SHEPHERD+WEDDERBURN

OUR REF C0348.23/BRC/AMK
YOUR REF
19 February 2013

The Futures & Options Association
2nd Floor
36-38 Botolph Lane
London
EC3R 8DE

Dear Sirs

Netting Analyser Library

1. Background

1.1 You have asked us to give an opinion in respect of the laws of Scotland in respect of the enforceability and validity of the Security Interest Provisions contained in an agreement on the terms of the forms specified in Annex 1 to this Opinion (each referred to in this Opinion as the "**Agreement**") or contained in an Equivalent Agreement (as defined below).

1.2 We understand that your fundamental requirement is for the enforceability of the Security Interest Provisions to be substantiated by a written and reasoned opinion. Our opinions on the enforceability of the Security Interest Provisions are given in paragraph 5 of this Opinion.

1.3 Any reference to "**the opinions**" are to the opinions given in this Opinion.

2. Definitions and interpretation

2.1 In this Opinion:

2.1.1 "**Annex**" means an annex to this Opinion;

2.1.2 "**Bank**" means a Counterparty (other than a Foreign Company) which has permission to accept deposits under Part IV of FSMA;

2.1.3 "**Banking Act**" means the Banking Act 2009;

2.1.4 "**Bankruptcy Act**" means the Bankruptcy (Scotland) Act 1985;

2.1.5 "**CASS**" means the client assets sourcebook of the FSA Handbook of Rules;

2.1.6 "**CI Regulations**" means the Credit Institutions (Reorganisation and Winding-up) Regulations 2004;

2.1.7 "**Collateral**" means margin which is cash or account-held securities and which is subject to the Security Interest Provisions;

2.1.8 "**Collateral Directive**" means Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements;

2.1.9 "**Companies Act**" means the Companies Act 2006;

2.1.10 "**Core Provisions**" has the meaning given to it in Annex 2:

2.1.11 "**Counterparties**" means the parties listed in Schedule 1 who will provide Collateral to the Firm pursuant to the Security Interest Provisions;

2.1.12 "**Cross-Border Regulations**" means the Cross-Border Insolvency Regulations 2006;

2.1.13 "**EEA Credit Institution**" has the meaning given to it in the CI Regulations;

2.1.14 "**Equivalent Agreement**" means an agreement:

(i) which is governed by the law of England and Wales;

(ii) which has broadly similar function to any of the Agreements listed in Annex 1;

(iii) which contains the Core Provisions (with no amendments, or with Non-material Amendments); and

(iv) which neither contains (nor is modified, amended, or superseded by) any other provision which may invalidate, adversely affect, modify, amend, supersede, conflict with, provide alternatives to, compromise or fetter the operation, implementation, enforceability and effectiveness of all or part of the Core Provisions (in each case, excepting Non-material Amendments);

2.1.15 "**EU Regulation**" means EU Council Regulation No. 1346/2000 on insolvency proceedings;

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

2.1.17 "**Firm**" means the party to an Agreement and the relevant Transactions which is referred to as "we" or "us" in the Agreement;

2.1.18 **"FOA Published Form Agreement"** means a document listed at Annex 1 in the form published by the Futures and Options Association on its website as at the date of this Opinion;

2.1.19 "**FSMA**" means the Financial Services and Market Act 2000;

2.1.20 "**Insolvency Act**" means the Insolvency Act 1986;

2.1.21 "**Insolvency Proceedings**", means any receivership, administration, liquidation, winding up, dissolution, bankruptcy, sequestration or other insolvency proceedings in Scotland or any other jurisdiction;

2.1.22 "**Insolvency Representative**" means a receiver, administrator, liquidator, trustee or other insolvency or bankruptcy official appointed (or in office) in each case in connection with an Insolvency Proceeding;

2.1.23 "**Insurers**" means insurers (as defined in Article 2 of the Financial Services and Markets Act 2000 (Insolvency) (Definition of "Insurer") Order 2001;

2.1.24 "**Investment Bank**" means a Counterparty (other than a Foreign Company) which:

(a) has permission under Part 4 of FSMA to carry on the regulated activities of (i) safeguarding and administering investments; (ii) dealing in investments as principal or (ii) dealing in investments as agent; and

(b) holds client assets (as defined in and for the purposes of section 232 of the Banking Act and The Investment Bank (Amendment of Definition) Order 2011);

2.1.25 "**Investment Bank Regulations**" means The Investment Bank Special Administration Regulations 2011;

2.1.26 "**MiFID Directive**" means Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments;

2.1.27 "**MiFID Instruments**" means instruments referred to in Section C of Annex I to the MiFID Directive;

2.1.28 "**Non-material Amendment**" means an amendment having the effect of one of the amendments set out at Annex 3:

2.1.29 **"OEIC Regulations"** means the Open Ended Investment Company Regulations 2001;

2.1.30 **"Parties"** means the Counterparty and the Firm;

2.1.31 "**Safeguards Order**" means The Banking Act (Restrictions of Partial Property Transfers) Order 2009;

2.1.32 "**Schedule**" means a schedule to this Opinion;

2.1.33 **"Schedule B1"** means Schedule B1 to the Insolvency Act;

2.1.34 "**Security Interest**" means the security interest created by a Counterparty in favour of a Firm pursuant to the Security Interest Provisions;

2.1.35 "**Security Interest Provisions**" has the meaning given to it in Annex 2;

2.1.36 "**Settlement Finality Regulations**" means the Financial Markets and Insolvency (Settlement Finality) Regulations 1999;

2.1.37 "**Transaction**" means a Transaction under the Agreement; and

2.1.38 capitalised terms which are used but not defined in this Opinion have the meaning given to them in the Agreement.

2.2 Annex 2 contains further definitions of terms relating to the Agreement. Schedule 1 contains the definition of each Counterparty.

2.3 References in this Opinion to:

2.3.1 the "**Agreement**" (other than specific cross references to clauses in such Agreement and references in the paragraph 1 of this Opinion) shall include an Equivalent Agreement;

2.3.2 "**enforcement**" in relation to the Security Interest means, the act of:

(i) sale and application of proceeds of the sale of Collateral against monies owed, or

(ii) appropriation of the Collateral,

in either case in accordance with the Security Interest Provisions;

2.3.3 any term of the Agreement being **"enforceable"** and cognate terms are used to refer to the ability of a Firm to exercise its rights under that term against (or in respect of) a Counterparty in accordance with that term;

2.3.4 a **"paragraph"** and a "**sub-paragraph**" are (unless the context otherwise requires) to a paragraph and a sub-paragraph (as appropriate) of this Opinion (or, if so stated, a Schedule or an Annex);

2.3.5 "**this jurisdiction**" are to Scotland; and

2.3.6 any statute, statutory instrument, order or other legislation is to that statute, statutory instrument, order or other legislation as amended as at the date of this Opinion.

2.4 For the avoidance of doubt, references in this Opinion to the "**Core Provisions**" include Core Provisions that have been modified by Non-material Amendments.

2.5 In this Opinion, any references to the "**location**" of any Collateral or other asset (or any cognate terms) in any jurisdiction are references to assets situated in or which are governed by the laws of that jurisdiction, in each case whether for the purposes of the EU Regulation, the CI Regulations, the FCA Regulations and/or the rules of Scottish private international law (as applicable).

3. Terms of reference and exclusions

3.1 The opinions are given in respect of the entry into an Agreement by a Counterparty, but only when such Agreement is expressed to be governed by English law or, where expressly envisaged as an election in the relevant FOA Published Form Agreement, the laws of the State of New York.

3.2 The opinions are given only in respect of the enforceability and enforcement of the Security Interest Provisions in respect of Collateral which is not located in this jurisdiction.

3.3 No opinions are given in this Opinion on (or in relation to):

3.3.1 the availability of any judicial remedy;

3.3.2 any matters of fact;

3.3.3 any provisions of the Agreement, other than the Security Interest Provisions;

3.3.4 the enforceability or effectiveness of any purported declaration of trust (or any provision which requires any asset to be held on trust) by a Counterparty in the Agreement;

3.3.5 any person found or alleged to be a trustee of a constructive, implied, resulting or other trust constituted by operation of law or who is a trustee in sequestration, or an executor acting in that capacity; or

3.3.6 any tax that may arise or be suffered as a result of the entry into or performance of the Agreement or any Transactions.

3.4 For the purposes of this Opinion we have reviewed the documents listed in Annex 1 and no other documents.

3.5 The opinions are given solely in relation to matters of Scots law. This Opinion does not consider the impact of the law of any other jurisdiction, even where, under Scots law, the law of that jurisdiction falls to be applied. We express no opinions on the laws of any jurisdiction other than Scotland.

3.6 This Opinion is governed by Scots law and relates only to Scots law as applied by the Scottish courts as at today's date. All non-contractual matters which arise out of this Opinion are governed by Scots law.

3.7 Certain other exclusions from the opinions are set out in paragraph 6 below.

4. Assumptions

For the purposes of this Opinion we have assumed the following (in addition to the assumptions made in respect of specific Counterparties which are set out in Schedules 2 to 5 and the other specific assumptions contained elsewhere in this Opinion):

4.1 That all of the provisions of the Agreement (including the Security Interest Provisions) would be valid, binding and enforceable in accordance with their terms on all of the Parties thereto in terms of their governing law, the law of the jurisdiction of the location of any Collateral and any other applicable law (other than, to the extent opined upon in this opinion, Scots law).

4.2 That all of the Transactions entered into pursuant to the Agreement would be valid, binding and enforceable in accordance with their terms on all of the Parties thereto in terms of their governing law, the law of the jurisdiction of the location of any Collateral and any other applicable law.

4.3 That any evidence of the law of any jurisdiction other than Scotland which was required to be pleaded, led and/or proved in a Scottish court in connection with the Agreement and/or any Collateral could be so pleaded, led and/or proved.

4.4 That each Party validly exists in the jurisdiction in which it is organised, formed and/or incorporated, is in good standing, has the capacity, power and authority under its constitutional and other governing documentation and all applicable law(s) to enter into the Agreement and Transactions and to perform its obligations under the Agreement and Transactions (and more specifically, the Collateral does not belong to a client of a Counterparty which is subject to CASS 6.3.5R unless CASS 6.3.6R applies) and that each Counterparty has taken all necessary steps to execute, deliver and perform the Agreement.

4.5 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 Agreement and Transactions and to ensure the legality, validity, enforceability or admissibility in evidence of the Agreement in this jurisdiction.

4.6 That the Agreement has been properly executed by both Parties.

4.7 That the Agreement is entered into prior to the formal commencement of any Insolvency Proceedings against either Party and has not been entered into at a time when one party has actual notice of the insolvency of the other Party or of any steps that have been taken by a Party (or any other person) with a view to (or for) the formal commencement of Insolvency Proceedings.

4.8 That no provision of the Agreement that is necessary for the giving of the Opinion, has been altered or modified in any material respect. In our view, an alteration contemplated in the definition of "Equivalent Agreement" in paragraph2 above would not constitute a material alteration for this purpose. We express no view as to whether an alteration not contemplated in that definition would or would not constitute a material alteration to the Agreement.

4.9 That no provisions of the Agreement, or a document of which the Agreement forms part, or any other arrangement between the Parties, invalidates the enforceability or effectiveness of the Security Interest Provisions.

4.10 That the making or performance of the Agreement and all Transactions does not constitute or form part of a regulated activity carried on by any person in breach of (a) section 19 of FMSA, or (b) any other regulatory rule applicable to any party and is not entered into in the course of carrying on any such regulated activity or other regulatory rule in breach of such provisions.

4.11 That the Agreement and the Transactions are not entered into by any person in consequence of a communication made in breach of section 21 of FSMA or by any authorised person (within the meaning of FSMA) in consequence of anything said or done by any other person in breach of section 19 of FSMA.

4.12 The directors, trustees, partners, members or other officers (as appropriate) of each Party have, in authorising its entry into the Agreement and all Transactions, exercised their powers in accordance with their duties under all applicable laws and the constitution of the Party.

4.13 The Agreement has been entered into, and each of the Transactions is carried out, by each of the parties thereto 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.

4.14 That the Agreement accurately reflects the true intentions of each Party.

4.15 That each Party has entered into the Agreement and the Transactions as principal (and not as agent), is the sole obliger in respect of any obligations owed by it and the sole beneficial owner in respect of all rights owed to it under the Agreement and each Transaction, and no such rights are subject to any mortgage, charge, pledge, lien, encumbrance, assignation, assignment, right in security or security

interest and no creditor of any Party has attached, arrested, executed, done diligence, levied execution or otherwise exercised a creditors process in respect of such Party's rights under the Agreement, any Transaction.

4.16 Other than in the case of a Trustee acting as trustee of a Trust, that neither Party has entered into the Agreement or any Transaction in its capacity as trustee, nor has the Counterparty provided any Collateral in its capacity as trustee.

4.17 That the Agreement and Transactions do not constitute market contracts within section 155 of the Companies Act 1989, none of the Security Interest Provisions are market charges within the meaning of section 173 of the Companies Act 1989 and no Collateral is margin within the meaning of section 190 of the Companies Act 1989.

4.18 That any obligation or transfer under the Agreement or any Transaction is not a transfer order or equivalent overseas order under the Settlement Finality Regulations and that the Security Interest Provisions are not collateral security or equivalent collateral security under the Settlement Finality Regulations.

4.19 That neither Party is a *"group undertaking"* in relation to the other Party as that phrase is defined in Section 1161(5) of the Companies Act 2006.

4.20 That neither Party is a *"bridge bank"* as defined in section 12 of the Banking Act.

4.21 That all acts, steps, things, conditions or payments required under all applicable law (other than Scots law) to be fulfilled, performed or effected (including any necessary registrations and filings) in connection with the Agreement and the creation and perfection of any security interest under the Security Interest Provisions have been duly fulfilled, performed, effected and made.

4.22 That any cash Collateral is in a currency that is freely transferable internationally under the laws of all relevant jurisdictions.

4.23 That the contractual arrangements and obligations established pursuant to and by the Agreement and any Transactions thereunder (and the performance of such arrangements and obligations) are:

4.23.1 not entered into in breach of and not avoidable or reducible for any reason under or in connection with any (a) anti-terrorism, anti-corruption, anti-money laundering, "know your customer" and human rights laws, rules or regulations or (b) any laws, rules or regulations relating to economic or other sanctions; and

4.23.2 not capable of being so avoided or reduced,

in each case whether under Scots law, the law governing the Agreement or any Transactions or any other applicable law.

4.24 That the Agreement is entered into on or after the date of this Opinion.

5. Opinions

On the basis of the foregoing terms of reference and assumptions and subject to the qualifications set out or referred to in paragraph 6 below, we are of the following opinions as to the laws of Scotland.

5.1 **Valid Security Interest**

5.1.1 Following the occurrence of an Event of Default, including as a result of the opening of any Insolvency Proceedings, the Firm would be entitled to enforce the Security Interest in respect of the Collateral.

5.1.2 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 right of the Firm to enforce the Security Interest in respect of the Collateral.

5.1.3 Following exercise of the Firm's rights under the Security Interest Provisions, the ranking of the Firm's rights to the proceeds of realisation of the Collateral in relation to the interests of the Counterparty and any other person would generally be a matter to be determined under the law of the jurisdiction in which the Collateral is located.

5.2 **Further acts**

No further acts, conditions or things would be required by the law of this jurisdiction to be done, fulfilled or performed under the laws of this jurisdiction in order to enable the Firm to enforce the Security Interest in respect of the Collateral.

6. Qualifications

The opinions given in this Opinion are subject to the following qualifications (in addition to the qualifications made in respect of specific Counterparties which are set out in Schedules 2 to 5 and the other specific qualifications contained elsewhere in this Opinion):

6.1 **Security interests**

Registration

6.1.1 In relation to a Counterparty that is a Scottish Company or an LLP, the Agreement must be delivered to the Registrar of Companies in Scotland (together with the prescribed particulars of the charges constituted by the Security Interest Provisions) for registration within 21 days after the date of creation of the charges constituted by it[1]. If it is not so registered, those charges will be void against the liquidator or administrator or any creditor of the relevant Counterparty. The requirement for registration is disapplied in certain circumstances under the FCA Regulations (on which please see paragraph 6.2 below).

6.1.2 In relation to a Counterparty that is a Foreign Company that is an overseas company (within the meaning of the Companies Act 2006), the charges constituted by the Security Interest Provisions do not need to be delivered to the Registrar of Companies for registration.

Effectiveness of security

6.1.3 The Scottish courts may reserve the right, in any question as to the validity of the security purported to be created by the Security Interest Provisions in respect of any asset located in Scotland, to deny effect to the security if it is not equivalent in form or substance to a type of security available and recognised under Scots law[2]. Accordingly, we have assumed that the Collateral is not located in Scotland and no opinions are given in this Opinion in relation to whether the Security Interest creates a valid and effective security interest over any assets of the Counterparty which are located in Scotland.

6.1.4 The opinions are subject to the following:

(i) any Collateral being capable of forming the subject of a security interest under applicable law;

[1] Where the Counterparty is a Trustee or Trustees of a Trust and one or more of the Trustees is a Corporate Trustee (ie a Scottish Company), it is unclear whether the Agreement must be registered with the Registrar of Companies in Scotland. Given the potential consequences if this is required, we would recommend that the Agreement is so registered.

[2] In particular (and without limitation), although floating charges are recognised under Scots law, the Scottish courts would be unlikely to recognise that a floating charge had been created over any asset located in Scotland which was expressed to be the subject of any fixed or specific security interest under the Agreement (even if this is the effect under English law).

(ii) the creation of any security interest not requiring any authorisation, consent or fulfilment or other pre-condition or formality (in each case under any applicable law, other than Scots law) which has not been done or obtained;

(iii) all consents, approvals and authorisations which are required to be given by any third party in order to create, maintain, perfect or enforce any security interest having been given;

(iv) any relevant contract or other obligation comprised in any security interest being capable of being set aside or avoided for any reason; and

(v) the security interest validly and effectively securing the assets which it is expressed to secure under all applicable laws (other than Scots law), including, without limitation, the governing law of the Agreement and the law of the jurisdiction where the asset is located.

6.1.5 No opinions are given in this Opinion as to:

(i) whether any Counterparty has good legal or other title to the assets or rights which are expressed to be subject to the Security Interest, or as to the existence or value of any such assets or rights;

(ii) whether the Security Interest constitutes a fixed or specific (rather than a floating) charge for the purposes of Scots law (or any other applicable law);

(iii) whether any events in relation to any non-cash Collateral or issuer of any non-cash Collateral may devalue the Collateral or impair the Firm's ability to enjoy such Collateral or the full value thereof (for example, where such Collateral loses value following a default or failure of the issuer thereof or is compulsorily acquired as a result of a share transfer pursuant to the Banking Act or other nationalisation measure); or

(iv) whether the Agreement breaches any other agreement or instrument.

6.1.6 Where a Counterparty is subject to Insolvency Proceedings in this jurisdiction, the Firm's rights in respect of the proceeds of realisation of the Collateral may rank behind:

(i) expenses of the relevant Insolvency Proceeding and Insolvency Representative (including without limitation corporation tax and remuneration of the Insolvency Representative) and liabilities incurred by the Insolvency Representative during the Insolvency Proceeding[3];

(ii) certain preferential debts; and

(iii) rights of unsecured creditors up to £600,000 if the Counterparty's net property is £10,000 or more[4];

6.1.7 We express no opinion as to whether any other creditor of, or claimant in respect of, the Counterparty or its assets (including any creditor or claimant who holds a security interest over such assets) could assert superior title in respect of the Counterparty, for example on the grounds of its prior acquisition of an interest in the assets, its having taken any action to enforce any amount owed to it (such as diligence, arrestment or distress) or its having a security interest over the assets.

[3] This will not be the case in an administration where the relevant Security Interest is a security financial collateral arrangement under the FCA Regulations (on which please see below).

[4] This will not be the case where the relevant Security Interest is a security financial collateral arrangement under the FCA Regulations (on which please see below). It will also not be the case if the Counterparty is an Individual, Partnership, or Trust.

Moratorium on enforcement

6.1.8 A moratorium on the enforcement of any security interest under the Agreement will arise in the following circumstances:

(i) A Counterparty is in:

(a) administration under the Insolvency Act;

(b) bank administration or building society special administration under the Banking Act; or

(c) special administration, special administration (bank insolvency) or special administration (bank administration) under the Investment Bank Regulations.

(ii) An application for an order for:

(a) administration under the Insolvency Act;

(b) bank administration or building society special administration under the Banking Act; or

(c) special administration, special administration (bank insolvency) or special administration (bank administration) under the Investment Bank Regulations,

has been made in respect of a Counterparty and has not been granted or dismissed, or has been granted but the order has not yet taken effect.

(iii) A notice of intention to appoint an administrator in respect of a Counterparty has been filed under paragraph 14 of Schedule B1. In this case, the moratorium will last until the earlier of the time of appointment of an administrator (when the moratorium described at paragraph (i) above will take effect) and the expiry of five business days beginning with the date of filing.

(iv) A notice of intention to appoint an administrator in respect of a Counterparty has been filed under paragraph 22 of Schedule B1. In this case, the moratorium will last until the earlier of the time of appointment of an administrator (when the moratorium described at paragraph (i) above will take effect) and the expiry of ten business days beginning with the date of filing.

6.1.9 A moratorium on the enforcement of any security interest under the Agreement may also arise under Schedule A1 of the Insolvency Act in connection with a proposed voluntary arrangement.

6.1.10 The moratoria on enforcement described above will prevent the Firm from taking any action to enforce any security interest arising under the Agreement without the permission of the administrator (if one is appointed) or the court[5]. However, such moratoria will not prevent the enforcement of a security interest to the extent that the security interest is a security interest for the purposes of the FCA Regulations and arises under a financial collateral arrangement (on which please see paragraph 6.2 below).

6.2 **FCA Regulations**

6.2.1 The FCA Regulations apply to financial collateral arrangements which are entered into between two non-natural persons. For the purposes of this opinion we have assumed that

[5] In a bank administration or building society special administration under the Banking Act the permission of the administrator may, in certain circumstances, not be given without the approval of the Bank of England.

the Firm will be a non-natural person. It should be noted that Individuals will not be non-natural persons for the purposes of the FCA Regulations. It is unclear whether Trustees of a Trust will be non-natural persons, even where the only Trustees are Corporate Trustees.

Security financial collateral arrangements: registration

6.2.2 Any requirement to register a charge created by a Counterparty with the Registrar of Companies in Scotland does not apply in relation to a financial collateral arrangement or any charge created or otherwise arising under a financial collateral arrangement. For these purposes, a "financial collateral arrangement" is a "title transfer collateral arrangement" or a "security financial collateral arrangement".

6.2.3 A "security financial collateral arrangement" is an agreement or arrangement, evidenced in writing, where:

(i) the purpose of the agreement or arrangement is to secure the relevant financial obligations owed to the collateral-taker;

(ii) the collateral-provider creates or there arises a security interest in financial collateral to secure those obligations;

(iii) the financial collateral is delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral-taker or a person acting on its behalf. (Any right of the collateral-provider to substitute financial collateral of the same or greater value or withdraw excess financial collateral or to collect the proceeds of credit claims until further notice does not prevent the financial collateral being in the possession or under the control of the collateral-taker); and

(iv) the collateral-provider and the collateral-taker are both non-natural persons.

6.2.4 For these purposes, a "security interest" is any legal or equitable interest or any right in security, other than a title transfer financial collateral arrangement, created or otherwise arising by way of security including:

(i) a pledge;

(ii) a mortgage;

(iii) a fixed charge;

(iv) a charge created as a floating charge where the financial collateral charged is delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral-taker or a person acting on its behalf. (Any right of the collateral-provider to substitute financial collateral of the same or equal value or withdraw excess financial collateral or to collect the proceeds of credit claims until further notice does not prevent the financial collateral being in the possession or under the control of the collateral-taker); or

(v) a lien.

6.2.5 In *Gray & Others v GTP Group Limited re F2G Realisations Limited (in liquidation)* (the "**GTP Case**") it was held that the concept of "possession" was not relevant in relation to security interests in respect of intangible assets. In addition, the court decided that the requirement for the collateral taker to have "control" of the relevant financial collateral for these purposes means that the collateral taker should have a legal right to prevent the collateral provider from using or dissipating the financial collateral.

6.2.6 The requirement has also recently been considered in *Re Lehman Brothers International (Europe) (in administration)* (the "**Lehman Case**"). The court agreed with the judge in the GTP Case in relation to the meaning of "control" but decided that the concept of "possession" could be applied to intangible property. It appears from the case that the arrangement must have two related characteristics in order for the "possession or "control" requirement to be satisfied:

(i) the relevant collateral is delivered, transferred, held, registered or otherwise designated as part of the arrangement (the "**Transfer Element**"); and

(ii) this must be such that the collateral taker has sufficient possession or control for it to be proper to describe the collateral provider as having been "dispossessed" of the collateral (the "**Possession/Control Element**").

It is still not entirely clear, however, what "possession" and "control" actually means in any particular case (and, in particular, the extent of any rights in relation to the secured assets that the collateral provider can be permitted to continue to exercise under the arrangement).

6.2.7 The judge in the Lehman Case came to the conclusion that, in the context of a custody agreement which contained a security interest in favour of the custodian, a right to retain sufficient collateral to cover the estimated liabilities of the collateral provider would provide sufficient control so as to satisfy the Possession/Control Element.

6.2.8 Following the GTP Case, the FCA Regulations were amended to include a (non-exclusive) definition of "possession" of financial collateral in the form of cash or financial instruments. Such "possession" now includes the case where the cash or financial instruments have been credited to an account in the name of the collateral-taker or a person acting on his behalf (whether or not the collateral-taker, or person acting on his behalf, has credited the financial collateral to an account in the name of the collateral provider on his or that person's books) provided that any rights the collateral-provider may have in relation to that financial collateral are limited to the right to substitute financial collateral of the same or greater value or withdraw excess financial collateral[6].

6.2.9 On the basis of the GTP Case and Lehman Case, we consider that the Security Interest Provisions may be security collateral financial arrangements. The restriction on the ability of the Counterparty to withdraw or substitute Collateral may be sufficient to satisfy the Possession/Control Element, especially when this is combined with the Rehypothecation Clause (which we note that the Retail Client Agreements do not contain). However this is not certain. Furthermore, the Agreement is not clear as to how the Collateral is to be held and/or provided. This means that it is not certain whether the Transfer Element will be satisfied for any particular Collateral. Where the Transfer Element is not satisfied for particular Collateral it is not clear whether this would prevent the Security Interest Provisions from qualifying as a security financial collateral arrangement for the purposes of the FCA Regulation where the Transfer Element is satisfied for other Collateral. However, we consider that it is more likely that the Security Interest Provisions would not qualify in these circumstances.

Book entry securities collateral: conflict of laws rules

6.2.10 "Book entry securities collateral" is defined in the FCA Regulations as "financial collateral subject to a financial collateral arrangement which consists of financial instruments, title to

[6] It is unclear what the phrase "excess collateral" means, and, in particular whether it means collateral with a value in excess of the amount of the secured obligations and/or refers to a provision in an arrangement whereby collateral up to an agreed value requires to be posted, with any excess over that value being capable of being withdrawn by the collateral provider.

which is evidenced by entries in a register or account maintained by or on behalf of an intermediary".

6.2.11 An "intermediary", for the purposes of the FCA Regulations, is a person who maintains registers or accounts to which financial instruments may be credited or debited, but excludes (a) a person who acts as a registrar or transfer agent for the issuer of the financial instruments and (b) a person who maintains registers or accounts in its capacity as operator of a system for the holding and transfer of financial instruments or records of the issuer or other records which constitute the primary record of entitlement to financial instruments as against the issuer.

6.2.12 Regulation 19 of the FCA Regulations applies to financial collateral arrangements where book entry securities collateral is used as collateral under the arrangement and are held through one or more intermediaries.

6.2.13 The effect of regulation 19, is, among other things, to ensure that the legal and proprietary effects of the book entry securities collateral and the requirements for perfecting a financial collateral arrangement relating to book entry securities collateral are determined under the domestic law of the country in which the relevant account is maintained (the "**FCA Governing Law**"), which, as indicated in paragraph 3 we have assumed will not be Scotland[7]. Accordingly, for the purposes of Scots law, where book entry securities collateral is used as Collateral under the Agreement, the effectiveness of and any security interest which arises under the Security Interest Provisions in relation to the matters set out in regulation 19 would be determined by the FCA Governing Law (and not Scots law or the governing law of the Agreement).

Ultra vires

6.2.14 It should be noted that there has been some discussion amongst commentators in Scotland as regards the extent to which the FCA Regulations may be ultra vires and invalid because they go beyond the scope of certain aspects of the Collateral Directive (which the FCA Regulations implement). In particular, for the Collateral Directive to apply to a transaction, the counterparties to it must consist either of a non-natural person and one of a specified list of persons, being a public sector body, central bank, central counterparty or clearing house or "financial institution under prudential supervision[8]" and certain other similar bodies to those persons from the specified list. In contrast, for the FCA Regulations to apply to a transaction, the counterparties to it can both be non-natural persons.

6.2.15 The reason for the suggestion that the FCA Regulations may be ultra vires is that the FCA Regulations are secondary legislation, made under the powers given by the European Community Act 1972 (the "**1972 Act**") for the purpose of implementing obligations under EU law. The extent to which the 1972 Act permits secondary legislation to be made which goes beyond the scope of the relevant provisions of EU law is unclear.

6.2.16 It has been suggested by the English Court of Appeal that subordinate legislation passed pursuant to the 1972 Act could be wider in scope than the provisions of EU law being implemented. This approach was also adopted in the High Court in England in one recent case when the question whether the FCA Regulations were ultra vires was raised. In that case, it was held that the arguments that the FCA Regulations were ultra vires or that they should be restricted to the scope of the Collateral Directive were not of sufficient strength to

[7] We would point out that it is not entirely clear how the country in which the relevant account is maintained is to be determined for the purposes of the FCA Regulations.

[8] "Financial institutions under prudential supervision" would include banks which are authorised to accept deposits for the purposes of FSMA.

justify allowing them to be raised at that point in the case[9]. The case did not, however, decide that the FCA Regulations are intra vires.

6.2.17 In an earlier case in the lower courts in Scotland, however, a more restrictive view than has been given by the English courts was taken. In that case it was thought that the relevant secondary legislation, in order to be valid, had to be within the scope of the relevant EU law being implemented. This approach has been specifically rejected by the English Court of Appeal. While we believe that, if the validity of the FCA Regulations fell to be considered by the Scottish courts, they would find the decisions of the English Courts persuasive, it is possible that they would take a more restrictive approach based on the earlier Scottish case law. If such a view was taken, it is more likely that the FCA Regulations would be found to be ultra vires.

6.2.18 Were a Scottish court to take the view that the FCA Regulations are ultra vires to the extent that they exceed the scope of the Collateral Directive, it would need to address the question whether the FCA Regulations should be struck down in whole or in part.

6.2.19 In carrying out this assessment, the court would, in broad terms, consider whether it is possible to sever the ultra vires aspects of the FCA Regulations. The fundamental consideration would be the extent to which the FCA Regulations, absent the ultra vires aspects, would remain coherent and operate effectively.

6.2.20 The English courts have developed a two-fold test to severability which is likely to be the methodology that a Scottish court would also follow (along with a consideration of its EU law obligations noted below). The first question is whether the offending text is "textually severable": that is to say, whether a "clause, a sentence, a phrase or a single word may be disregarded as exceeding the law-maker's power, and what remains is still grammatical and coherent". The second question is whether the offending text is "substantially severable"- that is to say, whether "what remains after severance is essentially unchanged in its legislative purpose, operation and effect."[10] The courts have suggested that the tests are not cumulative in the sense that the textual severability need not always be satisfied so long as the substantially severable test is met.

6.2.21 In addition, a court is required under EU law to read national law as far as possible in a manner consistent with the UK's EU law obligations under the Collateral Directive.[11] In particular, the courts have recognised an obligation to give a purposive interpretation to UK measures taken to implement an EU Directive: "If the legislation can reasonably be construed so as to conform with those obligations...such a purposive construction will be applied, even though, perhaps, it may involve some departure from the strict and literal application of the words which the legislature has elected to use."[12] Further, there appear to us to be strong policy reasons for adopting this approach given the validity of the FCA Regulations "has been accepted in commercial transactions for a number of years"[13].

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[9] The Financial Markets Law Committee (which includes practitioners from certain of the major English law firms and certain leading English Counsel) also considered the issue in a paper in July 2008 and concluded that the FCA Regulations were not ultra vires.

[10] See DPP v Hutchinson [1990] 2 AC 738 as well as R vs IR Commissioners, [1990] 1 WLR 1400

[11] See the European Court of Justice's decision in Case C-106/89, Marleasing SA v La Comercial Internacional de Alimentacion SA, [1993] BCC 421.

[12] See Lister v Forth Fry Dock & Engineering Co. Ltd, [1989] SLT 540. Evidently, in Marleasing the issue was the wrongful transposition of a Directive, where as here we are dealing with a case where the UK legislation correctly implements the EU legal requirements. However, the Marleasing principle is of ready application in a case such as this where, absent a purposive interpretation, the UK implementing legislation is struck down in its totality as invalid. This very point was argued though not ultimately deliberated on in R (on the application of Cukurova Finance International Ltd and another) v HM Treasury [2008] EWHC 2567 (Admin).

[13] See comments of Lord Justice Moses in Cukurova, *ibid.*

6.2.22 There has not been a definitive judicial ruling on the issue and it is therefore not clear what approach the courts would take in these circumstances. However, we consider that, based on the above, it is likely that a Scottish court would decide that, if it considers that certain aspects of the FCA Regulations are ultra vires, a substantial severability test would be applied and, accordingly, that the FCA Regulations should be upheld as regards those aspects which do not go beyond the scope of the Collateral Directive.

6.2.23 In practice, this would mean limiting the transactions to which the FCA Regulations apply to those between non-natural persons and the list of counterparties specified in the Collateral Directive (on which please see above).

6.2.24 Sections 255 and 256 of the Banking Act give HM Treasury the power to make regulations about financial collateral arrangements. That power is not restricted to implementing the Collateral Directive and may be used for the purpose of enabling financial collateral arrangements to be commercially useful and effective. The regulations can, in particular, provide for any other provision by any legislation to have effect despite any lack of vires. Regulations removing the risk that the FCA Regulations are ultra vires have, as at the date of this Opinion, however, not been made.

6.3 **CI Regulations**

6.3.1 The CI Regulations broadly have the effect that no winding-up proceedings or reorganisation measures in respect of EEA credit institutions (as defined in the CI Regulations) can be undertaken in the UK except in the circumstances permitted by the CI Regulations. The aim of the CI Regulations is to harmonise the way in which credit institutions are treated in insolvency throughout member states. In relation to UK credit institutions, the CI Regulations provide protection for creditors in certain situations.

6.3.2 A UK credit institution for the purposes of the CI Regulations is an "undertaking" whose head office is in the United Kingdom and which has permission under Part IV of FSMA to accept deposits or to issue electronic money. Undertakings which also have permission to effect contracts of insurance under Part IV of FSMA are not UK credit institutions for the purposes of the CI Regulations.

Security Interest

6.3.3 Under Regulation 26, a Scottish relevant reorganisation or relevant winding up will not affect any right in rem (ie proprietary right), which would include a security interest under the Security Interest Provisions, over any assets of a Counterparty which is a UK credit institution located in another Member State for the purposes of the EU Regulation. A right which is recorded in a public register and which is enforceable against third parties is a right in rem for the purposes of Regulation 26. Regulation 26 will not preclude actions for voidness, voidability or unenforceability under Scots law.

6.3.4 In additional under Regulation 33, the effects of a Scottish relevant reorganisation or relevant winding up on proprietary rights in MiFID Instruments the existence or transfer of which is recorded in a register, an account or centralised deposit system held or located in an EEA State are determined by the law of that EEA State.

Regulated markets

6.3.5 Subject to Regulation 33 (on which please see above), the effects of a Scottish relevant reorganisation or relevant winding up on transactions carried out in the context of a regulated market operating in an EEA State is to be determined in accordance with the law applicable to those transactions. For these purposes, a "regulated market" has the meaning given by Article 4.1.14 of the MiFID Directive.

6.4 **EU Regulation on Insolvency Proceedings**

6.4.1 The objective of the EU Regulation is to establish common rules on cross-border insolvency proceedings, based on principles of mutual recognition and co-operation. The EU Regulation applies to "collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator" (Article1(1)). The EU Regulation lists the relevant insolvency proceedings to which it applies in each Member State in Annex A thereto. The insolvency proceedings to which the EU Regulation applies are referred to as **"EU Regulation Insolvency Proceedings"**.

6.4.2 Certain types of entity are specifically excluded from its operation (for example credit institutions (on which please see paragraph 3 above), Insurers who are "insurance undertakings") within the meaning of Directive 2001/17/EC on the reorganisation and winding up of insurance undertakings), investment undertakings which provide services involving the holding of funds or securities for third parties and collective investment undertakings (Article 1(2)).

6.4.3 Broadly, the EU Regulation serves to grant the courts of the Member State of the European Union (other than Denmark) (a **"Member State"**) within the territory of which the centre of a debtor's main interests are located, jurisdiction to open EU Regulation Insolvency Proceedings in respect of such debtor. These proceedings are, with regards to other Member States, international in scope, to be governed by the law of the Member State where proceedings are opened and effective in all Member States, unless secondary proceedings are opened in another Member State[14]. In the case of companies or legal persons, the place of the registered office of such company or legal person is presumed to be the centre of the company's main interests in the absence of proof to the contrary (Article 3(1)).

6.4.4 Even if the centre of a debtor's main interests is in a Member State, the courts of another Member State may open secondary proceedings in the event that such debtor possesses an establishment (being any place of operations where the debtor carried out a non-transitory economic activity with human goods and means) in the territory of such other Member State (Article 3(2)). The applicable law will be the law of that other Member State. However, secondary proceedings are territorial in scope and so will not extend beyond the Member State where they are opened, save in respect of creditors who have given their consent. Generally, they will be opened following the opening of the main proceedings, but there are exceptions to this principle.

Security Interest

6.4.5 Under Article 5, the opening of EU Regulation Insolvency Proceedings in Scotland will not affect any proprietary rights created by a security interest under the Security Interest Provisions over any assets of a Counterparty which are situated in another Member State. The rule for establishing where assets are situated is as follows[15]:

(i) Where the assets are tangibles, those assets will be situated in the Member State where they are situated.

[14] It should be noted that the United Kingdom (and not its constituent nations) is one Member State. Therefore, the EU Regulation has no application in relation to intra-United Kingdom matters (such as the determination of whether English, Scots or Northern Irish law applies to a particular matter and the recognition or any security interest over any assets located in England, Wales or Northern Ireland).

[15] Please note that it is not clear whether these rules are intended to be comprehensive and to cover all kinds of assets.

(ii) Where title to any assets is entered in a public register, those assets will be situated in the Member State under which the authority of which the register is kept.

(iii) Where the assets are claims, those assets are situated in the Member State in which the person required to meet them has its centre of main interests.

6.4.6 Article 5 will not however preclude actions for voidness, voidability or unenforceability as referred to in Article 4(2)(m) under the law of the opening of the insolvency proceedings.

Financial market

6.4.7 Article 9 provides that the effects of EU Regulation Insolvency Proceedings on the rights and obligations of parties to a payment or settlement system or to a financial market are governed by the law of the Member State which is applicable to that system or market[16]. Article 9 will not however preclude actions for voidness, voidability or unenforceability as referred to in Article 4(2)(m) under the law of the opening of the insolvency proceedings.

6.5 **Cross-Border Regulations**

6.5.1 The Cross-Border Regulations implement the provisions of the model law on cross-border insolvency as adopted by the United Nations Commission on International Trade Law. The Cross-Border Regulations require a court in Scotland to recognise foreign insolvency proceedings where certain procedural requirements have been complied with.

6.5.2 The Cross-Border Regulations do not apply to, among others, UK credit institutions (as defined by Regulation 2 of the CI Regulations).

6.5.3 Where an insolvency proceeding is taking place in a jurisdiction where the insolvent party has its centre of main interests, and these insolvency proceedings are recognised by the courts in Great Britain, any insolvency proceedings which are opened in Scotland will be restricted to assets located in Great Britain[17] (and so may not apply to some or all of the Collateral). In addition, the Courts are given wide powers upon recognition of a foreign insolvency proceeding (whether main or non-main) which could conceivably be exercised in a way which disrupts or renders ineffective one or more of the Security Interest Provisions.

6.5.4 Please see above for a discussion on the interaction of the Cross-Border Regulations with the FCA Regulations. In addition, where the application of any provision of the Cross-Border Regulations would conflict with the application of the EU Regulation, the EU Regulation will apply.

6.6 **Other recognition of foreign insolvency proceedings.**

6.6.1 Under section 426 of the Insolvency Act ("**Section 426**"), the Scottish courts may apply the law of one of a list of specified jurisdictions to the insolvency of an entity if so requested by the competent court of that other jurisdiction in giving assistance to those courts. Those specified jurisdictions are currently: other parts of the United Kingdom (ie, in respect of Scotland, England and Wales and Northern Ireland), the Channel Islands, the Isle of Man, Anguilla, Australia, The Bahamas, Bermuda, Botswana, Canada, Cayman Islands, Falkland

[16] It is unclear what the meaning of "financial market" is in these circumstances. However, the commentary on a draft instrument which was the predecessor of the EU Regulation by Virgos and Schmit indicates that it is understood to be a market where financial instruments, other financial assets or commodity futures and options are traded, and which is subject to supervision by the Member State's regulatory authorities.

[17] In practice the jurisdiction of the Scottish courts in such proceedings may be restricted to assets in Scotland. The Cross-Border Regulations provide that any order of the Courts in one jurisdiction in Great Britain shall be effective in the other jurisdiction as if it had been made by the Courts in the other jurisdiction. However, the Courts in one jurisdiction are not bound to enforce the order of a court in the other jurisdiction in respect of property situated in its jurisdiction. There is, however, a provision requiring the Courts in each jurisdiction to cooperate with each other.

Islands, Gibraltar, Hong Kong, Eire, Montserrat, New Zealand, St Helena, Turks and Caicos Islands, Tuvalu, Virgin Islands, Malaysia, South Africa and Brunei Darussalam. Accordingly, the effectiveness of an Agreement may be determined by reference to the laws of one of these jurisdictions (as to which we express no opinion) and the Scottish courts could take some other action which impacts on the effectiveness of the Agreements.

6.6.2 At common law, a Scottish court may seek to assist the courts or insolvency representatives in a foreign jurisdiction in respect of insolvency proceedings in that jurisdiction and may accordingly exercise its discretion to (a) apply the law of the foreign jurisdiction rather than (if it was otherwise applicable) Scots law to determine the effectiveness of the Security Interest or (b) take some other action which impacts on the effectiveness of the Security Interest Provisions.

6.6.3 However, a court may not in pursuance of Section 426 (or any common law power of recognition) recognise or give effect to an order of a foreign court or a foreign Insolvency Representative insofar as this would be prohibited by Part 3 of the FCA Regulations if made by a court in the United Kingdom or an office holder in any insolvency proceedings in the United Kingdom. Part 3 of the FCA Regulations disapplies certain provisions of United Kingdom insolvency law in relation to financial collateral arrangements.

6.7 **Banking Act**

Introduction

6.7.1 The Banking Act gives the Bank of England, the Financial Services Authority ("**FSA**") and HM Treasury ("**HMT**") (each an "**Authority**") powers to deal with banks that are at risk of failing.

6.7.2 The opinions given in this Opinion are subject to any limitations arising from the application of the provisions of the Banking Act.

Part 1: General

6.7.3 Part 1 of the Banking Act applies:

(i) to institutions that are incorporated in, or formed under the laws of, the United Kingdom and which have authority to carry on the regulated activity of accepting deposits under FSMA; and

(ii) with certain modifications, Building Societies,

(each a "**Banking Act Institution**").

6.7.4 Banking Act Institutions will include Banks. Under the Banking Act 2009 (Exclusion of Insurers) Order 2009 insurers who have permission under Part 4 of FSMA to effect or carry out contracts of insurance as principal will not be Banking Act Institutions even if they have permission to accept deposits.

6.7.5 Part 1 of the Banking Act implements a Special Resolution Regime (the "**Special Resolution Regime**") which gives the Authorities various options in dealing with failing Banking Act Institutions. There are two components to the Special Resolution Regime:

(i) three stabilisation options (the "**Stabilisation Options**"); and

(ii) two insolvency procedures for Banking Act Institutions.

6.7.6 The Stabilisation Options comprise:

(i) private sector purchaser transfers (whereby all or part of the business of a Banking Act Institution or securities issued by it can be transferred to private sector purchaser);

(ii) bridge-bank transfers (whereby all or part of the business of a Banking Act Institution can be transferred to a new company wholly owned by the Bank of England); and

(iii) temporary public ownership transfers (whereby securities issued by a Banking Act Institution can be transferred to a nominee of, or company wholly owned by, HMT).

6.7.7 To implement the Stabilisation Options, the Authorities are given two stabilisation powers:

(i) the ability to make share transfer orders (which, broadly, provide for securities issued by a Banking Act Institution to be transferred); and

(ii) the ability to make property transfer orders (which, broadly, provide for property, rights and liabilities of a Banking Act Institution to be transferred)[18].

6.7.8 Private sector purchaser transfers may, and bridge-bank transfers must, operate through the use of property transfer orders. Property transfer orders may provide for all property, rights and liabilities of a Banking Act Institution to be transferred ("**Full Property Transfers**") or for only certain specified property, rights and liabilities of a Banking Act Institution to be transferred (or left with the Banking Act Institution) ("**Partial Property Transfers**").

Part 1: Effect on the Security Interest

6.7.9 In the context of the Agreements, a Partial Property Transfer may effect the transfer of property, rights and liabilities under certain Transactions (including Collateral transferred in accordance with those Transactions) to a third party transferee ("**Transferred Transactions**"), with the rights and liabilities under other Transactions remaining with the Banking Act Institution ("**Retained Transactions**"). Where this is the case, the operation of the Security Interest may be disrupted.

6.7.10 The Banking Act (Restriction of Partial Property Transfers) Order 2009 (the "**Safeguards Order**") does, however, provide certain safeguards in the case of Partial Property Transfers. Paragraph 5 of the Safeguards Order provides that a Partial Property Transfer may not transfer:

(i) the property or rights against which the liability is secured unless the liability which is secured and the benefit of the security are also transferred;

(ii) the benefit of a security interest unless the liability which is secured is also transferred; or

(iii) the liability which is secured by the security interest unless the benefit of the security interest is also transferred[19].

6.7.11 The remedies for contravention of paragraph 5 are weak. Therefore, if a property transfer instrument is abused so as to affect the enforceability of the Security Interest, the Firm may not have adequate remedies on which to rely.

[18] Please note that, the implementation of the any Stabilisation Option and the use of any stabilisation power may not be an Event of Default for the purposes of the Agreements.

[19] Paragraph 5 of the Safeguards order does not apply where the arrangement of which the security interest forms part was entered into in contravention of any rules of the FSA or in breach of its permission under FSMA.

6.7.12 Under section 34(7) of the Banking Act, where a property transfer instrument makes provision in respect of property held on trust, it may also make provision about:

(i) the terms on which the property is to be held after the instrument takes effect; and

(ii) how any powers, provisions and liabilities in respect of the property are to be exercisable or have effect after the instrument takes effect.

6.7.13 In particular, where cash collateral that is subject to the Security Interest created pursuant to the Client Money Additional Security Clause is also subject to a statutory trust pursuant to CASS, section 34(7) would give the Bank of England, HM Treasury or the FSA (as the case may be) broad powers to alter the terms on which such assets are held, which may affect the enforceability of the Security Interests. However, under paragraph 7A of the Safeguards Order, these powers must only to the extent that it is necessary or expedient for the purpose of transferring from the Banking Act Institution to the transferee:

(i) the legal or beneficial interest of the Banking Act Institution in the property held on trust;

(ii) any powers, rights or obligations of the Banking Act Institution in respect of the property held on trust.

Part 1: Power to alter the law

6.7.14 Section 75 of the Banking Act contains wide-ranging powers allowing HM Treasury to amend the law for the purpose of enabling the powers under the Special Resolution Regime to be used effectively. While this provision cannot be used to amend the Banking Act or any Subordinate Legislation passed under it (which would include the Safeguards Order), it could be used to amend or disapply any other rule of law (whether statutory or otherwise). This could prejudice the effectiveness of Security Interest.

6.8 **Investment Bank Regulation**

6.8.1 Regulation 12 of the Investment Bank Regulation provides for a pro rata allocation of shortfalls among persons whose securities are held as client assets by an investment bank.

6.8.2 Regulation 12(3) and (4) of the Investment Bank Regulation provides that any person with a security interest over securities held in the client omnibus account of an investment bank (which is undergoing an investment bank special administration pursuant to the Investment Bank Regulation) on behalf of a particular client shall be entitled to participate in distributions in respect of those securities in accordance with their entitlement as against that particular client, but will also be subject to the sharing of shortfalls, so that such security interest holders shall not be entitled to claim in aggregate in excess of the distribution to which that particular client would have been entitled.

6.8.3 Regulation 12(3) and (4) will be relevant either:

(i) where the Counterparty is an Investment Bank which is undergoing an investment bank special administration and where the assets over which security has been created pursuant to the Security Interest Provisions are held in such Counterparty's client omnibus account (which will, in practice be where the Counterparty maintains a client omnibus account with the Firm); or

(ii) where the Firm itself is subject to investment bank special administration and has taken security (pursuant to the Security Interest Provisions) over assets held in its own client omnibus account.

6.8.4 If Regulation 12(3) and (4) applies in relation to securities provided to the Firm as Collateral, the amount of such securities available as Collateral may be reduced by reason of the shortfall.

6.9 **Client Assets Rules**

6.9.1 CASS 6.3.5R provides that, in relation to a third party with which a FSA authorised firm deposits safe custody assets belonging to a client, such firm must ensure that any agreement with that third party relating to the custody of those assets does not include the grant to that party, or to any other person, of a lien or a right of retention or sale over the safe custody assets, or a right of set-off over any client money derived from those safe custody assets. Where the Counterparty is itself subject to CASS 6, and it posts its own clients' assets as collateral with the Firm, CASS 6.3.5R would raise concerns as to the lawfulness of the creation if and therefore the enforceability of, any Security Interest over such assets pursuant to the Security Provision.

6.9.2 CASS7A addresses "primary pooling events" and "secondary pooling events". Very broadly, a primary pooling event is a failure of an FSA authorised firm that holds client money whereas a secondary pooling event is the failure of a third party to which client money held by an FSA authorised firm has been transferred. If a Primary Pooling Event occurs in relation to the Firm, or in relation to client money received by the Firm a Secondary Pooling Event occurs, the amount of client money available as Collateral may be reduced owing to a reduction in the Counterparty's own entitlement to such client money.

6.10 **Re-characterisation of a fixed security interest as a floating charge**

6.10.1 Under Scots law, only incorporated companies and limited liability partnerships can create floating charges. This will include Companies, OEICs and LLP's but not Individuals or Partnerships. Furthermore, it will not include a Trust where all of the Trustees are Individuals, is highly unlikely to include a Trust where some of the Trustees are Individuals and some are Corporate Trustees and may not include a Trust where all of the Trustees are Corporate Trustees. In addition, Building Societies are specifically prohibited from creating floating charges under section 9B of the Building Societies Act 1986.

6.10.2 As a result, there is a risk that, if a fixed security interest under the Agreement which is entered into by a Counterparty which is not able to create floating charges is re-characterised as a floating charge under the governing law of the Agreement, the law of the jurisdiction in which the Collateral is located or any other applicable law, a Scottish court would regard that security interest as invalid.

6.11 **Charities**

6.11.1 Where a Counterparty is a charity section 28 of the Charities and Trustee Investment (Scotland) Act 2005 gives the Office of the Scottish Charity Regulator ("**OSCR**") wide powers to inquire into the activities of charities or bodies controlled by charities. Under the same section it may make directions (for six months) to prohibit the organisation from undertaking the activities specified in the direction. Section 31 of that Act gives OSCR the powers, where inquiries under section 28 have shown misconduct, to require the charity to cease activities or to restrict transactions or to refrain from parting with property. It is possible that action taken by OSCR pursuant to such powers might adversely affect the Security Interest Provisions as it might disrupt the fulfilment of obligations under those provisions.

6.11.2 Section 87 of The Charities Act 2011 gives the Charities Commissioners similar powers over certain Scottish charities controlled wholly or mainly in England or Wales where misconduct has been shown. It is possible that action taken by Charities Commissioners pursuant to

such powers might adversely affect the Security Interest Provisions as it might disrupt the fulfilment of obligations under those provisions.

6.12 **General**

6.12.1 A Scottish court will not necessarily grant any remedy the availability of which is subject to equitable or public policy considerations or which is otherwise at the discretion of the court. In particular, the power of a court to order specific performance or implement of an obligation or to grant interdict (the Scottish equivalent of injunction) is discretionary and, accordingly, a Scottish court may in its discretion refuse to make an award of specific performance or implement or to grant interdict and may instead make an award of damages where specific performance or implement of an obligation or any other equitable remedy was sought if damages were considered by the court to be an adequate remedy.

6.12.2 Under section 242 of the Insolvency Act and section 34 of the Bankruptcy Act a transaction entered into at any time within certain specified periods ending with the commencement of certain Insolvency Proceedings whereby assets of the relevant party are alienated may be reduced and an order for restoration of the property made on application to the court. The court will not grant such an order if it is shown that after the date of the alienation the assets of the relevant party were greater than its liabilities or the alienation was made for adequate consideration or it was a birthday, Christmas or other conventional gift or was a charitable gift to a non-associate which in all the circumstances it was reasonable to make[20].

6.12.3 Under section 243 of the Insolvency Act and section 36 of the Bankruptcy Act anything done within specified periods ending with the commencement of certain Insolvency Proceedings which has the effect of creating a preference in favour of a creditor to the prejudice of the general body of creditors may be challenged and reduced. However certain transactions cannot be challenged, namely:

(i) a transaction in the ordinary course of business;

(ii) a payment in cash for a due debt, unless such payment was collusive with the purpose of prejudicing the general body of creditors;

(iii) a transaction whereby the parties to it undertake reciprocal obligations, unless the transaction is collusive as aforementioned; and

(iv) the granting of a mandate authorising payment of arrested funds to the arrester where decree for payment or a warrant for summary diligence has been given and this was preceded by arrestment on the dependence of the action or followed by arrestment in execution[21].

6.12.4 Failure by a Firm to exercise any rights under the Agreement prior to the approval of a scheme of arrangement under Part 26 of the Companies Act or a voluntary arrangement under Part I of the Insolvency Act (if applicable) by the Counterparty's creditors, or the entry by the Counterparty into a trust deed for a its creditors or a debt payment programme under the Debt Arrangement and Attachment (Scotland) Act 2002 may prejudice the Firm's rights to enforce the Agreement (including the Security Interest Provisions).

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[20] It is also possible under common law to challenge a transaction giving rise to an alienation where the Counterparty did not receive adequate consideration. There is no time limit beyond which such a challenge becomes unavailable. However, for a challenge to succeed, the Counterparty would need to be insolvent (on a balance sheet or cash from basis) for the whole of the period from the transaction giving rise to the preference until the date of formal insolvency proceedings.

[21] It is also possible under common law to challenge a preference in favour of a creditor. There is no time limit beyond which such a challenge becomes unavailable. However, for a challenge to succeed, the Counterparty would need to be insolvent (on a balance sheet or cash from basis) for the whole of the period from the transaction giving rise to the preference until the date of formal insolvency proceedings.

6.12.5 Where the winding up of a Counterparty under the Insolvency Act is commenced by the presentation of a petition for winding up, Section 127 of the Insolvency Act provides that any disposition of that party's property made after the presentation of the petition is void, unless the Court orders otherwise. This may affect the validity of the transfer of any asset (including Collateral) by the Counterparty pursuant to the terms of the Agreement and could prejudice the operation of the provisions of the Agreement (including the Security Interest Provisions) in relation to those assets. However, to the extent that the Security Interest Provisions are a security financial collateral arrangement for the purposes of the FCA Regulations (on which please see above), Section 127 will not apply to any property or security interest subject to a disposition or created or arising under the Security Interest Provisions.

6.12.6 Where the sequestration of a Counterparty under the Bankruptcy Act is commenced by a petition for sequestration, the assets of the Counterparty will vest in the trustee in sequestration on the date of sequestration. This date is either (a) where the Counterparty presents the petition, the date that the sequestration order is made by the Court or (b) in all other cases, the first date that the Court grants a warrant to cite the Counterparty (or any other persons) in connection with the petition. Any disposition following the date of sequestration may (depending on the circumstances) be void. This may affect the validity of the transfer of any asset (including Collateral) by the Counterparty pursuant to the terms of the Agreement and could prejudice the operation of the provisions of the Agreement (including the Security Interest Provisions) in relation to those assets.

6.12.7 To the extent that any Security Interest Provision is re-characterised as a floating charge and such floating charge is recognised under Scots law (on which please see above) Section 245 of the Insolvency Act will apply to it, such that (if the Counterparty enters into Insolvency Proceedings within 12 months of the creation of the charge) it will be invalid to the extent of the aggregate value of the consideration for the charge as consists of:

(i) new monies lent or goods or services supplied to the Counterparty; or

(ii) the discharge or reduction of any debt of the Counterparty,

at the same time as, or after, the charge is created, together with contractual interest. The relevant period is extended to 2 years if the Counterparty if connected with the firm. Section 245 does not apply:

(iii) if the Counterparty and the Firm are not connected with each other, and the Counterparty was able to pay its debts in accordance with section 123 of the Insolvency Act at the time the charge was entered into; or

(iv) if the charge is a security collateral financial arrangement for the purposes of the FCA Regulations (on which please see above).

6.12.8 Any provision to the effect that any calculation, determination or certification will be conclusive and binding will not be effective if such calculation, determination or certification is fraudulent, and a Scottish court may regard any calculation, determination or certification as no more than prima facie evidence of the matter calculated, determined or certified. Furthermore, notwithstanding the terms of the Agreements, the certification, determination, notification or opinion of any party as to any matter therein provided might be held by a Scottish court not to be conclusive if it could be shown to the satisfaction of the court to have any unreasonable or arbitrary basis.

6.12.9 Any question as to whether or not any provision of any agreement or instrument which is illegal, invalid, not binding, unenforceable or void may be severed from the other provisions thereof in order to save those other provisions would be determined by a Scottish court in its discretion.

6.12.10 Any opinions expressed in this Opinion as regards the binding effect or enforceable nature of obligations are subject to the provisions of Scots law applicable to contracts held to have been frustrated by events happening after their execution.

6.12.11 Any agreement may be varied, amended or discharged, or any provision thereof waived, by a further agreement or effected by a collateral agreement which may be effected by oral agreement between the parties, or by a course of dealing, notwithstanding any provision to the contrary.

6.12.12 Under section 8 of the Law Reform (Miscellaneous Provisions) Scotland Act 1985, a court may, on application to that effect, declare the terms of a contract to be varied on the basis that they fail to express accurately the common intention of the parties thereto at the date when they were made. However, where the parties have sought legal advice prior to executing such agreements, a presumption that those agreements do accurately express the common intention of the parties will be more difficult for the applicant to rebut.

6.12.13 A judgement obtained by a court in a foreign jurisdiction may, in certain circumstances, be enforced in Scotland without the Scottish courts considering the merits of it having been examined by them. If such a judgement is so enforced, it may, depending on the circumstances of the case, undermine the effectiveness of the Agreement as applied in Scotland. Furthermore, 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 Scottish courts may recognise the extinction of those claims or liabilities.

6.12.14 Under Section 186 of the Insolvency Act, a court may, on the application of a liquidator entitled to the benefit subject to the burden of a contract made with a Counterparty make an order rescinding the contract on such terms as to the payment by or to either Counterparty of damages for the performance of the contract or otherwise as the court thinks just. Where such an order is made in relation to the Agreement (or any transaction) this could prejudice the operation of the provisions of the Agreement.

6.12.15 Any provision of the Agreement which constitutes or purports to constitute a restraint on the exercise of any statutory power of the Counterparty may be ineffective.

6.12.16 Following an insolvency of any Counterparty, any rights arising under the Agreement may be affected by the application of anti-deprivation principles.

6.12.17 Any obligation of a Counterparty under the Agreement which involves the currency (and is contrary to the exchange control rules) of any member of the International Monetary Fund may not be enforceable.

6.12.18 The enforceability of obligations may be limited by the provisions of Scots law applicable to agreements held to have been frustrated by events happening after their execution.

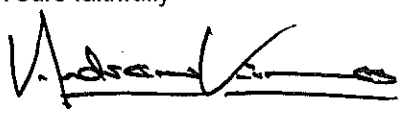
6.12.19 The enforceability of a contract or obligation in accordance with its terms may be impaired as a result of any actings of the parties to it which are not in accordance or consistent with those terms.

7. Reliance

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 FSMA) 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



Andrew Kinnes, Partner
For and on behalf of
Shepherd and Wedderburn LLP

ANNEX 1

FORM OF FOA AGREEMENTS

1. Professional Client Agreement (2007 Version), including Module G (Margin and Collateral) (the "**Professional Client Agreement 2007**")
2. Professional Client Agreement (2009 Version), including Module G (Margin and Collateral) (the "**Professional Client Agreement 2009**")
3. Professional Client Agreement (2011 Version) including Module G (Margin and Collateral) (the "**Professional Client Agreement 2011**")
4. Retail Client Agreement (2007 Version) including Module G (Margin and Collateral) (the "**Retail Client Agreement 2007**")
5. Retail Client Agreement (2009 Version) including Module G (Margin and Collateral) (the "**Retail Client Agreement 2009**")
6. Retail Client Agreement (2011 Version) including Module G (Margin and Collateral) (the "**Retail Client Agreement 2011**")
7. Eligible Counterparty Agreement (2007 Version) including Module G (Margin) (the "**Eligible Counterparty Agreement 2007**")
8. Eligible Counterparty Agreement (2009 Version) including Module G (Margin) (the "**Eligible Counterparty Agreement 2009**")
9. Eligible Counterparty Agreement (2011 Version) including Module G (Margin) (the "**Eligible Counterparty Agreement 2011**")

For the avoidance of doubt none of the forms of the Agreements listed at this Annex 1 include or incorporate the Title Transfer Securities and Physical Collateral Annex to the Netting Modules published by the Futures and Options Association.

Where the form of any Agreement listed in this Annex 1 (as published by the Futures and Options Association) (the "**FOA Published Form Agreement**") expressly contemplates the election of certain variables and alternatives, the Agreements listed above shall be deemed to include any such document in respect of which the parties have made such expressly contemplated elections (and have made any deletions required by such elections, where such deletions are expressly contemplated in the event of such election by the applicable FOA Published Form Agreement).

Each of the Agreements listed in this Annex 1 may be deemed to include Agreements identical to the relevant FOA Published Form Agreement, save for the substitution of Two Way Clauses in place of the equivalent terms in the FOA Published Form Agreement.

ANNEX 2

DEFINED TERMS RELATING TO THE AGREEMENTS

1. The "**Eligible Counterparty Agreements**" means each of the Eligible Counterparty Agreement 2007, the Eligible Counterparty Agreement 2009 and the Eligible Counterparty Agreement 2011 (each as listed and defined at Annex 1).

2. The "**Professional Client Agreements**" means each of the Professional Client Agreement 2007, the Professional Client Agreement 2009 and the Professional Client Agreement 2011 (each as listed and defined at Annex 1).

3. The "**Retail Client Agreements**" means each of the Retail Client Agreement 2007, the Retail Client Agreement 2009 and the Retail Client Agreement 2011 (each as listed and defined at Annex 1).

4. An "**Equivalent 2011 Agreement without Core Rehypothecation Clause**" means an Equivalent Agreement in the form of the Eligible Counterparty Agreement 2011, Retail Client Agreement 2011 or Professional Client Agreement 2011 but which does not contain the Rehypothecation Clause.

5. "**Core Provisions**" means:

   (a) with respect to all Equivalent Agreements, the Security Interest Provisions; and

   (b) with respect to Equivalent Agreements that are in the form of the Eligible Counterparty Agreement 2011, Retail Client Agreement 2011 or Professional Client Agreement 2011 (but not with respect to an Equivalent 2011 Agreement without Core Rehypothecation Clause), the Rehypothecation Clause.

6. "**Rehypothecation Clause**" means:

   (i) in the case of Agreements in the form of the Professional Client Agreement 2011, clause 8.13 (**Rehypothecation**);

   (ii) in the case of Agreements in the form of the Retail Client Agreement 2011, clause 8.15 (**Rehypothecation**);

   (iii) in the case of Agreements in the form of the Eligible Counterparty Agreement 2011, clause 7.13 **(Rehypothecation)**; and

   (iv) in the case of an Equivalent Agreement, a clause that is identically the same in form and language as a clause referred to in any of the foregoing paragraphs (i) to (iii) of this definition (except insofar as variations may be required for internal cross-referencing purposes);

7. "**Security Interest Provisions**" means:

   (a) the "**Security Interest Clause**", being:

      (i) in the case of Agreements in the form of the Professional Client Agreement 2007, clause 8.6 **(Security interest)**;

      (ii) in the case of Agreements in the form of the Professional Client Agreement 2009, clause 8.6 **(Security interest)**;

      (iii) in the case of Agreements in the form of the Professional Client Agreement 2011, clause 8.7 **(Security interest)**;

      (iv) in the case of Agreements in the form of the Retail Client Agreement 2007, clause 8.8 **(Security interest)**;

      (v) in the case of Agreements in the form of the Retail Client Agreement 2009, clause 8.8 **(Security interest)**;

      (vi) in the case of Agreements in the form of the Retail Client Agreement 2011, clause 8.9 **(Security interest)**;

      (vii) in the case of Agreements in the form of the Eligible Counterparty Agreement 2007, clause 7.6 **(Security interest)**;

(viii) in the case of Agreements in the form of the Eligible Counterparty Agreement 2009, clause 7.6 **(Security interest)**;

(ix) in the case of Agreements in the form of the Eligible Counterparty Agreement 2011, clause 7.7 **(Security interest)**; and

(x) in the case of an Equivalent Agreement, a clause that is identically the same in form and language as a clause referred to in any of the foregoing paragraphs (i) to (ix) of this definition (except insofar as variations may be required for internal cross-referencing purposes);

(b) the "**Power to Charge Clause**", being:

(i) in the case of Agreements in the form of the Professional Client Agreement 2007, clause 8.10 **(Power to charge)**;

(ii) in the case of Agreements in the form of the Professional Client Agreement 2009, clause 8.10 **(Power to charge)**;

(iii) in the case of Agreements in the form of the Professional Client Agreement 2011, clause 8.10 **(Power to charge)**;

(iv) in the case of Agreements in the form of the Retail Client Agreement 2007, clause 8.12 **(Power to charge)**;

(v) in the case of Agreements in the form of the Retail Client Agreement 2009, clause 8.12 **(Power to charge)**;

(vi) in the case of Agreements in the form of the Retail Client Agreement 2011, clause 8.12 **(Power to charge)**;

(vii) in the case of Agreements in the form of the Eligible Counterparty Agreement 2007, clause 7.10 **(Power to charge)**;

(viii) in the case of Agreements in the form of the Eligible Counterparty Agreement 2009, clause 7.10 **(Power to charge)**;

(ix) in the case of Agreements in the form of the Eligible Counterparty Agreement 2011, clause 7.10 **(Power to charge)**; and

(x) in the case of an Equivalent Agreement, a clause that is identically the same in form and language as a clause referred to in any of the foregoing paragraphs (i) to (ix) of this definition (except insofar as variations may be required for internal cross-referencing purposes);

(c) the "**Power of Sale Clause**", being:

(i) in the case of Agreements in the form of the Professional Client Agreement 2007, clause 8.11 **(Power of sale)**;

(ii) in the case of Agreements in the form of the Professional Client Agreement 2009, clause 8.11 **(Power of sale)**;

(iii) in the case of Agreements in the form of the Professional Client Agreement 2011, clause 8.11 **(Power of sale)**;

(iv) in the case of Agreements in the form of the Retail Client Agreement 2007, clause 8.13 **(Power of sale)**;

(v) in the case of Agreements in the form of the Retail Client Agreement 2009, clause 8.13 **(Power of sale)**;

(vi) in the case of Agreements in the form of the Retail Client Agreement 2011, clause 8.13 **(Power of sale)**;

(vii) in the case of Agreements in the form of the Eligible Counterparty Agreement 2007, clause 7.11 **(Power of sale)**;

(viii) in the case of Agreements in the form of the Eligible Counterparty Agreement 2009, clause 7.11 **(Power of sale)**;

(ix) in the case of Agreements in the form of the Eligible Counterparty Agreement 2011, clause 7.11 **(Power of sale)**; and

(x) in relation to an Equivalent Agreement, a clause that is identically the same in form and language as the clauses referred to in any of the foregoing paragraphs (i) to (ix) of this definition (except insofar as variations may be required for internal cross-referencing purposes);

(d) the "**Power of Appropriation Clause**", being:

(i) in the case of Agreements in the form of the Professional Client Agreement 2007, clause 8.12 **(Power of appropriation)**;

(ii) in the case of Agreements in the form of the Professional Client Agreement 2009, clause 8.12 **(Power of appropriation)**;

(iii) in the case of Agreements in the form of the Professional Client Agreement 2011, clause 8.12 **(Power of appropriation)**;

(iv) in the case of Agreements in the form of the Retail Client Agreement 2007, clause 8.14 **(Power of appropriation)**;

(v) in the case of Agreements in the form of the Retail Client Agreement 2009, clause 8.14 **(Power of appropriation)**;

(vi) in the case of Agreements in the form of the Retail Client Agreement 2011, clause 8.14 **(Power of appropriation)**;

(vii) in the case of Agreements in the form of the Eligible Counterparty Agreement 2007, clause 7.13 **(Power of appropriation)**

(viii) in the case of Agreements in the form of the Eligible Counterparty Agreement 2009, clause 7.13 **(Power of appropriation)**;

(ix) in the case of Agreements in the form of the Eligible Counterparty Agreement 2011, clause 7.12 **(Power of appropriation)**; and

(x) in the case of an Equivalent Agreement, a clause that is identically the same in form and language as a clause referred to in any of the foregoing paragraphs (i) to (ix) of this definition (except insofar as variations may be required for internal cross-referencing purposes);

(e) the "**Lien Clause**", being:

(i) in the case of Agreements in the form of the Professional Client Agreement 2007, clause 8.13 **(General lien)**;

(ii) in the case of Agreements in the form of the Professional Client Agreement 2009, clause 8.13 **(General lien)**;

(iii) in the case of Agreements in the form of the Professional Client Agreement 2011, clause 8.14 **(General lien)**;

(iv) in the case of Agreements in the form of the Retail Client Agreement 2007, clause 8.15 **(General lien)**;

(v) in the case of Agreements in the form of the Retail Client Agreement 2009, clause 8.15 **(General lien)**;

(vi) in the case of Agreements in the form of the Retail Client Agreement 2011, clause 8.16 **(General lien)**;

(vii) in the case of Agreements in the form of the Eligible Counterparty Agreement 2007, clause 7.12 **(General lien)**;

(viii) in the case of Agreements in the form of the Eligible Counterparty Agreement 2009, clause 7.12 **(General lien)**;

(ix) in the case of Agreements in the form of the Eligible Counterparty Agreement 2011, clause 7.14 **(General lien)**; and

(x) in the case of an Equivalent Agreement, a clause that is identically the same in form and language as a clause referred to in any of the foregoing paragraphs (i) to (ix) of this definition (except insofar as variations may be required for internal cross-referencing purposes); and

(f) the "**Client Money Additional Security Clause**", being:

(i) in the case of Agreements in the form of the Professional Client Agreement 2007, clause 7.8 **(Additional security)** at module F Option 4 (where incorporated into such Agreement);

(ii) in the case of Agreements in the form of the Professional Client Agreement 2009, clause 7.9 **(Additional security)** at module F Option 1 (where incorporated into such Agreement);

(iii) in the case of Agreements in the form of the Professional Client Agreement 2011, clause 7.9 **(Additional security)** at module F Option 1 (where incorporated into such Agreement);

(iv) in the case of Agreements in the form of the Retail Client Agreement 2007, clause 7.8 **(Additional security)** at module F Option 4 (where incorporated into such Agreement);

(v) in the case of Agreements in the form of the Retail Client Agreement 2009, clause 7.9 **(Additional security)** at module F Option 1 (where incorporated into such Agreement);

(vi) in the case of Agreements in the form of the Retail Client Agreement 2011, clause 7.9 **(Additional security)** at module F Option 1 (where incorporated into such Agreement);

(vii) in the case of Agreements in the form of the Eligible Counterparty Agreement 2007, clause 6.8 **(Additional security)** at module F Option 4 (where incorporated into such Agreement);

(viii) in the case of Agreements in the form of the Eligible Counterparty Agreement 2009, clause 6.9 (Additional security) at module F Option 1 (where incorporated into such Agreement);

(ix) in the case of Agreements in the form of the Eligible Counterparty Agreement 2011, clause 6.9 (Additional security) at module F Option 1 (where incorporated into such Agreement); and

(x) in the case of an Equivalent Agreement, a clause that is identically the same in form and language as the clauses referred to in any of the foregoing paragraphs (i) to (ix) of this definition (except insofar as variations may be required for internal cross-referencing purposes).

8. "**Two Way Clauses**" means each of the Futures and Options Association's Short-Form Two-Way Clauses 2007, the Short-Form Two-Way Clauses 2009, the Short-Form Two-Way Clauses 2011, the Long-Form Two-Way Clauses 2007, the Long-Form Two-Way Clauses 2009 and the Long-Form Two-Way Clauses 2011.

ANNEX 3

NON-MATERIAL AMENDMENTS

1. Any change to the numbering or order of a provision or provisions or the drafting style thereof (e.g., addressing the other party as "**you**", "**Counterparty**", "**Counterparty A/Counterparty B**") provided in each case that the plain English sense and legal effect both of each such provision and of the Agreement as a whole (including the integrity of any cross references and usage of defined terms) remains unchanged.

2. Any change to a provision or provisions by defining certain key terms (e.g., party, exchange, currency, defaulting party or non-defaulting party) and using these terms in large caps throughout the Agreement provided in each case that the plain English sense and legal effect both of each such provision and of the Agreement as a whole (including the integrity of any cross references and usage of defined terms) remains unchanged.

3. An addition to the list of events that constitute an Event of Default (e.g. without limitation, the failure to deliver securities or other assets, a force majeure, cross default or downgrading event the death or incapacity of a Counterparty or its general partner any default under a specified transaction or a specified master agreement), such change may or may not be coupled with a grace period or the serving of a written notice on the Defaulting Counterparty by the Non-Defaulting Counterparty, such change may be expressed to apply to one only of the Parties.

4. Any change to an Insolvency Event of Default (i) introducing a grace period for the filing of a petition for bankruptcy proceedings (of e.g. 15 or 30 days), (ii) modifying or deleting any such grace period, (iii) requiring that the filing of the petition is not frivolous, vexatious or otherwise unwarranted or (iv) that the non-defaulting party has reasonable grounds to conclude that the performance by the defaulting party of its obligations under the Agreement, Transactions, or both, is endangered.

5. Any change to an Insolvency Event of Default more particularly describing (i) the relevant procedures that would or would not constitute such event of default or termination event (ii) the relevant officers the appointment of which would or would not constitute such Insolvency Event of Default.

6. Any change to an Insolvency Event of Default extending its scope to events occurring with respect to the credit support provider, an affiliate, a custodian or trustee of a Counterparty.

7. Any change to an Insolvency Event of Default replacing such event of default with a provision aligned to Section 5(a)(vii) of the 1992 or 2002 ISDA Master Agreement (or relevant part thereof).

8. Any change to the Agreement requiring the Non-defaulting Counterparty when exercising its rights under the Security Interest Provisions (or other provisions) or making determinations to act in good faith and/or a commercially reasonable manner.

9. Any change clarifying that the Non-defaulting Counterparty must, or may not, notify the other party of its exercise of rights under the Security Interest Provisions or other provision.

SCHEDULE 1

Counterparties covered by this opinion

1. Counterparties covered by this Opinion

The parties to the Agreements and Transactions which are, to the extent and in the manner specified, covered in this Opinion are:

1.1 Companies which are:

1.1.1 formed and registered in Scotland under the Companies Act or the former Companies Acts (as defined by section 1171 of the Companies Act) ("**Scottish Companies**"); or

1.1.2 incorporated outside the United Kingdom but which have a branch established or located in Scotland ("**Foreign Companies**" and, together with Scottish Companies, "**Companies**"),

including:

1.1.3 those Scottish Companies which are Banks;

1.1.4 those Companies which are securities dealers having permission under Part IV of the FSMA to carry on the regulated activity of dealing in investments as principal, dealing in investments as agent and/or managing investments; and

1.1.5 those Scottish Companies which are insurers (as defined in Article 2 of the Financial Services and Markets Act 2000 (Insolvency) (Definition of "Insurer") Order 2001 ("**Insurers**").

1.2 Individuals who have the centre of their main interests in Scotland for the purposes of the EU Regulation and who have an established place of business or are habitually resident in Scotland ("**Individuals**").

1.3 Building Societies incorporated and registered in Scotland under the Building Societies Act 1986 ("**Building Societies**").

1.4 Open ended investment companies incorporated under the Open-Ended Investment Companies Regulations 2001 (the "**OEIC Regulations**") in respect of which an authorisation order had been made pursuant to Paragraph 14 of the OEIC Regulations and which have their head office in Scotland in terms of the OEIC Regulations ("**Open Ended Investment Companies**" or "**OEICs**").

1.5 Partnerships constituted and formed under Scots law and carrying on business in Scotland and Limited Partnerships formed and constituted under Scots law and registered in Scotland under the Limited Partnership Act 1907 ("**Partnerships**").

1.6 Limited Liability Partnerships formed and registered in Scotland under the Limited Liability Partnerships Act 2000. ("**Limited Liability Partnerships**" or "**LLPs**").

1.7 Scottish Companies ("**Corporate Trustees**") and Individuals ("**Individual Trustees**", and, together with Corporate Trustees, "**Trustees**") which are acting as trustees of trusts ("**Trusts**") constituted and formed under Scots law and carrying on business in Scotland, including Corporate Trustees of Trusts which are:

1.7.1 authorised unit trust schemes (as defined in Section 237(3) of FSMA) in respect of which an authorisation order has been made pursuant to Section 242 of FSMA ("**AUTs**") (a Corporate Trustee acting as a trustee of an AUT being an "**AUT Trustee**"); and

1.7.2 occupational pension schemes ("**Pension Trusts**") (a Corporate Trustee acting as a trustee of a Pension Trust being a "**Pension Trustee**").

1.8 Local Authorities constituted under the Local Government Etc (Scotland) Act 1994 acting in their capacity as Administering Authorities ("**Administering Authorities**") within the meaning of the Local Government Pension Scheme (Administration)(Scotland) Regulations 2008 (the "**LGPS Scotland Regulations**") for the purpose of maintaining funds under the Local

Government Pension Scheme (Scotland), a funded statutory pension arrangement established under the Superannuation Act 1972 and governed by, among other things, the LGPS Scotland Regulations ("**Local Authority Pension Funds**").

2. Counterparties which are not covered by this Opinion

To the extent that they would otherwise be included within paragraph 1 above, the following parties are not covered by this Opinion:

2.1 Companies incorporated or formed in England and Wales or Northern Ireland (whether under the Companies Act or otherwise).

2.2 EEA insurers (as defined in the Insurers (Reorganisation and Winding Up) Regulations 2004) and a branch established or located in Scotland of EEA insurers.

2.3 Other than Insurers, insurers (as defined in Article 2 of the Financial Services and Markets Act 2000 (Insolvency) (Definition of "Insurer") Order 2001 and any other person carries on the activity of effecting or carrying out contracts of insurance.

2.4 Persons to whom the provisions of the Insurers (Reorganisation and Winding Up) (Lloyds) Regulations 2005 apply.

2.5 Societas Europaea established pursuant to EU Council Regulation No. 2157/2001 of 8 October 2001 on the European Company Statute.

SCHEDULE 2

Open Ended Investment Companies (OIECs)

1. Restrictions on Investment Powers

COLL imposes restrictions on the investment powers of OEIC's. The restrictions which apply would depend on the rules applicable to the particular OEIC (which would depend principally on whether it is an UCITS Scheme or a non-UCITS Scheme). However, section 151 of FSMA provides that any transaction entered into in contravention of such rules will not be void or unenforceable by reason only of such contravention.

2. Protected cell regime

2.1. On 20 December 2011 the OEIC Regulations were amended in order to provide for a "protected cell regime" for umbrella OEICs. Under that regime, each sub-fund of the OEIC is generally treated as a separate legal entity, and the assets of a particular sub-fund belong exclusively to that sub-fund and cannot be used to discharge any liabilities of the company or any other person, except where they were incurred on behalf of (or are attributable to) that sub-fund.

2.2. Accordingly, any security interest or other right arising under the Security Interest Provisions in respect of any Collateral which has been provided from (or is attributable to) one sub-fund will not be enforceable in respect of liabilities attributable to another sub-fund.

2.3. Given the points made above, we consider that a Firm should ensure that the sub-fund with which they are entering into Transactions with is clearly identified and that the Agreement clearly provides that if it only applies in relation to Transactions entered into in respect of that sub-fund. Where the Firm is entering into Transactions with more than one sub-fund of an OEIC, we recommend that separate Agreements are entered into in respect of each sub-fund.

SCHEDULE 3

Insurers

1. Restrictions on investment powers

1.1. Insurers are required to be authorised by the FSA for the purpose of carrying on insurance business. Insurers are subject to a number of regulatory rules imposed by the Authority including rules contained in the FSA's General Prudential Sourcebook (GENPRU), and the Prudential Sourcebook for Insurers (INSPRU).

1.2. Insurers may not carry on any commercial business other than insurance business and activities directly arising from that business. Insurers are required to make deductions from their regulatory capital in respect of assets which are inadmissible and/or which exceed various specified "concentration limits" (which impose limits in Insurers' exposure to particular categories of assets and to hold particular counterparties). They are also required to hold admissible assets of a value at least equal to the amount of their technical provisions. A transaction entered into in breach of the asset admissibility rules will affect the value which an Insurer may attribute to the transaction for insolvency purposes. Insurers carrying on "*long term insurance business*" (as defined in the glossary to the FSA Handbook) are required to maintain a separate account in respect of the long term business. They are also required to ensure that (subject to certain qualifications) long term insurance business assets are applied only for the purposes of the Insurer's long term business. In relation to linked long term contracts of insurance, there are restrictions under INS PRU on the types of asset or index by reference to which benefits may be determined.

1.3. Where an Insurer enters into a Transaction in breach of any FSA rules (including those in INSPRU, and GENPRU (as applicable)), this would not affect the validity or enforceability of Transactions against the Insurer as section 151 of FSMA provides that contravention of FSA rules does not make any transaction void or unenforceable. It should also be noted that a contravention of the rules in INSPRU, and GENPRU does not give rise to a right of action by a private person against the counterparty.

2. Insurers Winding Up Regulations

2.1. The insolvency of Insurers is governed by the provisions of the Insolvency Act, the Bankruptcy Act, FSMA, the Insolvency Rules, the Insurers (Reorganisation and Winding Up) Regulations 2004 (the "Insurers Winding Up Regulations"), the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2010, and the Insurers (Winding Up) (Scotland) Rules 2001[22].

2.2. The Insurers Winding Up Regulations were enacted to implement the Directive of the European Council and of the Parliament of 19 March 2001 on the reorganisation and winding up of insurance undertakings (2001/17/EC).

2.3. The general effect of the Insurers Winding Up Regulations is that voluntary arrangements, administrations or winding ups in respect of insurers (referred to below as "**relevant reorganisations**" and "**relevant winding ups**") must be started in the member state where the relevant insurer is authorised.

2.4. Regulation 4 contains a general prohibition (subject to limited exceptions) on the commencement of certain insolvency proceedings in the UK in respect of an EEA Insurer. The definition of "EEA Insurer" for these purposes is contained in the Insurers Winding Up Regulations. Specifically excluded from the definition of EEA Insurer are UK Insurers, which the Insurers Winding Up Regulations define as being all persons having permission under Part IV of FSMA to effect or carry out contracts of insurance (referred to below as "**Included Insurers**"), except any person who, in accordance with that permission, carries on that activity exclusively in relation to reinsurance contracts (referred to below as "**Excluded Insurers**"). The Insurers Winding Up Regulations therefore require that, in respect of UK Insurers which are incorporated in the UK and are Included Insurers, the relevant insolvency proceedings should be commenced in the United Kingdom.

[22] One effect of the modified regime is that an Insurer cannot be placed into administration using the "out of court" administration appointment route provided for in paragraphs 14 and 22 of Schedule B1.

2.5. The Insurers Winding Up Regulations also apply to a certain extent to third country insurers which do not fall within the definition of an "EEA Insurer", where the third country insurer is subject to a "relevant measure" (as defined in regulation 48(1)(a) of the Insurers Winding Up Regulations). A third country insurer is a person who has permission under FSMA to effect or carry out contracts of insurance, but whose head office is not in the UK or an EEA state (a third country insurer subject to a relevant measure is referred to below as a relevant third country insurer). The Insurers Winding Up Regulations do not specifically prohibit the commencement of relevant reorganisations and winding ups of third country insurers.

2.6. Under regulation 41 of the Insurers Winding Up Regulations, a relevant reorganisation or relevant winding up will not affect any proprietary rights created by a security interest under the Security Interest Provisions over any assets of a Counterparty which are situated another EEA State[23]. Regulation 41 will not however preclude actions for voidness, voidability or unenforceability of legal acts detrimental to creditors under the general law of insolvency of the United Kingdom.

2.7. The Insurers Winding Up Regulations do not apply to Excluded Insurers. Although it is not beyond doubt, it seems to us to be likely that Excluded Insurers are subject to the EU Regulation (on which please see paragraph 6.4 of this Opinion).

3. Composite insurers

3.1. In the context of the Security Interest Provisions, the separate regime which applies to insurers under the Insurers Reorganisation and Winding Up Regulations means that on a winding-up the assets and liabilities of insurer's *long-term business* have to be treated separately. The creditors of the *long-term fund* of an Insurer carrying on *long-term business* have priority in respect of the assets of that fund and other creditors have priority as regards other assets.

3.2. Where an Insurer carries on both *long-term business* and *general business* it is not clear what the effect of this is on an Insurers unsecured creditors (not being in the category of preferential creditors or direct insurance creditors) in a winding up or an administration. It may be that a liquidator or administrator would be able to satisfy liabilities in relation to Transactions entered into by the Insurer in relation to its *long-term business* and *general business* only from the assets attributable to its *long-term business* and *general business* respectively. Accordingly, any security interest or other right under the Security Interest Provisions in respect of Collateral (or any other asset) which relates to one of the businesses may not be enforceable if the liabilities which it secures (or covers) relate to the other business.

4. Section 377 of FSMA

4.1. Under section 377 of FSMA, where an Insurer is unable to pay its debts, the court charged with the winding up of the Insurer may reduce certain of the contracts of the Insurer on such terms and subject to such conditions as the court thinks fit in place of making a winding-up order. Accordingly, the enforceability of Netting Provision and Set-Off Provisions in relation to an insolvent Insurer will be subject to the application of the provisions of FSMA and the ability of a Scottish court to reduce contracts of the Insurer thereunder.

4.2. It is currently unclear whether this power under section 377 can be used in connection with insurance policies only or whether it applies to more general contracts including the Agreements. There is currently no authority giving clear support for either position and there are arguments either way.

4.3. An argument in favour of a wider interpretation of section 377 can be made by reference to the rules of statutory construction. The argument is based on reading section 377 with section 376(8) of FSMA. section 376(8) deals with a liquidator's right to apply to the court for the reduction of contracts of *long-term insurance*. Section 376(8) states that the section applies only to *long-term insurance* and the argument is therefore that the use of the term "insurer's contracts" in section 377 must have been

[23] Unlike the equivalent provision of the EU Regulation, the Insurers Winding Up Regulation does not set out rules for determining where an asset is situated for these purposes.

intended to apply to a wider category of contracts and therefore cover all contracts, including the Agreements. Equally however a wider interpretation can be given to section 377 by applying the term "insurer's contracts" to both *long-term insurance* and *general insurance* but not to a wider category of all contracts.

4.4. In our experience, most practitioners support a narrower construction of section 377. They argue that section 377 should apply only to contracts of insurance. It is possible to support this by reference to the Insurers Winding Up Regulations. Regulation 43 there states that a reorganisation or winding up is not to affect the right of creditors to demand the set off of their claim where such set off would otherwise be permissible. Section 377 applies instead of a winding up and is not a relevant reorganisation for the purposes of the Insurers Winding Up Regulations so Regulation 43 does not apply directly to it. Regulation 43 is a provision introduced to protect creditors' rights of set off in insolvency proceedings and a wide interpretation of section 377 would provide a way of getting around it. Accordingly, such a result might be seen by a court as grounds for construing Section 377 narrowly.

4.5. It is also worth noting that section 22 of the Life Assurance Companies Act 1870, the statutory predecessor to section 377, was only ever exercised by the court in relation to policies of insurance.

4.6. In *Re Nelson & Co*[24] the court refused to sanction a scheme under section 22 which was intended to enable an insolvent company to continue to carry on business by relieving it of part of its present and future liabilities. Accordingly, if a wider interpretation were to be given to section 377 then it is likely that the court would only use section 377 to reduce the value of a subsequent net claim under an Agreement if owed by an Insurer.

4.7. Accordingly, while we favour a narrow interpretation of section 377, we are unable to state with certainty whether the Security Interest Provisions would be effective in the context of the insolvency of an Insurer.

[24] (1905) 1 Ch 551

SCHEDULE 4

Partnerships

Additional Qualifications

1. There are a number of circumstances in which a Partnership may be dissolved under the 1890 Act. These include the death or bankruptcy of one of its partners (unless the partners have agreed otherwise); if the partnership is entered into for a fixed term or for a single purpose, the expiry of that term or the occurrence of that purpose (as the case may be); the dissolution by the court in certain circumstances; and in any circumstances where the partners have agreed that it shall be dissolved.

2. On dissolution of a Partnership, certain partners may continue the business of it under a new Partnership. In such circumstances, the Security Interest Provisions in the Agreement entered into by the dissolved Partnership may not secure the obligations or liabilities of the new Partnership.

SCHEDULE 5

Trustees and Trusts

1. Additional Assumptions

1.1 Additional assumptions: all Trustees

The opinions expressed in this Opinion, are, in respect of a Trustee who is entering into Agreements and Transactions and transfers thereunder as a trustee of a Trust, subject to the following assumptions:

1.1.1 the Trustee(s) has/have been validly appointed as trustees of the Trust and is/are entitled to deal with all of the Trust's assets;

1.1.2 there has been no breach of trust in connection with the entry by the Trustee(s) into the Agreement or the Transactions or transfers thereunder or otherwise;

1.1.3 the Trustee(s) has/have specific capacity, power and authority to enter into the Agreement, and Transactions or transfers thereunder and to perform all of its obligations in relation thereto under the terms of the Trust's governing documentation, including its trust deed, its rules and, in the case of AUTs, its prospectus;

1.1.4 the Trustee(s) has/have validly exercised its/their powers in entering into an Agreement and into any Transactions or transfers thereunder;

1.1.5 where the Trustee(s) has/have delegated authority to any other person to enter into the relevant Agreement or any Transaction or transfers thereunder on its behalf, this has been properly done in accordance with an available power of delegation; and

1.1.6 the Trustee(s) have entered into the Agreement and each Transaction, and has provided all Collateral, as trustee of the same Trust (or, in the case of a Corporate Trustee of an AUT, as trustee of the same sub-fund).

2. Additional Qualifications

2.1 Change of Trustee

Provided the relevant Agreement (1) expressly excludes personal liability on the Trustee(s); (2) sets out that it is entered into by the Trustee(s) as trustee of the Trust, and (3) sets out that any liabilities under it are limited to the trust estate of the Trust, then, upon a change of Trustee(s), the trust estate of the Trust will retain any liabilities, and these will be passed to any new or replacement Trustee(s), as trustee of the Trust. Where this is the case, the Security Interest Provisions should secure any obligations or liabilities under the Agreement which have been incurred by the previous Trustee(s) and the new Trustee(s).

2.2 Restrictions on investment powers

2.2.1 In relation to assumption at paragraph 1.1.4 above, if a Corporate Trustee does not have appropriate capacity, power and authority under the scheme's governing documentation, Scots trust law will not provide appropriate default powers to Trustee(s) to enter into an Agreement or transactions thereunder. The Trust (Scotland) Act 1921 (the "**1921 Act**") gives trustees certain default powers in relation to the administration of the trust estate. Wider powers of investment were added to the original powers contained in the 1921 Act by the Charities and Trustees Investment (Scotland) Act 2005 (the "**2005 Act**"). However, we do not consider that the entry by Trustees into any Agreement and Transactions would fall within these wider powers. Even if they did, the wider powers of investment are not available to AUTs and any other Trust, the Trustees powers of investment of which are governed any other piece of legislation.

2.2.2 In addition:

(i) While Pension Trustees are granted certain powers of investment under the Pensions Act 1995[25] (the "**1995 Act**") we do not consider that the

[25] Section 34 of the Pensions Act 1995 gives the trustees of an occupational pension scheme, subject to any restriction imposed by the scheme, the same power to make an investment of any land as if they were absolutely entitled to the assets of the scheme.

1995 Act would apply to allow a Pension Trustee to validly enter into the Agreements or Transactions. In our view, entry into the Agreements or the Transactions would not fall within the statutory powers of investment contained within the 1995 Act.

(ii) The Financial Services Authority's ("**FSA**") New Collective Investment Schemes Sourcebook ("**COLL**") imposes restrictions on the investment powers of Corporate Trustees of AUTs. The restrictions which apply would depend on the rules applicable to the particular AUT and whether it is an UCITS Scheme or a non-UCITS Scheme. However, section 151 of FSMA provides that any transaction entered into in contravention of such rules will not be void or unenforceable by reason only of such contravention.

2.3 **Trustees of different Trusts**

Where a Trustee acts as trustee of more than one Trust (including where a Trustee acts as a Trustee of more than an AUT with two or more sub-funds) no opinions are given in relation to the Agreement (including the Security Interest Provisions) except to the extent that the terms of the Agreement apply separately to each Trust (or, as the case may be, sub-fund).

2.4 **Transfers of the assets and liabilities of a Pension Trust to the PPF**

Where the Pension Protection Fund assumes responsibility for a Pension Trust all of the assets and liabilities of the Pension Trust will transfer to the Board of the PPF. If, in those circumstances, the Board considers that a provision of a contract entered into by the trustee(s) of the Pension Trust is onerous, the Board may disapply that provision or substitute it for a provision that the Board considers reasonable. If the Board were to exercise this power in relation to a provision of the Agreement or any Transaction, this could adversely affect the operation of the Security Interest Provisions.

SCHEDULE 6

Administering Authorities and Local Government Pension Schemes

1. **Change of administering authority**

We have assumed that the Administering Authority that is party to the Agreement and Transactions will remain the contracting party, except in circumstances where there is a statutory reorganisation of Local Authorities (in which case we assume that any assets and liabilities of the Administering Authority under the relevant Agreement will be dealt with in accordance with the arrangements made under the statutory reorganisation concerned, and that all of the obligations and liabilities of an Administering Authority under the Agreement and the Transactions are transferred to the same successor entity).

2. **Additional assumptions**

The opinions expressed in this opinion, and the opinions expressed in the Original Opinion are, in respect of an Administering Authority, subject to the following assumptions:

2.1. the Administering Authority is entitled to deal with the assets of the pension scheme to which the Agreement and Transactions relate (this will be the relevant LGPS Fund);

2.2. the Administering Authority has specific power and authority to enter into the Agreement and the Transactions on its behalf, and to enter into the transactions thereunder and is not prevented by, or otherwise acting ultra vires or in breach of, its statutory powers in so doing;

2.3. without limiting the assumption at paragraph 2.2 above, the Administering Authority has formulated an investment policy and prepared and maintained a statement of investment principles in accordance with the requirements of The Local Government Pension Scheme (Management and Investment of Funds)(Scotland) Regulations 2010 (the "**LGPS Investment Regulations**"), and the Agreement and Transactions fall within and comply with such investment policy and statement of investment principles;

2.4. the Administering Authority has validly exercised its statutory powers in entering into the relevant Agreement and any Transactions; and

2.5. where the Administering Authority has delegated authority to any person to enter into the relevant Agreement (or the Transactions thereunder), this has been properly done in accordance with an available power of delegation.