

C L I F F O R D

C H A N C E

England and Wales / IAS 32/
CCP (RepoClear)

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23 January 2014

Dear Sirs

IAS 32 opinion relating to LCH.Clearnet Limited in respect of its RepoClear Service

You have asked us to give an opinion in respect of the laws of England and Wales ("this jurisdiction") in relation to certain netting and set-off provisions in the Rules of the following CCP in relation to the following selected service (the "Service"):

LCH.Clearnet Limited, a clearing house established in England (the "CCP") in respect of its RepoClear Service governed by the laws of England and Wales

as such provisions apply between the CCP and its RepoClear Clearing Members, its RepoClear SGC Members and its RepoClear €GC Members (each an "RCM").

We understand that your requirement is for the enforceability and validity of such netting and set-off provisions and collateral arrangements to be substantiated by a written and reasoned legal opinion for the purposes of demonstrating compliance with International Accounting Standard 32 ("IAS 32") and the clarification amendments made to IAS 32 in December 2011 and effective on 1 January 2014.

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

1. TERMS OF REFERENCE

- 1.1 This opinion is given in respect of the Rules of the CCP and the laws of this jurisdiction in force **as at 30 September 2013**. We express no opinion as to any provisions of the Rules of the CCP other than those on which we expressly opine.
- 1.2 This opinion is given only in respect of payments (each an "**Applicable Amount**") due in respect of payment of a repurchase price (net, where applicable, of any income amount falling due on the repurchase date) in relation to RepoClear Contracts cleared pursuant to the Service.
- 1.3 This opinion does not apply to any clearing services or contracts other than in respect of the Service specified and do not address services offered to FCM Clearing Members in respect of FCM Contracts.
- 1.4 This opinion letter relates solely to matters of English law and does not consider the impact of any laws (including insolvency laws) other than English law, even where, under English law, any foreign law falls to be applied. This opinion letter and the opinions given in it are governed by English law and relate only to English law as applied by the English courts as 30 September 2013. All non-contractual obligations and any other matters arising out of or in connection with this opinion letter are governed by English law. We express no opinion in this opinion letter on the laws of any other jurisdiction.
- 1.5 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 Provisions or otherwise.
- 1.6 We express no opinion as to any provisions of any CCP Documentation or the Rules other than those to which express reference is made in this opinion letter except insofar as any such provision relates to the effectiveness of the Netting Provisions.
- 1.7 We do not express any opinion as to any matters of fact or accounting policy.

1.8 Definitions

In this opinion, terms not otherwise defined in this opinion shall have the meanings ascribed to them in the Rules of the CCP and the following terms shall have the following meanings:

- (a) "**BAU Netting Provisions**" means the RepoClear Netting Provision, the RepoClear SGC Netting Provision and the RepoClear €GC Netting Provision;

(b) "**CCP Default**" means the situations identified by Regulation 39A, namely:

- (i) if at any time the CCP fails to make a payment to a Member, other than a defaulter, under a Contract for a period of 30 days from the date when the obligation to pay fell due; or
- (ii) if at any time the CCP commences a voluntary case or other procedure seeking or proposing liquidation, administration, receivership, voluntary arrangement or a scheme of arrangement, or other similar relief with respect to itself or to its debts under any bankruptcy, insolvency, regulatory, supervisory or similar law, or if any of the foregoing cases or procedures is commenced in relation to the CCP by any other person which results in liquidation or winding up of the CCP, or if the CCP takes corporate action to authorise any of the foregoing, in any such case other than for the purposes of corporate restructuring (including any consolidation, amalgamation or merger).

(c) "**CCP Default Netting Provision**" means the rules in Regulation 39A and Regulation 5(i) of the Rules providing, in the event of a CCP Default, for the determination of one or more net amounts between the CCP and a Member (other than a defaulter) in the event of a CCP Default and the set-off of such amounts;

(d) "**CCP Documentation**" means the contractual documents entered into between the Parties pursuant to which the Rules are made contractually binding upon them;

(e) "**Client Account**" means a segregated account with the CCP opened in the name of an RCM in which RepoClear Contracts relating to contracts made by an RCM with one or more segregated clients are registered and to which monies in respect of such RepoClear Contracts are credited;

(f) "**€GC Basket**" means any of the issues of securities when, taken together, are specified by Part H of the Schedule to the ReproClear Regulations as being eligible for trading under the RepoClear €GC Contract Terms;

(g) "**Defaulter**" means an RCM: (i) in respect of whom the CCP has issued a Default Notice under Rule 3 of the Default Rules; or (ii) in respect of whom an Automatic Early Termination Event has occurred;

(h) "**Financial Collateral Regulations**" means the Financial Collateral Arrangements (No. 2) Regulations 2003;

- (i) "**FSMA**" means the Financial Services and Markets Act 2000;
- (j) "**Insolvency Proceedings**" means those bankruptcy, composition, rehabilitation or other insolvency or reorganisation procedures to which the CCP could be subject under the laws of this jurisdiction, and which are relevant for the purposes of this opinion, namely administration, liquidation (including provisional liquidation), receivership, voluntary arrangements and schemes of arrangement;
- (k) "**Member Default**" means any situation specified in Default Rule 3 of the Rules where a Member appears to the CCP to be unable, or to be likely to become unable, to meet its obligations in respect of one or more Contracts and the CCP takes steps to instigate the procedures set out in the Default Rules or the occurrence of an Automatic Early Termination Event;
- (l) "**Member Default Netting Provision**" means the procedures set out in Default Rules 6 and 8 of the Rules, which provide for the CCP to close out and bring into account all sums payable by or to a defaulting Member in respect of its Contracts (including RepoClear Contracts) and all other sums payable under the Rules and aggregate these to produce a single net sum for each kind of account of the RCM, as provided for under Default Rule 10;
- (m) "**Netting Provisions**" means the CCP Default Netting Provision, the Member Default Netting Provision and the BAU Netting Provisions;
- (n) "**Party**" means the CCP or the relevant RCM and a reference to "**Parties**" is a reference to both the CCP and an RCM;
- (o) "**Proprietary Account**" means any account which is not a Client Account and which is for the clearing of the RCM's own business;
- (p) "**RepoClear Contract**" means a Contract entered into by the CCP with an RCM on either the RepoClear Contract Terms, the RepoClear SGC Contract Terms or the RepoClear €GC Contract Terms;
- (q) "**RepoClear Contract Terms**" means the terms set out in Parts A and B of the Schedule to the RepoClear Regulations;
- (r) "**RepoClear €GC Contract Terms**" means the terms set out in Parts G and H of the Schedule to the RepoClear Regulations;

- (s) "**RepoClear €GC Netting Provision**" means the provisions in sections 2.4(c) and (d) of the RepoClear €GC Contract Terms detailing the netting arrangements for Applicable Amounts on a business as usual basis;
- (t) "**RepoClear Netting Provision**" means the provisions in section 2.1(d) of the RepoClear Contract Terms detailing the netting arrangements for Applicable Amounts on a business as usual basis;
- (u) "**RepoClear SGC Contract Terms**" means the terms set out in Parts E and F of the Schedule to the RepoClear Regulations;
- (v) "**RepoClear SGC Netting Provision**" means the provisions in sections 2.5(c) and (d) of the RepoClear SGC Contract Terms detailing the netting arrangements for Applicable Amounts on a business as usual basis;
- (w) "**Rules**" means the rules of the CCP, including the relevant CCP Documentation, in force as at 30 September 2013;
- (x) "**Settlement Finality Regulations**" means the Financial Markets and Insolvency (Settlement Finality) Regulations 1999;
- (y) 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. We do not opine on the availability of any judicial remedy;
- (z) a reference to a "**financial collateral arrangement**" is to an arrangement defined as such in the Financial Collateral Regulations;
- (aa) references to a "**section**" are (except where the context otherwise requires) to a section of this opinion;
- (bb) 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);
- (cc) references to legislation in this opinion letter is to the legislation as amended to the date 30 September 2013;
- (dd) a reference to a "**Regulation**" is to a Regulation of the General Regulations; and

(ee) a reference to the "**UNCITRAL Model Law**" is to the Model Law on cross-border insolvency as adopted by the United Nations Commission on International Trade Law on 30th May 1997.

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 CCP Documentation and RepoClear Contracts, and to perform its obligations under the CCP Documentation and Rules.
- 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 CCP Documentation and RepoClear Contracts, and to ensure the legality, validity, enforceability or admissibility in evidence of the CCP Documentation and RepoClear Contracts in this jurisdiction.
- 2.3 The CCP Documentation and each of the RepoClear 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.
- 2.4 That, except as regards the provisions discussed and opined upon in this opinion letter, the CCP Documentation and the RepoClear Contracts (including the obligations to pay Applicable Amounts) are legal, valid, binding and enforceable against both Parties.
- 2.5 That the CCP Documentation has been entered into by the Parties prior to the commencement of any insolvency procedure under the laws of any jurisdiction in respect of either Party.
- 2.6 That each payment which is to be set-off under the BAU Netting Provisions is due and payable on the date on which the rights under the BAU Netting Provisions are to be exercised.
- 2.7 Save in relation to any non-performance leading to the taking of action by an RCM under the Netting Provisions, each Party performs its obligations under the CCP Documentation and the Rules in accordance with their terms.

- 2.8 That the CCP is at all material times a recognised clearing house within the meaning of Section 285 of the FSMA and for the purposes of Part VII and a designated system within the meaning, and for the purposes, of the Settlement Finality Regulations.
- 2.9 That the CCP has (i) the centre of its main interests in this jurisdiction for the purposes of EU Council Regulation No. 1346/2000 of 29 May 2000 on insolvency proceedings (the "EUIR") and the Cross-Border Insolvency Regulations 2006 and (ii) no "establishment" in any other EU Member State for the purposes of the EUIR but an "establishment" in the United States for the purposes of the Cross-Border Insolvency Regulations 2006.
- 2.10 That the CCP is not subject to Part VII by reason of being a member or designated non-member of a recognised investment exchange (within the meaning of Section 155 of the Companies Act 1989) or a member of any other recognised clearing house, or being a person in respect of whom a recognised investment exchange or another recognised clearing house has taken action under its own default rules.
- 2.11 That, apart from any circulars, notifications and equivalent measures published by the CCP in accordance with the CCP Documentation, there are no other agreements, instruments or arrangements between the Parties which modify or supersede the terms of the Rules; and in particular, in relation to the settlement of payments due in respect of Applicable Amounts, that there are no provisions in the rules of any relevant designated system (other than the CCP itself) which purport to override or are inconsistent with the Netting Provisions.
- 2.12 That none of the provisions discussed and opined on in this opinion letter has been disallowed pursuant to Section 300A of the FSMA.

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 Recognition of Choice of Law

The choice of law provisions contained in Regulation 38 (Governing Law and Jurisdiction) and the CCP Documentation would be recognised under the laws of this jurisdiction, notwithstanding that the RCM may not be incorporated, domiciled or established in this jurisdiction, subject to and in accordance with the provisions of the Contracts (Applicable Law) Act 1990 (in relation to CCP Documentation entered into prior to 17 December 2009) or Council Regulation (EC) No. 593/2008 of 17 June

2008 on the law applicable to contractual obligations (in relation to CCP Documentation entered into on or after that date).

However, there are some matters which are not determined by reference to governing law, but which are mandatory in the forum irrespective of the choice of governing law. In particular, where all the elements relevant to a situation being adjudicated upon were, at the time the choice of law was made, connected with a particular country, the courts of this jurisdiction may apply rules of law of that country which cannot be derogated from by contract.

3.2 Set-off under the Netting Provisions

3.2.1 The BAU Netting Provisions:

- (a) require the set-off of all Applicable Amounts due and payable so as to produce one or more net sums as further described in section 3.2.4 below;
- (b) are enforceable as a matter of the laws of this jurisdiction; and
- (c) do not permit either Party to demand payments of Applicable Amounts on a gross basis.

3.2.2 The Member Default Provision:

- (a) requires the set-off of all Applicable Amounts payable together with amounts representing Applicable Amounts which are due (but not immediately payable) so as to produce one or more net sums as further described in section 3.2.4 below;
- (b) is enforceable as a matter of the laws of this jurisdiction; and
- (c) does not permit either Party to demand payments of Applicable Amounts on a gross basis.

Although the Member Default Netting Provision is effective at the election of the CCP once an RCM is in default according to the Rules, until its activation the BAU Netting Provisions will continue to bind the Parties.

3.2.3 The CCP Default Netting Provision:

- (a) requires the set-off of all Applicable Amounts payable together with amounts representing Applicable Amounts which are due (but not

immediately payable) so as to produce one or more net sums as further described in 3.2.4 below;

- (b) is enforceable as a matter of the laws of this jurisdiction; and
- (c) does not permit either Party to demand payments of Applicable Amounts on a gross basis.

3.2.4 In relation to any netting and set-off:

- (a) the RepoClear Netting Provision provides for a single net sum to be produced in respect of Proprietary Accounts and Client Accounts combined for RepoClear Contracts, on the RepoClear Contract Terms;
- (b) the RepoClear €GC Netting Provision provides for the following net sums to be produced in respect of Proprietary Accounts and Client Accounts combined for RepoClear Contracts, on the RepoClear €GC Contract Terms:
 - (i) one net sum for the Daily Return Amount (which includes the daily movements in respect of Applicable Amounts) in respect of a particular €GC Basket; and
 - (ii) one net sum for the Daily Cash Amount (which relates to Opening Cash Amounts and not Applicable Amounts) in respect of a particular €GC Basket.

These two net sums for a particular €GC Basket are not set-off against each other under the Rules nor are the amounts from one particular €GC Basket netted and set-off against another particular €GC Basket;

- (c) the RepoClear SGC Netting Provision provides for two net sums to be produced in respect of Proprietary Accounts and Client Accounts combined for RepoClear Contracts on the RepoClear SGC Contract Terms:
 - (i) one net sum for the Daily Return Amount (which includes the daily movements in respect of Applicable Amounts); and
 - (ii) one net sum for the Daily Cash Amount (which relates to Opening Cash Amounts and not Applicable Amounts).

These two net sums are not set-off against each other under the Rules.

- (d) the Member Default Netting Provision provides for a separate net sum to be produced in respect of each Client Account and a separate single net sum is produced in respect of the Proprietary Accounts (combined together); and
- (e) CCP Default Netting Provision provides for a single net sum to be produced in respect of Proprietary Accounts (combined together) and a separate net sum is produced in respect of the Client Accounts (combined together); and thereafter both net sums are aggregated and set off against each other.

Under the BAU Netting Provisions, Applicable Amounts payable in relation to any Client Account will be included in an aggregation or set-off of Applicable Amounts due or payable in respect of a Proprietary Account. The CCP Default Netting Provision also provides for the set-off of all amounts due between the RCM and the CCP, irrespective of whether such amounts have arisen in respect of the Proprietary Account or a Client Account.

Therefore, Applicable Amounts due in respect of a Proprietary Account will be payable together with Applicable Amounts due in respect of a Client Account except where the CCP has issued a Default Notice in respect of the RCM (which will result in a distinction between net Client Accounts and net Proprietary Accounts under the Member Default Netting Provision).

However, if the CP is in liquidation or administration, there may be a mandatory Statutory Insolvency Set-Off (as defined in section 3.4.5) of Applicable Amounts to the extent that they are mutual and that Statutory Insolvency Set-Off is not overridden by other statutory provisions discussed in section 3.4 below.

3.3 Relationship of the Netting Provisions in point of time

- 3.3.1 The BAU Netting Provisions will apply between an RCM and the CCP in respect of the set-off of sums including Applicable Amounts until the earliest to occur of (i) the CCP issuing a Default Notice in respect of that RCM; (ii) an Automatic Early Termination Event occurring in respect of that RCM; and (iii) the RCM having implemented the CCP Default Netting Provision.

- 3.3.2 The Member Default Netting Provision will apply between an RCM who is a Defaulter¹ (whether or not the Defaulter is subject to insolvency proceedings) and the CCP in respect of the netting and set-off of sums including Applicable Amounts.
- 3.3.3 Following the occurrence of a CCP Default, an RCM which is not a Defaulter may exercise its rights under the CCP Default Netting Provision (whether or not the default is in relation to the opening of Insolvency Proceedings), in which case the CCP Default Netting Provision will apply between the RCM and the CCP in respect of the netting and set-off of sums including Applicable Amounts.

3.4 Reasons for Opinions

We are of the opinions expressed in section 3.2 in respect of the Netting Provisions for the following reasons:

3.4.1 *All Netting Provisions recognised under English Law*

There is no rule of law in this jurisdiction which would apply to prohibit the Parties from entering into a contract upon the terms of the BAU Netting Provisions, the Member Default Netting Provision or the CCP Default Netting Provision or which would render such terms ineffective.

Prior to the opening of insolvency proceedings, as a matter of contract the courts will recognise the terms of the Netting Provisions. Notwithstanding the opening of insolvency proceedings affecting a Party, the Netting Provisions will continue to have effect under the laws of this jurisdiction, albeit that a Statutory Insolvency Set-Off (as more particularly described in section 3.4.5) may, where applicable, achieve a set-off of sums including Applicable Amounts through statutory rather than contractual means where Statutory Insolvency Set-Off is not overridden by other statutory provisions as discussed later in this section. The Netting Provisions are additionally afforded further statutory protection as described in sections 3.4.2-3.4.4 and 3.4.6.

¹ See definition at section 1.8(f) – this is a person in respect of whom the CCP has issued a Default Notice or an Automatic Early Termination Event has occurred.

3.4.2 *Member Default Netting Provision protected by Recognition Requirements Regulations*

Furthermore, as regards the Member Default Netting Provision, paragraph 25 of the Schedule to the Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001, requires (regardless of the possible effect of the insolvency of an RCM) that the default rules of the CCP must provide:

- (a) for all rights and liabilities of the Defaulter under or in respect of unsettled market contracts to be discharged and for there to be paid by or to the Defaulter such sum of money (if any) as may be determined in accordance with the Rules; and
- (b) the sums so payable by or to the Defaulter in respect of different contracts entered into by the Defaulter to be aggregated or set off so as to produce a net sum.

3.4.3 *Member Default Netting Provision and CCP Default Netting Provision protected by Financial Collateral Regulations*

In relation to the Member Default Netting Provision and the CCP Default Netting Provision, Regulation 12(1) of the Financial Collateral 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, not 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 Financial Collateral Regulations). In our view, the Member Default Netting Provision and the CCP Default 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 of the Financial Collateral Regulations, the relevant "financial collateral arrangement" for these purposes is a "title transfer financial collateral arrangement" in respect of "financial collateral" in the form of "cash" (as each term is defined in the Financial Collateral Regulations). The arrangements for the transfer of cash collateral (i) between the CCP and an RCM in respect of their respective variation margin obligations (subject to the observations at section 0) and (ii) by an RCM to the CCP in respect of its initial margin obligations constitute the relevant title transfer collateral arrangements.

In relation to the termination and liquidation of obligations by an RCM under the CCP Default Netting Provision, Regulation 12(1) of the Financial Collateral Regulations does not apply (at all) if at the time that (any of) the relevant financial obligations came into existence:

- (a) a Party was aware, or should have been aware, that winding up proceedings or reorganisation measures (as such terms are defined in the Financial Collateral Regulations) had commenced in relation to the other Party;
- (b) a Party had notice that a meeting of creditors of the CCP had been summoned under Section 98 of the Insolvency Act 1986 or that a petition for the winding-up of the other Party was pending; or
- (c) a Party 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 other Party,

but the fact that Regulation 12(1) does not apply would not affect the general conclusions expressed in section 3.1 for the other reasons set out in this section 3.4.

Subject to the other observation in this section 3.4.3, Regulation 12 of the Financial Collateral Regulations will apply to the exclusion of any contrary requirement of Statutory Insolvency Set-Off.

3.4.4 *Member Default Netting Provision and CCP Default Netting Provision protected by Settlement Finality Regulations*

The Member Default Netting Provision and the CCP Default Netting Provision would in our view qualify as "default arrangements" of a designated system as defined in Regulation 2(1) of the Settlement Finality Regulations. Pursuant to Regulation 14 of the Settlement Finality Regulations:

- (a) the default arrangements of a designated system shall not be regarded as invalid at law on the grounds of inconsistency with the laws of this jurisdiction relating to the distribution of assets of a person subject to winding-up or administration; and
- (b) the powers of an insolvency officer and of the courts of this jurisdiction in 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 opening of insolvency proceedings in this jurisdiction in respect of a Party would not interfere with netting and set-off of sums including Applicable Amounts in this jurisdiction pursuant to the Member Default Netting Provision or the CCP Default Netting Provision.

In the event that insolvency proceedings against a Party are opened in another jurisdiction, Regulation 25 of the Settlement Finality Regulations provides that no court in this jurisdiction shall recognise or give any effect to any order of a court exercising jurisdiction in relation to insolvency laws in a country or territory outside the United Kingdom or any act of a person appointed in such a country or territory to discharge any functions under insolvency law pursuant to Section 426 of the Insolvency Act 1986 to the extent that such order or act would be prohibited in the case of a court in this jurisdiction.

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 CCP (which we take to mean registered with the CCP) after the court has made a winding-up or administration order in relation to the CCP or the CCP 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 CCP would not have such notice of such an order or resolution and, accordingly, we express no view as to whether obligations between the Parties (in respect of RepoClear 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 netting or set-off under the Netting Provisions, but the exclusion of any such obligation would not affect the enforceability of the Netting Provisions in respect of any other obligations entered into before such time.

Subject to the other observations in this section 3.4.4, the Settlement Finality Regulations will apply to the exclusion of any contrary requirement of Statutory Insolvency Set-Off.

3.4.5 Netting Provisions protected by Statutory Insolvency Set-Off in Insolvency Proceedings of CCP

When the CCP is subject to Insolvency Proceedings, payment due in respect of Applicable Amounts (which will include the termination amount(s) determined and payable under the CCP Default Netting Provision) must be taken into account under Rule 2.85 of the Insolvency Rules 1986 ("**Rule 2.85**") (in the case of the CCP entering administration and the issue by the administrator of a notice under Rule 2.95 of the Insolvency Rules 1986) or Rule 4.90 of the Insolvency Rules 1986 ("**Rule 4.90**") (in the case of the CCP being wound up) (Rule 2.85 and Rule 4.90 together or individually, a "**Statutory Insolvency Set-Off**"). A Statutory Insolvency Set-Off will include all sums due in respect of other mutual dealings between the CCP and RCM. A Statutory Insolvency Set-Off will, to the extent of any inconsistency with a Netting Provision, override the Netting Provision.

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 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).

A Statutory Insolvency Set-Off would, subject to the requirements of Section 187 of the Companies Act 1989 result in a net amount payable between the Parties in respect of such amounts, subject to the other qualifications set out in this opinion and subject also to the inclusion of any Statutory Insolvency Set-off of other mutual obligations between the Parties. Section 187 of the Companies Act 1989 provides that where a person enters into market contracts in more than one capacity, the provisions of Part VII apply as if the contracts entered into in each different capacity were entered into by different persons. By virtue of the Financial Markets and Insolvency Regulations 1991, an RCM enters into RepoClear Contracts in "different capacities" for those purposes where RepoClear Contracts are entered into on behalf of a client of the RCM

in respect of whom the RCM owes duties to segregate client money under the Financial Conduct Authority's rules. Accordingly, sums including Applicable Amounts payable in respect of such RepoClear Contracts may be set off separately from other sums including Applicable Amounts payable in respect of other RepoClear Contracts so as to produce two distinct net amounts.

The provisions of Rule 2.85 and Rule 4.90 relating to the set-off of mutual credits and debts between the Parties do not apply to amounts arising under contracts entered into at certain times, and accordingly, an English court may not allow such amounts to be included in an aggregation and set-off pursuant to the CCP Default Netting Provision or a Statutory Insolvency Set-Off. The times referred to are, so far as relevant, as follows:

- (a) after the CCP had entered administration;
- (b) at a time when the RCM had notice that an application for an administration order in respect of the CCP was pending or that any person had given notice of intention to appoint an administrator in respect of the CCP;
- (c) at a time when the RCM had notice that a meeting of creditors of the CCP 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 CCP was pending; or
- (d) during a winding-up of the CCP.

However, amounts which arise under contracts entered into at the times mentioned in sub-sections 3.4.5(a) and 3.4.5(d) above may still (save where Regulation 12(1) of the Financial Collateral Regulations would not apply, as described in paragraph 3.4.3) be included in the aggregation or set-off unless, at the time the relevant financial obligations came into existence, the RCM was aware, or should have been aware, that winding-up proceedings or reorganisation measures (as such terms are defined in the Financial Collateral Regulations) had commenced in relation to the CCP.

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

In addition, Statutory Insolvency Set-Off would not apply in circumstances where contrary statutory rules (such as Regulation 12(1) of the Financial Collateral Regulations, Regulation 14 of the Settlement Finality Regulations or Section 159 of Part VII) apply.

3.4.6 *BAU Netting Provisions and Member Default Netting Provision protected by Part VII*

Part VII will apply in respect of the BAU Netting Provisions and the Member Default Netting Provision in the following situations:

- (a) Sections 159(1)(b)-(c) of Part VII provide that the Default Rules of the CCP or other rules of the CCP as to the settlement of market contracts not dealt with under its default rules (which would include the BAU Netting Provisions and the Member Default Netting Provision) are not to be regarded as to any extent invalid at law on the grounds of inconsistency with the law relating to the distribution of the assets of a person in insolvency. Similarly, Sections 159(2)(a)-(b) of Part VII provide that an insolvency office-holder may not exercise its powers in any way so as to prevent or interfere with the settlement of a market contract in accordance with the rules of the CCP not dealt with under its default rules, or any action taken by the CCP under its default rules. Accordingly, the BAU Netting Provisions and the Member Default Netting Provision would be applied, as a matter of the laws of this jurisdiction, notwithstanding the commencement of insolvency proceedings in this jurisdiction in respect of the RCM.

However, if the RCM or CCP is insolvent and the CCP has power to take action under the Default Rules in consequence of the relevant insolvency but has not yet done so, Section 167 of Part VII provides that an insolvency officer may apply to the appropriate regulator, who may notify the CCP, following which, if the CCP does not take action under its Default Rules, the Section 159 statutory protections will fall away.

Section 159 will apply to the exclusion of any contrary requirement of Statutory Insolvency Set-Off.

(b) Section 183(2) of Part VII provides that a court in this jurisdiction shall not recognise or give effect to any order of a court exercising jurisdiction in relation to the insolvency law in a country or territory outside the United Kingdom or any act of a person appointed in such country or territory to discharge functions under insolvency law in so far as the making of the order or the doing of the act would be prohibited in the case of a court in the United Kingdom or a relevant office-holder by provisions made under Part VII. Accordingly, even if the courts of another jurisdiction were to make an order or an insolvency office-holder were to seek to exercise any powers under the insolvency law of another jurisdiction in a manner which is inconsistent with the enforceability of the BAU Netting Provisions or the Member Default Netting Provision, the courts of this jurisdiction would not recognise or give effect to such order or action.

3.5 **Conditions**

There are no rules of law of this jurisdiction which would require the fulfilment of any conditions before the exercise in accordance with their terms of rights of set-off under the Netting Provisions. It is not the case, as far as the general laws of this jurisdiction are concerned, that such rights are enforceable only on the occurrence of some future event.

4. **QUALIFICATIONS**

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

4.1 **Qualifications in relation to the BAU Netting Provisions**

RepoClear Contracts, other than those on RepoClear €GC Contract Terms, are subject to "settlement shaping" which aims to tranche the net amounts so that settlement instructions can be aligned with a standardised size of the relevant underlying security. While this may impact the ultimate net amount determined to be payable because there may be residual amounts due that cannot be bundled into the settlement shape for the relevant security, it does not affect the underlying legally enforceable right to net the amounts pursuant to the CCP's Rules.

4.2 Qualifications in relation to CCP Default

4.2.1 In a winding-up by the courts under the laws of England and Wales, any disposition of the CCP's property made after the commencement of winding-up of the CCP (which, in this context, means the time of presentation of the petition for winding-up; or, if earlier, the time of passing of 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 Financial Collateral Regulations prevent the application of such provision (see sections 3.4.3 and 3.4.4 above). Pursuant to Regulation 16(3) of the Settlement Finality Regulations, Section 127 of the Insolvency Act 1986 does not apply to a transfer order, or any disposition of property in pursuance of such an order. Pursuant to Regulation 10(1)(b) of the Financial Collateral Regulations, Section 127 of the Insolvency Act 1986 does not apply (if it would otherwise do so) to prevent a close-out netting provision (as defined in the Financial Collateral Regulations) taking effect in accordance with its terms. Pursuant to Section 164(3) of Part VII, Section 127 of the Insolvency Act 1986 does not apply to a market contract, or any disposition of property in pursuance of such a contract, or the provisions of margin in relation to market contracts.

Accordingly, in circumstances where Section 127 of the Insolvency Act 1986 is not overridden, an Applicable Amount which constitutes a disposition of property after the commencement of winding-up may not be capable of being included on a set-off or netting under the Netting Provisions or a Statutory Insolvency Set-Off.

4.2.2 There are provisions in 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.

If set-off under a 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.

4.2.3 If any creditor of the CCP were to attach, execute, levy execution or otherwise exercise a creditor's process (whether before or after judgment) over or against any Applicable Amount(s) owing by the RCM to the CCP, then the RCM would be able to exercise its rights under a Netting Provision against the creditor of the CCP in respect of the Applicable Amounts which existed at the date of the attachment or other process, including Applicable Amount(s) which are the subject of the attachment or other process. However, if the attaching creditor has become subject to Statutory Insolvency Set-Off before the exercise of such rights, it may be possible for the liquidator or administrator of the attaching creditor to claim the amounts subject to the attachment free of the RCM's rights under the Netting Provision. This is because it may be argued that the RCM seeks to exercise a set-off right in respect of an amount which is now owed by the RCM to the attaching creditor rather than to the CCP, 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 CCP 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 RCM under the Netting Provisions. Further, the protections available under the Financial Collateral Regulations, the Settlement Finality Regulations and Part VII may have effect to override the claim of the attaching creditor.

4.2.4 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 of that company may be set aside as a voidable 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 within the meaning of Section 123 of the Insolvency Act 1986 or became unable to pay its debts

within the meaning of that Section 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.

Under Regulation 17(1) of the Settlement Finality Regulations, no order can be made by a court under Section 239 of the Insolvency Act 1986 in relation to a transfer order or any disposition of property in pursuance of such a transfer order. Further, Section 165(3) of Part VII provides that no order may be made under Section 239 (preferences) of the Insolvency Act 1986 in respect of any market contract or any disposition of property in pursuance of a market contract.

Qualifications in relation to Member Default

4.2.5 Pursuant to the RepoClear Default Management Process undertaken on the default of an RCM, the CCP will attempt to auction portfolios representing RepoClear Contracts of a defaulting RCM to other (non-defaulting) RCMs. Following this, Rule 6 and 8 of the Default Rules provide for the calculation of a single net sum (payable by the defaulting RCM to the CCP or the CCP to the defaulting RCM) including all sums payable in respect of RepoClear Contracts (including Applicable Amounts) and all sums payable under, or due to a breach of, the Regulations (for example hedging costs or losses to the CCP as a result of auctions). The Rules provide for this net sum to be set off or aggregated (as applicable) with the value of cash cover standing to the credit of the relevant account of the defaulting RCM so as to produce a further net sum finally payable by the CCP to the defaulting RCM or by the defaulting RCM to the CCP.

4.2.6 We express no view in this opinion letter as to the effects in relation to any RCM of a reconstruction, arrangement or compromise, a scheme within the meaning of Part 7 of the Financial Services and Markets Act 2000, insolvency, liquidation, administration, moratorium, reorganisation and similar laws

generally affecting the rights of creditors under the laws of this jurisdiction or any other jurisdiction.²

However, in the insolvency of an RCM (including where insolvency proceedings are governed by the laws of another jurisdiction), the provisions of law described in sections 3.4.2-3.4.4 and 3.4.6 may be available as described in those sections to protect the netting and set-off of sums including Applicable Amounts.

4.3 General qualifications

- 4.3.1 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 English courts may recognise the extinction of those claims or liabilities. In particular, in relation to any RepoClear Contract which is governed by a law other than the law of this jurisdiction, such proceedings may affect whether or not that RepoClear Contract is available for inclusion in any netting or set-off pursuant to the Netting Provisions.
- 4.3.2 Under the Cross-Border Insolvency Regulations, a court may recognise a foreign insolvency proceeding, and in consequence of such recognition may limit the application of English insolvency law, or apply certain of the provisions of English insolvency law at times, or in circumstances, where they would not otherwise be available.

However, Regulation 2 of the Cross-Border Insolvency Regulations provides that the UNCITRAL Model Law shall have the force of law in Great Britain and, under Regulation 4 of Article 1 of the UNCITRAL Model Law, an English court shall not grant any relief or provide any co-operation or coordination under or by virtue of any provisions of the UNCITRAL Model Law if and to the extent that such relief, co-operation or coordination would be prohibited under Part 3 of the Settlement Finality Regulations (which includes Regulation 14 of the Settlement Finality Regulations); Part 3 of the Financial Collateral Regulations (which includes Regulations 10 and 12 of the Financial Collateral Regulations), or Part VII. Hence, the conclusions set out in this opinion as to the effect of the Netting Provisions should not be undermined as a consequence of the recognition of a foreign insolvency proceeding under the

² Please see the relevant Clearing Member jurisdiction opinion in relation to any impact of the insolvency law of the Clearing Member's jurisdiction.

Cross-Border Insolvency Regulations when the Settlement Finality Regulations, the Financial Collateral Regulations or Part VII apply.

4.3.3 Where a Party is vested with 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 CCP Documentation and Rules 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.

4.3.4 If a Party 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 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.

This opinion is given for the benefit of the Futures and Options Association (the "FOA"). This opinion may be disclosed to:

- (a) the International Swaps and Derivatives Association, Inc. ("ISDA")
- (b) such of the FOA's members (excluding associate members) or ISDA's members (excluding associate members) as subscribe to the FOA's opinions library and whose terms of subscription give them access to this opinion (each a "**subscribing member**") and the officers, employees, and professional advisors of such subscribing member;
- (c) any affiliate of a subscribing member (being a member of the subscribing member's group, as defined by the UK Financial Services and Markets Act 2000) and the officers, employees, and professional advisors of such affiliate; and
- (d) the officers, employees and professional advisors of the FOA,

(each a "**Relevant Person**"). Each Relevant Person is authorised to make a copy of this opinion available to its auditors solely as evidential matter in support of their evaluation of a Relevant Person's management's assertion that the requirements of IAS 32 have been met, and a copy of this opinion may be furnished to them in connection therewith. In authorising Relevant Persons to make copies of this opinion available to their auditors for such purpose, we are not undertaking or assuming any duty or obligation to Relevant Persons or their auditors or establishing any lawyer-client relationship with them. Further, we do not undertake or assume any responsibility with respect to financial statements of any Relevant Person.

We accept responsibility only to the FOA in relation to the matters opined on in this opinion.

Yours faithfully



Clifford Chance LLP

ANNEX 1
SERVICE AND NETTING PROVISIONS

Service	CCP	CCP Type	Applicable Amounts ³	BAU Netting Provisions	Member Default Netting Provisions	CCP Default Netting Provisions
RepoClear	LCH.Clearnet Ltd	UK Clearing House	Cash amounts of individual repos and reverse repos	Section 2.1(d) of the RepoClear Contract Terms Sections 2.4(c) and (d) of the RepoClear €GC Contract Terms Sections 2.5(c) and (d) of the RepoClear SGC Contract Terms	Default Rule 6 Default Rule 8 Default Rule 10	Regulation 39A and Regulation 5(i)

³ Terms used in this column have the meanings given to them in the Rules.