

Attachment 1

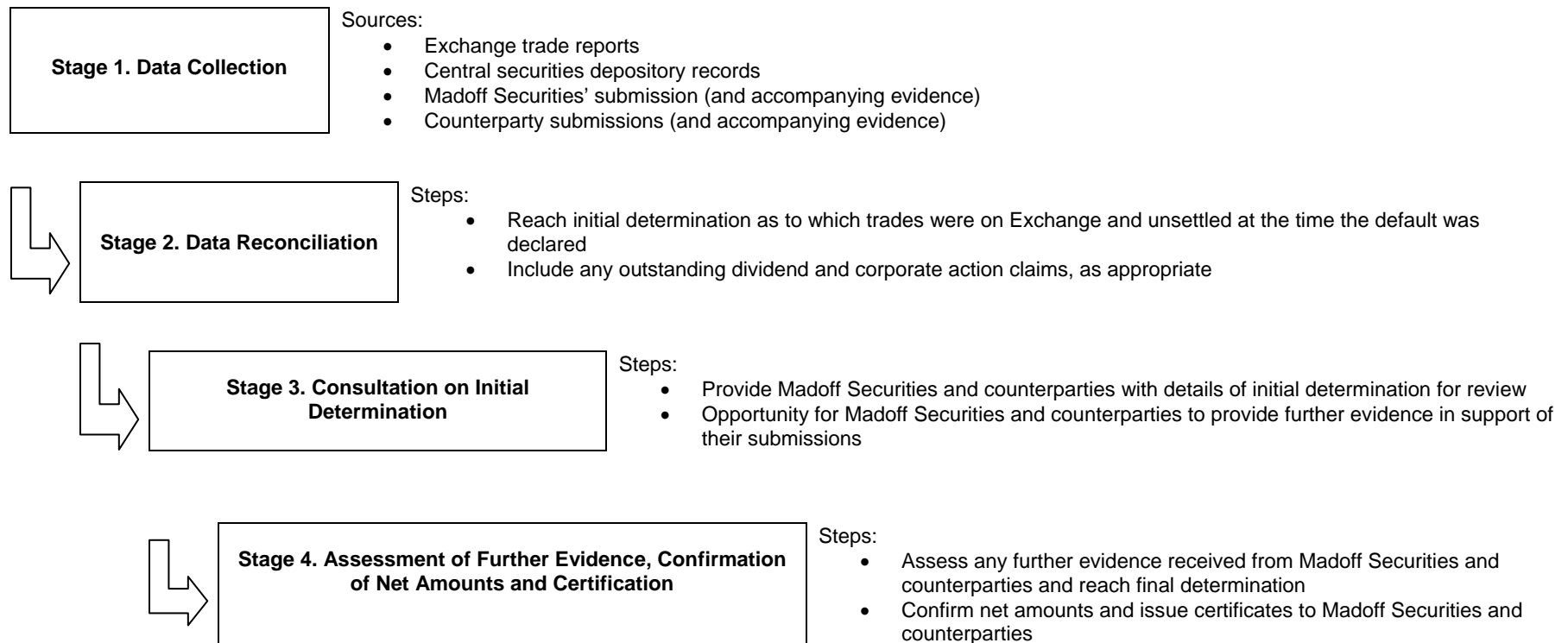
Madoff Securities International Limited - in Default

Data Reconciliation and Net Amount Certification Process for Relevant Principal Contracts

This document describes the data reconciliation and net amount certification process that the Exchange proposes to apply in relation to the default by Madoff Securities International Limited ("Madoff Securities"). This default was declared at 16:00 hours on 20 May 2009 (see Stock Exchange Notice N25/09 issued on that date).

The process set out in this document relates only to on Exchange non-central counterparty trades that were unsettled at the time the default was declared and to which Madoff Securities is party as principal ("relevant principal contracts")

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 Madoff Securities default was declared. Broadly speaking, these are trade reports submitted to the Exchange, the submissions made by Madoff Securities and counterparties and accompanying evidence, and the records of central securities depositories (“CSDs”) such as Euroclear UK and Ireland Limited (“EUI”).

With respect to trade reports, there are some important points to note:

- Trades executed on a central counterparty 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 Rules of the London Stock Exchange (“the Rules”).
- Trades executed away from an order book require a trade report to be submitted to the Exchange by one member firm (Rule 3010). A trade report is therefore evidence that a trade is on Exchange.
- However, the Exchange may not have a trade report for all on Exchange trades. In particular: (i) the trading venue may not have been agreed definitively between Madoff Securities and its counterparty, resulting in confusion as to whether trades were conducted on Exchange or off Exchange; and (ii) trades in AIM securities may, erroneously, not have been reported (but may still be deemed on Exchange in accordance with Rule 3000.2 of the Rules).

There are also some important points of note with respect to CSD records:

- The Exchange has received transaction records from EUI based on the Trade System of Origin (“TSO”) field within the settlement instructions submitted to CREST being populated with an ‘S’ (signifying the Exchange). However, this field may not have been completed correctly in some cases or the EUI data may be missing settlement instructions for on Exchange trades altogether.
- The Exchange is not currently aware of any Madoff Securities transactions being unsettled at other CSDs.

Claims Processing

The Exchange also proposes to include in its default procedures any outstanding dividend and corporate action claims relating to on Exchange trades, whether those trades are settled or unsettled.

A claim is a form of unsettled transaction, sometimes generated automatically by the 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 Ireland trades, EUI will automatically raise a claim to pass the dividend/stock from the seller to the buyer. A claim generated in CREST exists as an independent transaction and may settle at a different time from the underlying trade. Unfortunately, there is no reliable central data source for any claims which are not automatically generated by the CSD. If details of claims are provided, the Exchange will determine whether to include them in its default procedures. If no details are received, the Exchange proposes not to include in its default procedures any claims which are not automatically generated by the CSD.

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.

At present the Exchange is not aware of Madoff Securities and its counterparties having any unsettled claims relating to trades that were already settled at the time the default was declared.

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 a trade did not take place.

If it determines that there is a trade, the Exchange will reach an initial determination as to whether that trade was on or off Exchange having regard to the existence (or otherwise) of a trade report and the submissions and accompanying evidence from Madoff Securities 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 Madoff Securities 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>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><i>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.</i></u>" (emphasis added)</p>

<p>AIM securities</p>	<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...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.”</i> (emphasis added)</p> <p>Therefore, where the Exchange is in receipt of a trade report in relation to a trade in an AIM security, 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 Madoff Securities and the counterparty), the Exchange will also presume that the trade was on Exchange.</p>
<p>Pre-MiFID transaction reports</p>	<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 several years, to the oldest unsettled trade with Madoff Securities in CREST, to identify any pre-MiFID trades to which Madoff Securities 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>
<p>EUI data</p>	<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 Madoff Securities 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>
<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 the 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>	

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.

Specifically, the Exchange proposes to give greater weight to **contemporaneous** evidence (i.e. evidence which was created at the time of the relevant trade), **bilateral** evidence (i.e. evidence of agreement between the parties) and/or **unambiguous** evidence (i.e. evidence which is clear and capable of one interpretation only). Conversely, the Exchange proposes to give less weight to evidence which is **ex post facto** (i.e. evidence which was created after the relevant trade), **unilateral** evidence (i.e. evidence which relates to one party only) and/or **ambiguous** evidence (i.e. evidence which is unclear, uncertain and capable of more than one interpretation).

The Exchange proposes to apply the 'best evidence' principle in a fair and consistent way in order to reach an initial determination as to which trades were on Exchange and unsettled at the time the Madoff Securities 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 Madoff Securities default was declared, and which it therefore proposes to include in the net amount certificate ("NAC").

Both Madoff Securities 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 Madoff Securities and each of its counterparties with its initial determination – comprising a schedule of trades together with a draft Net Amount Calculation – for review.

Each schedule will identify:

- those trades submitted by Madoff Securities as having been conducted with the counterparty;
- those trades submitted by the counterparty as having been conducted with Madoff Securities;
- those trades where neither Madoff Securities 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 an unsettled, on Exchange trade exists between Madoff Securities and the counterparty; and
- any outstanding 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 under Rules D141-144.

Therefore:

Presumed status	Consequence
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.
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.

Madoff Securities and the counterparty will be asked to inform the Exchange within three weeks of receipt of the initial determination if they disagree with that 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 Madoff Securities and/or the counterparty providing evidence that contradicts the Exchange’s initial view.

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

Assessment of Further Evidence

Where Madoff Securities 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 that 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 confirm, in accordance with Rules D141-D144, the net amount to be paid to Madoff Securities by each counterparty or claimed from Madoff Securities by each counterparty.

Certification

The Exchange will issue NACs to Madoff Securities 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.

If Madoff Securities (through its joint provisional liquidators at Grant Thornton) and a counterparty have bilaterally settled a trade included in the NAC, this will not affect the issuance of the NAC by the Exchange or the net amount specified therein. 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 the 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
June 2009	Complete data reconciliation process
Late June 2009	Commence issuance of initial determinations for review
July 2009	Commence issuance of NACs
Late July 2009	Completion of default procedures

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