

Determination of Client Money Entitlement: Modified MIFCA

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. It assumes that sums paid to LBIE by the Creditor were paid pursuant to the terms of the Financial Contract.

Definitions

Financial Contract:	Modified form of Master Institutional Futures Customer Agreement (no provision for segregation of excess margin).
Financial Contract Terms:	Financial Contract entered into on terms modified from the standard with the addition of supplements authorising third party trading and applicable exchange rules for futures and options trading. The terms do not provide for surplus balances to be segregated as client money. The relevant provision in clause 2 of the “standard” form document has been excluded. The terms do however provide for total title transfer collateral arrangements to apply.
Obligations:	LBIE’s obligations to return/account for net sums characterised as excess margin under the Financial Contract.
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).

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 (other than by virtue of the attachment to the Financial Contract of a generic description of the Client Money rules). 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 exclusive market convention to the contrary.

Cash receipts from the Creditor under the Financial Contract were 'title transfer collateral arrangements' under the margin provisions contained within clause 2 of the Financial Contract (which therefore do not attract Client Money protection due to a specific provision under the FSA rules – see below). That clause provides that "[a]ll right, title and interest in and to all cash or property delivered to

LBIE pursuant to the Margin Requirement [including by virtue of permitted appropriation by LBIE] shall pass to LBIE upon receipt (or appropriation) of such cash or property by LBIE...”.

If income was derived from transferred securities during the term of a transaction involving those securities, that income was not a receipt of Client Money by LBIE, since the income was derived from securities owned beneficially by LBIE and so was not received for or on behalf of the Creditor. There was a separate 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 in question and which obligation is itself within the scope of that arrangement.