

Lehman Brothers International (Europe) (in administration)

**Lehman Brothers International
(Europe) (in administration)**
25 Bank Street
London
E14 5LE

12th May 2009

[Client]
[Address]

Our Client GAC Reference:

Dear Sirs

Re: Lehman Brothers International (Europe) (in administration) (“LBIE”) - Client Money

Introduction

We are writing to you as a client of LBIE who, according to LBIE’s records, may be entitled to a claim for client money (as defined in the Financial Services Authority’s (“FSA”) Client Asset sourcebook) held by LBIE at 07:56 on 15th September 2008, the time LBIE was placed into administration. In this letter we refer to this as “Pre-Administration Client Money”. This letter does not address issues in respect of any entitlement you may have to client money that may have been received by LBIE after 15th September 2009.

On 1st May 2009, the Joint Administrators made an application to the High Court seeking directions in relation to Pre-Administration Client Money held by LBIE. The Joint Administrators wish to provide affected clients with further information about the LBIE Pre-Administration Client Money position, the issues they are seeking to address to allow the partial return of such client money, the actions which have been taken to seek to address these issues and the steps underway to make a distribution of such client money.

The determination of the issues set out in the court application will impact the manner in which funds held in segregated Pre Administration Client Money accounts (see below) are ultimately distributed to claimants to the Pre-Administration Client Money pool. As such, you are encouraged to consider this letter and the directions sought by the Joint Administrators as the determination of the issues in the court application may affect your recoveries from the Pre-Administration Client Money pool. Clients wishing to gain a detailed understanding of the issues should seek independent legal advice on their particular rights against LBIE and the Pre-Administration Client Money pool and on any steps they should take at this time.

Background

In accordance with FSA’s client money rules, LBIE deposited segregated client money in accounts at banks, clearing houses and brokers, including Lehman Brothers Bankhaus AG (“Bankhaus”), an affiliate of LBIE.

These deposits represented amounts that LBIE calculated it needed to segregate for clients under the FSA’s rules. LBIE segregated client money under an approach referred to as the “Alternative Approach”. Under the

*AV Lomas, SA Pearson, DY Schwarzmann and MJA Jervis were appointed as Joint Administrators of Lehman Brothers International (Europe) on 15 September 2008 to manage its affairs, business and property as agents without personal liability. AV Lomas, SA Pearson, DY Schwarzmann and MJA Jervis are licensed to act as insolvency practitioners by the Institute of Chartered Accountants in England and Wales.
Lehman Brothers International (Europe) registered in England and Wales with registered no. 02538254.
VAT registration no. 446 9315 28*

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Alternative Approach, a daily calculation was performed to determine the amount of client money to be segregated. The amount of client money segregated was adjusted each business day to reflect the calculated requirement.

The last calculation and segregation by LBIE was performed on 12th September 2008 and was based on data as at the close of business UK time on 11th September 2008. As of this date LBIE had segregated approximately US\$2.1 billion of Pre-Administration Client Money.

The administration of LBIE constituted a “Primary Pooling event” under the FSA’s rules. On administration, the client money in LBIE’s segregated client money accounts was notionally pooled for the benefit of all the clients entitled to claim against that pool. The effect of this pooling is that shortfalls in the pool (if any) are shared pro-rata among those clients with claims to the pool.

LBIE’s client money calculation is unusually complex, as it involves an assessment of each clients’ claims in respect of a number of components for which client money was segregated. The nature of some of these components is such that clients would not be aware of all of them in the ordinary course of business. Therefore clients may not be aware of the full extent of Pre-Administration Client Money which was segregated on their behalf.

The Joint Administrators have conducted a detailed analysis of the Pre-Administration Client Money components and a summary of these components is attached at Appendix 1.

The Joint Administrators’ approach to handling Pre Administration Client Money

Upon their appointment as administrators of LBIE, the Joint Administrators had three key objectives in relation to Pre-Administration Client Money:

- 1) Securing the recovery of Pre-Administration Client Money deposited with third parties;
- 2) Identifying the clients with a claim to this client money; and
- 3) Distributing Pre-Administration Client Money as soon as possible.

Recovery of deposits

The first of these objectives has involved extensive dealings with third parties, including Bankhaus which is also in an insolvency process. The Joint Administrators have recovered approximately US\$950 million of Pre-Administration Client Money to date, and are actively pursuing the return of the remainder. The Joint Administrators are dealing with a number of issues, some of them significant:

- Of the approximately US\$2.1 billion segregated by LBIE on 12th September 2008, US\$1 billion was deposited with Bankhaus. Bankhaus was due to repay the deposit on 15th September 2008, but failed to do so and has been placed into an insolvency process in Germany. At this stage the German administrator has not confirmed the status of the deposit and it is unclear if and when the US\$1 billion deposit will be returned.
- Certain of the banks LBIE deposited client money with have sought to set off amounts payable by LBIE against funds held by LBIE and recorded as LBIE client money. The Joint Administrators are assessing

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the validity of such claims and are taking appropriate steps to protect LBIE's client interests, including by pursuing recovery proceedings against these institutions, where appropriate.

It is likely that the resolution of these matters will take some time and, given the fundamental uncertainty over the Bankhaus deposit we again caution that there is a reasonable prospect of a material shortfall in recoveries of the segregated Pre-Administration Client Money.

Determination of entitlements to Pre Administration Client Money

The Joint Administrators have also dedicated resources to determining which clients are entitled to the money in LBIE's Pre Administration Client Money pool. Through this work it has become apparent that a number of significant legal issues require resolution prior to the distribution of the Pre-Administration Client Money pool. In order to address these issues, the Joint Administrators are seeking court directions in relation to certain specific matters. A number of the issues relevant to LBIE's client money position were considered by the High Court in the *Global Trader* case and whilst the directions from that case are useful, LBIE's client money position is significantly larger and more complex and, as such, requires a court determination on a number of other matters. An application was filed with the High Court on 1st May 2009 to commence the process to gain clarity over the various uncertainties.

The High Court Application

The High Court application made on 1st May 2009 was the subject of a Client Money Update issued by the Joint Administrators on 5th May 2009. This update, which provides a brief explanation of the application, is available on the LBIE administration website (for convenience a copy of the update is attached to this letter at Appendix 2). The full text of the High Court application is also available on the LBIE administration website at the following address:

http://www.pwc.co.uk/pdf/lehmans_court_application_may09.pdf.

You are encouraged to review the Client Money Update as well as the application, and any supplemental evidence as it becomes available. The Joint Administrators recognise that the ultimate resolution of these issues will impact individual clients and clients are encouraged to consider making representations to the court or to the Joint Administrators in relation to any issues that may impact or concern them.

Next Steps

Following the determination of the issues by the High Court, the Joint Administrators intend to finalise individual clients' entitlements to the Pre-Administration Client Money pool and provide a statement to each client. Prior to any distribution to a client, account will be taken of any indebtedness that the client may have to LBIE and an appropriate deduction will be made. The Joint Administrators will communicate this process once it has been finalised.

While a final distribution of Pre-Administration Client Money will be dependent on, among other things, the recovery of amounts from Bankhaus and is therefore some time away, the Joint Administrators are targeting making one or more interim distributions. The Joint Administrators expect to be in a position to provide a further update in June 2009 and therefore request that **all clients submit client name and contact details, including e-**

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mail addresses by 1st June 2009. Please ensure that you quote your unique reference number (GAC code) noted at the top of this letter in all submissions or other correspondence. Please email your details to the following address:

clientpositionresponses@lbia-eu.com

The Joint Administrators are aware that you may have already submitted these details in other correspondence in relation to the LBIE administration. However, the Joint Administrators have determined that it is appropriate to make a Pre-Administration Client Money distribution separately from other claims. It is important, therefore, that your details are submitted if you are to participate in any distribution.

Scheme of Arrangement

You may be aware that the Joint Administrators intend to propose a trust asset scheme of arrangement which, if approved, will govern the return of segregated client assets held by LBIE. While this scheme will not apply to Pre-Administration Client Money we expect there to be overlap in relation to clients who held both assets and client money at LBIE and, in particular, for those clients for whom client money was segregated in lieu of client assets ("Depot Breaks"- see Appendix 1 for a description of Depot Breaks). Details on the trust asset scheme of arrangement will be posted on the PwC LBIE website in due course.

The Joint Administrators encourage all clients to continue to review the FAQ's and client updates available on http://www.pwc.co.uk/eng/issues/lehman_updates.html. This will remain one of the Joint Administrators primary methods of communicating with clients in general.

Please note that the Joint Administrators have sent this letter to clients that they believe may be entitled to make a Pre-Administration Client Money claim. However, the Joint Administrators are not making any representation or warranty that any recipient is in fact entitled to make any such claim or, if so entitled, what amount of client money (if any) will ultimately be received.

Should you have any queries in relation to the matters discussed in this letter please contact Andrew Clark on +44 20 7102 0587.

Yours faithfully,

Andrew P. Clark
For S A Pearson
Joint Administrator
Lehman Brothers International (Europe) (in administration)

Appendix 1

The following make up the client money components LBIE generally included when calculating the amount of client money to be segregated on a daily basis. The extent to which each of these components was relevant to a particular client varied according to, among other things, the specific arrangements with such clients, e.g. where LBIE held money as collateral (under a “total title transfer arrangement), such money was not treated as client money under FSA’s rules. Some of these components would not have been visible to clients at the time of segregation and so clients may not be aware of their full entitlement to Pre-Administration Client Money.

1. **Cash Balances.** LBIE’s policy was to segregate safe custody cash as well as cash dividends and coupons credited to client accounts on corporate action events.
2. **Futures.** It was LBIE’s policy to segregate an amount equal to a clients’ free cash balance (if any), plus certain amounts in respect of the client’s exchange traded futures, options and forwards positions, including the initial margin posted by the client and any unrealised gains in connection with futures positions.
3. **Margin Excess/Margin.** For certain (but not all) prime brokerage clients, LBIE agreed to segregate cash equal to any balances on their account in excess of their margin requirement. For certain other (but not all) prime brokerage clients, LBIE agreed to segregate an amount equal to the clients’ margin requirement.
4. **Stock Loan Payables.** It was LBIE’s policy to segregate cash in respect of stock loan fees, rebates and dividends payable to clients in connection with stock lending business. In relation to fees and rebates, these amounts were generally segregated on a monthly basis.
5. **Depot Breaks.** Where LBIE held assets on behalf of clients in a client depot and there was a shortfall in the assets actually in the depot relative to client asset entitlements (e.g. because of a settlement problem), LBIE’s policy was to segregate cash in an amount equal to the cash value of the shortfall, until such time as the shortfall was rectified. For clarity, LBIE’s policy was to segregate cash in respect of assets that should have been in the depot and therefore no segregation was made in respect of re-hypothecated assets.
6. **Fails.** Where LBIE entered into a delivery versus payment transaction but only delivered part of the stock required against full payment by the client, LBIE’s policy was to segregate an amount equal to the amount paid by the client that related to the undelivered stock.
7. **Unapplied Ledger Credits.** Where LBIE was due to pay cash from its house account to or to the order of the client but such cash remained unpaid, it was LBIE’s policy to segregate cash representing this amount in two ways:
 - a. In respect of unpaid cash that remained on LBIE’s house account for more than 3 days, LBIE’s policy was to segregate these amounts in full; and
 - b. In respect of unpaid cash that remained on LBIE’s house account for 3 days or less, LBIE’s policy was to estimate the total value of these unapplied credits and segregate cash equal to this amount.

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8. **Unapplied Statement Credits.** Where LBIE received money into its house account but was unable to identify immediately whether this related to a client and so needed to be segregated, it was nevertheless LBIE's policy to segregate cash representing this amount in two ways, pending it resolving whether the receipt was client money or not:
 - a. In respect of unapplied statement credits that remained on LBIE's house account for more than 3 days, LBIE's policy was to segregate these in full; and
 - b. In respect of unapplied statement credits that remained on LBIE's house account for 3 days or less, LBIE's policy was to estimate the total value of these unapplied credits and segregate cash equal to this amount.
9. **Manual Items.** From time to time LBIE deemed it necessary to segregate amounts that were in addition to those that formed part of the daily calculation. These would be calculated manually.

Appendix 2

Client money update - Court application 1 May 2009

On 1st May 2009 the Joint Administrators made an application to the High Court seeking directions on the client money held by Lehman Brothers International (Europe) (in administration) (“LBIE”).

The application has been made following the Joint Administrators’ consideration of the 24th March High Court judgment in the Global Trader case.

As noted in the Client Money and Assets FAQ’s of 27th March, the Global Trader judgment is relevant to issues that have arisen in relation to the treatment of client money in the administration.

However, the LBIE client money position is significantly more complicated than that of Global Trader and it is therefore necessary for the Joint Administrators to consider factors that were not present in Global Trader. The purpose of the Joint Administrators application is to initiate the process to address the issues relevant to LBIE to expedite the return of client money.

[The full text of the High Court application is available here.](#)

Over the coming weeks, the Joint Administrators intend to supplement the evidence presented to the High Court in order to explain in detail the factual background against which the issues raised in the application need to be determined.

The Joint Administrators believe the active engagement of clients in relation to the issues raised in the application is important to this process. Therefore, clients are encouraged to review the application, and any supplemental evidence as it becomes available, and to consider making representations to the court or to the Joint Administrators in relation to those issues that may impact them. The answers to some of the questions may affect the money available for distribution to the general estate. Therefore the application may be of interest to creditors in general.

What questions have the Joint Administrators asked the court in the application?

The application asks the Court to address many questions relating to a wide range of complex issues. You are encouraged to read the full text of the application ([the full text of the application is available here](#)). However, broadly, the application addresses two key issues:

1. What monies constitute the client money pool?

The questions relating to constitution are to determine, among other things, which accounts are included in the client money pool, in what circumstances and to what extent should money be added to or removed from the pool by the LBIE estate.

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2. How are client entitlements to the pool determined?

The questions relating to entitlement are to determine, among other things, which clients have an entitlement to the client money pool, the method for calculating the amount of any entitlement, the time when entitlement should be determined, the treatment of money segregated by LBIE for shortfalls in client stock depots and the treatment of post administration events.

How can I make representations to the Joint Administrators regarding the application?

If you would like to make any representations to the Joint Administrators regarding the application please send your communication to the Administration Trust Property team:

clientpositionresponses@lbia-eu.com

Please ensure that the subject matter in your email reads: **Client Money Court Application**

When will the High Court rule on the application?

The Joint Administrators will announce the dates of any hearings that are listed in connection with the application as and when such dates become available.