no provision "*for the relative entitlements of the segregated beneficiaries to the pooled money to be changed by reference to events*")

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<sup>7</sup> See paragraph 145 of the judgment.

*occurring after that date*<sup>8</sup>) that any amounts withheld from client money claimants by reason of events which have occurred since the time of administration should accrue in favour of the general estate. This seems to the Administrators to be a logical approach, particularly in those circumstances where the post-administration event included the transfer-out of an estate asset, such as delivery under a previous fail, or purchasing in of securities subject to a depot-break.

- 9.10** As to the supplemental issue of how much, if anything, may be withdrawn, the Administrators' current view is that only a pro rata share of the money could be withdrawn. In effect the estate would share in the shortfall on the CMP.

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<sup>8</sup> See paragraph 129 of the judgment.

## Calculation of client money entitlements

### 10 Issue 15

**10.1** Issue 15 deals with the question of the extent of a client's client money entitlement in circumstances where money was properly segregated for one position, but not in relation to another. Put another way: can a client for whom some client money was segregated claim against the CMP for both the client money that was segregated and the money that was not? The following are examples of this issue.

#### 10.2 Examples:

- LBIE purchased securities from Client Q in two tranches. LBIE was due to settle the first tranche on 4 September, by paying GBP500 to Client Q's bank. LBIE procured an affiliate to pay the money to the bank, but without indicating to which account the money should be credited. The bank returned the money to the affiliate which recognised in its records that the money was related to a client of LBIE's. However, LBIE did not process the payment again, nor did it segregate an equivalent amount as client money prior to administration. The second tranche was due to settle on 9 September, with LBIE to pay a further GBP300 to Client Q's bank. At the client's request pending a currency conversion, LBIE segregated the GBP300 as client money. Accordingly, as at the time of administration, Client Q was unsegregated in respect of the proceeds which were due to it in connection with tranche one, but segregated in respect of the proceeds which were due to it in connection with tranche two.
- Client R traded in OTC options with LBIE. Cash provided by Client R in connection with its options trading was provided under a total title transfer arrangement (pursuant to CASS 7.2.3R) such that LBIE was not required to segregate such money as client money. As a result of this arrangement, LBIE believed that it did not need to segregate client money in respect of Client R's unrealised profit on its open options positions. It is possible that that interpretation could be open to challenge. Client R also traded in exchange-traded futures with LBIE. Cash provided by Client R in connection with its futures trading was not subject to any total title transfer arrangement and so it was segregated by LBIE. As at the time of administration, therefore LBIE had segregated money in respect of Client R's net equity balance for futures and nothing in respect of Client R's unrealised profit on its open option positions.

**10.3 Comment:** The Administrators cannot currently calculate the total value of clients' possible claims in these sorts of situations, but believe it could be substantial.

**10.4 Administrators' current view:** The Administrators believe that this point raises difficult issues - in some cases it seems right that a client should only be entitled to claim on the CMP for what was actually segregated for the client. However, it is less clear that this is the correct result in other situations. Global Trader indicates that a client does not have an entitlement to the CMP where no money at all has at any time been segregated for him, essentially because the client is not a "person for

whom that money is held” within the terms of CASS 7.7.2R. The Administrators consider that this is the correct interpretation of CASS on this point.

- 10.5** Global Trader did not deal with the case where the firm had segregated money for some positions but not others. Nevertheless, the Administrators’ working assumption will be to calculate client’s client money entitlements starting from the basis of what was segregated. They will only depart from this where the Court directs them to do so.

## 11 Issue 16

**11.1** Issue 16 deals with the situation of a client who was not entitled to client money protection, but for whom LBIE's records show that some client money was nevertheless held on a segregated basis at the time of administration. The following is an example.

### 11.2 Example:

- Client S had agreed to sell 150 securities to LBIE for 450 South African Rand in a trade due to settle on 11 September. On 10 September, Client S delivered the securities. Upon realising that it did not have sufficient South African Rand, LBIE proceeded to segregate an equivalent amount as client money on 12 September. In fact under CASS, LBIE was not required to segregate an amount in US Dollars equivalent to 450 South African Rand unless it failed to pay Client S before close of business on 16 September (being three business days after the due date for settlement). As at the time of administration therefore, money was segregated for Client S in circumstances where LBIE need not yet have done so.

**11.3 Comment:** Issue 16(b) raises, for completeness, the same question posed by Issue 15 but in respect of clients who are not entitled to client money protection. Essentially, if some money was segregated, and other money was not, this question addresses whether the client has an entitlement as against the CMP in respect of both amounts of money.

**11.4** The Administrators do not currently have data available on the quantum of this issue. However, they do know that, as at close of business on 11 September, LBIE had segregated US\$7.8m in respect of all fails and they believe that a material proportion of this sum could have been segregated in respect of fails for which LBIE was not at that time required to segregate money.

**11.5 Administrators' current view:** This issue was raised but not resolved in Global Trader (although Sir Andrew Park appeared to favour the view (without deciding the point) that such clients should be entitled to receive a distribution from the CMP).<sup>9</sup> The Administrators' view is that the client should have an entitlement against the CMP – but only in respect of money which was clearly identified as having being segregated for him.

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<sup>9</sup> See paragraphs 140 to 142.

## 12 Issue 17

**12.1** Issue 17 addresses the situation where client money should have been segregated for a client but was not and client money relating to that client is held in a LBIE account which is not a client money account and all or an identifiable part of that money can be identified as money held for a particular client. The following is an example.

**12.2 Example:**

- On 12 September, Client T, a custody client, paid US\$100 to LBIE's house account (which account was in credit at the time of the receipt). LBIE should then have segregated US\$100 as client money, but did not do so. No withdrawal has been made from the house account since Client T's money was received.

**12.3 Comment:** The scope of this issue is dependent on the proper definition of "client money accounts". If the Court determines that the account in which the money was held as at the time of the administration was a client money account, this question does not arise. However, if the Court decides that the account is not a client money account, then it is relevant.

**12.4** The Administrators have not so far identified any clients in this position but it is likely that such clients exist.

**12.5 Administrators' current view:** The Administrators at present consider that any such money falls outside the CMP. The Administrators consider that if the client can identify the money held or received for him (applying the usual rules of tracing/following) then he may be able to recover it as trust property in full without sharing in the shortfall on the CMP. The Administrators would note, however, that the process of identifying client money as attributable to a particular client is likely to be difficult or even impossible. Tracing (or following) is most likely to be feasible only for payments received shortly before administration.

## 13 Issue 18

**13.1** Issue 18 addresses the situation where LBIE segregated client money for a client in relation to some positions or instruments but subsequently wrongly desegregated it.

**13.2 Example:**

- Client U purchased securities from LBIE for US\$150. Client U paid the purchase money to LBIE. Since LBIE had not yet delivered the securities, it segregated US\$150 for Client U in its client bank accounts. Subsequently, in anticipation that the transaction would settle later that day, LBIE transferred the US\$150 previously segregated to a house account. The balance on that house account was transferred to an affiliate at the close of business in accordance with LBIE's normal intra-group cash management procedures. However, the transaction did not in fact settle. The money is no longer identifiable in LBIE's accounts.

**13.3** Issue 18(b) addresses the situation where, in addition to the facts above, Client W also had other instruments or positions for which wrongly, no segregation was made. For further discussion on the question of whether the Administrators should adopt a "position by position" approach to ascertaining the extent of a client's client money entitlement, please see Issue 15.

**13.4 Comment:** Issue 18 is concerned with establishing the extent to which, if at all, the fact that LBIE at one time prior to (but not at) administration held money on a segregated basis in respect of a client's particular position has any effect on that client's client money entitlement in circumstances where that money ought to have remained but is no longer so segregated for that client. Essentially, the question posed is whether the effect of the erroneous transfer is to diminish (or to extinguish, if the transfer was in an amount equal to the entirety of the client's client money entitlement) that client's client money entitlement, on the basis that LBIE earmarked the withdrawal to a particular contributor.

**13.5** The Administrators are not currently aware of any clients having been wrongly desegregated but it is conceivable that such clients may exist.

**13.6 Administrators' current views:** In Global Trader, Sir Andrew Park refers briefly to a client in the position of Client U<sup>10</sup> and indicated (without definitively deciding the point) that such a client did not have a client money entitlement.<sup>11</sup> However, there is a tension between this approach and the Judge's conclusion on the incomplete transfer issue<sup>12</sup> where the Judge is plainly proceeding on the basis that the shortfall caused by the incomplete transfer was to be borne *pari passu* by those clients with a client money entitlement, rather than by Mr Crawford-Brunt alone. This question is further considered in Issue 23(a) below.

**13.7** The Administrators' working assumption is that clients can claim only for the money segregated at the time of the administration, unless the Court orders otherwise. Accordingly, they do not believe desegregated client money claimants would have entitlements in respect of such sums relating to them as may have been removed

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<sup>10</sup> See the "case with special features" referred to in paragraph 137(ii) of the judgment.

<sup>11</sup> See paragraph 144.

<sup>12</sup> See paragraphs 102 to 112.

from the CMP prior to administration. However, they recognise that Global Trader did not decide this issue and so they are seeking directions in respect of it.

## 14 Issue 19

- 14.1** Issue 19 addresses whether a client for whom LBIE should have segregated client money (but did not) and in respect of whom no client money is identifiable in LBIE's house accounts, and for whom LBIE at no time held client money on a segregated basis, nevertheless has a claim on the CMP for that unsegregated money (regardless of whether or not LBIE now has an obligation to top-up the CMP – see issue 10).
- 14.2** **Examples:** See the factual scenarios set out under Issue 10 above for examples of unsegregated clients.
- 14.3** **Comment:** If unsegregated clients have a claim against the CMP in these circumstances and if LBIE has no obligation to top-up the CMP, this would result in the amounts which would otherwise be distributed to segregated clients from the CMP being significantly diluted – as there would be substantial, additional claims against the CMP. Accordingly, segregated client money claimants will generally wish to resist any argument that unsegregated client money claimants should have a claim against the CMP if there is no obligation on LBIE to top-up the CMP.
- 14.4** As noted under Issue 10 above, the potential size of unsegregated client money claimants' claims may run into billions of US Dollars. Allowing such clients to claim against the CMP in circumstances where the size of it remains unchanged would significantly reduce what is available to be distributed to segregated client money claimants.
- 14.5** **Administrators' current view:** Global Trader indicates that a client has no entitlement against the CMP in these circumstances. They are not persons for whom the CMP is held within the meaning of CASS 7.7.2R. The Administrators consider that this is the correct interpretation of CASS on this point.

## 15 Issue 20

**15.1** Issue 20 deals with a situation where a client traded for its proprietary account through LBIE and also for the account of its own customers, and LBIE segregated money in relation to the client's trading for its customers but not for its proprietary trading. The following is an example.

### 15.2 Example:

- Affiliate 4 was an investment firm which dealt in exchange-traded derivatives for its own customers via other brokers, including LBIE. Affiliate 4 also traded for its own account. Affiliate 4 had opened two accounts with LBIE, one for its trading on behalf of customers (number 1), the other for its proprietary trading (number 2). Affiliate 4 had paid to LBIE US\$500 in initial margin in respect of trading for its customers. At close of business on 11 September, those customers' positions showed a net unrealised profit of US\$200. On 12 September LBIE accordingly segregated US\$700 for Affiliate 4 in respect of account 1. Affiliate 4 had also paid to LBIE US\$1,000 in respect of initial margin in respect of its proprietary positions on account 2. At close of business on 11 September, those proprietary positions showed a net unrealised profit of US\$400. LBIE did not, however, ever segregate any money for Affiliate 4 in respect of account 2.

**15.3 Comment:** So far as the Administrators are aware, one of LBIE's affiliates is the only example of a person affected by this issue, but it is possible that this situation could arise for other clients who traded for others. This question becomes relevant only if the Court holds in relation to Issues 15(b) and 18(b) that the client can claim for the aggregate of the segregated and unsegregated positions. Issue 20 raises the question as to whether that principle can be extended to cases where the segregated and unsegregated positions were held by a person in different capacities (e.g. if the client acted as agent for its own customers) and/or ultimately for different persons (e.g. if the client traded its customer positions on a riskless principal basis – i.e. it entered into a contract as principal with LBIE and a matching or “mirror” contract as principal with its own customer).

**15.4 Administrators' current view:** Given the Administrators' current view on Issues 15(b) and 18(b), the Administrators do not at present believe that this issue will become relevant.

## 16 Issue 21

**16.1** Issue 21 asks as at what time and date clients' client money entitlements should be calculated. The following example illustrates how an entitlement could vary depending on the date as at which it is calculated.

### 16.2 Example:

- Client V had open margined derivative transactions. As at close of business on 11 September, Client V's net equity balance was US\$500. At administration, adverse market movements had reduced that balance to US\$400. Client V's margined transactions were closed out on 17 September at a loss of US\$200.

**16.3 Comment:** The obvious time at which to calculate clients' client money entitlements is the time of administration. However, alternatives might be close of business on 11 September (being the time as at which values used in the calculation of what client money was segregated at the time of administration were set) or the time at which the relevant position was actually closed out – typically within a few days after administration. This issue will therefore be particularly relevant to, for example, clients whose derivatives positions moved significantly between close of business on 11 September and administration or between administration and closing-out.

**16.4 Administrators' current view:** Global Trader (see the judgment of David Richards J at [2009] EWHC 699 (Ch)) decides that entitlements are calculated at the time of administration. The Administrators agree with that view but consider that clients should not be able to make double or other over-recovery from the CMP where the obligations in respect of which money was segregated have subsequently been settled or have declined in value following the time of administration. These latter matters are addressed in Issues 13 and 14 above.

## 17 Issue 22

**17.1** Issue 22 deals with a situation where LBIE owes a client obligations in a currency (the “claim currency”) other than US Dollars and asks whether, in such cases, the Administrators may convert entitlements into Dollars using a spot rate of exchange at or around the time of administration.

**17.2 Example:**

- Client W has sold securities denominated in Japanese Yen for JPY5,000. Prior to administration, LBIE segregated the US Dollar equivalent of JPY5,000. If the Administrators value Client W’s claim as at the time of administration using the then prevailing USD/JPY spot rate of, say, 1:100, Client W’s entitlement will be US\$50. The US Dollar subsequently weakens against the Japanese Yen.

**17.3 Comment:** Clients whose claims are converted from the claim currency into US Dollars will be exposed to currency risk if the claim currency strengthens against the US Dollar. The converse situation will exist for currencies which weaken against the US Dollar.

**17.4 Administrators’ current view:** The Administrators consider that conversion of claims into US Dollars at the spot rate prevailing at administration will facilitate efficient distribution. Whilst clients with non-US Dollar claims may thereby be exposed to some currency exposure, they have the possibility of gain as well as loss. Clients with US Dollar claims will not, as such, be exposed to currency risk, but currency movements may have the effect that they receive a lesser (or greater) proportion of their claim than claimants in other currencies when each is measured in the original currency of their claim.

## 18 Issue 23

- 18.1** Issue 23(a) addresses how the client money entitlement of a client who was unsegregated or undersegregated is to be calculated: see previous examples of cases where clients' money may be unsegregated or undersegregated, especially the examples under issues 8, 9 and 10.
- 18.2** Issue 23(b) addresses the question of how a client's "individual client balance" should be calculated under CASS 7.9.7R, and in particular whether a client's liabilities to LBIE should be taken into account. The following is an example.
- 18.3 Example:**
- On 12 September, LBIE had segregated US\$100 for Client X in connection with its futures trading. However, Client X then owed LBIE US\$50 of unpaid margin amounts in connection with its futures account – that amount remained unpaid at the time of administration.
- 18.4 Comment:** In essence, Issue 23(a) raises the fundamental question as to whether a client's claim against the CMP is quantified by reference to what was actually segregated for it (or subsequently brought into the CMP by way of required top-up, if any) or the amount which ought to have been segregated for it. Client money claimants who (following any applicable top-up) remain undersegregated may wish to argue that the client money entitlement is based on what their claims were (and hence what ought to have been in the CMP) rather than what was actually segregated for them. Fully segregated client money claimants may wish to argue the converse.
- 18.5** Issue 23(b) is significant for clients who had open margined derivative transactions with LBIE at the time of administration and who also had outstanding liabilities too. The Administrators cannot currently calculate the total value of such offsetting amounts in these sorts of situations, but estimate that it could be in excess of US\$2bn.
- 18.6 Administrators' current view:** Global Trader establishes apparently conflicting principles.
- 18.6.1** First, Sir Andrew Park held that clients for whom no client money was held on a segregated basis and for whom no money had ever been so held have no claim against the CMP. This tends to suggest that it is the amount segregated which determines entitlement. The Administrators consider that this is the correct interpretation of CASS on this point.
- 18.6.2** Secondly, Mr Justice David Richards directed that "*For the purposes of distribution pursuant to CASS 7.9.6R, the client money entitlement calculated in accordance with CASS 7.9.7R of each [client with a client money entitlement] is to be calculated as at the Time of the Appointment. The Liquidators shall, in respect of each position held by each such client which was closed during the administration or liquidation of the Company, quantify the client entitlement as though that position was liquidated and closed at the closing or settlement prices published by the relevant exchange ... at the Time of the Appointment.*" It arguably follows from this direction that the client money entitlements of margined transaction clients

of Global Trader (or at least those who had open margined transaction positions at the time that administrators were appointed) were calculated without reference to the amounts which had in fact been segregated. If a client was a client for whom money was segregated at the time of the appointment, that client's client money entitlement was not affected by a shortfall in the funds held for the client at the point of the appointment. An alternative argument, however, is that entitlement is still calculated by reference to, and can be no greater than, the amount segregated but may be less where losses are crystallised by the notional close-out. On that argument, the notional close-out simply prevents over-recovery.

**18.6.3** Thirdly, Sir Andrew Park seems to proceed on the basis that the shortfall caused by the incomplete transfer of funds referable to Mr Crawford-Brunt (which, briefly summarised, meant that only GBP1.5m was segregated on behalf of that client, rather than GBP2m, as should have been the case) would be borne *pari passu* by the entire class of clients with a client money entitlement.<sup>13</sup> This would tend to suggest that a client's client money entitlement is not calculated by reference to the amount in fact segregated for that client at the time of the appointment.

**18.7** There is one further matter which may impact on the calculation of client money entitlements, and it relates to any adjustment required by CASS 7.9.7R which operates in relation to those clients with open margined transactions. (The movement in the prices of the open transactions between the last reconciliation and the time of the appointment will be catered for, if the CMP is adjusted as outlined in Issue 8 above, as Sir Andrew Park directed that it should be.)

**18.8** The Administrators currently propose to invite the Court to confirm that the amount which LBIE's books and records disclose as having been segregated for a particular client is the amount of that client's client money entitlement, subject to such adjustments required by CASS 7.9.7R.

**18.9** On the issue of whether LBIE may offset a client's liabilities when calculating a client's client money entitlement, the Administrators believe that this is permissible in limited circumstances, e.g. where LBIE's agreements with its clients permitted liabilities to be deducted from client money held.

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<sup>13</sup> See paragraphs 105, 107 and 111.

## Distribution of client money

### 19 Issue 24

**19.1** Issues 24 addresses further the position of a clients' whose original claim was in a currency other than US Dollars. It addresses the currency in which payment will actually be made. The following is an example.

- Client Y has sold securities denominated in Japanese Yen for JPY5,000. Client Y has delivered the securities to LBIE but LBIE has not yet paid the purchase price. Accordingly it had segregated the US Dollar equivalent of JPY5,000.

**19.2 Comment:** Issues 21 and 22 deal with the issue of how, and as at what time, a client's client money entitlement is to be calculated. Issue 24 deals with the separate question of the currency in which that entitlement is actually paid. So for example, although Client Y's Japanese Yen claim may be translated into US Dollars for the purposes of calculating his pro rata share of the pool, that share could be paid either in US Dollars, Japanese Yen or indeed any other currency if the Administrators effect the necessary currency exchanges and have access to payment facilities in the relevant currencies.

**19.3 Administrators' current view:** In circumstances where the majority of the CMP is held in US Dollars and the majority of client money claimants' entitlements in US Dollars the Administrators take the view that distribution in US Dollars will be the most efficient means of distribution. However, where clients wish to receive money in other currencies the Administrators are minded at their discretion to consider effecting the necessary currency exchanges at the rates prevailing as close as practicable to distribution and at the expense of the client.

## 20 Issue 25

**20.1** Issue 25 addresses the process by which the valuation of claims as at administration is translated into an actual payment amount. For ease of illustration a simplified example is used.

### **20.2 Example:**

- At administration there were only two clients with claims against the CMP - Clients Z and AA.
  - At the time of distribution, the CMP consists of US\$60 and Euro 50.
  - Client Z's claim was for US\$100. Client AA's claim was for GBP50.
  - Accordingly, there is a shortfall in the CMP.
  - The USD/GBP exchange rate at administration was USD:2/GBP:1.
  - The costs of distribution turn out to be US\$2.
  - The USD/Euro exchange rate at the time of distribution is USD:1.4/Euro: 1

**20.3 Comment:** There are various methodologies by which a distribution of the CMP pro rata to clients' claims can be calculated. That set out below is the methodology which the Administrators consider the most appropriate.

**20.4 Administrators' current view:** The clients' claims are valued in a common currency as at the date of administration. The Administrators currently propose to choose US Dollars because it is the currency in which the majority of claims and the majority of the CMP is denominated and because it is a major international currency.

**20.5** Accordingly, Client Z's claim is already in US Dollars and is therefore valued at US\$100. Client AA's claim is GBP50 and the USD/GBP exchange rate at administration was 2:1. Client AA's claim is therefore also valued at US\$100.

**20.6** Consequently, each client has an equal share of the pool.

**20.7** At distribution, the Administrators calculate the costs of distribution in US Dollars as US\$2. They will also sell the non-Dollar currencies in the CMP for Dollars at prevailing rates at the time of distribution so as to convert the entire CMP into US Dollars. The Euro 50 are therefore sold for US\$70 leaving a total CMP of US\$130.

**20.8** Costs of distribution will then be deducted from the pool leaving US\$128. The remainder will be divided between Client Z and AA in the previously calculated proportions of 50% each, so each is entitled to US\$64. This is paid to them in US Dollars.

## Money held on behalf of affiliates

### 21 Issue 26 and 27

- 21.1** Issues 26 and 27 deal with whether LBIE's affiliates were entitled to client money protection.
- 21.2** See the factual scenarios provided in Issue 10.
- 21.3** **Comment:** whether money ought to have been segregated for affiliates is likely to depend on the proper construction of CASS in the light of Article 2(1)(b) of the Markets in Financial Instruments Directive<sup>14</sup> which provides a so-called "group exemption", and how the "total title transfer" exemption in CASS 7.2.3R might apply to LBIE's various relationships with its affiliates.
- 21.4** If money for affiliates ought to have been segregated, then there will be very significant amounts of unsegregated monies.
- 21.5** **Administrators' current view:** This issue is of relevance only if the Court determines that unsegregated client money claimants have a claim to the CMP either in all events or because a top-up is required or because (in cases where some monies were segregated) a claim can be brought against the CMP for the aggregate of segregated and unsegregated monies. Given the Administrators' views on these topics in the light of Global Trader, they do not believe that any affiliate will have a valid claim on the CMP for their own unsegregated monies.

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<sup>14</sup> DIRECTIVE 2004/39/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145, 30.4.2004, p. 1)

## 22 An actual illustration

**22.1** The above examples are intended to illustrate individual points raised by the Application. Whilst the majority of LBIE's clients were segregated for only one component (for example, futures, cash or stock loan payables), any given client's overall position may be affected by a combination of the issues identified above. The following example illustrates an actual client's overall position for whom more than one component was segregated, although the numbers and amounts have been changed in order to protect client confidentiality.

- Real Life Client traded exchange-traded futures and options with LBIE. As at close of business on 11 September, Real Life Client's cash balance on its account was US\$13.4m, which was made up of US Dollars and Euros. This money was segregated by LBIE. During the course of 12 September, Real Life Client's Euro balance increased due to a transfer in, increasing Real Life's total cash balance to US\$15.7m.

In relation to securities held by LBIE for Real Life Client, four depot breaks existed on 11 September. As a consequence, LBIE locked up US\$350,200 on 12 September. However, during the course of 12 September:

- (i) a further depot break occurred, which, in the ordinary course, would have required LBIE to segregate a further US\$120,000; and
- (ii) the net value of those securities for which LBIE had already segregated money decreased in value such that, in the ordinary course, LBIE would have been entitled to reduce the amount segregated in respect of Real Life Client's segregated depot breaks by US\$10,000.

LBIE did not segregate Real Life Client's unrealised profit on its exchange-traded options. As at the time of administration, the net unrealised profit on Real Life Client's exchange-traded options was US\$500,000.

In addition to being a segregated client money claimant in respect of some monies and potentially an unsegregated client money claimant in respect of unrealised profit on its exchange-traded options (depending on whether or not LBIE was in fact required to segregate such money), Real Life Client is also likely to be a substantial unsecured creditor of the general estate.