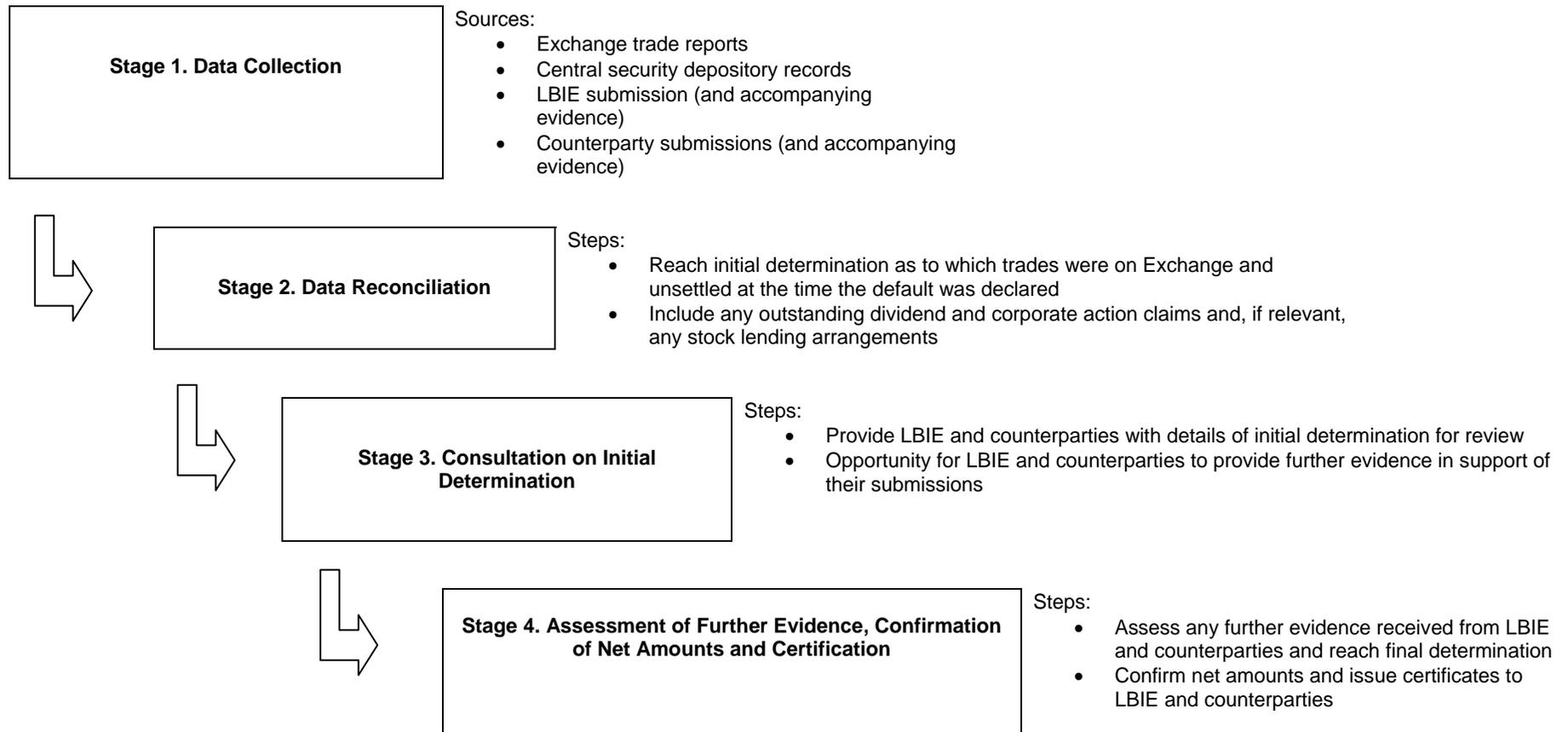


Lehman Brothers International (Europe) - in default

Data Reconciliation and Net Amount Certification Process

This paper describes the data reconciliation and net amount certification process that the Exchange proposes to apply in relation to the default by Lehman Brothers International (Europe) (“**LBIE**”). It should be read in full by LBIE and its counterparties, and any submissions regarding its content should be made in accordance with the instructions in Stock Exchange Notice N44/08 by 12:00 hours on Monday 19 January 2009.

A high level overview of the proposed data reconciliation and net amount certification process is shown below:



Stage 1. Data Collection

Equity Trades

The Exchange is reliant on a number of data sources in order to determine which trades were on Exchange and unsettled at the time the LBIE default was declared. Broadly speaking, these are trade reports submitted to the Exchange, the submissions made by LBIE and counterparties and accompanying evidence, and the records of central security depositories (“**CSDs**”) such as Euroclear UK and Ireland (“**EUI**”), Euroclear Bank (“**EB**”) and the Depository Trust and Clearing Corporation (“**DTCC**”).

The Exchange lists each of these data sources below in more detail, together with a number of points to note regarding the data it has received to date.

Source	Notes
Trade Reports	
Trade reports submitted to the Exchange	<ul style="list-style-type: none"> • Trades executed on a central counterparty (“CCP”) order book are excluded from the Exchange’s default procedures. They are managed by LCH.Clearnet under its default rules (Rule D115.5 of the Exchange Rules). • Trades executed on a non-CCP order book (such as the International Order Book (“IOB”)) are automatically trade reported and deemed to be on Exchange (Rule 2000 of the Exchange Rules). • Trades executed away from an order book require a trade report to be submitted to the Exchange by one member firm (Rule 3010 of the Exchange Rules). A trade report is therefore evidence that a trade is on Exchange. • However: <ul style="list-style-type: none"> (a) The Exchange may not have a trade report for all on Exchange trades. In particular: (i) the trading venue was not always agreed definitively between LBIE and its counterparty, resulting in confusion as to whether trades were conducted on Exchange or over-the-counter (“OTC”); and (ii) trades in AIM securities have, erroneously, not been reported (but may still be deemed on Exchange in accordance with Rule 3000.2 of the Exchange Rules). (b) The Exchange may have received duplicate trade reports in respect of OTC trades.
LBIE Submissions	
Trades submitted by LBIE	<ul style="list-style-type: none"> • LBIE has stated that all trades in EU regulated market securities where it was the selling party were OTC trades. However, the Exchange has received trade reports from LBIE in respect of EU regulated market securities, the existence of which contradict this statement. • LBIE issued contract notes to some counterparties stating that trades were on Exchange, whilst reporting those trades elsewhere as OTC. LBIE states that the contract notes indicating the trades were “subject to the rules of the London Stock Exchange” were issued in error. • LBIE was not a member of Plus Markets and was therefore unable to take trades in AIM securities off Exchange under Rule 3000.2 of the Exchange Rules.

Source	Notes
Counterparty Submissions	
Trades submitted by member firms	<ul style="list-style-type: none"> Member firms have included in their submissions trades in relation to which they were not the party obliged to report the trade to the Exchange (under Rule 3012 of the Exchange Rules, or as otherwise agreed under Rule 3013 of the Exchange Rules). They have assumed that these trades were on Exchange and have been reported by LBIE, without knowing whether such reports have been made. There is limited use of reference codes linking submissions to trade reports and CSD instructions (including partial settlements and stock splits/shapes). It is therefore difficult to identify clearly whether a particular trade is, for example, settled or partially settled.
Trades submitted by non-member firms	<ul style="list-style-type: none"> The Exchange has received submissions from a number of non-member firms, but has not yet been able to identify all non-member firm counterparties to unsettled on Exchange trades with LBIE. The Exchange is therefore contacting all possible non-member firm counterparties, providing them with relevant information, and asking them to make submissions if they believe they are counterparty to any unsettled on Exchange trade(s) with LBIE (if they have not already done so). A number of non-member firms from whom submissions have been received are unsure whether they traded with LBIE on Exchange or OTC.
CSD Records	
EUI records (for UK, Irish and AIM equity securities)	<ul style="list-style-type: none"> The Exchange has received transaction records from EUI based on the Trade System of Origin (“TSO”) field being populated with an ‘S’ (signifying the Exchange). However, this field has not been completed correctly in many cases (e.g. the Exchange has data from EUI with settlement instructions flagged ‘S’ that relate to OTC trades) or the EUI data may be missing settlement instructions for on Exchange trades altogether.
EB records (for IOB securities)	<ul style="list-style-type: none"> There are no specific points to note in relation to the EB records received.
DTCC records (for IOB securities)	<ul style="list-style-type: none"> The Exchange has received initial confirmation of the positions held at the DTCC for Lehman Brothers Inc (“Lehman”) as custodian to LBIE. However, as LBIE used Lehman to pass data to the DTCC, the DTCC has not yet been able to confirm independently whether the information from Lehman represents a complete data set of unsettled trades. If necessary, the Exchange will rely on reconciliation and agreement between LBIE and the counterparty on a trade by trade basis.

Claims Processing

The Exchange also proposes to include in its default procedures any outstanding dividend and corporate action claims in relation to on Exchange transactions with LBIE. This is because the Exchange considers that such claims amount to an unsettled element of the trade as originally traded.

A claim is a form of unsettled transaction usually generated by a settlement system to deal with the situation that arises when a trade in a security settles on a date which results in the wrong party (buyer or seller) receiving the results of a corporate action relating to that security (e.g. dividend payment, rights issue etc). The purpose of the claim is to create a transaction intended to pass the benefit of the corporate action to the correct party.

The most common sort of claim arises when a trade is executed cum dividend before an ex dividend date but settles (late) after the record date. In this case, the seller will receive the dividend, but it should have been paid to the buyer. Claims can also arise on stock distributions, in which case the claim consists of a stock amount rather than a cash amount.

For UK and Irish trades, EUI will automatically raise a claim to pay the money from the seller to the buyer. A claim generated in EUI exists as an independent transaction and may settle at a different time from the underlying trade. Therefore, LBIE and its counterparties may have unsettled claims relating to trades which were already settled at the time the default was declared.

EB and the DTCC do not automatically generate claims for trades in IOB securities, so the Exchange's default procedures will only include claims relating to unsettled trades at the time the default was declared.

As a general rule, where the trade as executed (including the impact of any claim) has the same cum or ex status as the hammer price, then the resulting net amount calculation will take the claim into account. However, where this is not the case, the resulting net amount calculation will be amended to reflect the claim.

References to trades in this paper include references to claims where appropriate.

Category	Principle
For securities settling in CSDs where claims are automatically generated (e.g. EUI)	All outstanding claims relating to both unsettled and settled on Exchange trades will be included.
For securities settling in CSDs where claims are not automatically generated (e.g. EB, DTCC)	Only claims relating to unsettled on Exchange trades will be included.

Lending Arrangements

The Exchange has not to date received any submissions from LBIE or its counterparties regarding on Exchange lending arrangements.

Member firms conducting on Exchange stock lending arrangements are required to enter into a written agreement with their counterparty prior to execution (Rule 3002 of the Exchange Rules). The Exchange has authorised standard forms of agreement for this purpose (e.g. the Global Master Securities Lending Agreement) which contain provisions to be followed in the event of the default of either party (see http://www.isla.co.uk/industry_documentation.asp).

The Exchange's default procedures require LBIE and its counterparties to establish the values of the securities to be delivered and the cash payments to be made between them under any unsettled lending arrangements, based on the provisions of the relevant written agreements (Rule D160 of the Exchange Rules), and to notify these values to the Exchange. The Exchange must then ensure that the resulting net sums are included in establishing the net amounts for certification (Rule D163 of the Exchange Rules).

The Exchange's Rule 3001 requires member firms to identify their on Exchange lending arrangements by inserting an 'S' in the TSO field on their EUI settlement instructions. However, the Exchange is aware that many member firms have incorrectly completed the TSO field in EUI with an 'S' in respect of off Exchange lending arrangements.

Any firm wishing to make a submission regarding any on Exchange lending arrangements should do so as soon as possible using the Excel spreadsheet template available at <http://www.londonstockexchange.com/en-gb/products/membershiptrading/rulesreg/defaultinfo/lendingarrangements.htm>.

If no submissions are received by 12:00 hours on Monday 19 January 2009, the Exchange will conclude that there are no on Exchange lending arrangements, and therefore that there is no need to apply those parts of its default procedures relating to such arrangements in the context of this default.

References to trades in this paper include references to lending arrangements as appropriate.

Stage 2. Data Reconciliation

The Exchange will reach an initial determination as to whether there is a trade based on all the evidence before it. If there is no trade report, no CSD data, and the trade is alleged by one party only with no accompanying evidence, it is proposed that the Exchange adopt a rebuttable presumption that there is not trade.

If it determines that there is a trade, the Exchange will reach an initial determination as to whether that trade is on or off Exchange having regard to the existence (or otherwise) of a trade report and the submissions and accompanying evidence from LBIE and its counterparties.

Similarly, it will reach an initial determination as to whether the trade was settled or unsettled at the time the default was declared having regard to relevant CSD data. The Exchange will seek to match trades with settlement instructions using common reference codes (e.g. trade code, settlement ID) and matching algorithms based on security, trade date, buyer/seller, price and size.

Where all of the available evidence is consistent, this will lead to a clear determination. So, for example, if there is a trade report, the trade is alleged by both LBIE and the counterparty, and the CSD data shows the trade to be unsettled, this will result in a determination that the trade was on Exchange and unsettled at the time the default was declared.

However, where there is inconsistent or incomplete evidence, the Exchange will (necessarily) have to make a judgment as to the status of a trade.

Data Reconciliation Principles

In these circumstances, the Exchange proposes to use the following data reconciliation principles in order to establish a rebuttable presumption regarding a trade's status.

Subject	Data Reconciliation Principle
EU regulated market securities	<p>As set out in Stage 1, LBIE has stated that any trade report to the Exchange in respect of EU regulated market securities was made by it in error, and that all such trades were OTC. However, in some cases, counterparties have alleged that those trades were on Exchange.</p> <p>Where a trade has been alleged by a counterparty and the Exchange is in receipt of a trade report in relation to that trade, the Exchange proposes to adopt, for the purposes of its initial determination, a rebuttable presumption that the trade was on Exchange. Conversely, if no trade report has been received, the Exchange will presume that the trade was off Exchange.</p> <p>This proposed approach is consistent with Rule 3000.1 of the Exchange Rules, which provides: "<u>A trade is on Exchange if one or both of the parties to the trade is a member firm...and the trade is effected in [an EU regulated market security]...and the member firm and its customer or counterparty agree at or prior to the time of effecting the trade that it shall be subject to the rules of the Exchange.</u>" (emphasis added)</p>

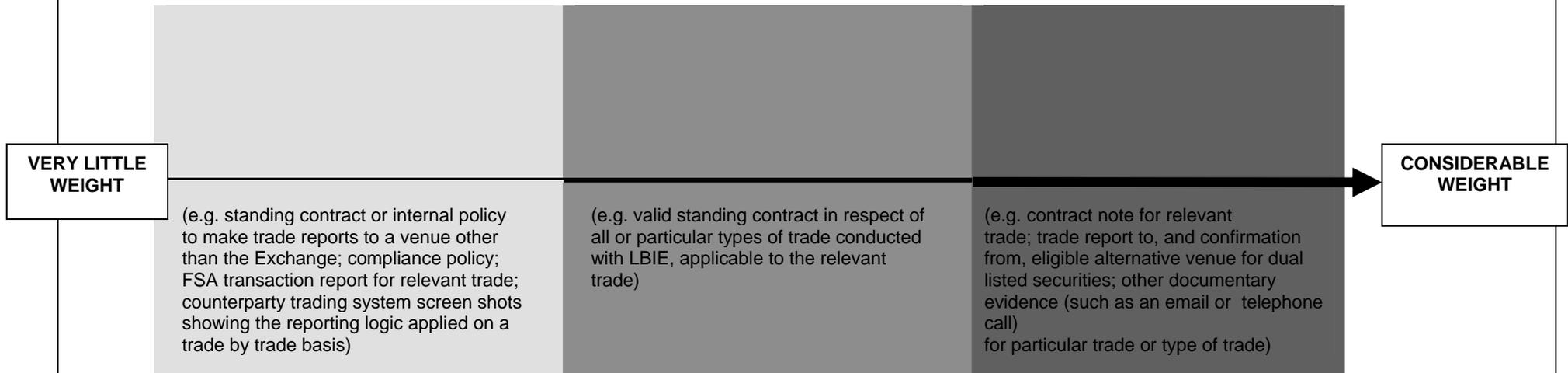
Subject	Data Reconciliation Principle
AIM securities	<p>Rule 3000.2 of the Exchange Rules provides: <i>“A trade is <u>on Exchange</u> if one or both of the parties to the trade is a member firm...and the trade is effected in an AIM security...<u>unless the member firm and its customer or counterparty agree at or prior to the time of effecting the trade that it shall be subject to the rules of an AIM primary market registered organisation.</u>”</i> (emphasis added)</p> <p>Therefore, where the Exchange is in receipt of a trade report in relation to a trade in AIM securities, it proposes to adopt, for the purposes of its initial determination, a rebuttable presumption that the trade was on Exchange. If there is no trade report, but there is other information (e.g. a settlement instruction in EUI, matching submissions from LBIE and the counterparty), the Exchange will also presume that the trade was on Exchange.</p>
Other securities	<p>Rule 3000.3 of the Exchange Rules provides: <i>“A trade is <u>on Exchange</u> if one or both of the parties to the trade is a member firm...and the trade is effected in any security admitted to trading on the Exchange’s markets not covered by 3000.1 & 3000.2 above...<u>unless the member firm and its customer or counterparty agree at or prior to the time of effecting the trade that it shall be reported to a venue that has equivalent or greater post-trade transparency than the Exchange’s regime for that security.</u>”</i> (emphasis added)</p> <p>Therefore, where the Exchange is in receipt of a trade report in relation to such securities, it proposes to adopt, for the purposes of its initial determination, a rebuttable presumption that the trade was on Exchange. Conversely, if no trade report has been received, it will presume that the trade was off Exchange.</p>
Pre-MiFID transaction reports	<p>Pre-MiFID (i.e. before 1 November 2007): (a) all trades conducted by a member firm were considered to be on Exchange unless they fell within an exemption; and (b) a (two-sided) transaction report (rather than a (single-sided) trade report) was required for an on Exchange trade.</p> <p>The Exchange has used EUI data dating back to 2002 (which is the date of the oldest unsettled trade with LBIE in the EUI system) to identify any pre-MiFID trades to which LBIE is a party and which remained unsettled at the time the default was declared (see further below regarding the Exchange’s use of this data).</p> <p>The Exchange proposes to adopt, for the purposes of its initial determination, a rebuttable presumption that a trade was on Exchange where there is a transaction report. If there is no transaction report, the Exchange will presume that the trade was off Exchange.</p>

Subject	Data Reconciliation Principle
EUI data	<p>For pre-MiFID transactions, the Exchange believes that it can rely on unsettled trade information in EUI where the TSO flag is set to 'S' (signifying the Exchange) (see above).</p> <p>However, for post-MiFID transactions, the Exchange cannot rely on the TSO flag being correctly marked. It will therefore require either a trade report or a reference in the submissions by LBIE and/or the counterparty in order to adopt, for the purposes of its initial determination, a rebuttable presumption that a trade was on Exchange.</p>
DTCC data	<p>The Exchange has received initial confirmation of the positions held at the DTCC for Lehman Brothers Inc (“Lehman”) as custodian to LBIE. However, as LBIE used Lehman to pass data to the DTCC, the DTCC has not yet been able to confirm independently whether the information from Lehman represents a complete data set of unsettled trades. If necessary, the Exchange will rely on reconciliation and agreement between LBIE and the counterparty on a trade by trade basis.</p>
<p><u>Best Evidence</u></p> <p>Having established a rebuttable presumption as to the status of a trade using the data reconciliation principles, the Exchange will then consider all other evidence in its possession in relation to that trade (if any) in order to determine whether that presumption is rebutted. In so doing, the Exchange proposes to apply the 'best evidence' principle. In essence, the 'best evidence' principle means that, where the evidence in relation to the status of a particular trade is inconsistent - or, at least, not entirely consistent - the Exchange will make a judgment as to its status which involves choosing to prefer the evidence having the greatest weight.</p> <p>Clearly, the weighing of evidence is not a mechanical process and will need to be assessed on a case by case basis. However, the Exchange has identified three key features in determining how much weight to attribute to evidence put before it.</p> <p>Specifically, the Exchange proposes to attribute greater weight to evidence which is contemporaneous, bilateral and/or unambiguous. And, conversely, it proposes to attribute less weight to evidence which is ex post facto, unilateral and/or ambiguous.</p> <p>So, for example, the following would be the case if these proposals were applied:</p> <ul style="list-style-type: none"> • Evidence of a telephone call made before or at the time the trade is effected, which is unambiguous in establishing an agreement between LBIE and the counterparty that the relevant trade or type of trade will be on Exchange, will be given considerable weight because it has all of the key features mentioned above. Similarly, a copy of a contract note in respect of the relevant trade, to the extent to which it is clear in establishing whether the trade is on or off Exchange, will be given considerable weight. • However, a copy of an internal policy to report certain types of trade OTC will be given very little weight as it is not contemporaneous to the relevant trade, is ambiguous as the fact that a policy exists does not mean that is observed, and is, by definition, unilateral. 	

The Exchange sets out in Stage 3 a (non-exhaustive) list of the categories of evidence that LBIE and its counterparties may be able to produce in relation to trades, based on the types of evidence of which it has been made aware to date.

As it is the existence (or otherwise) of one or more of the key features set out above, rather than the form of the evidence, which will determine the weight attributed by the Exchange, it is difficult to provide generic guidance in relation to these categories of evidence.

However, the diagram below is designed to provide some initial indication of where, on a spectrum of weighting from 'very little weight' to 'considerable weight', each of those categories of evidence might fall.



It is of course the case that each category of evidence listed may move up or down this weighting spectrum depending on the extent to which it meets any or all of the three key features, and any other categories of evidence produced by LBIE and its counterparties will be attributed weight having regard to these three key features.

The Exchange proposes to apply the 'best evidence' principle in a fair, consistent and transparent way in order to reach an initial determination as to which trades were on Exchange and unsettled at the time the LBIE default was declared.

Initial Determination

Once completed, the Exchange's data reconciliation process will produce a schedule identifying (among other things) those trades the Exchange has initially determined as being on Exchange and unsettled at the time the LBIE default was declared, and which it therefore proposes to include in the net amount certificate ("**NAC**").

Both LBIE and its counterparties will be given an opportunity to comment on this initial determination, as set out in Stage 3.

Stage 3. Consultation on Initial Determination

The Exchange proposes to provide LBIE and each of its counterparties with its initial determination – comprising a schedule of trades – for review.

Each schedule will identify:

- those trades submitted by LBIE as having been conducted with the counterparty;
- those trades submitted by the counterparty as having been conducted with LBIE;
- those trades where neither LBIE nor the counterparty have submitted details of a trade, but where the Exchange has evidence – either from its own records or from those of a CSD – that a trade exists between LBIE and the counterparty; and
- any outstanding on Exchange dividend or corporate action claims.

In respect of each trade, the Exchange will indicate its presumed status and whether, based on the Exchange’s initial determination, it is proposed that trade be included in the net amount calculation.

Therefore:

Presumed status	Consequence
Presumed no trade existed	The alleged trade is <u>outside</u> the scope of the Exchange’s default procedures and not subject to the net amount calculation.
Presumed on Exchange and unsettled	The trade is <u>within</u> the scope of the Exchange’s default procedures and subject to the net amount calculation.
Presumed on Exchange but settled	The trade is <u>outside</u> the scope of the Exchange’s default procedures and not subject to the net amount calculation.
Presumed off Exchange and unsettled	The trade is <u>outside</u> the scope of the Exchange’s default procedures and not subject to the net amount calculation.
Presumed off Exchange and settled	The trade is <u>outside</u> the scope of the Exchange’s default procedures and not subject to the net amount calculation.

LBIE and the counterparty will be asked to inform the Exchange within a specified time period (of not less than 14 days) if they disagree with its initial determination in any respect, and to provide any further evidence to the Exchange in support of their claim(s).

In every case, the presumption of the Exchange may be rebutted by LBIE and/or the counterparty providing evidence that contradicts the Exchange's initial view.

At present, the Exchange considers that the types of evidence that LBIE and its counterparty may be able to produce in relation to a trade are likely to fall within the following categories (based on the types of evidence of which it has been made aware to date):

- Contract note for the relevant trade;
- Copy of trade report to, and confirmation from, eligible alternative venue for dual listed securities;
- Other documentary evidence (including, for these purposes, emails and taped telephone calls) relating to the particular trade or type of trade;
- Valid standing contract in respect of all or particular types of trades conducted with LBIE, applicable to the trade in question;
- Standing contract or internal policy to make trade reports to an alternative reporting venue;
- Compliance policy;
- FSA transaction report for the relevant trade;
- Counterparty trading system screen shots showing the reporting logic applied on a trade by trade basis.

This list is not exhaustive and there may be other types of evidence which can be produced.

Stage 4. Assessment of Further Evidence, Confirmation of Net Amounts and Certification

Assessment of Further Evidence

Where LBIE and/or its counterparty do not agree with the Exchange's initial determination in respect of a trade and provide further evidence in support of their claim(s), the Exchange will assess this further evidence in order to reach a final determination.

The Exchange's final determination will be reached having regard to the totality of the evidence available to it, and it is proposed to base it on the 'best evidence' principle described in Stage 2.

Confirmation of Net Amounts

Having reached a final determination as to which trades must be included in the net amount calculation, the Exchange will carry out the calculation and confirm the net amount to be paid to LBIE by each counterparty or claimed from LBIE by each counterparty.

In relation to any non-sterling trades, Rule D144.2 of the Exchange Rules provides that they must be converted into sterling at the spot rate of exchange as set by the Bank of England for the purchase of sterling with the relevant currency on the day of default. In accordance with this rule, the Bank of England spot rate fixed at 16:00 hours on 12 September 2008 (the business day before the LBIE default) for the purchase of sterling with the relevant currency on 15 September 2008 (the day of the LBIE default) will be applied (see Stock Exchange Notice N37/08 of 18 November 2008).

Certification

The Exchange will issue NACs to LBIE and each counterparty as soon as possible after confirming the net amounts payable. Details of all trades included in establishing the net amount will be included with each NAC as evidence of the calculation of a single net cash amount in sterling.

If LBIE (through its joint administrators at PricewaterhouseCoopers LLP) and a counterparty have settled bilaterally one or more of the trades included in the NAC, this will not affect the amount or issue of the NAC by the Exchange. In these circumstances, it is for the parties to agree what impact such settlement has on the way in which they deal with their respective liabilities and entitlements.

Indicative Timetable

The Exchange is currently working to the following indicative timetable.

However, this timetable is dependent upon a number of factors – including the amount of further evidence provided during the consultation on initial determination stage and the time needed to assess such evidence – and, as such, may be subject to amendment. The Exchange will amend the timetable if it needs to do so in order to ensure that it has adequate time to consider any further evidence provided.

Date	Activity
19 January 2009	Deadline for receipt of submissions in response to Stock Exchange Notice N44/08 (and this attachment)
Late January 2009	Finalisation of data reconciliation and net amount certification process
Early February 2009	Complete data reconciliation process
Mid February 2009	Commence consultation on initial determination
March 2009	Commence issue of NACs
April/May 2009	Completion of default procedures

The Exchange will keep LBIE and its counterparties informed regarding any amendments to this indicative timetable.