

**C L I F F O R D**

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28 May 2013

Dear Sirs

**NETTING ANALYSER LIBRARY - CCP Opinion in relation to Singapore Exchange Derivatives Clearing Limited**

You have asked us to give an opinion in respect of the laws of Singapore ("this jurisdiction") as to the effect of certain netting provisions and collateral arrangements in relation to Singapore Exchange Derivatives Clearing Limited (the "Clearing House") as 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 provisions 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 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 powers under the Clearing House Documentation as at the date of this opinion. We express no opinion on any provisions of the Clearing House Documentation other than those on which we expressly opine.
- 1.3 Where Contracts are governed by laws other than the laws of this jurisdiction, the opinions contained in Section 3 are given in respect of only those Contracts which are capable, under their governing laws, of being terminated and liquidated in accordance with the provisions of the Netting Provision.

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1.4 The opinions given in Section 3.8 are given only in relation to Non-cash Collateral comprising securities credited to an account.

1.5 **Definitions**

In this opinion, unless otherwise indicated:

- (a) "**Assessment Liability**" means a liability of a Member to pay an amount to the Clearing House (including a contribution to the assets or capital of the Clearing House, or to any default or similar fund maintained by the Clearing House); but excluding:
  - (i) any obligations to provide margin or collateral to the Clearing House, where calculated at any time by reference to Contracts open at that time;
  - (ii) membership fees, fines and charges;
  - (iii) reimbursement of costs incurred directly or indirectly on behalf of or for the Member or its own clients;
  - (iv) indemnification for any taxation liabilities;
  - (v) payment or delivery obligations under Contracts; or
  - (vi) any payment of damages awarded by a court or regulator for breach of contract, in respect of any tortious liability or for breach of statutory duty;
- (b) "**Clearing House Documentation**" means the Rules and the Security Deed;
- (c) "**Customer Account**" has the meaning ascribed to it in the Rules, being an account carried on the books of a Member for a Customer;
- (d) "**Customer**" has the meaning ascribed to it in the Rules;
- (e) "**Collateral**" has the meaning ascribed to it in the Rules;
- (f) "**Contract**" has the meaning ascribed to it in the Rules;
- (g) "**Exchange**" has the meaning ascribed to it in the Rules;
- (h) "**House Account**" has the meaning ascribed to it in the Rules, being an account which is not a Customer Account;

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- (i) "**Multiple Default Period**" has the meaning ascribed to it in the Rules;
- (j) "**Netting Provision**" means Rule 7A.07 of the Rules;
- (k) "**Non-cash Collateral**" means the non-cash Collateral provided to the Clearing House pursuant to the Rules;
- (l) "**Non-Relevant Market Contract**" has the meaning ascribed to it in the Rules, being a contract or transaction that is not listed or quoted for trading on the Exchange or any Relevant Market but which does not include any OTCF Contract or OTCF Transaction;
- (m) "**OTCF Contract or Transaction**" has the meaning ascribed to it in the Rules, being a contract or transaction that is not listed or quoted for trading on the Exchange or any Relevant Market and which relates to a financial derivative;
- (n) "**Relevant Market**" has the meaning ascribed to it in the Rules;
- (o) "**Party**" means the Clearing House or the relevant Member;
- (p) "**Rules**" means the Clearing Rules of the Clearing House in force as at the date of this opinion;
- (q) "**Security Deed**" has the meaning ascribed to it in the Rules, being the deed setting out the terms under which a Member's Collateral is provided to, and held by, the Clearing House, in the form of the version of the Security Deed published by the Clearing House at the time of the implementation of the trust and collateral provisions under the Rules on or about 26 April 2013;
- (r) "**SFA**" means the Securities and Futures Act (Chapter 289) of Singapore;
- (s) 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; and
- (t) references to a "**section**" or to a "**paragraph**" are (except where the context otherwise requires) to a section or paragraph of this opinion (as the case may be).

## 2. ASSUMPTIONS

We assume the following:

- 2.1 That, except with regards to the provisions discussed and opined on in this opinion letter, the Clearing House Documentation and Contracts are legally binding and enforceable against both Parties under their governing laws.
- 2.2 That each Party has the capacity, power and authority under all applicable law(s) to enter into the Clearing House Documentation and Contracts; to perform its obligations under the Clearing House Documentation and Contracts; and that each Party has taken all necessary steps to execute and deliver and perform the Clearing House Documentation and Contracts.
- 2.3 That each Party has obtained, complied with the terms of and maintained all authorisations, approvals, licences and consents required to enable it lawfully to enter into and perform its obligations under the Clearing House Documentation and Contracts and to ensure the legality, validity, enforceability or admissibility in evidence of the Clearing House Documentation in this jurisdiction.
- 2.4 That, in the case of the opinion given at paragraph 3.8 only, both Parties have properly executed the Security Deed, in substantially the form examined by us.
- 2.5 That the Clearing House Documentation has been entered into prior to the commencement of any insolvency procedure under the laws of any jurisdiction in respect of either Party.
- 2.6 That each Party acts in accordance with the powers conferred by the Clearing House Documentation and Contracts; and that (save in relation to any non-performance leading to the taking of action by the Members under the Netting Provision), each Party performs its obligations under the Clearing House Documentation and each Contract in accordance with their respective terms.
- 2.7 That there are no other agreements, instruments or arrangements between the Parties which modify or supersede the terms of the Clearing House Documentation.
- 2.8 That the Member is at all relevant times solvent and not subject to insolvency proceedings under the laws of any jurisdiction.
- 2.9 That the obligations assumed under the Clearing House Documentation and Contracts are mutual between the Parties, in the sense that the Parties are each personally and solely liable as regards obligations owing by it and is solely entitled to the benefit of obligations owed to it.

2.10 The choice of Singapore law to govern the Rules and Security Deed has been made by the parties thereto freely and for bona fide purposes and is not contrary to public policy. We are not aware of any reason to believe that such choice of Singapore law would be contrary to public policy in Singapore.

### 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

3.1.1 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:

- (a) winding up (including provisional winding up);
- (b) judicial management (subject to the qualification in paragraph 4.4 below);
- (c) receivership; and
- (d) schemes of arrangement.

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

3.1.3 The legislation applicable to Insolvency Proceedings is:

- (a) the Companies Act (Chapter 50) of Singapore (the "**Companies Act**"); and
- (b) the Bankruptcy Act (Chapter 20) of Singapore (the "**Bankruptcy Act**"),

together with certain subsidiary legislation, including the Bankruptcy Rules, each as modified up to the date hereof.

#### 3.2 Special provisions of law

The following special provisions of law apply to Contracts by virtue of the fact that the Contracts are, or relate to, exchange-traded derivative products and are cleared

through a central counterparty: Division 3 (*Regulation of Designated Clearing Houses*) and Division 4 (*Insolvency*) of Part III (*Clearing Facilities*) of the SFA.

**3.3 Recognition of choice of law**

The choice of law provisions of Rule 1.06.1 and Clause 7.1 (*Governing law and jurisdiction*) of the Security Deed would be recognised under the laws of this jurisdiction, even if the Member is not incorporated, domiciled or established in this jurisdiction.

**3.4 Netting: General**

3.4.1 The Netting Provision will be immediately (and without fulfilment of any further conditions) enforceable in accordance with its terms so that, upon the occurrence, in relation to the Clearing House, of either of the events described in paragraphs (a) or (b) of Rule 7A.07.1 (being, broadly, a failure to pay or the commencement of Insolvency Proceedings in relation to the Clearing House):

- (a) the non-defaulting Member would be entitled immediately to exercise its rights under the Netting Provision (being the right to specify a date for the termination and liquidation of all Contracts to which it is a party) ; and
- (b) the non-defaulting Member would be entitled to receive or be obliged to pay only the net sum of the positive and negative mark-to-market values of the included individual 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 or which would render such terms ineffective. 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 non-defaulting Member.

**3.5 Netting: House Accounts and Customer Accounts**

3.5.1 Where a Member has exercised its rights under the Netting Provision, a Termination Amount payable on Contracts registered in any Customer Account of a Member would not be aggregated with or netted against a Termination Amount payable on Contracts registered in any House Account of the Member.

3.5.2 However, where a Member has exercised its rights under the Netting Provision, a balance in respect of Contracts registered in one Customer Account of a Member would be required to be aggregated with or (as the case may be) netted against the balances in respect of Contracts registered in each other Customer Account of that Member.

3.5.3 This is because Rule 7A.07.4 provides that where a Member has a House Account and one or more Customer Accounts, the "*Clearing House shall determine two net amounts... one net amount in respect of gains and losses arising on Contracts registered in the Clearing Member's client account (or client accounts as combined) and a second net amount in respect of gains and losses arising on all other Contracts*" and the two net amounts each shall constitute Termination Amounts. Therefore, Rule 7A.07.4 operates so as to produce two separate Termination Amounts between the Clearing House and the Member, one in respect of Contracts registered in the House Account and one in respect of Contracts registered in the Customer Accounts.

### 3.6 Netting: Cross-Product Netting

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

3.6.2 This is because Rule 7A.07 refers throughout to Contracts as defined under the Rules. "Contract" is defined broadly to include Contracts novated to the Clearing House pursuant to Rule 7.04.

3.6.3 The Rules do not differentiate, nor enable the Clearing House or Member to differentiate, between sub-sets of Contracts for the purposes of the Netting Provision.

### 3.7 Cash Collateral

3.7.1 Payments made by a Member to the Clearing House as Collateral in the form of cash (irrespective of the currency of the Collateral) do not constitute an absolute transfer of cash, so that, in the event of Insolvency Proceedings relating to the Clearing House, such cash would not be treated as the property of the Clearing House available to its creditors generally.

3.7.2 This is because the Clearing House holds Collateral in the form of cash on trust for Members (where the cash Collateral is provided in respect of Contracts registered in House Accounts) and Customers of Members (where

the cash Collateral is provided in respect of Contracts registered in Customer Accounts).

3.7.3 The holding of Collateral provided in respect of Contracts registered in Customer Accounts on trust for Customers of Members is also required under the provisions of the SFA. Section 62(2) of the SFA provides that "*where a member has notified a designated clearing house... that the money or assets are deposited or paid for or in relation to a contract of a customer of the member, the designated clearing house shall... ensure that such money is deposited in a trust account... to be held for the benefit of the customers of the member and disposed of or used only for or in relation to contracts of customers of the member*". Therefore, the Clearing House must deposit cash Collateral provided in respect of Contracts registered in Customer Accounts in an account with a third party and hold its rights to that account on trust for the Customers of the relevant Member.

3.7.4 The holding on trust of cash Collateral provided in respect of Contracts registered in House Accounts is not a mandatory requirement under the SFA. However, the Clearing House has elected to hold such cash Collateral in this way. Rule 7.03A.1 (*Trust Arrangements*) provides that:

*"Collateral held by or otherwise deposited with or provided to the Clearing House shall be held on trust by the Clearing House for the benefit of:*

a. *Clearing Members, except where such Collateral is held by or otherwise deposited with or provided to the Clearing House solely in respect of Customer Contracts; and*

b. *the relevant customers of the Clearing Member pursuant to the SFA, where such Collateral is held by or otherwise deposited with or provided to the Clearing House solely in respect of Customer Contracts."*

3.7.5 Under the Security Deed, however, to the extent that any cash is to be held on trust by the Clearing House for the Member (or its Customers), and to the extent permitted by the Rules and the SFA, the Clearing Member (for itself and for and on behalf of its Customers to the extent that they are beneficiaries under such trust) grants a charge in favour of the Clearing House over its rights and interest in respect of such cash as security for the obligations of the Member to the Clearing House.

### 3.8 Non-cash Collateral

3.8.1 Any securities provided to the Clearing House as Collateral and constituting Non-cash Collateral would not be treated as the property of the Clearing House and would be returnable to the Member, even in the event of Insolvency Proceedings relating to the Clearing House, subject to the Member satisfying its obligations to the Clearing House.

3.8.2 This is because the Clearing House holds Non-cash Collateral on trust for Members (where the Non-cash Collateral is provided in respect of Contracts registered in House Accounts) and Customers of Members (where the Non-cash Collateral is provided in respect of Contracts registered in Customer Accounts).

3.8.3 The holding of Non-cash Collateral provided as Collateral in respect of Contracts registered in Customer Accounts on trust for Customers of Members is required under the provisions of the SFA. Section 62(2) of the SFA provides that "*where a member has notified a designated clearing house... that the money or assets are deposited or paid for or in relation to a contract of a customer of the member, the designated clearing house shall... ensure that... such assets are deposited in a custody account... to be held for the benefit of the customers of the member and disposed of or used only for or in relation to contracts of customers of the member*". Therefore, the Clearing House must transfer such Non-cash Collateral to a custody account with a third party and must hold its interest in that Non-cash Collateral on trust for the Customers of the relevant Member.

3.8.4 The holding on trust of Non-cash Collateral provided as Collateral in respect of Contracts registered in House Accounts is not a mandatory requirement under the SFA. However, the Clearing House has elected to hold such Non-cash Collateral in this way. Rule 7.03A.1 (*Trust Arrangements*) provides that:

*"Collateral held by or otherwise deposited with or provided to the Clearing House shall be held on trust by the Clearing House for the benefit of:*

- a. *Clearing Members, except where such Collateral is held by or otherwise deposited with or provided to the Clearing House solely in respect of Customer Contracts; and*
- b. *the relevant customers of the Clearing Member pursuant to the SFA, where such Collateral is held by or otherwise deposited*

*with or provided to the Clearing House solely in respect of Customer Contracts."*

### 3.9 Members' Assessment Liabilities

A Member's Assessment Liability is as follows.

3.9.1 The Clearing Fund consists of Security Deposits and Further Assessment Amounts of Members and the Aggregate Clearing House Contribution (each as defined in the Rules).

#### Security Deposit

3.9.2 Under Rule 7A.06.2.1 (*Security Deposit*), upon being granted eligibility by the Clearing House to clear a relevant class of Contract, each Member wishing to clear that class of Contract must deposit with the Clearing House as security for its obligations to the Clearing House (the "**Security Deposit**") the following amounts:

- (a) for clearing Contracts which are listed or quoted for trading on the Exchange or any Relevant Market and/or Non-Relevant Market Contracts, the higher of:
  - (i) SGD1,000,000 or such lower amount as prescribed by the Clearing House from time to time; or
  - (ii) 3.0 percent, or such lower amount as prescribed by the Clearing House from time to time, of the daily average of the risk margin of such Member during the preceding three month period;
- (b) for clearing OTCF Contracts, the higher of:
  - (i) USD 5,000,000; or
  - (ii) 3.0 percent, or such lower amount as prescribed by the Clearing House from time to time, of the daily average of the risk margin of such Member for such OTCF Contracts during the preceding three month period; or
- (c) for clearing (i) Contracts which are listed for trading on the Exchange or any Relevant Market and/or Non-Relevant Market Contracts; and

(ii) OTCF Contracts, the sum of the amounts specified in (a) and (b) above.

3.9.3 Rule 7A.06.2.2 provides that the Security Deposit must be in cash, government securities or other forms of Collateral acceptable to the Clearing House.

**Security Deposit to be Restored**

3.9.4 Rule 7A.06.8.1 provides that in the event that it becomes necessary as provided in Rule 7A.06 to apply all or part of the Security Deposits to meet obligations to the Clearing House (other than a Member's own obligation resulting from the substitution of the Clearing House on its trades), the Member shall immediately make good any such deficiency in Security Deposits prior to the close of business on the Business Day immediately following such application.

3.9.5 Rule 7A.06.8.2 provides that in the event that the limits to the application of the Member's Security Deposit under Rule 2.28.2A.1 (as described in paragraph 3.9.23) have been reached, the Security Deposits restored in accordance with Rule 7A.06.8.1 (as described in paragraph 3.9.4) shall be applied only to meet the Member's own obligations to the Clearing House, resulting from the substitution of the Clearing House on its trades.

**Further Assessment Amount**

3.9.6 Under Rule 7A.06.3.1 (*Further Assessment Amount*), Members are also obliged to contribute a further amount (a "**Further Assessment Amount**") which may be up to three times the Member's Security Deposit requirement, as prescribed by the Clearing House from time to time. Under Rule 7A.06.03.2, each Member is required to deposit with the Clearing House a percentage of its Further Assessment Amount as set out below:

- (a) in respect of any Further Assessment Amount attributable to Contracts traded on the Exchange or any Relevant Market or Non-Relevant Market Contracts, an amount up to 50% (fifty percent) in the form of cash or government securities; or
- (b) in respect of any Further Assessment Amount attributable to OTCF Contracts, an amount up to 100% (one hundred percent) in the form of cash or government securities,

or any other forms of Collateral acceptable to the Clearing House from time to time.

3.9.7 Rule 7A.06.3.3 provides that, in the use and application of the Further Assessment Amounts pursuant to Rule [7A.01A.2]<sup>1</sup> (as described in paragraph 3.9.15) in an event of default, the Clearing House shall be entitled to call for payment of any balance of the Further Assessment Amount, which has not been deposited with the Clearing House pursuant to Rule 7A.06.3.2 (as described in paragraph 3.9.6) at such time as it deems appropriate. A Member must immediately furnish such amount to the Clearing House prior to the close of business on the business day immediately following such call.

### **Offences**

3.9.8 Under Rule 4.12.1.6 (*Major Offences*), it is a major offence for a Member to fail to maintain minimum financial requirements or fail to maintain the required Security Deposit. Under Rule 4.13.4 (*Minor Offences*), any violation of the Rules which is not a major offence is a minor offence.

3.9.9 Under Rule 4.10.2, major offences may be dealt with by expulsion, suspension or a fine not exceeding SGD250,000. Under Rule 4.10.3, minor offences may be dealt with by a fine not exceeding SGD10,000 or suspension for not more than one year.

3.9.10 Under Rule 4.11, where a violation of the Rules results in a condition or state of affairs that unless rectified by the Clearing Member charged is liable to continue, the Clearing Member charged is liable to pay a fine not exceeding SGD250,000 in the case of a major offence, or a fine not exceeding SGD10,000 in the case of a minor offence, for every day during which the said violation, condition or state of affairs continues.

### **Protection of Clearing House**

3.9.11 Rule 7A.05.1 sets out, amongst other things, what happens in the event of the failure by a Member to discharge its obligations to the Clearing House in respect of Contracts.

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<sup>1</sup> Rule 7A.06.3.3 still refers to Rule 7A.06.5.2 in this instance. Rule 7A.06.5 was deleted on 26 April 2013. Rule 7A.01A.2 is its direct replacement and was added on 26 April 2013. We assume the correct reference should be Rule 7A.01A.2 and have, therefore, included this in square brackets each time the reference in the Rules is to Rule 7A.06.5.2.

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3.9.12 Rule 7A.05.1.1 provides that, where a Member has failed promptly to discharge any of its obligations to the Clearing House in respect of a House Contract, the Clearing House may apply any or all of the following to discharge such obligations:

- (a) the Member's Collateral deposited with or provided to the Clearing House (except such Collateral deposited or provided in relation to Customer Contracts); and
- (b) in the case of a Bank Clearing Member incorporated outside Singapore which has satisfied Rule 2.02B.1.11.a or b, the Collateral deposited or provided by the Bank Clearing Member pursuant to Rule 2.08.1B.1.

3.9.13 Rule 7A.05.1.2 provides that where a Member has failed promptly to discharge any of its obligations to the Clearing House in respect of a Customer Contract, the Clearing House may apply any or all of the following to discharge such obligations:

- (a) the Member's Collateral deposited with or provided to the Clearing House (except such Collateral deposited or provided in relation to Customer Contracts);
- (b) Collateral deposited or provided by the Member in relation to Customer Contracts provided that the conditions in the SFA in relation to the permissible use of customer's money and assets are satisfied;
- (c) in the case of a Bank Clearing Member incorporated outside Singapore which has satisfied Rule 2.02B.1.11.a or b, the Collateral deposited or provided by the Bank Clearing Member pursuant to Rule 2.08.1B.1; and
- (d) the qualifying letters of credit deposited with the Exchange by a Trading Member sponsored by the Member, pursuant to Rule 7.3.6 of the Trading Rules, provided that the Member's default is attributable to such Trading Member's act or omission.

3.9.14 Rule 7A.05.1.3 provides that the Clearing House may liquidate any non-cash Collateral deposited with it by a Member:

- (a) in respect of Collateral in relation to House Contracts, where the Member has failed to promptly discharge its obligations to the Clearing House in respect of any Contract; and

(b) in respect of Collateral in relation to Customer Contracts, where the Clearing Member has failed to promptly discharge its obligations in respect of a Customer Contract and the conditions in the SFA in relation to the permissible use of customers' money and assets are satisfied.

The Clearing House will not be liable for any losses arising from such liquidation.

**Order of Application of Clearing Fund**

3.9.15 Under Rule 7A.01A.2, any losses suffered by the Clearing House arising from an event of default shall be met and made good by the application of funds from the following sources (collectively known as the "**Clearing Fund**") in the order of priority listed, with each source to be completely exhausted before the next source is applied:

(a) Clearing House Contribution (as defined in the Rules);

(b) Security Deposits of Members (excluding any Member who is insolvent or deemed to be insolvent) where each Member had:

(i) cleared Contracts belonging to the Contract Class in which the event of default occurred, during the six month period preceding the day the event of default was declared by the Clearing House; or

(ii) an open commitment in Contracts belonging to the same Contract Class in which the event of default occurred, during the six month period preceding the day the event of default was declared by the Clearing House.

Such Member will be liable for the loss remaining on a pro-rata basis, calculated as the proportion of its Security Deposit requirement relative to the aggregate Security Deposit requirement for the category of Members referred to above;

- (c) Further Assessment Amounts (excluding any Member who is insolvent or deemed to be insolvent) of the same category of Members referred to above. Such Member shall be liable for the loss remaining on a pro-rata basis, calculated as the proportion of its Further Assessment Amount requirement relative to the aggregate Further Assessment Amount requirement for the category of Members referred to above;
- (d) any contributions to the Clearing Fund by the Clearing House or any of its related entities to that Contract Class in which the event of default occurred, the amount of such contributions (if any) being determined by the Clearing House in its sole discretion;
- (e) Security Deposits of Members (excluding any Member who is insolvent or deemed to be insolvent) where that Member had:
  - (i) cleared Contracts, not belonging to the same Contract Class in which the event of default occurred, during the 6 (six) month period preceding the day the event of default was declared by the Clearing House; or
  - (ii) an open commitment in Contracts, not belonging to the same Contract Class in which the event of default occurred, during the 6 (six) month period preceding the day the event of default was declared by the Clearing House; or
  - (iii) not cleared or had no open commitment in Contracts belonging to the same Contract Class in which the event of default occurred during the above periods.
- (f) Further Assessment Amounts of the same category of Member referred to in (e) above but excluding any Member which has been levied the maximum amounts that may be levied against it in accordance with (c) above. Such Member shall be liable for the loss remaining on a pro-rata basis, calculated as the proportion of its Further Assessment

Amount requirement relative to the aggregate Further Assessment Amount requirement for the category of Members referred to in (e) above; and

(g) any other contributions to the Clearing Fund.

**Consequences Where the Limit to One or More Member's Liabilities as Set Out in Rule 2.28.2A or Rule 7A.06.06.6 are Reached**

3.9.16 Rule 7A.01A.3 provides that where a Member's Security Deposit or Further Assessment Amounts are used and applied in accordance with Rule 7A.01A.2 b, c, d or e (as described in paragraph 3.9.15 (b), (c), (e) or (f) respectively), the limits to one or more Member's liabilities in respect of such funds as set out in Rule 2.28.2A (as described in paragraph 3.9.23) or Rule 7A.06.6.6 (as described in paragraph 3.9.20) may be reached. As a consequence, the contributions of Members which remain liable in respect of the relevant source of funds may remain unexhausted, while outstanding losses remain following such use and application of the source funds. In such instances, the following shall apply:

(a) the remaining contributions of Members in respect of the relevant source of funds shall be applied to meet the outstanding loss, subject to their limits set out in Rule 2.28.2A and Rule 7A.06.6.6 (as described in paragraph 3.9.20); and

(b) the liability of each Member for such loss shall be determined as described in Rules 7A.01A.2.b, c, d or e (as described in paragraphs 3.9.15 (b), (c), (e) and (f) respectively), whichever is applicable, subject always to the operation of Rule 7A.06.6.5 (as described in paragraph 3.9.24).

**Use of the Clearing Fund in Respect of Events of Default Occurring Within a Multiple Default Period**

3.9.17 Rule 7A.06.6 (*Use of the Clearing Fund in respect of Events of Default occurring within a Multiple Default Period*)<sup>2</sup> provides for how the Clearing Fund shall be applied during any "Multiple Default Period", being a fixed

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<sup>2</sup> Rule 7A.06.6 still refers to Rule 7A.06.5.2 in certain places. Rule 7A.06.5 was deleted on 26 April 2013. Rule 7A.01A.2 is its direct replacement and was added on 26 April 2013. We assume the correct reference should be to Rule 7A.01A.2 and have, therefore, included this in square brackets each time the reference in the Rules is to Rule 7A.06.5.2.

period of 90 (ninety) days commencing on the day an event of default occurs as declared by the Clearing House, where such event of default results in the use and application of the Clearing Fund.

3.9.18 Rule 7A.06.6.2 provides that an event of default occurring within a Multiple Default Period shall not trigger the commencement of a new Multiple Default Period. Rule 7A.06.6.3 provides that the Clearing House shall notify Members of the commencement date of any Multiple Default Period.

3.9.19 Rule 7A.06.6.4 provides that the Clearing Fund, in the order of priority listed in Rule [7A.01A.2] (as described in paragraph 3.9.15), will be used and applied in the following manner in respect of events of default occurring within a Multiple Default Period:

- (a) the Clearing Fund will only be drawn upon after the monies of the defaulted Member have been exhausted in accordance with the Rules;
- (b) the Clearing Fund will be utilised in the order of priority listed in Rule [7A.01A.2] (as described in paragraph 3.9.15) irrespective of the number of draw downs on the Clearing Fund;
- (c) in the event that a utilisation of the Clearing Fund draws only part of the funds available at any source under Rule [7A.01A.2] (as described in paragraph 3.9.15), the next utilisation of the Clearing Fund in connection with an event of default occurring within the same Multiple Default Period, will draw first from the remaining funds available at the unexhausted source before drawing on the next source, taking into account, at all times, the relevant Contract Class;
- (d) once all the sources of the Clearing Fund have been exhausted, any current or subsequent utilisation of the Clearing Fund in connection with an event of default occurring within the same Multiple Default Period shall revert to the sequence of priority set out in listed in Rule [7A.01A.2] (as described in paragraph 3.9.15); and
- (e) upon the commencement of a new Multiple Default Period, the first draw down on the Clearing Fund in connection with an event of default occurring in the new Multiple Default Period will commence from the first source of funds listed in Rule [7A.01A.2] (as described in paragraph 3.9.15), subject to Rule 7A.06.8.2 (as described in paragraph 3.9.5), and the subsequent sources of funds will follow accordingly. This applies regardless of the source from which the last payment out

of the Clearing Fund was made in connection with an event of default which occurred in any previous Multiple Default Period.

3.9.20 Rule 7A.06.6.6 confirms that nothing in Rule 7A.06.6 (as described above) shall be construed as permitting the Clearing House to apply more than the Member's Security Deposit and Further Assessment Amount as at the time of the event of default, to meet the losses arising from or in connection with any individual event of default.

**Assignment and transfer of open positions**

3.9.21 Rule 7A.02.1.4 provides that where a Member having open positions has defaulted upon its obligations to the Clearing House, or has been suspended, the Clearing House may where the open positions relate to an Eligible Non-Relevant Market Transaction or a Contract subject to physical delivery prior to re-novation, and it is in the Clearing House's good faith opinion impossible or impracticable for the open position to be transferred or closed out pursuant to the Rules, the Clearing House may, in addition to any other power or right it may have, invoice back such positions to the defaulting or suspended Member. The Clearing House shall then simultaneously invoice back the equivalent number of positions or as nearly equivalent number of such positions as the Clearing House may deem practical to the following:

- (a) in the case of an Eligible Non-Relevant Market Transaction or a Contract subject to physical delivery prior to the matching process, to other non-defaulting and non-suspended Members, and/or any other non-defaulting Relevant Market (or its clearing house) holding appropriate opposite positions (whether reported to the Clearing House as being House or Customer positions) as at the date of such invoicing back, on a pro-rata basis; or
- (b) in the case of a Contract subject to physical delivery after the matching process and before re-novation, to the non-defaulting and non-suspended Members and/or clearing member of another Relevant Market (or its clearing house) with which the defaulting or suspended Member has been matched (whether reported to the Clearing House as being House or Customer positions).

3.9.22 Under Rule 7A.02.1.5, where the open positions relate to OTCF Contracts and the Clearing House is of the good faith opinion that it is impossible or impracticable to conduct an auction of such open positions, the Clearing

House may assign and transfer residual open positions to non-defaulting Member(s) provided that:

- (a) the residual OTCF Contracts assigned and transferred to the non-defaulting Member shall not be of such amount as to increase its risk margin requirement by more than 100 percent of its average end-of-day risk margin requirement for OTCF Contracts in the 30 days preceding, and excluding, the day on which the event of default occurs; and
- (b) the non-defaulting Member has cleared such product group in such currency in the last three months.

#### Resignation of Member

3.9.23 A Member may resign in order to limit the period in which it has default management obligations. However, such resignation is only effective upon the Member closing out its positions in all Contracts and is subject to a minimum period of 30 days from the Clearing House's receipt of the Member's notice of resignation. Under Rule 2.28.2A, during the period between the receipt of notice of resignation and the effective date of resignation, the Member will be liable for all defaults except that the following shall apply:

- (a) the Clearing House shall apply the resigning Member's Security Deposit and Further Assessment Amount in accordance with Rule [7A.01A.2]<sup>3</sup> (as described in paragraph 3.9.15), except that the aggregate amount applied in respect of all such defaults shall be subject always to a limit of no more than two times the resigning Member's Security Deposit requirement and Further Assessment Amount as at the time the Clearing House receives its notice of resignation (once this limit has been reached any further restored Security Deposit will only be applied to meet the Member's own obligations to the Clearing House resulting from the substitution of the Clearing house on its trades (see paragraph 3.9.5)); and

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<sup>3</sup> Rule 2.28.2A still refers to Rule 7A.06.5.2 in this instance. Rule 7A.06.5 was deleted on 26 April 2013. Rule 7A.01A.2 is its direct replacement and was added on 26 April 2013. We assume the correct reference should be Rule 7A.01A.2 and have, therefore, included this in square brackets each time the reference in the Rules is to Rule 7A.06.5.2.

(b) the resigning Member will not be assigned and transferred residual OTCF Contracts in respect of more than two defaults occurring within the notice period.

This restriction will only apply if the resigning Member does not undertake any transactions which have the effect of increasing its positions in any Contract during the notice period as per Rule 2.28.2B.

3.9.24 Rule 7A.06.6.5<sup>4</sup> provides that a resigning Member whose Security Deposit and Further Assessment Amount have been applied fully as specified in Rule 2.28.2A (as described in paragraph 3.9.23) shall thereafter:

- (a) not be taken into account for the calculation of the aggregate Security Deposit requirement referred to in Rules [7A.01A.2.b and d] (as described in paragraphs 3.9.15 (b) and (e) respectively); and
- (b) not be taken into account for the calculation of the aggregate Further Assessment Amount referred to in Rules [7A.01A.2.c and e] (as described in paragraphs 3.9.15 (c) and (f) respectively).

**Market Disorders, Impossibility or Performance, Emergency Situations and Powers of Clearing House**

3.9.25 Under Rule 2.34.1B, if the Clearing House determines that an emergency exists which threatens the financial integrity of the Clearing House or any of the Clearing Members, it may order special or advance margins or funds to be deposited with the Clearing House from all or any Clearing Members or from Clearing Members having cleared particular long and/or short contracts which remain open.

**4. QUALIFICATIONS**

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

**4.1 Qualification relating to Netting: General**

**Terms of the Netting Provision**

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<sup>4</sup> Rule 7A.06.6 still refers to Rule 7A.06.5.2 in certain places. Rule 7A.06.5 was deleted on 26 April 2013. Rule 7A.01A.2 is its direct replacement and was added on 26 April 2013. We assume the correct reference should be to Rule 7A.01A.2 and have, therefore, included this in square brackets each time the reference in the Rules is to Rule 7A.06.5.2.

4.1.1 The only right of the non-defaulting Member under the Netting Provision is to specify a date for the termination and liquidation of all Contracts. The Netting Provision provides for the Clearing House to make all the relevant determinations in calculating any Termination Amounts. As such, the efficacy of the Netting Provision will depend on the Clearing House actually making such determination.

**Applicability of the SFA rules supporting the procedures of the Clearing House**

4.1.2 Generally, a contractual provision for set-off (and/or netting) (such as the Netting Provision) will be effective unless and until an Insolvency Proceeding occurs and then only to the extent that it does not contravene or infringe a mandatory rule of insolvency law.

4.1.3 We note that, like jurisdictions such as the United Kingdom, this jurisdiction has passed legislation the effect of which is to give certain proceedings of the Clearing House precedence over the laws of insolvency. However, there is some doubt as to whether this legislation would cover action taken pursuant to the Netting Provision in circumstances where the Clearing House (rather than a Member) is insolvent.

4.1.4 Section 81F(1)(i) of the SFA provides that "default proceedings" of the Clearing House shall not be invalid at law by reason only of inconsistency with any law relating to the distribution of the assets of a person on insolvency or on the appointment of a receiver or manager. However, while the definition of "default proceedings" clearly covers proceedings that apply where a Member is in default, it is difficult to interpret this definition as covering proceedings that apply where just the Clearing House is in default. The relevant definitions are as follows:

***"default proceedings"*** is defined as *"proceedings or other action taken by the Clearing House under its default rules"*;

***"default rules"*** is defined as *"the business rules of the Clearing House which provide for the taking of proceedings or other action if a participant has failed, or appears to be unable or to be likely to become unable, to meet his obligations for any unsettled or open market contract to which he is a party"*; and

***"participant"*** is defined, for the purposes Section 81F of the SFA, as *"a person who, under the business rules of the Clearing House, may participate*

*in one or more of the services provided by the Clearing House in its capacity as a designated clearing house".*

4.1.5 In our view, the definition of "participant" appears to exclude the Clearing House and only include those persons that use the Clearing House's services. If this is the case, the Netting Provision would not fall within the definition of "default rules" (which are rules that provide for the taking of action if a "participant" has or is likely to fail) and any action taken under it would not, as a consequence, constitute "default proceedings". This is because the Netting Provision is only applicable upon the default of the Clearing House not the default of a Member. On this basis, the Netting Provision would not take precedence over the laws of insolvency pursuant to Section 81F(1)(i) of SFA.

4.1.6 Section 81F(2) of the SFA provides that *"a relevant office holder, or a court applying the law of insolvency in Singapore, shall not exercise his or its power to prevent, or interfere with –*

- (a) the settlement of a market contract in accordance with the business rules of a designated clearing house, or proceedings or other action taken under those business rules; or*
- (b) default proceedings."*

The term "default proceedings" for the purpose of sub-section (b) is defined in the same way as set out above. However, sub-section (a) is broader and could arguably apply to action taken pursuant to the Netting Provision. If the phrase *"proceedings or other action taken under those business rules"* is read disjunctively with the rest of the sub-section, then this would appear to cover action taken pursuant to the Netting Provision. Alternatively, if action taken pursuant to the Netting Provision could be argued to be *"settlement of a market contract in accordance with the business rules"* of the Clearing House, then Section 81F(2) would provide protection. However, this interpretation is not certain and we are not aware of any Singapore case law where the provision has been considered. If, as seems possible, Section 81F(2) of the SFA is interpreted to be a provision which was inserted into the SFA to support the other provisions of the SFA which give statutory support to the proceedings of the Clearing House, such as Section 81F(1) of the SFA, then it would arguably be inconsistent with those other provisions to interpret Section 81F(2) as covering action pursuant to the Netting Provision in a situation where the Clearing House is in default because those other provisions refer to "default proceedings" which do not cover this.

4.1.7 If action taken pursuant to the Netting Provision is not afforded protection by statute under the SFA because of the issues raised above, then any such action will be subject to the laws of insolvency that are applicable in this jurisdiction.

## 4.2 General insolvency issues

### 4.2.1 *Mandatory insolvency rules of set-off*

- (a) Section 88(1) of the Bankruptcy Act, which is made applicable to companies by Section 327(2) of the Companies Act prescribes that in a winding up of a company (the "**Insolvent Party**") under Singapore law, where there have been any mutual credits, mutual debts or other mutual dealings between the Insolvent Party and a creditor, the debts and liabilities to which each party is or may become subject as a result of such mutual credits, debts or dealings shall be set-off against each other and only the balance shall be a debt provable in bankruptcy.
- (b) Set-off pursuant to Section 88(1) of the Bankruptcy Act ("**Statutory Insolvency Set-Off**") is mandatory and occurs automatically on the date of the winding-up order. It is not possible for parties to contract out of Statutory Insolvency Set-Off. Accordingly, a contractual set-off provision (such as the Netting Provision) between the Clearing House and a Member will be effective in the Insolvency Proceedings of the Clearing House only if, and to the extent that, such provision is consistent with Statutory Insolvency Set-Off.
- (c) In our view, the operation of the Netting Provision, insofar as it relates to the aggregation of amounts representing terminated obligations and the determination of the Termination Amount, may be viewed as a mere accounting between the Parties which does not involve set-off. However, there is currently insufficient case law in Singapore for us to be confident that the Netting Provision is effective on this basis alone.
- (d) In any case, even if the Netting Provision is viewed as involving set-off of amounts representing terminated obligations, in our opinion, the Netting Provision would, if it were implemented on the date of the winding-up order, operate to produce the same net amount that would have been produced if set-off had been implemented under Statutory Insolvency Set-Off, subject to the other qualifications set out in this opinion letter, including, without limitation, in paragraph 4.2.2 below, and subject also to the inclusion in any Statutory Insolvency Set-Off of other mutual obligations between the Parties.

4.2.2 *Netting: House Accounts and Customer Accounts*

Where the Clearing House is subject to Insolvency Proceedings, any amounts due in respect of Contracts registered in a House or a Customer Account would be aggregated and set-off separately, subject as follows:

- (a) if the Clearing House is being wound up, there would be mandatory Statutory Insolvency Set-Off (as defined in paragraph 4.2.1) of the amounts due in respect of Contracts registered in House Accounts and Customer Accounts if those amounts are considered to be "mutual" for the purposes of Statutory Insolvency Set-Off;
- (b) the effect of Section 62(2) of the SFA is that all money and assets deposited or paid for or in relation to Contracts registered in Customer Accounts are held on trust for Customers collectively and such amounts would not be "mutual" with (and therefore could not be set off against) amounts due with respect to Contracts registered in House Accounts;
- (c) the amounts due in respect of Applicable Customer Contracts relating to an Applicable Customer Account of a Member may not be considered to be mutual with (and therefore could not be set off against) amounts due in respect of Contracts registered in House Accounts and other Customer Accounts of that Member; and
- (d) 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 Contracts registered in a Customer Account of a Member not mutual with amounts due in respect of House Accounts, or, possibly, other Customer Accounts of that Member.

4.2.3 *Dispositions of property void*

In a winding up of the Clearing House under the laws of Singapore, any dispositions of the Clearing House's property made after the commencement of its winding up are void under Section 259 of the Companies Act unless the court otherwise orders. Accordingly, we express no opinion as to whether or not an obligation incurred after the commencement of a winding-up of the Clearing House could properly be included in an aggregation or a set-off pursuant to the Netting Provision or Statutory Insolvency Set-Off. The avoidance of any obligation on this basis would not prejudice the effectiveness

of the aggregation and set-off of other obligations pursuant to the Netting Provision or Statutory Insolvency Set-Off.

4.2.4 *Obligations incurred after certain times*

(a) In circumstances where a winding-up petition is presented for the winding-up of the Clearing House and a winding-up order is ultimately made pursuant to that petition, an obligation (a "Post-Notice Obligation") incurred between:

- (i) the date on which the Member has notice of the winding-up petition; and
- (ii) the date of the winding-up order,

may not be included in any aggregation or set-off pursuant to the Netting Provision or Statutory Insolvency Set-Off if the Post-Notice Obligation (looked at in isolation) gives rise to an amount owing by the Clearing House.

(b) However, this would not affect the aggregation or set-off of the obligations of the parties in respect of (i) any obligation incurred before such Member had notice of the winding-up petition and (ii) any Post-Notice Obligation (looked at in isolation) giving rise to an amount owing to the Clearing House by the Member.

4.2.5 *Vulnerable transactions*

Sections 98 and 99 (read with Section 100) and Section 103 of the Bankruptcy Act (which apply to the winding up of a Singapore company through Section 329 of the Companies Act and to a company under judicial management through Section 227T of the Companies Act (and references to winding up in this paragraph 4.2.5 shall also refer to judicial management)) provide that certain transactions entered into by a company prior to the commencement of winding up may be challenged on the grounds that they are transactions at an undervalue, unfair preferences or extortionate credit transactions.

(a) *Section 98 of the Bankruptcy Act: Transactions at Undervalue*

(i) A liquidator of a company may apply to the court to set aside transactions entered into at an undervalue within five years prior to the commencement of winding up, if the company was insolvent at the time the transaction was entered into, or

became insolvent in consequence of the transaction. For this purpose a transaction is at an undervalue if it constitutes a gift, is entered into for no consideration, or if the value of the consideration received (in money or moneys worth) by the company is significantly less than the consideration provided (in money or moneys worth) by the company.

- (ii) Regulation 6 of the Companies (*Application of Bankruptcy Provisions*) Regulations provides, however, that a transaction will not be set aside if the court is satisfied that the relevant transaction was entered into in good faith and for the purpose of carrying on its business and at the time it did so there were reasonable grounds for believing that the transaction would benefit the company.
- (iii) The matters on which we opine in Section 3 above are unlikely to be characterised as transactions at an undervalue. However, the matters referred to in paragraph (i) and (ii) above are questions of fact in each case.

(b) *Section 99 of the Bankruptcy Act: Unfair Preferences*

- (i) A liquidator of a company may apply to the court to set aside transactions which occurred within six months prior to the commencement of winding up (extended to two years for transactions involving connected parties) which have the effect of putting the creditor, surety or guarantor in a better position in the liquidation than would otherwise have been the case, if the company was insolvent at the time the preference was given, or became insolvent in consequence of the giving of the preference.
- (ii) In deciding to give the preference, a company must have been influenced by a desire to produce the effect of putting the creditor, surety or guarantor in a better position in a winding up of the company. The court would not otherwise make an order to set aside the transaction.
- (iii) If there is evidence to show that an arrangement for set-off is entered into by a company and another party within the applicable period referred to in paragraph (i) above and the company had the intention of giving the other party an unfair

preference in the winding up of the company, the arrangement may be invalidated.

- (iv) The matters on which we opine in Section 3 above are unlikely to be characterised as preferences, but the matters referred to in this paragraph are primarily questions of fact.
- (c) *Section 103 of the Bankruptcy Act: Extortionate Credit Transactions*
  - (i) A liquidator of a company may apply to set aside transactions which occurred within three years prior to the commencement of winding up involving the provision of credit to a company. A transaction will be extortionate if, having regard to the risk accepted by the party providing the credit, (A) the terms of it are or were such as to require grossly exorbitant payments to be made (whether unconditionally or in certain contingencies) in respect of the provision of the credit, or (B) it is harsh and unconscionable or substantially unfair. A court would presume, unless the contrary is proved, that such a transaction is extortionate.
  - (ii) The matters on which we opine in Section 3 above are unlikely to be characterised as extortionate credit transactions, but the matters referred to in this paragraph are primarily questions of fact.

#### 4.2.6 *Disclaimer of onerous property*

Section 332 of the Companies Act allows the liquidator, in a winding up of a Singapore company, to disclaim any onerous property with the leave of the court or committee of inspection of the company. For this purpose, onerous property means, *inter alia*, shares in corporations, any unprofitable contract and any other property which is unsaleable or not readily saleable by reason of its binding the possessor thereof to the performance of any onerous act, or to the payment of any sum of money. A liquidator may, upon the commencement of winding up of a company, therefore seek to disclaim any such onerous property, including any contract entered into by the company if the liquidator considers the contract to be an unprofitable contract. If any such property is disclaimed after the commencement of winding up of the company and loss or damage is suffered by the relevant creditor of the company as a result, such creditor may prove such loss or damage as a debt in the winding up of the company. Accordingly, we do not consider that the existence of the possibility

of 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 extinguish any rights a Member or a customer of a Member has under a trust.

#### 4.3 Other insolvency issues

4.3.1 A Singapore court may, on proof to its satisfaction that there is sufficient reason, stay winding up proceedings against a company either altogether or for a limited time on such terms and conditions as the court may think fit.

4.3.2 It is possible that:

- (a) the valuation and calculation made to determine the Termination Amount or the net amount resulting from the set-off implemented under the Netting Provision;
- (b) any currency conversion rate applied; or
- (c) any other valuation, calculation or determination made or other action or discretionary decision taken under the Netting Provision,

could be challenged by an insolvency representative if they were or it was not done fairly or in a manner consistent with applicable law.

4.3.3 We express no opinion as to the effectiveness of the Netting Provision in relation to any obligation owing by one Party the benefit of which is acquired by another company after a winding up order has been made in respect of that company.

#### 4.4 Judicial management

4.4.1 Under Singapore law, a company or its directors (pursuant to a resolution of its members or the board of directors) or a creditor may apply to court for the company to be placed under judicial management and for the appointment of a judicial manager (Sections 227A and 227B of the Companies Act).

4.4.2 The court may make a judicial management order in relation to the company only if: (a) it is satisfied that the company is or will be unable to pay its debts; and (b) it considers that the making of the judicial management order would be likely to achieve one or more of the following purposes, namely: (i) the survival of the company or the whole or part of its undertaking as a going concern; (ii) the approval of a compromise or arrangement under Section 210

of the Companies Act between the company and any such persons mentioned in that section; and (iii) a more advantageous realisation of the company's assets would be effected than on a winding up. During the period beginning with the making of an application for a judicial management order and ending with the making of such an order, the following shall apply: (a) no resolution shall be passed or order made for the winding up of the company; (b) no steps shall be taken to, inter alia, enforce any charge or security over the company's property; and (c) no other proceedings, execution or other legal process shall be commenced or continued against the company except with the leave of court (Section 227C of the Companies Act). On the making of a judicial management order, any receiver or receiver and manager shall vacate office and any application for the winding up of the company shall be dismissed (Section 227D of the Companies Act).

#### 4.5 Schemes of arrangement

There is a provision in the Companies Act for schemes of arrangement in respect of companies to be approved by creditors or, in some cases, shareholders of the company. A court will not sanction a scheme of arrangement unless it is satisfied that creditors and shareholders have been provided with sufficient information in order to make an informed decision. Approval at the creditors' meeting of the terms of a scheme of arrangement does not require unanimity of the affected creditors, whether or not present at the meeting. Such a scheme of arrangement could affect both netting or set-off rights of creditors and the amount of claims which the creditors may have against the company. However, any such scheme of arrangement could impair the effectiveness of the Netting Provision only if the aggregation or set-off provided for in the Netting Provision, as applicable, has not taken place before the coming into effect of such a scheme of arrangement. If the aggregation or set-off has taken place before the coming into effect of such a scheme of arrangement, that scheme of arrangement could affect only the value (and other terms) of any resulting net claim.

#### 4.6 Qualifications relating to Netting: House and Customer Accounts

4.6.1 In the event of Insolvency Proceedings relating to the Clearing House, the continued ability of the Member to treat the amounts due to or from the Clearing House in respect of Contracts registered in one or more Customer Accounts separately from the amount owed to or from the Clearing House in respect of Contracts registered in its House Account may be affected by the operation of Statutory Insolvency Set-Off. Statutory Insolvency Set-Off is (in the absence of any contrary statutory rule, such as Section 81F of the SFA) is mandatory, and has the effect that all mutual debts, mutual credits, and other

mutual dealings must be aggregated and set off so that only a single net balance is payable between the Parties. As to whether amounts due in respect of Contracts registered in a Member's different House Accounts and Customer Accounts are mutual, we would make the following observations.

- 4.6.2 Members are obliged to enter into all positions with the Clearing House on a principal to principal basis. Therefore, *prima facie*, this suggests that amounts due in respect of Contracts registered in Customer Accounts are mutual with amounts due in respect of House Accounts, and amounts due in respect of Contracts registered in different Customer Accounts are mutual *inter se*.
- 4.6.3 Although we are not aware of Singapore judicial precedent in the context of positions with clearing houses, there is some judicial precedent in England for the proposition that obligations between parties in different capacities are not mutual.
- 4.6.4 It could be argued that a Member transacts in a different "capacity" when entering into Contracts registered in a House Account and Contracts registered in a Customer Account, or when entering into Contracts registered in different Customer Accounts, even if such different capacity cannot be explained or differentiated under the traditional nomenclature of contract law or equity.
- 4.6.5 Such different capacity could be justified as grounded in the commercial intentions of the parties, or long-standing usage, and acknowledged by the fact that house and customer positions are recorded differently by both Clearing House and Member and by the fact that Contracts registered to House Accounts and Contracts registered to Customer Accounts are treated differently in the Rules.
- 4.6.6 Furthermore the different capacity in which a Member acts in relation to Customer Contracts as opposed to House Contracts is acknowledged and reflected by various regulatory measures (which may or may not be applicable to all Members but nonetheless demonstrate the general perception among regulators and legislators that Members generally act in different capacities). For example, Section 62 of the SFA requires the Clearing House to require each of the Members to notify it whether a market contract is a contract of a customer of the Member.
- 4.6.7 However, we cannot confirm that a court would adopt such a view that amounts due in respect of Contracts registered in Customer Accounts and in House Accounts are not mutual, or that amounts due in respect of Contracts registered in different Customer Accounts are not mutual, and the court may

require that a single net amount is payable between the Member and the Clearing House in respect of all Contracts registered in House Accounts and Customer Accounts in aggregate.

- 4.6.8 If Statutory Insolvency Set-Off applies so as to require that a single net amount is payable in respect of Contracts registered in House Accounts and Customer Accounts, it is unlikely that the Member and its own Customers would be left in a worse position than in the absence of such Statutory Insolvency Set-Off; in such a case, the Member would, in principle, be able to re-allocate positions between its own House Accounts and Customer Accounts to achieve the same position that would have arisen in the absence of Statutory Insolvency Set-Off. However, we express no view as to whether a Member would properly be able or permitted to effect such a re-allocation under applicable rules and regulation to which it might be subject.
- 4.6.9 If an obligation which is owed by a Party is a contingent obligation, Section 87(4) of the Bankruptcy Act, which is made applicable to companies by Section 327(2) of the Companies Act, will operate to allow a liquidator to value that obligation. The valued amount would be included in the Statutory Insolvency Set-Off notwithstanding that the amount so included may differ from the other Party's assessment of the value of that obligation. A right of appeal to the court is available against the liquidator's valuation.

#### **4.7 Qualifications relating to Cash Collateral**

- 4.7.1 A Member's right against the Clearing House in respect of payments relating to cash Collateral (provided in respect of Contracts registered in Customer Accounts) is subject to the trust for the benefit of such Member's Customers described in paragraph 3.7 and as such the relevant cash Collateral will not be freely returnable to the Member beneficially.
- 4.7.2 Section 81M of the SFA applies to property provided to a designated clearing house (such as the Clearing House) as market Collateral. Pursuant to Section 81M(2) such property may be applied in accordance with the business or default rules of the designated clearing house so far as it is necessary for it to be so applied notwithstanding:
  - (a) any prior equitable interest or right, or any right or remedy arising from a breach of fiduciary duty, unless the designated clearing house had actual notice of the interest, right or breach of duty (other than any interest or right arising from the situation referred to in paragraph (b)),

as the case may be, at the time the property was provided as market Collateral; or

- (b) that the property is deposited by the designated clearing house in a trust account held for the benefit of a participant.

Section 81M(3) provides that no right or remedy arising subsequent to the provision of such property as market collateral may be enforced to prevent, or interfere with, the application of the property by the designated clearing house in accordance with its business or default rules.

#### 4.8 Qualifications relating to Non-cash Collateral

- 4.8.1 A Member's right against the Clearing House in respect of Non-cash Collateral (provided in respect of Contracts registered in Customer Accounts) is subject to the trust for the benefit of such Member's Customers described in paragraph 3.8 and as such the relevant Non-cash Collateral will not be freely returnable to the Member beneficially.
- 4.8.2 Insofar as fungible assets posted as Non-cash Collateral (notwithstanding the requirement under Rule 7.03A.1.1) 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 Non-cash Collateral may be lost. It may be asserted, based on the English 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 Non-cash 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 the English case *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*, while not binding on a court in this jurisdiction, may be followed by the courts of this jurisdiction notwithstanding that it has been academically criticised.
- 4.8.3 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 Member in the Non-cash Collateral may be lost.
- 4.8.4 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 the English case *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 Non-cash Collateral may not be returned to the Member.

- 4.8.5 Section 212 of the Companies Act 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 212 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 Collateral 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 Non-cash Collateral. The Member would therefore be entitled to recover the Collateral in accordance with the terms of the Rules and/or the trust arrangements even against the new chargor and/or new chargee.
- 4.8.6 Any security comprised in the Non-cash Collateral may be subject to corporate events 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 Non-cash Collateral which is subject to such events while in the possession or control of the Clearing House.
- 4.8.7 If an asset which constitutes Non-cash Collateral is situated outside Singapore, the courts of Singapore 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 Singapore law as the governing law). Accordingly, the issue of entitlement to the Non-cash Collateral may be determined by a system, or systems, of law other than the laws of this jurisdiction.
- 4.8.8 There is appellate court authority in England (*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 Singapore authority which has considered the question of location of such entitlements. Accordingly, to the extent any of the Non-cash Collateral consists of shares and if a court were to conclude that such Non-cash Collateral should be regarded as being located outside this jurisdiction, the issue of enforceability of such Non-cash Collateral may be determined by a system, or systems, of law other than the laws of this jurisdiction.

#### **4.9 Qualifications Relating to Special provisions of law**

- 4.9.1 The list of special provisions at paragraph 3.2 is not an exhaustive list of all Singapore laws that may apply to Contracts, their interpretation and enforcement (which, among other things, shall be subject to general principles of Singapore contract law and laws particular to individual Members).
- 4.9.2 The Monetary Authority of Singapore ("MAS") may, in certain circumstances under Sections 80(8) and 81(1) of the SFA, direct the Clearing House to take certain actions. These actions may include, without limitation, modifying or suspending any of the Rules. MAS may direct the Clearing House to take actions under Section 80(8) of the SFA where MAS has given an order to the Clearing House to cease operations of its clearing facility under Section 80(1) of the SFA and MAS considers such actions necessary. Under Section 81(1) of the SFA, where MAS has reason to believe that an emergency exists, or thinks that it is necessary or expedient in the interests of the public or a section of the public or for the protection of investors, MAS may direct the Clearing House to take such actions as it considers necessary to maintain or restore safe and efficient operations of the clearing facilities operated by the Clearing House. Under Rule 1.05, the Clearing House may effect amendments to the Rules in such manner as directed by MAS or pursuant to the SFA.

#### **4.10 Qualifications relating to choice of law**

The choice of Singapore law to govern the Rules and the Security Deed would be recognised and upheld provided that:

- 4.10.1 the choice of such law was made in good faith and not with a view to avoiding the provisions or effect of any other applicable law;

- 4.10.2 such law is pleaded and proved to the satisfaction of the courts of Singapore (which satisfaction is within the discretion of the said courts); and
- 4.10.3 such law will be disregarded if its application will be illegal or contrary to public policy or mandatory rules in Singapore.

4.11 General

- 4.11.1 If any creditor (the "attaching creditor") of a Party ("**the defendant Party**") 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 other Party ("**the debtor Party**") to the defendant Party, then the debtor Party would following a Termination Date, be able to exercise its rights under the Netting Provision against the creditor of the defendant Party 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 gone into liquidation or bankruptcy under Singapore law before the Termination Date, it may be possible for the liquidator or trustee in bankruptcy of the attaching creditor to claim from the debtor Party the amounts which are subject to the attachment free of the debtor Party's rights under the Netting Provision. This is because it may be argued that the debtor Party seeks to exercise a set-off right in respect of an amount which is now owed by the debtor Party to the attaching creditor rather than to the defendant Party, and a contractual provision which purports to create a right of set-off in respect of non-mutual claims may not be effective in the liquidation or bankruptcy of the attaching creditor.
- 4.11.2 However, after the commencement of a winding-up or the bankruptcy of the defendant Party 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 debtor Party under the Netting Provision.
- 4.11.3 Where under the Clearing House Documentation any Party is vested with a discretion or may determine a matter, Singapore law may require that such discretion is exercised or determination is made reasonably. Any provision in the Clearing House Documentation providing that any calculation or certification is to be conclusive and binding will not be effective if such calculation or certification is fraudulent, incorrect, unreasonable, arbitrary or shown not to have been given or made in good faith and will not necessarily prevent judicial enquiry into the merits of any claim by a Party. The Singapore court may regard any calculation, determination or certification as no more than *prima facie* evidence of the matter calculated, determined or certified.

- 4.11.4 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 Singapore courts may recognise the extinction of those claims or liabilities.
- 4.11.5 Any provision of the Clearing House Documentation which constitutes, or purports to constitute, a restriction on the exercise of any statutory power by any Party or any other person may be ineffective.
- 4.11.6 Under Singapore 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 a bankruptcy order or the passing of a winding-up resolution in respect of the Party liable to pay such interest, but the fact that such interest was held to be irrecoverable would not of itself prejudice the legality or validity of any other provision of the Clearing House Documentation.
- 4.11.7 While a Singapore court has power to give judgment in a currency other than Singapore dollars, it has the discretion to decline to do so.
- 4.11.8 Conveyance with intent to defraud creditors: Under Section 73B of the Conveyancing and Law of Property Act (Chapter 61) of Singapore, every conveyance of property, made with intent to defraud creditors shall be voidable, even if the person is not the subject of a bankruptcy order, at the instance of any person prejudiced by the conveyance, unless the estate or interest in property is disposed of for valuable consideration and in good faith or upon good consideration and in good faith to any person not having, at the time of the disposition, notice of the intent to defraud creditors.
- 4.11.9 The Singapore Government has, together with other recommendations, accepted a recommendation made by the Company Legislation and Regulatory Framework Committee ("CLRFC") to consolidate and refine Singapore's bankruptcy and insolvency legislation (which is currently contained in the Companies Act and the Bankruptcy Act and related subsidiary legislation) into an omnibus insolvency act and subsidiary legislation. It is expected that this recommendation will be implemented in due course and there is a possibility that, when implemented, Singapore's insolvency laws could be amended in a way which could affect the conclusions set out in this opinion letter. However, we are not able to advise in detail on this matter at this stage as no legislation to implement the CLRFC's recommendation has been introduced. While we are unable to conclude if such consolidation of legislation may affect the opinions given in this opinion letter, there is at this juncture no

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reason to believe that such proposed consolidation of legislation will adversely affect such opinions.

4.11.10 The opinions expressed in this opinion letter are subject to the effects of United Nations or Singapore sanctions or other similar measures implemented or effective in Singapore with respect to a Party which is, or is controlled by or otherwise connected with, a person resident in, incorporated or constituted under the laws of, or carrying on business in a country to which any such sanctions or other similar measures apply.

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 sole benefit of the Futures and Options Association and such of its members (excluding associate members) as subscribe to the Futures and Options Association's opinions library (and whose terms of subscription give them access to this opinion). This opinion may not be relied upon by any other person unless we otherwise specifically agree with that person in writing, although we consent to it being shown to such Futures and Options Association members' affiliates (being members of such persons' groups, as defined by the UK Financial Services and Markets Act 2000) and to any competent authority supervising such member firms and their affiliates in connection with their compliance with their obligations under prudential regulation.

Yours faithfully

*Clifford Chance Pte Ltd*

**Clifford Chance Pte Ltd**