

Determination of Client Money Entitlement: 1992/2002 ISDA MA and CSA (NY Law); Long Form Confirmation

This paper summarises the approach taken with respect to potential Client Money entitlements of parties (each, a “Creditor”) with whom LBIE had, prior to 07.56am 15 September, 2008, entered into an agreement on terms which are identical to, or sharing the same characteristics as, the Financial Contract, and for whom no Client Money had been segregated in relation to that contract (in the event that it is determined in any individual case that LBIE had segregated funds as Client Money, the relevant parties will be contacted directly in that regard). It further assumes that sums paid to LBIE by the Creditor were paid pursuant to the terms of the Financial Contract.

Definitions

Financial Contract:	(i) 1992 or 2002 ISDA Master Agreement (Multicurrency Cross Border; New York Law) incorporating a Schedule and the ISDA Credit Support Annex (Bilateral Form; New York Law); and (ii) Long Form Confirmation incorporating the terms of the 1992 or 2002 ISDA Master Agreement (Multicurrency Cross Border; New York Law) and either accompanied by or itself incorporating the ISDA Credit Support Annex (Bilateral Form; New York Law).
Financial Contract Terms:	Financial Contract entered into on standard form terms with the addition of variables and elections within the Schedule and/or Credit Support Annex but with no specific reference to ‘client money’ within the Financial Contract. The terms include a “right to use” provision within the Credit Support Annex (paragraph 6(c) of the standard form of the Credit Support Annex governed by New York Law contains such a provision) and this Determination assumes such right has been exercised by LBIE, including through the operation of LBIE’s usual “daily sweep” mechanism.
Obligations:	LBIE’s obligations to pay/account for money under the Financial Contract to the Creditor, including for derived income on securities collateral.
Client Money:	Money which was client money as defined in the FSA rules (at the Administration Time).
Client Money Claim:	Any claim by the Creditor that it has an entitlement to a distribution from the pre-administration Client Money pool constituted under the FSA rules, on the basis that it had a “client money entitlement” as at the Administration Time. This is a “contractual entitlement” and does not depend upon actual segregation of funds. In LBIE’s view this means an individual client balance falling within paragraph 7 of CASS 7 Annex 1G (“ICB”) and/or a client equity balance as defined in the FSA Rules (“CEB”) which, in each case, fell within the scope of CASS 7.

Administration Time: 07.56am, London time, on 15 September, 2008.

Assessment of Client Money Claim

This paper summarises LBIE's view as to whether parties who have entered into a Financial Contract on the Financial Contract Terms have a Client Money Claim against LBIE pursuant to that contract.

Client Money Claim: No. It is however LBIE's view that a Client Money Claim generally arises in relation to sums specifically segregated on behalf of a client by LBIE prior to the Administration Time and which remained so segregated at that time. There may however be some limited instances where a Client Money Claim is determined by LBIE not to arise notwithstanding segregation of sums. In such cases, the relevant clients will be contacted directly by LBIE to explain the rationale for such a determination.

Rationale: Court Judgment; FSA Rules; Contract Terms/Facts.

Court Judgment: The judgment given by the Supreme Court does not specifically address whether Obligations arising under the Financial Contract give rise to a Client Money Claim. The Court has confirmed that distribution of the client money pool is based on client money entitlement under Chapter 7 of the CASS Rules construed in accordance with the judgment. LBIE considers that this means that the client money entitlement is equal to ICB plus CEB (as defined above) (see paragraph 153 of the judgment).

Although not specifically addressed in the judgment, it is consistent with the judgment and it is LBIE's view that ICB and CEB only cover balances which were within the scope of the client money rules and hence would exclude any balances which were not client money, for example, due to the operation of title transfer collateral arrangements or to which the client money rules otherwise did not apply.

FSA Rules: There is a provision in the client money rules which provides that money received on a title transfer collateral arrangement basis is not regarded as Client Money (CASS 7.2.3R). This extends to cash received other than on a title transfer collateral arrangement basis, but in relation to which a right of use is exercised (CASS 7.2.5G).

Where a Financial Contract contains no right of use or if there is a circumstance in which such a right does exist but the right has not been exercised, the receipt of cash collateral or cash income derived from securities collateral would, in LBIE's view, give rise to a Client

Money Claim as it would form part of CEB as defined in the client money rules.

Contract Terms/Facts:

Consistent with the FSA rules, there are no references to 'client money' or the FSA rules with respect to Client Money within the Financial Contract Terms. There is therefore no express contractual provision under which LBIE promised to give Client Money protection to the Creditor. This is believed to be in line with market practice. It is LBIE's considered view that a court would not find the existence of any implied term to the contrary: no such term would be required in order to make the contract operate effectively, nor is there any market convention to the contrary.

Cash receipts from the Creditor under the Financial Contract which were made in payment of the Creditor's debts due to LBIE do not attract Client Money protection. Cash margin payments under the CSA would attract Client Money protection, unless a right of use (as was normally contained within paragraph 6(c) of the ISDA Credit Support Annex governed by New York law) were then exercised, which would be subject to the 'title transfer collateral arrangements' provision under the FSA rules (see above).

If LBIE received income derived from securities collateral, that income would also be a Receipt of Client Money by LBIE, unless a right of use had been exercised in relation to the securities, in which case the income would be derived from securities owned beneficially by LBIE and so would not be Client Money. For the latter, however, there was a separate solely contractual obligation on LBIE to pay from time to time to the Creditor an amount equivalent to the amount paid by the issuer of the securities that were subject to the title transfer collateral arrangement and which obligation is itself within the scope of that arrangement.