England and Wales / Prudential Regulation / CCP / LME Clear / December 2014

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09 December 2014

Dear Sirs

CCP Opinion in relation to LME Clear

You have asked us to give an opinion in respect of the laws of England and Wales ("**this jurisdiction**") as to the effect of a netting provision and certain collateral arrangements in relation to LME Clear (the "**Clearing House**") as they apply between the Clearing House and its clearing members (each a "**Member**").

We understand that your requirement is for the enforceability and validity of such netting provision and collateral arrangements to be substantiated by a written and reasoned opinion letter.

References herein to "**this opinion**" are to the opinion given in Section 3.

1. TERMS OF REFERENCE

1.1 Except where otherwise defined herein, terms defined in the Rules (as defined below) of the Clearing House have the same meaning in this opinion letter.

1.2 The opinions given in Section 3 are in respect of a Member's rights and obligations under the Clearing House Documentation (as defined below) as at the date of this opinion. We express no opinion as to any provisions of the Clearing House Documentation other than those on which we expressly opine.

1.3 The opinions given in Section 3 are given in relation to the exercise of rights and obligations under the Clearing House Documentation by a Member who is a non-natural person (as defined in the Financial Collateral Arrangements (No.2) Regulations 2003 (the "**FCA Regulations**")) and who is neither a recognised investment exchange (within the meaning of section 155 of the Companies Act 1989) nor a recognised clearing house.

1.4 The opinions contained in Section 3 are not limited to any specific services offered by the Clearing House.

1.5 The opinion given in paragraph 3.8 is given only in relation to Securities Collateral comprising securities credited to an Account.

1.6 **Definitions**

In this opinion, unless otherwise indicated:

1.6.1 "**Clearing House Documentation**" means the Membership Agreement, the Rules and the Security Deed;

1.6.2 "**Client Money Rules**" means the rules set forth in chapters CASS 7 and 7A of the Client Assets Sourcebook of the Financial Conduct Authority's Handbook of Rules and Guidance, as in force at the date of this opinion;

1.6.3 "**Netting Provision**" means Rules 10.13.3 to 10.13.8;

1.6.4 "**Party**" means the Clearing House or the relevant Member and a reference to the "**Parties**" is to both of them;

1.6.5 "**Rules**" means the rules and the Procedures (including any Annexes) of the Clearing House in force and published on the Clearing House website as at the date of this opinion;

1.6.6 "**Secured Obligations**" has the meaning ascribed to such term in the Security Deed;

1.6.7 "**Security Deed**" means, in respect of each Member who provides Collateral to the Clearing House in the form of securities and/or Gold, a Security Document in the form of the security deed set out in Annex 2;

1.6.8 "**Statutory Insolvency Set-Off**" has the meaning ascribed to such term in paragraph 4.1.1;

the following principles of interpretation apply:

1.6.9 references to the "**Banking Act**" are to the Banking Act 2009;

1.6.10 references to a "**designated system**" are to a designated system within the meaning of and for the purposes of the Settlement Finality Regulations (as defined below);

1.6.11 except in paragraphs 2.2, 3.8.2 (in relation to which the qualification set out in paragraph 4.3.5 will additionally apply) and 4.3.5, references to the word "**enforceable**" and cognate terms are used to refer to the ability of a Party to exercise its contractual rights in accordance with their terms and without risk of successful challenge. Except in those paragraphs, we do not opine on the availability of any judicial remedy, including in respect of any net obligation resulting from any netting or set-off, whether pursuant to the Netting Provision or otherwise;

1.6.12 references to the "**EUIR**" are to the EU Council Regulation No. 1346/2000 of 29 May 2000 on insolvency proceedings;

1.6.13 a reference to "**FCA Regulations**" is to the Financial Collateral Arrangements (No. 2) Regulations 2003;

1.6.14 a reference to a "**financial collateral arrangement**" is to an arrangement defined as such in the FCA Regulations;

1.6.15 a reference to "**FSMA**" is to the Financial Services and Markets Act 2000;

1.6.16 references to a "**paragraph**" are (except where the context otherwise requires) to a section or paragraph of this opinion (as the case may be);

1.6.17 a reference to "**Part VII**" is a reference to Part VII of the Companies Act 1989 together with the Schedule to the Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001 (to the extent applicable in the relevant context);

1.6.18 a reference to a "**Rule**" is, unless the context otherwise requires, a reference to a rule forming part of the Rules, and a reference to a "**Procedure**" is to a procedure forming part of the Procedures;

1.6.19 a reference to the "**Settlement Finality Regulations**" is to the Financial Markets and Insolvency (Settlement Finality) Regulations 1999; and

1.6.20 a reference to a statutory provision includes a reference to the statutory provision as modified or re-enacted or both from time to time before the date of this opinion and any subordinate legislation made or other thing done under the statutory provision before the date of this opinion.

2. ASSUMPTIONS

We assume the following:

2.1 That each Party has the capacity, power and authority under all applicable law(s) to enter into the Clearing House Documentation and the Contracts and to perform its obligations under the Clearing House Documentation and the Contracts.

2.2 That each Party has taken all necessary steps and obtained and maintained all authorisations, approvals, licences and consents necessary to execute, deliver and perform the Clearing House Documentation and the Contracts and to ensure the legality, validity, enforceability or admissibility in evidence of the Clearing House Documentation and the Contracts in this jurisdiction.

2.3 That, except with regards to the provisions discussed and opined on in this opinion letter, the Clearing House Documentation and the Contracts are legal, valid, binding and enforceable against both Parties.

2.4 That the Membership Agreement and (where applicable) the Security Deed have been entered into prior to the commencement of any insolvency procedure under the laws of any jurisdiction in respect of either Party.

2.5 For the purposes of the opinions set out in paragraphs 3.4 to 3.8, that the Member is at all relevant times able and not likely to become unable to meet its obligations in respect of one or more Contracts (whether due to winding-up, administration, receivership, bankruptcy, dissolution or analogous insolvency proceedings or any of the other events specified in Rule 10.2).

2.6 That the Clearing House is at all material times a recognised central counterparty within the meaning of section 285 of FSMA and for the purposes of Part VII; a designated system within the meaning and for the purposes of the Settlement Finality Regulations; and a UK Clearing House within the meaning and for the purposes of the Banking Act.

2.7 That the Clearing House has (i) the centre of its main interests in the United Kingdom for the purposes of the EUIR and (ii) no "establishment" in any other jurisdiction for the purposes of the EUIR and the Cross-Border Insolvency Regulations 2006.

2.8 That, apart from any circulars, notifications and equivalent measures published by the Clearing House in accordance with the Rules, there are not any other agreements, instruments or arrangements between the Parties which modify or supersede the terms of the Clearing House Documentation; and in particular, that there are no provisions in the rules of any relevant designated system (other than the Clearing House itself) which purport to override or are inconsistent with the Netting Provision.

2.9 That none of the provisions discussed and opined on in this opinion letter has been disallowed pursuant to section 300A of FSMA.

2.10 That the Clearing House Documentation and each of the Contracts accurately reflect the true intentions of the Parties and have been entered into and are carried out by the Parties in good faith, for the benefit of each of them respectively, on arms' length commercial terms and for the purpose of carrying on, and by way of, their respective businesses.

2.11 That each Party acts in accordance with the terms of the Clearing House Documentation; and that (save in relation to any non-performance leading to the taking of action by a relevant Member under the Netting Provision), each Party performs its obligations under the Clearing House Documentation in accordance with its terms.

3. OPINION

On the basis of the foregoing terms of reference and assumptions and subject to the qualifications set out in Section 4 below, we are of the following opinions.

3.1 Insolvency Proceedings

The only bankruptcy, composition, rehabilitation or other insolvency or reorganisation procedures to which the Clearing House could be subject under the laws of this jurisdiction, and which are relevant for the purposes of this opinion, are liquidation (including provisional liquidation), administration, receivership, voluntary arrangements and schemes of arrangement.

These procedures are together called "**Insolvency Proceedings**".

The legislation applicable to Insolvency Proceedings is:

3.1.1 in relation to all Insolvency Proceedings except schemes of arrangement, the provisions of the Insolvency Act 1986 and the Insolvency Rules 1986; and

3.1.2 in relation to schemes of arrangement, section 895 to 901 of the Companies Act 2006,

each as modified up to the date hereof.

In relation to a transfer order or collateral security in connection with a system, or an obligation which arises under the default arrangements of a designated system, the Settlement Finality Regulations will also be applicable. Insofar as the Clearing House Documentation and the arrangements made thereunder constitute a financial collateral arrangement, the FCA Regulations will also apply.

Furthermore, the EUIR would apply to the Clearing House and has direct effect in this jurisdiction.

3.2 Banking Act

3.2.1 Instead of or in addition to Insolvency Proceedings, the Clearing House may be subject to a "property transfer instrument" under sections 11 and 12 of the Banking Act if the Bank of England is satisfied that (i) the Clearing House is failing, or likely to fail, to satisfy the recognition requirements and (ii) it is not reasonably likely that other action(s) will be taken by or in respect of the Clearing House which would enable the Clearing House to maintain the critical clearing services it provides while also satisfying the recognition requirements.

For the purposes of the foregoing:

"**critical clearing services**" has the meaning ascribed to such term in section 7 of the Banking Act, being "central counterparty clearing services the withdrawal of which may, in the Bank of England's opinion, threaten the stability of the financial systems in the United Kingdom"; and

"**recognition requirements**" has the meaning ascribed to such term in section 7 of the Banking Act, being "the requirements resulting from section 286 of FSMA" (which the Clearing House is required to satisfy on an ongoing basis

as a condition for maintaining its status as a recognised clearing house within the meaning and for the purposes of FSMA).

3.2.2 In relation to netting, the effects of a partial property transfer, and other powers exercisable in respect of the Clearing House under the Banking Act, are considered at paragraph 4.2 below.

3.3 Recognition of choice of law

The choice of law provisions of Rule 2.12 (*Governing Law and Jurisdiction*), which apply to the Netting Provision, and the choice of law provisions pursuant to the Security Deed and Membership Agreement would be recognised under the laws of this jurisdiction, notwithstanding that the Member may not be incorporated, domiciled or established in this jurisdiction.

3.4 Netting and Set-off: General

3.4.1 The Netting Provision will be enforceable in accordance with its terms so that, upon the occurrence of a LME Clear Default and following the specification by a Member of a Close Out Date:

(a) all Open Contracts between the Clearing House and the relevant Member would automatically terminate on the Close Out Date and on and from the Close Out Date neither the Clearing House nor the Member would be obliged to perform further Payment Obligations or Delivery Obligations in respect of such Open Contracts (save in respect of the net sums representing the Close Out Amounts as described in paragraph (c) below);

(b) the relevant Member would calculate in respect of a relevant Account (i) its Aggregate Member Entitlement (comprising the aggregate rights of the Member to receive payment from the Clearing House, whether current, contingent or future, and including, without limitation, rights of the Member to receive amounts payable by the Clearing House in respect of the settlement or performance of Open Contracts, in respect of costs reasonably incurred by the Member in accordance with Rules 10.13.7(a)(1)), and in respect of the return of Cash Collateral (please refer to paragraph 3.6 *(Cash Collateral*) for an analysis of the circumstances in which the relevant obligations of the Clearing House to return Cash Collateral might be expected to arise); and (ii) the

Aggregate Member Obligation (comprising the aggregate rights of the Clearing House to receive payment from the Member, whether current, contingent or future, and including, without limitation, rights of the Clearing House to amounts payable by the Member in respect of the settlement or performance of Open Contracts); and

(c) in respect of each Account, the Member would be (i) entitled to receive only a single net positive Close Out Amount; or (ii) obliged to pay only a single net negative Close Out Amount, each such Close Out Amount being the result of a set-off between the Aggregate Member Entitlement and the Aggregate Member Obligation in respect of the relevant Account.

Further, there is no rule of the laws of this jurisdiction which would impose a moratorium or stay which would prevent, delay or otherwise affect the exercise of such rights by the Member.

In addition, the Rules do not contain a "walkaway" clause (i.e. a provision which would permit the Member to make a lower payment than the Close Out Amount calculated in respect of the Contracts, together with other losses or gains referable to the Contracts).

3.4.2 We are of this opinion because there is no rule of the laws of this jurisdiction which would, in our view, apply to prohibit the Parties from entering into a contract upon the terms of the Netting Provision.

In the event of a LME Clear Default in respect of the Clearing House, we are of the opinion that Regulation 12(1) of the FCA Regulations would apply to the Netting Provision. Regulation 12(1) of the FCA Regulations provides that a close-out netting provision constituting a term of a financial collateral arrangement, or an arrangement of which a financial collateral arrangement forms part, shall take effect in accordance with its terms, notwithstanding that the collateral-provider or collateral-taker under the arrangement is subject to winding-up proceedings or reorganisation measures (as such terms are defined in the FCA Regulations). In our view, the Netting Provision would qualify as a close-out netting provision constituting a term of an arrangement of which a financial collateral arrangement forms part under Regulation 12(1) of the FCA Regulations, the relevant "financial collateral arrangement" for these purposes being a "title transfer financial collateral arrangement" in respect of "financial collateral" in the form of "cash" (as each such term is defined in the FCA

Regulations). The arrangements for the transfer of Cash Collateral by the Member to the Clearing House in respect of its Margin Requirement constitute the relevant title transfer financial collateral arrangement.

3.4.3 Furthermore, the Netting Provision is triggered by any LME Clear Default, including a LME Clear Default which constitutes or results in a default on a transfer order, and would in our view qualify as "default arrangements" of a designated system. Pursuant to Regulation 14 of the Settlement Finality Regulations: (i) the default arrangements of a designated system shall not be regarded as invalid at law on the ground of inconsistency with the laws (of this jurisdiction) relating to the distribution of assets of a person subject to winding-up or administration; and (ii) the powers of an insolvency officer and of the courts of this jurisdiction under the Insolvency Act 1986 shall not be exercised in such a way as to prevent or interfere with any action taken under the default arrangements of a designated system. Therefore, the onset of any Insolvency Proceeding in respect of the Clearing House which constitutes a LME Clear Default (in the form of an LME Clear Insolvency Default) would not interfere with the netting in accordance with the Netting Provision of amounts including amounts due in respect of (i) payment obligations in respect of the performance or settlement of Contracts and (ii) the Cash Collateral held by the Clearing House in respect of the Member's Margin Requirement.

Regulations 14(1)(b) and 14(2)(b) of the Settlement Finality Regulations provide that the totality of default arrangements of a designated system take precedence over insolvency laws, including Statutory Insolvency Set-Off (please see paragraph 3.4.5 below for further details), whether or not the default arrangements apply to "transfer orders", since these are separately dealt with in Regulations 14(1)(a) and 14(2)(a). Regulation 14(3) provides that "nothing in the following provisions of this Part shall be construed as affecting the generality of the above provisions". The "following provisions" – *inter alia* Regulations 15, 16 and 17 – specify certain provisions of insolvency law which are explicitly disapplied as regards transfer orders. We believe that the effect of Regulation 14(3) is to confirm that these exclusions are not intended to be construed restrictively, and that they do not have the effect of limiting the precedence of "default arrangements" over the general law of insolvency to transfer orders only.

3.4.4 For the reasons described in paragraph 3.4.2, Regulation 12(1) of the FCA Regulations provides that close-out netting provisions in relation to financial collateral arrangements take effect in accordance with their terms. Furthermore, for the reasons given in paragraph 3.4.3 above, Regulation 14 of the Settlement Finality Regulations would have the effect that the requirement of the Netting Provision to determine a number of Close Out Amounts (including a separate Close Out Amount in respect of each Client Account) will take precedence over insolvency laws. In addition to the netting arrangements provided under the Netting Provision, Rule 2.17 provides for a discretionary right of the Clearing House, which is exercisable at any time, to set off indebtedness due to it by a Member against indebtedness owed to it by that Member. However, the Clearing House is prevented from exercising this right in a manner inconsistent with the arrangements for the segregation of Accounts set out in Rule 4.3. This means that a Close Out Amount determined in respect of a particular Account would not be aggregated with, or set-off against, a Close Out Amount or any other amount arising in respect of any other Account, notwithstanding an exercise by the Clearing House of its rights under Rule 2.17 following the occurrence of a LME Clear Default.

3.4.5 In a case where the Clearing House is in administration or liquidation and a LME Clear Default (in the form of an LME Clear Insolvency Default) has occurred but a Close Out Date has not occurred (whether because the Member has not issued a Close Out Netting Notice or because the Close Out Date specified by the Member is due to occur on a future date), there may be a set-off of amounts due pursuant to one or more Statutory Insolvency Set-Offs.

3.4.6 However, Statutory Insolvency Set-Off would not apply in respect of amounts which are considered not to be "mutual" for the purposes of Statutory Insolvency Set-Off. For such purposes, "mutual obligations" are those where each party is personally and solely liable as regards obligations owing by it and is solely entitled to the benefit of obligations owed to it. Circumstances in which the requisite mutuality will not be established include, without limitation, where a party is acting as agent for another person, or is a trustee, or in respect of which a party has a joint interest (other than, for the purposes of this opinion, where a Member is a partnership organised under the laws of this jurisdiction and then only in relation to the position between the Member and the Clearing House) or in respect of which a party's rights or obligations or any interest therein have been assigned, charged, attached or transferred (whether in whole or in part) whether unilaterally, by agreement or by

operation of law or by order (including, without limitation, pursuant to section 111 of FSMA).

In addition, Statutory Insolvency Set-Off would not apply in circumstances where Regulation 12(1) of the FCA Regulations and/or Regulation 14 of the Settlement Finality Regulations apply (as noted in paragraphs 3.4.2 and 3.4.3 above). In this regard, please refer to the qualifications in paragraph 4.1.6 in relation to the circumstances in which Regulation 12(1) of the FCA Regulations may not apply, and paragraphs 4.1.7 to 4.1.9 in relation to the circumstances in which Regulation 14 of the Settlement Finality Regulations may not apply.

Furthermore, section 182A of the Companies Act 1989 provides that nothing in the law of insolvency shall enable the setting off against each other of positions and assets recorded in a client account of a recognised central counterparty against positions and assets recorded in any other account at the recognised central counterparty. For these purposes, "recognised central counterparty" has the meaning given to such term in section 285 of FSMA. The effect of this provision in respect of the Clearing House (which, per the assumption at paragraph 2.6, would qualify as a recognised central counterparty) is that in no circumstances will amounts due in respect of a Client Account held by a Member with the Clearing House be set off pursuant to a Statutory Insolvency Set-Off (or any other set-off otherwise provided for under insolvency law) against an amount due in respect of any other Account held by the Member with the Clearing House.

Hence, even in the case where the Clearing House is subject to Insolvency Proceedings but, either the Member has not exercised its right to deliver a Close Out Netting Notice, or such notice has been delivered by the Member to the Clearing House but the associated Close Out Date has not yet occurred, any amounts due in respect of the House Accounts of the Member, on the one hand, and each of the Client Accounts of the Member, on the other hand, would be payable separately.

3.5 Netting and Set-Off: Cross-Product Netting

3.5.1 The effect of the Netting Provision is to apply close-out netting to all Open Contracts cleared by the Member with the Clearing House.

3.5.2 This is because the Netting Provision refers throughout to Contracts as defined under the Rules. "Contract" is defined to mean a "binding agreement between the Clearing House and a Member that is formed under and in accordance with Rule 6 and which is to be performed or discharged in accordance with the Rules". The Rules apply generally to all types of Contract cleared by the Clearing House.

3.5.3 The Netting Provision does not differentiate, nor enable the Clearing House or a Member to differentiate, between sub-sets of Contracts for the purposes of the netting arrangements provided for thereunder. In this regard, however, the comments set out in paragraph 3.4.4 in relation to the calculation of a separate Close Out Amount in relation to the Contracts recorded in each Client Account should be borne in mind.

3.6 Cash Collateral

3.6.1 Payments made by a Member to the Clearing House under Rule 8 as Cash Collateral in respect of its Margin Requirement constitute the absolute transfer of cash (as is provided for in Rule 8.3.2), so that, in the event of Insolvency Proceedings, such Cash Collateral would be treated as the property of the Clearing House available to its creditors generally.

3.6.2 However, the amount of cash so provided would constitute a debt owed by the Clearing House to the Member as principal, and would be subject to (i) close-out netting under the Netting Provision; or (ii) (where close-out netting did not apply under the Netting Provision and, in the event of liquidation or, if the administrator has issued a notice under Rule 2.95 of the Insolvency Rules 1986, administration) Statutory Insolvency Set-Off (subject to the observations in paragraph 3.4.6 regarding mutuality and the preclusion, under section 182A of the Companies Act 1989, of a set-off of any amounts due in respect of a Client Account of a Member against any amounts due in respect of any other Account of the Member).

3.6.3 A transfer of Cash Collateral made by a Member to the Clearing House would not be treated as subject to a charge pursuant to the Rules. This is because there is no rule of the laws of this jurisdiction to the effect that a payment made to another person and credited to an account by them would be subject to a charge, even where the transfer is of Cash Collateral in respect of its Margin Requirement, and express words would be required to establish the existence of a charge.

3.6.4 Payment Obligations determined and payable by a Party in accordance with the Procedures are distinct from the obligation of a Member to transfer Cash Collateral to the Clearing House and from the debt obligation of the Clearing House which arises in respect of each such transfer. However, as described in paragraph 3.4.1, in the event of an occurrence of an LME Clear Default, any such outstanding Payment Obligations would constitute "payments made in settlement or performance of a Contract" for the purposes of Rule 10.13.7(a)(2), and, as such, would also be included in the determination of the relevant Aggregate Member Entitlement or Aggregate Member Obligation (as the case may be) and netted under the Netting Provision.

3.7 Gold Collateral

3.7.1 In addition to the arrangements in respect of Cash Collateral and Securities Collateral, the Clearing House accepts Precious Metals as Collateral (currently restricted to Gold) in respect of Members' Margin Requirements.

3.7.2 Gold Collateral is originally provided by a Member to the Clearing House in the form of unallocated Gold. However, the Clearing House may convert any unallocated Gold received by it from a Member into allocated Gold. Gold Collateral does not qualify as Eligible Collateral unless and until it has been converted by the Clearing House into allocated Gold. In order for the Clearing House to return Gold Collateral to a Member, the relevant allocated Gold would be converted back into unallocated Gold following which it would be credited to such account with London Precious Metals Clearing Limited as the relevant Member directs.

3.7.3 Clause 7 of the Security Deed provides that Gold Collateral is provided to the Clearing House by a Member by way of title transfer, with the result that such Gold Collateral is owned by the Clearing House outright and the Member does not retain any proprietary or other rights in it. Hence, in the event of Insolvency Proceedings in respect of the Clearing House, Gold Collateral held by the Clearing House would be treated as the property of the Clearing House available to its creditors generally, and a Member who has provided Gold Collateral to the Clearing House would rank as an unsecured creditor to the extent of the value of the Gold Collateral (whether in the form of unallocated Gold or allocated Gold) it has so provided.

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3.8 Securities Collateral

3.8.1 Any Securities Collateral delivered by a Member to a Clearing House will not be treated as the property of the Clearing House. The arrangements by which such securities are transferred in accordance with the terms of the Security Deed and recorded in Accounts with the Clearing House give rise to an arrangement under which the relevant Member is beneficially entitled. Under the terms of the Security Deed, the Member charges its interests in favour of the Clearing House but retains an equity of redemption over those interests. Upon the extinction of the Secured Obligations, the charge under the Security Deed would fall away and the Member would revert to having beneficial rights in the relevant securities.

3.8.2 This is because Insolvency Proceedings generally recognise property rights existing prior to the onset of insolvency, and as a result, upon an insolvency of the Clearing House, only the assets of the Clearing House would be available to its creditors. A Member who has charged or mortgaged its assets to the Clearing House would have a pre-existing property right (in the form of an equity of redemption) in those assets, and that property right will be enforceable as against the Clearing House (in insolvency) and as against the insolvency practitioner of the Clearing House. Thus, the only claim which those creditors would have in the relevant Securities Collateral would be those rights which exist under the Security Deed to enforce against the assets in the event of a default by the relevant Member. As a result, the Clearing House holds the Securities Collateral in a way that does not give it beneficial ownership of such property and will not result in such property being subject to legally enforceable claims by creditors, or to a court-ordered stay of the return of such property, should it become insolvent, save for any claims arising under prior security arrangements.

3.8.3 There is no general doctrine of English law which would have the effect of converting a grant of security in property subject to a formal security arrangement into an absolute transfer so as to extinguish the chargor's right to recover the charged property on the extinction of the Secured Obligations in accordance with the security arrangement other than through the exercise of the right of the chargee to enforce against the charged asset. However, if the Member were to default in paying or discharging any of the Secured Obligations, the Clearing House would have the right to sell or otherwise dispose of the Securities Collateral and (subject to the duty to account for any

excess proceeds) apply the proceeds in satisfaction of the Secured Obligations. However, insofar as the security arrangements constituted by the Security Deed constitute a financial collateral arrangement, the right of use conferred by Rule 8.6.3 upon the Clearing House will have effect in accordance with Regulation 16 of the FCA Regulations. The effect of the exercise of the right of use by the Clearing House would be to discharge the Member's proprietary rights in relation to the Securities Collateral and instead oblige the Clearing House (as a personal, rather than proprietary obligation) to replace the Securities Collateral by transferring equivalent financial collateral in accordance with the FCA Regulations.

3.8.4 We understand that in addition to the Security Deed, the Clearing House may also enter into a Belgian or New York law governed Security Document with certain Members. On the assumption that these documents do not transfer ownership of the relevant Securities Collateral under the *lex situs* and their governing law and create a security interest similar to the one created in respect of Securities Collateral under the Security Deed, the analysis set out in paragraphs 3.8.1 to 3.8.3 will also apply in respect of Securities Collateral provided to the Clearing House under these two foreign law documents.

4. QUALIFICATIONS

The opinions in this opinion letter are subject to the following qualifications:

4.1 Qualifications relating to Netting and Set-off: General

4.1.1 The aggregation or set-off of amounts representing terminated obligations may, subject to any contrary statutory rule, such as Regulation 14 of the Settlement Finality Regulations, Regulation 12(1) of the FCA Regulations or, to the extent applicable, section 182A of the Companies Act 1989, be implemented, in a winding-up, under Rule 4.90 of the Insolvency Rules 1986 ("**Rule 4.90**") or in an administration, under Rule 2.85 of the Insolvency Rules 1986 ("**Rule 2.85**"), rather than under the specific provisions of the Rules.

Set-off pursuant to Rule 4.90 or Rule 2.85 ("**Statutory Insolvency Set-Off**") will result in a net amount payable in respect of amounts relating to mutual obligations between the Parties, subject to the other qualifications set out in this opinion.

It should be noted that, in relation to the matter of whether or not amounts due in respect of House Accounts and Client Accounts would be considered to be "mutual" for the purposes of Statutory Insolvency Set-Off:

(a) where a Member is subject to the Client Money Rules, the effect of section 139 of FSMA and the Client Money Rules is that all amounts due in respect of certain Client Accounts will be held on trust for clients collectively, and such amounts would not be "mutual" with (and therefore cannot be set off against) amounts due in respect of House Accounts or Client Accounts which are not subject to the trust; and

(b) where a Member is subject to client segregation requirements under the laws of its home jurisdiction, the segregation arrangements may be regarded under the laws of this jurisdiction as making amounts due in respect of a Client Account not "mutual" with (and therefore cannot be set off against) amounts due in respect of House Accounts, or, possibly, other Client Accounts.

Notwithstanding (a) and (b) above, if Statutory Insolvency Set-Off applies to any such amounts, the Member and its own clients would unlikely be left in a worse position than would be the case in the absence of such Statutory Insolvency Set-Off. This is because, as a practical matter, the Member would be able to determine separate mutual amounts equal to amounts which may have been aggregated and set-off under Statutory Insolvency Set-off. A Member would (under the laws of this jurisdiction) be able to re-allocate amounts as between its own House Accounts and Client Accounts to achieve the same position that would have arisen in the absence of Statutory Insolvency Set-Off.

4.1.2 In a winding-up by the courts under the laws of this jurisdiction, any dispositions of the Clearing House's property made after the commencement of winding-up of the Clearing House (which, in this context, means the time of presentation of the petition for winding-up; or, if earlier, the time of passing a resolution for voluntary winding-up; or, if the court makes a winding-up order on hearing an administration application, the making of the order) are void under section 127 of the Insolvency Act 1986 unless the court otherwise orders or the Settlement Finality Regulations or the FCA Regulations prevent its application.

Pursuant to Regulations 14(1)(b) and 14(3) of the Settlement Finality Regulations, the default arrangements of a designated system shall not be regarded as to any extent invalid at law on the ground of inconsistency with the law relating to the distribution of assets of a person on winding up. Accordingly, section 127 of the Insolvency Act 1986 would not apply to invalidate any transfer of cash or other disposition of property insofar as contrary to the default arrangements of the Clearing House (which, as discussed in paragraph 3.4.3, should include the Netting Provision).

Pursuant to Regulation 10(1) of the FCA Regulations, section 127 of the Insolvency Act 1986 does not apply to any property or security interest subject to a disposition or created or otherwise arising under a financial collateral arrangement or to prevent a close-out netting provision (as defined in the FCA Regulations) taking effect in accordance with its terms.

In any case where the Settlement Finality Regulations and the FCA Regulations do not apply, the effect of Statutory Insolvency Set-Off is such that obligations entered into after compulsory winding-up has commenced in relation to the Clearing House might not be capable of inclusion in the netting under the Netting Provision or a set-off pursuant to a Statutory Insolvency Set-Off, but this would not impair the effectiveness of the Netting Provision or a Statutory Insolvency Set-Off in respect of ~~(i)~~ Contracts entered into ~~and (ii) (other than where paragraphs (b) and (c) of Regulation 23 apply)~~ before the commencement of such Insolvency Proceedings.

4.1.3 Statutory Insolvency Set-Off may not apply to amounts which arise under Contracts entered into at certain times, and accordingly an English court might not allow such amounts to be included in an aggregation or set-off pursuant to the Netting Provision or a Statutory Insolvency Set-Off. The times referred to are, so far as relevant, as follows:

(a) after the Clearing House had entered administration;

(b) at a time when the Member had notice that an application for an administration order in respect of the Clearing House was pending or that any person had given notice of intention to appoint an administrator in respect of the Clearing House;

(c) at a time when the Member had notice that a meeting of creditors of the Clearing House had been summoned under section 98 of the

Insolvency Act 1986 (which requires a company which goes into creditors' voluntary winding-up to cause a meeting of creditors to be summoned for a day not later than the fourteenth day after the day on which there is to be held a shareholders' meeting at which the resolution for voluntary winding-up is to be proposed) or that a petition for the winding-up of the Clearing House was pending; or

(d) during a winding-up of the Clearing House.

Furthermore, any debt which has been acquired by the Member by assignment or otherwise pursuant to an agreement between the Member and any other person must be excluded from Statutory Insolvency Set-Off, and may not be included in an aggregation pursuant to the Netting Provision, where such assignment or other agreement was entered into at any of the times mentioned above.

However, since, in our opinion, the Netting Provision constitutes a provision of a financial collateral arrangement, or of an arrangement of which a financial collateral arrangement forms part, it appears that amounts which arise under Contracts may still be included in an aggregation or set-off:

(i) in an administration of the Clearing House, if they became due after the Clearing House entered administration or (if the administration was immediately preceded by a winding-up) during the winding-up; and

(ii) in a winding-up of the Clearing House which was immediately preceded by an administration, if they became due during the administration,

unless at the time the relevant financial obligations came into existence the Member was aware, or should have been aware, that winding up proceedings or reorganisation measures (as such terms are defined in the FCA Regulations) had commenced in relation to the Clearing House.

4.1.4 Liquidation and, where an administrator is authorised to make a distribution, administration procedures under the Insolvency Rules 1986 are conducted in sterling. Rule 2.86 and Rule 4.91 of the Insolvency Rules 1986 provide that, for the purposes of Statutory Insolvency Set-Off, a debt incurred in a currency other than sterling shall be converted into sterling at the "*official exchange-*

rate" (which is based on the market rate on the date the court makes the winding-up order, or the company concerned goes into liquidation or enters administration).

However, under Regulation 14 of the FCA Regulations, Rule 2.86 and Rule 4.91 of the Insolvency Rules 1986 are disapplied in the case of liquidation or administration proceedings in respect of a party to a financial collateral arrangement or a close out netting provision which permits conversion into sterling at a rate other than the "*official exchange rate*" unless the arrangement provides for an unreasonable exchange rate or the collateral taker uses the mechanism provided under the arrangement to impose an unreasonable exchange rate. In light of the opinion (given at paragraph 3.3.2) that the Netting Provision constitutes a "close-out netting provision" for the purposes of the FCA Regulations, Regulation 14 of the FCA Regulations should, in our opinion, apply in the case of a liquidation or an administration of the Clearing House, subject to the observations at paragraph 4.1.6 below.

4.1.5 In respect of any Contract entered into before the commencement of winding-up in respect of the Clearing House, under which property is to be delivered after the time of such commencement and in respect of which the Clearing House transfers ownership of the property to the Member after the time of such commencement, it may not be possible for the price payable in respect of such property transferred to be included in the relevant Close Out Amount. However, if such a Contract is terminated before ownership of the property to be delivered under such Contract is transferred, the gain or loss in respect of the Contract calculated in accordance with the Netting Provision should be capable of being included in the Close Out Amount. Any action taken by the liquidator of the Clearing House to recover the price from the Member would not prejudice the effectiveness of the netting pursuant to the Netting Provision of other, valid, obligations.

4.1.6 In relation to paragraph 3.4.2 above, Regulation 12(1) of the FCA Regulations may not apply if at the time that (any of) the relevant financial obligations came into existence:

(a) the Member was aware, or should have been aware, that winding up proceedings or reorganisation measures (as such terms are defined in the FCA Regulations) had commenced in relation to the Clearing House;

(b) the Member had notice that a meeting of creditors of the Clearing House had been summoned under section 98 of the Insolvency Act 1986 (as to which see paragraph 4.1.3(c) above) or that a petition for the winding-up of the Clearing House was pending; or

(c) the Member had notice that an application for an administration order was pending, or that a person had given notice of intention to appoint an administrator, in respect of the Clearing House.

Accordingly, in such circumstances, the protection granted under the FCA Regulations to a close-out netting provision may not be effective.

4.1.7 If any creditor of the Clearing House were to attach, execute, levy execution or otherwise exercise a creditor's process (whether before or after judgment) over or against any claim owing by the Member to the Clearing House, then the Member would be able to exercise its rights under the Netting Provision against the creditor of the Clearing House in respect of claims which existed at the date of the attachment or other process, including the claim which is the subject of the attachment or other process. However, if the attaching creditor has become subject to Statutory Insolvency Set-Off before a Close Out Date has occurred, it may be possible for the liquidator or administrator of the attaching creditor to claim the amounts subject to the attachment free of the Member's rights under the Netting Provision. This is because it may be argued that the Member is seeking to exercise a set-off right in respect of an amount which is now owed by the Member to the attaching creditor rather than to the Clearing House, and a contractual provision which purports to create a right of set-off between non-mutual claims may not be effective in Statutory Insolvency Set-Off when applied to the attaching creditor.

However, after the commencement of a winding-up of the Clearing House any attachment will be ineffective unless the court otherwise orders, and in our view the court would not validate the attachment in order to defeat the rights of the Member under the Netting Provision. Further, the protections available under the FCA Regulations and the Settlement Finality Regulations may have effect to override the claim of the attaching creditor.

4.1.8 In relation to our opinions at paragraph 3.4, and our observations regarding the application of insolvency laws, the provisions of the Settlement Finality Regulations referred to will not apply in relation to any transfer order entered into by the designated system of the Clearing House (which we take to mean

registered with the Clearing House) after the court has made a winding-up or administration order in relation to the Clearing House or the Clearing House has passed a resolution for creditors' voluntary winding-up, unless the transfer order is carried out on the same business day of the designated system as the order or resolution, and the system operator can show it did not have notice of the order or resolution. It seems unlikely that the Clearing House would not have notice of such an order or resolution and, accordingly, we express no view as to whether obligations between the Parties (in respect of Contracts or otherwise) which are, or arise from, transfer orders entered into after the commencement of the relevant Insolvency Proceedings may be included in the termination and liquidation under the Netting Provision, but the exclusion of any such obligation would not affect the enforceability of the Netting Provision in respect of any other obligations entered into before such time.

4.1.9 In relation to our opinion at paragraph 3.4.3, there is an argument that amounts due under Contracts which constitute derivatives do not constitute "transfer orders" for the purposes of the Settlement Finality Regulations. A "transfer order" may be either a "payment transfer order" or a "securities transfer order" (as defined in the Settlement Finality Regulations). While a cash sum due to be paid under a Contract ought to constitute, or give rise to, a "payment transfer order", it may be that the entirety of the Contract cannot properly be so regarded. Further, if under the terms of a Contract, title to, or an interest in, a commodity or other thing which is not a "security" (meaning an instrument referred to in section C of Annex I to Directive 2004/39/EC (MiFID)) is transferred, that Contract would not appear to constitute a "transfer order". If those arguments were to prevail, the additional protections provided by the Settlement Finality Regulations which are mentioned in paragraph 3.4.3 may not be available in respect of those Contracts.

4.1.10 There are provisions in both the Companies Act 2006 and the Insolvency Act 1986 for schemes of arrangement or voluntary arrangements in respect of companies to be agreed by creditors or, in some cases, shareholders of the company. The courts will not sanction a scheme of arrangement under sections 895-901 of the Companies Act 2006 unless reasonable efforts were made to notify those creditors whose rights would be affected by the scheme of the meeting to approve that scheme. In relation to company voluntary arrangements under Part I of the Insolvency Act 1986, a creditor can be bound by the relevant arrangement even if he has not been given notice of the creditors' meeting to approve the arrangement. In the case of either a scheme

of arrangement or a company voluntary arrangement, approval at the creditors' meeting of its terms does not require unanimity of the affected creditors, whether or not present at the meeting. Such arrangements could affect both the set-off rights of creditors and the value of claims which the creditors may have against the company, but not their property rights.

If the termination and liquidation provided for in the Netting Provision has been effected before the approval of such an arrangement, any provision of such an arrangement which purports to unwind the application of the Netting Provision would not bind the affected creditor if timely objection to the arrangement is made to the applicable court. An arrangement could, however, affect the value of any resulting net claim.

4.2 Banking Act

4.2.1 The Banking Act contains various provisions which might affect the effectiveness of the Netting Provision. In particular, Part I of the Banking Act provides for various remedies of a failing UK Clearing House, which include the ability of the Bank of England to cause the transfer of securities issued by a UK Clearing House, or property of a UK Clearing House, to another person, by means of a "share transfer instrument" or a "property transfer instrument". Based on the assumption set out at paragraph 2.6, the range of measures available to the Bank of England in respect of a UK Clearing House would be available (in the relevant circumstances) in respect of the Clearing House.

4.2.2 Section 75 of the Banking Act gives the Treasury the power to change the law (except the Banking Act itself) for the purpose of enabling the powers granted to the PRA, the FCA, the Treasury and the Bank of England under Part I of the Banking Act to be used effectively. Such changes might affect private law rights and might be used with retrospective effect.

4.2.3 Under section 38 of the Banking Act, a property transfer instrument may disapply a right to terminate a contractual arrangement which is exercisable by virtue of the existence or the making of the property transfer instrument. However, rights to terminate based on the existence or occurrence of other circumstances should not be affected.

The termination rights of Members under the Netting Provision depend upon the existence of an LME Clear Default and the subsequent occurrence of a Close Out Date. An LME Clear Default may take the form of either an LME

Clear Payment Default or an LME Clear Insolvency Default, both of which are, essentially, insolvency-based concepts. Rule 10.13.2 specifies that neither the exercise of the stabilisation powers under the Banking Act in respect of the Clearing House nor the occurrence of any event linked to the exercise of such powers would (of itself) constitute the basis for an LME Clear Default. Notably, however, those stabilisation powers (whether for the purposes of a property transfer or a share transfer) are intended to be pre-insolvency measures, implemented by the Bank of England with a view to rescuing from insolvency, and preventing insolvency in respect of, a UK Clearing House or its business.

4.2.4 A property transfer instrument may apply to only part of the Clearing House's assets and liabilities (such a transfer being referred to as a "partial property transfer"). A partial property transfer could, theoretically and absent any restrictions, apply so as to cause the transfer of some, but not all, of the Contracts and/or rights and obligations of the Clearing House arising in respect thereof (including repayment obligations of the Clearing House in respect of Cash Collateral) with the result that the ability of a Member to net the amounts due in respect of certain such obligations against the amounts due in respect of others in accordance with the rights otherwise available to it under the Netting Provision is impaired. In addition, a partial property transfer could, theoretically and absent any restrictions, apply so as to cause a separation of the rights of the Clearing House under the security interests in respect of securities that are constituted by the Security Deed (the "**benefit of security**") entered into by a Member from the relevant liability which is secured (the "**secured liability**").

Following a partial property transfer in respect of the Clearing House, the part of the business of the Clearing House that could not be successfully transferred to a third party would continue to be treated as part of the Clearing House's business and part of its insolvency estate in subsequent Insolvency Proceedings. Hence, close-out netting rights under the Netting Provision would likely only be triggered following the implementation of any relevant resolution measures under the Banking Act and would then only apply to the range of rights and obligations still remaining as property of the Clearing House at that time.

4.2.5 However, in this regard, article 3 of the Banking Act 2009 (Restriction of Partial Property Transfers) (Recognised Central Counterparties) Order 2014

(the "**Safeguards Order**") prohibits a partial property transfer which applies to some, but not all, of the "protected rights and liabilities" between a particular person and a UK Clearing House. In the case of a UK Clearing House such as the Clearing House which (despite offering clearing services in respect of various different Eligible Products) has established a single default fund, the relevant protected rights and liabilities would be all of the rights and liabilities between a clearing member and the relevant UK Clearing House recorded in the accounts of that UK Clearing House.

4.2.6 In addition, article 5 of the Safeguards Order would prevent a partial property transfer in respect of the Clearing House from transferring the benefit of security unless the secured liability was also transferred and vice versa.

4.3 General insolvency issues

The provisions of insolvency law have effect subject to contrary statutory rules, such as Regulation 14 of the Settlement Finality Regulations.

4.3.1 Under section 238 of the Insolvency Act 1986, a transaction entered into by a company at any time within a specified period ending with the onset of insolvency of the company (being, in broad terms, the earliest of: the date of the commencement of winding-up; the date on which an administration application is made; the date of filing with the court of a notice of intention to appoint an administrator; or the date of the company entering administration; or, where the court has made a recognition order in respect of a foreign proceeding under the Cross-Border Insolvency Regulations 2006, the date of opening of the foreign proceeding) with a person on terms that provide for the company to receive either no consideration, or a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by it, may be set aside as a transaction at an undervalue, if at the time the transaction is entered into that company was unable to pay its debts or became unable to pay its debts within the meaning of section 123 of the Insolvency Act 1986 in consequence of the transaction. In a case where the parties are "connected" within the meaning of section 249 of the Insolvency Act 1986, a presumption of inability to pay debts will apply. A court would not set aside such a transaction if it were satisfied that the company entered into the transaction in good faith and for the purpose of carrying on its business and that at the time it did so there were reasonable grounds for the belief that it would benefit the company.

Transactions entered into on arm's length terms and at the then prevailing market rates are unlikely to constitute transactions at an undervalue.

The matters on which we opine in paragraph 3.4 above are unlikely to be characterised as transactions at an undervalue, but the matters referred to in this paragraph are primarily questions of fact. We would also mention that under Regulation 17 of the Settlement Finality Regulations, no order may be made under section 238 of the Insolvency Act 1986 in respect of a transfer order or the provision of "collateral security" (as defined in the Settlement Finality Regulations).

4.3.2 Under section 239 of the Insolvency Act 1986 anything done or suffered to be done by a company within a specified period ending with the onset of insolvency (as defined in paragraph 4.3.1 above) of that company may be set aside as a preference. The thing done or suffered will be liable to be set aside if at the time it was done or suffered that company was unable to pay its debts or became unable to pay its debts within the meaning of section 123 of the Insolvency Act 1986 in consequence of the thing done or suffered and that thing has the effect of putting any person in a better position, in the event of that company going into insolvent liquidation, than that person would have been in if the thing had not been done or suffered. However, the court would not make such an order if it was satisfied that the company which gave the preference was not influenced to give it by a desire to put that person in such better position. In a case where the Parties are "connected" within the meaning of section 249 of the Insolvency Act 1986, a presumption that the desire to put the other Party in a better position will apply.

The matters on which we opine in paragraph 3.4 above are unlikely to be characterised as preferences, but the matters referred to in this paragraph are primarily questions of fact. We would also mention that under Regulation 17 of the Settlement Finality Regulations, no order may be made under section 239 in respect of a transfer order or the provision of "collateral security (as defined in the Settlement Finality Regulations)".

4.3.3 Under section 178 of the Insolvency Act 1986 a liquidator of a company being wound up may by notice disclaim any "onerous property", including any unprofitable contract.

However, any person sustaining loss or damage in consequence of the operation of a disclaimer is deemed a creditor of the company to the extent of

the loss or damage. Accordingly, we do not consider that the existence of the possibility of a disclaimer (even if theoretically exercisable) would affect the opinions expressed in Section 3. Specifically, as regards the opinions in paragraph 3.8, we do not consider that a disclaimer would operate so as to deprive a Member of the equity of redemption in its Securities Collateral.

4.3.4 Under section 186 of the Insolvency Act 1986 a person entitled to the benefit or subject to the burden of a contract with a company in liquidation may apply for an order rescinding the contract, on such terms as to payment by or to either party of damages for non-performance or otherwise as the court thinks just.

4.3.5 The enforceability of the property rights of a Member in Securities Collateral charged to the Clearing House under the Security Deed (as described in paragraph 3.8.2) may be limited by insolvency, liquidation, administration and other laws of general application relating to or affecting the rights of creditors as such law may be applied in the event of a LME Clear Default. In particular:

(a) if a winding-up order was made in respect of, or a provisional liquidator was appointed to, the Clearing House, the leave of the court would be required under section 130 of the Insolvency Act 1986 in order for a Member to enforce its property rights in respect of the Securities Collateral against the Clearing House; and

(b) if the Clearing House were to enter into administration or an application were to be presented to the court for the making of an administration order in respect of the Clearing House or notice of intention to appoint an administrator of the Clearing House were to be filed with the court, the leave of the court (or, if an administrator were appointed to the Clearing House, the consent of that administrator) would be required under Paragraph 43 or 44 of Schedule B1 in order for a Member to enforce its property rights in respect of the Securities Collateral against the Clearing House.

Furthermore, obligations of the Clearing House may not be enforced in all circumstances. In particular:

(a) the power of an English court to order specific performance of an obligation or other equitable remedy is discretionary and, accordingly,

an English court might make an award of damages where specific performance of an obligation or other equitable remedy is sought;

(b) claims may become barred under the Limitation Acts or under equitable principles relating to delay, or may be or become subject to a defence of set-off or counterclaim; and

(c) in some circumstances an English court may, and in certain circumstances it must, terminate or suspend proceedings commenced before it, or decline to restrain proceedings commenced in another court, notwithstanding the provisions of the Clearing House Documentation providing that the courts of England have jurisdiction in relation thereto.

4.4 Qualifications relating to Cash Collateral

4.4.1 A Member's right against the Clearing House in respect of payments relating to cash collateral may be subject to a trust or security or other interest for the benefit of such Member's own clients, and in such cases may not be owed to the Member beneficially.

4.4.2 Section 177 of the Companies Act 1989 applies to property held by a recognised clearing house (including a recognised clearing house which is a recognised central counterparty, such as the Clearing House) as margin in relation to a market contract. Where a UK recognised clearing house applies such property in accordance with its rules, section 177 permits the clearing house to do so notwithstanding any prior equitable interest or right, or any right or remedy arising from a breach of fiduciary duty, unless the clearing house had notice of the interest, right or breach of duty at the time the property was provided as margin.

4.5 Qualifications relating to Securities Collateral

4.5.1 Insofar as fungible assets posted as Securities Collateral are not held by the Clearing House separately from assets in the absolute beneficial ownership of the Clearing House, there is a risk that the property rights of the Member in the Securities Collateral may be lost. It may be asserted, based on the case *Re Goldcorp Exchange Ltd* [1995] 1 AC 74 that failure to segregate is fatal to the continuing property interest of the Member in the Securities Collateral. However, *Goldcorp* may be distinguished on the basis that it concerned

physical assets (gold bullion) rather than account-held securities and, on the basis of *Hunter v Moss* [1994] 1 WLR 452, a property interest can continue in a mixed pool of account-held securities. In our view *Hunter v Moss* is likely to be followed by the courts of this jurisdiction notwithstanding that it has been academically criticised.

4.5.2 If the records maintained by the Clearing House are unclear as to whether securities held by the Clearing House are held for the Clearing House beneficially or for Members, the property rights of the Members in the Securities Collateral may be lost.

4.5.3 Whether or not there is full and effective segregation of the Clearing House's own assets from those belonging to Members, if there is a shortfall of securities of a given class it is unclear how the remaining securities would be distributed among claimants. In *Barlow Clowes v Vaughan* [1992] 4 All ER 22 a shortfall was shared rateably, but this decision was at first instance and may not be followed. The more traditional approach is to apply the principles of *Clayton's Case* (1816) 1 Mer 572 (property received first is deemed to have been utilised first) and *re Hallett's estate* (1880) 13 Ch D 695 (a trustee's own property is deemed to have been utilised before that of others, i.e. in this case Members). Whichever approach is followed, the full amount of the securities posted as Securities Collateral may not be returned to the Member. As described at paragraph 4.1.10, section 900 of the Companies Act 2006 provides that a court order relating to a scheme of arrangement may provide for the transfer to any company of the property of any other company subject to the scheme, and "property" is broadly defined as "property, rights and powers of every description". However, section 900 does not provide for the order to include in the transfer property which does not belong to the company concerned. Thus, although it would be possible for the Clearing House's rights in the Securities Collateral (as Chargor under the Security Deed) to be transferred to a new legal entity under a scheme of arrangement, the order would not have the effect of reducing or extinguishing the Member's interest in the Securities Collateral. The Member would therefore be entitled to recover the Securities Collateral in accordance with the terms of the Security Deed, even against the new chargor and/or new chargee.

4.5.4 Any security comprised in the Securities Collateral may be subject to corporate actions or other events relating to the issuer of securities comprised in the Securities Collateral which affect the ability to hold or transfer the

security concerned. We express no view as to the ability of the Member to recover any Securities Collateral which is subject to such actions or events while in the possession or control of the Clearing House.

4.5.5 If an asset which constitutes Securities Collateral is situated outside England, the courts of this jurisdiction may take into account the law of the place where the asset or right is legally situated and the governing law of the asset (despite the choice of English law as the governing law). In relation to a financial collateral arrangement, Regulation 19 of the FCA Regulations provides that certain questions, including any question relating to the proprietary effects of "book entry securities collateral" provided under a financial collateral arrangement shall be governed by the domestic law of the country in which the "relevant account" is maintained. For these purposes, "book entry securities collateral" means financial collateral subject to a financial collateral arrangement which consists of financial instruments, title to which is evidenced by entities in a register or account maintained by or on behalf of intermediary (as defined in the FCA Regulations); and "relevant account" means the register or account in which entries are made by which book entry securities collateral is transferred or designated so as to be in the possession or under the control of the collateral-taker or a person acting on his behalf. Accordingly, the issue of entitlement to the Securities Collateral may be determined by a system, or systems, of law other than the laws of this jurisdiction.

There is appellate court authority (*Macmillan Inc v. Bishopsgate Investment Trust PLC (No.3) [1996] 1 WLR 387*) which can be interpreted as deciding that the place where shares are located is deemed to be the place where the share register is kept or the place where the issuer of the shares is incorporated, notwithstanding that the holder's interest in the shares is evidenced by book entries maintained by an intermediary. While in our view this authority does not exclude the analysis that an entitlement to securities held in book entry form is located where the books are situated, we are not aware of any binding authority which has considered the question of location of such entitlements. Accordingly, to the extent any of the Securities Collateral consists of shares and if a court were to conclude that such Securities Collateral should be regarded as being located outside this jurisdiction, the issue of enforceability of such Collateral may also be determined by a system, or systems, of law other than the laws of this jurisdiction.

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4.6 General Qualifications

4.6.1 If the effect of proceedings in a forum outside this jurisdiction is to extinguish claims or liabilities under the governing law of those claims or liabilities, the courts of this jurisdiction may recognise the extinction of those claims or liabilities.

4.6.2 An exchange contract[1] (which in our view, may include the Clearing House Documentation and certain Contracts) is unenforceable in the United Kingdom if (i) it involves the currency of any member of the International Monetary Fund and (ii) it is contrary to the exchange control regulations of any member of the International Monetary Fund maintained or imposed consistently with the International Monetary Fund Agreement. In our opinion, the Clearing House Documentation is not contrary to any exchange control regulations maintained or imposed by the United Kingdom. Further, there is inconsistent authority on what amounts to an "*exchange contract*" for these purposes. It is not clear whether the term encompasses any contract which in any way affects a country's exchange resources or only a contract for the exchange of one currency for another, although the better view is probably that the latter (narrow) interpretation is correct.

4.6.3 Under English law, interest imposed upon a Party by the Clearing House Documentation might be held to be irrecoverable on the grounds that it is a penalty, or to the extent that it accrues on an unsecured debt after the making of a winding-up order or the passing of a winding-up resolution by the company liable to pay such interest, but the fact that it was held to be irrecoverable would not of itself prejudice the legality or validity of any other provision of the Clearing House Documentation. If the Clearing House Documentation does not provide a contractual remedy for the late payment of any amount payable thereunder that is a substantial remedy within the meaning of the Late Payment of Commercial Debts (Interest) Act 1998, the Party entitled to that amount may have a right to statutory interest (and to payment of certain fixed sums) in respect of that late payment at the rate (and in the amount) from time to time prescribed pursuant to that Act. Any term of the Clearing House Documentation may be void to the extent that it excludes

[1] "*Exchange contract*" here has the meaning used in the International Monetary Fund Agreement and related legislation, and is not a reference specifically to on-exchange derivative contracts.

or varies the right to statutory interest, or purports to confer a contractual right to interest that is not a substantial remedy for late payment of that amount, within the meaning of that Act. We express no opinion as to whether any such provisions in the Clearing House Documentation do in fact constitute a "substantial remedy" in compliance with the conditions set out in section 9 of such Act.

4.6.4 Where a Party to the Clearing House Documentation is vested with a discretion or may determine a matter in its opinion, that Party may be required to exercise its discretion in good faith, reasonably and for proper purpose, and to form its opinion in good faith and on reasonable grounds. Any provision in the Clearing House Documentation providing that any calculation, determination or certification is to be conclusive and binding may not be effective if such calculation, determination or certification is fraudulent or manifestly incorrect and an English court may regard any calculation, determination or certification as no more than prima facie evidence of the matter calculated, determined or certified.

4.6.5 If a party to an agreement is controlled by or otherwise connected with a person (or is itself) resident in, incorporated in or constituted under the laws of a country which is the subject of United Nations, European Community or UK sanctions implemented or effective in the United Kingdom under the United Nations Act 1946, the Emergency Laws (Re-enactments and Repeals) Act 1964 or the Anti-terrorism, Crime and Security Act 2001, or under the Treaty establishing the European Community, or is otherwise the target of any such sanctions, then the obligations of the other party to that party under the relevant agreement may be unenforceable or void.

There are no other material issues relevant to the issues addressed in this opinion which we wish to draw to your attention.

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(A) the officers, employees, auditors and professional advisers of any addressee or any subscribing member;

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(B) any person to whom disclosure is required to be made by applicable law or court order or pursuant to the rules or regulations of any supervisory or regulatory body or in connection with any judicial proceedings; and

(C) any competent authority supervising a subscribing member or its affiliates

on the basis that (i) such disclosure is made solely to enable any such person to be informed that an opinion has been given and to be made aware of its terms but not for the purposes of reliance, and (ii) we do not assume any duty or liability to any person to whom such disclosure is made and in preparing this opinion we have not had regard to the interests of any such person.

This opinion was prepared by Clifford Chance LLP on the basis of instructions from FIA Europe in the context of the netting requirements of the Basel III capital rules in the EU and US and Clifford Chance LLP has not taken instructions from, and this opinion does not take account of the specific circumstances of, any subscribing member. In preparing this opinion, Clifford Chance LLP had no regard to any other purpose to which this opinion may be put by any subscribing member.

By permitting subscribing members to rely on this opinion as stated above, Clifford Chance LLP accepts responsibility to such subscribing members for the matters specifically opined upon in this opinion in the context stated in the preceding paragraph, but Clifford Chance LLP does not have or assume any client relationship in connection therewith or assume any wider duty to any subscribing member or their affiliates. This opinion has not been prepared in connection with, and is not intended for use in, any specific transaction.

Furthermore this opinion is given on the basis that any limitation on the liability of any other adviser to FIA Europe or any subscribing member, whether or not we are aware of that limitation, will not adversely affect our position in any circumstances.

Yours faithfully

Clifford Chance LLP

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Annex 1
Membership Agreement

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Annex 2

Security Deed